

Real Estate Capital Markets Update – May 25, 2007

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Special Comment: What is Responsible Property Investment?

The real estate investment industry and real estate capital markets are confronting another “Sea Change” as they learn that they are not immune or remote to the discussions going on around them regarding the environment and global warming; in fact, as we adjust to an entire new vocabulary, we also learn that we are a major “player” and a major “contributor” in this game and what we do, or do not do, individually, or as an industry, is going to have a major impact on society.

With that said we introduce Responsible Property Investment (RPI). Please take the few minutes necessary to read this brief introduction to RPI and then take a few minutes more and send us an e-mail at blank@uli.org with your reactions, thoughts, comments, suggestions, criticisms, etc. RPI is an evolving topic and issue; for it to reach its potential and impact the “environment” will require input into the discourse from a wide array of real estate industry and real estate capital markets participants.

And if you really become intrigued and think you may want to actively participate in the growth of the RPI community with the ULI, please let us know (blank@uli.org). We are working on a number of initiatives ranging from newsletters and sharing of information and “best practices” to the formation of a new “product” council which would hold its initial meeting at the ULI 2007 Fall Meeting.

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Responsible Property Investing: The Prequel

An investment strategy known as “Socially Responsible Investing” (SRI) has been used for many years by both individual and institutional investors as a means of integrating social, societal, or environmental selection criteria into financial analysis of proposed investments. In fact, according to the “2005 Report on Socially Responsible Investing Trends in the U.S.” by The Social Investment Forum (www.socialinvest.org), approximately \$2.3 trillion has been allocated to SRI investment strategies by investors.

Underlying Socially Responsible Investing is a belief that investors “can do well [financially] by going good [societally].”

SRI's origins may be traced back literally to biblical times wherein prohibitions regarding the uses of money were commonplace. In the mid-1700s, John Wesley, the founder of Methodism, noted that the use of money was the second most important (and possibly frequent) subject of New Testament teachings. And for well over the past 100 years, groups of highly religious investors have avoided investing in companies involved in the "Sin" industries of gambling, alcohol, and tobacco. Some believe the modern era of SRI began in the 1960s as the U.S. became more politically sensitive to social responsibility and sought to deal with concerns regarding the Vietnam War, the growing civil rights movement, nuclear proliferation, the women's rights movement, and environmentalism, to name just a few of the new issues straining our collective consciousness.

Today, SRI involves a wide array of analytical tools, screening processes, and decision matrices applied to potential investments so as to analyze their impact on both societal goals and the environment in general as well as on an investor's specific issues, concerns, and investment philosophy combined with their prospective required rates of return on investment. Among the myriad of issues used to screen potential investments is a corporation's involvement in one or more of the following: alcohol; tobacco; gambling; defense/weapons; animal testing; environment; human rights; labor practices; employment equality; community investment; and corporate governance. Remember, underlying SRI is a firm belief that you "can do well by doing good". In fact, numerous studies of investment portfolios constructed utilizing SRI strategies and screening techniques to invest in publicly-traded companies have shown rates of return comparable to non-SRI structured investment portfolios. In some respects this should be obvious as legislation and court rulings defining fiduciary responsibilities would preclude an institutional investor from any investment which did not provide a realistic potential for a competitive rate of return.

Responsible Property Investing: The Main Event

The real estate equivalent of Socially Responsible Investing" is known as "Responsible Property Investing" or RPI, which is serving as a catalyst in mobilizing the real estate

industry to assume responsibility for improving the environment. RPI represents the beginning of a paradigm shift in individual investors, owners and developers, real estate investment managers, and real estate service provider attitudes towards real estate investing. While in its nascent stage today, RPI is gaining adherents among a wide array of real estate industry participants. RPI reflects the same accountability premise and standards as Socially Responsible Investing; its argues that an investor can “do well” while “doing good” by embracing social and environmental concerns as well as economic returns.

Trying to “define” Responsible Property Investing is a little like “nailing Jell-O to a wall”. For example, it’s not just “Green”, the current term du jour for environmental correctness. RPI focuses on ways to continuously improve the in-place, existing environment, not just the “newly constructed” one, while receiving markets rates of return on invested capital. Remember, new construction represents an addition to supply of less than 10% per annum.

While not exactly reaching the “tipping point”—RPI is too new a concept—it’s on many real estate industry participant’s minds. For example, a survey of 1,500 senior officers of real estate owners and developers, public and private real estate investment trusts and real estate operating companies, real estate investment managers, and institutional investors was conducted between November 2006 and January 2007 by the University of Arizona and co-sponsored by the Urban Land Institute and other real estate industry associations. Among the results were the following:

- More than 80% of the respondents indicated their organization goes beyond the minimum legal requirements to address social or environmental issues;
- 90% agreed that pursuing social and environmental goals as a business strategy will be important in the future;
- 57% of participants said they were promoting energy conservation, water conservation or recycling in properties they own or manage;
- 47% said they were engaging “stakeholders” with some connection to the properties, such as neighborhood organizations, labor unions, or environmental groups;

- 44% include references to community, human resource or environmental issues in their mission statement; and
- 43% pay attention to social or environmental issues in developing their strategic plan.

When queried regarding the level of their commitment to investment in property development which “encourages restoration and revitalization”, and which conserves both land and energy use 63% said they have invested in urban infill or redeveloped properties with 16% responding that they were considering similar investments. 53% responded that they had invested in transit-oriented development with 15% planning to make similar investments in the future. 36% had invested in “Green” buildings; 31% planned to do so. 33% had invested in brownfields; 16% are considering such investments.

Importantly, more than 35% of the respondents said they were aware that Responsible Property Investing practices lower operating costs while more than 30% viewed RPI as providing a “potentially competitive” advantage and a sound business strategy.

Maybe it’s best to define Responsible Property Investing through a real world example wherein a property owner did well by doing good.

Adobe Systems, Inc., the developer of graphic design software such as the ubiquitous Adobe Acrobat and Adobe Reader, determined to improve the energy and environmental footprint of its three building headquarters facility. The results of Adobe’s efforts were impressive and included the following:

1. 35% decrease in energy usage;
2. 41% decrease in natural gas usage;
3. 22% decrease in domestic water consumption; and a
4. 76% decrease in landscape irrigation.

But in addition to achieving its societal and environmental objectives, Adobe did well financially as evidenced by the fact that it spent \$1.4 million on completing 72 projects which in total received \$389,000 in rebates from various utilities and \$1.2 million in

annual expense savings. According to analysis completed by Adobe and Cushman & Wakefield, Adobe's project manager, the average payback period was 9.5 months and the return on investment equaled 121%.

So, where do we go from here? ULI is currently participating in an ad-hoc group of interested parties studying RPI. This may lead to the establishment of a permanent center for the study of Responsible Property Investing; it may evolve into a standalone organization supported by real estate industry groups such as ULI or by its own membership.

Regardless, we are committed to applying the practices ULI is known for to the discipline of Responsible Property Investing—information sharing and exchange of best-practices combined with focused attention of “real deals and real numbers” and “mistakes made and lessons learned.”