

Social Investors Discover Real Estate

Multifamily housing is a natural fit for socially responsible investors looking to branch into real estate.

MONEY IS NOT IN SHORT SUPPLY for multifamily housing these days. But that is not to say developers are in a position to ignore potential new sources of capital, especially for projects not fitting the criteria of mainstream investors. Despite the historically high level of liquidity in today's real estate markets, most of the capital remains relatively risk averse.

The market's assessment of risk plays an important role in shaping the types of deals that get done. It is often harder to find financing at market rates for mixed-income or workforce housing developments, projects in changing neighborhoods or around transit, and projects that explore new models for green, sustainable development.

However, an imminent wave of equity investors chasing the perfect storm of a triple-bottom-line return—

financial, social, and environmental—could change that. This new money, which is beginning to look at real estate in new ways, is held by *social investors*—people who want their investments to have a positive impact on the world.

The potential pool of socially conscious financing available to the real estate industry—estimated at \$230 billion—is more than just pocket change. How can developers position projects to get access to this new capital source willing to invest in projects and locations shunned

by traditional capital? And how can they participate in the development of this new area of social investing, being called responsible property investment (RPI)?

Social Investing Comes of Age

Social responsibility has moved into the mainstream. Magazines from *Vanity Fair* to *Fortune* have recently dedicated entire issues to topics such as philanthropy and environmentalism. In the financial world, the personification of this movement comes in the form of socially responsible investing (SRI). Some might say that “social investment” is a tautology—that all investment is ipso facto for the public good, if it is legal. Others would say it is an oxymoron—that the objective of investment is to return profit to investors, regardless of the social good. However, socially responsible investments abound as individuals seek ways to invest in accordance with their social and environmental values.

According to a recent report by the Social Investment Forum, a Washington, D.C.-based nonprofit organization dedicated to promoting SRI, socially responsible investors have made investments totaling more than \$2.3 trillion. Currently, the majority of this money is invested in mutual funds, and almost none in real estate. However, commercial real estate typically accounts for about 10 percent of mainstream, non-SRI portfolios, meaning the multifamily industry could stand to attract \$230 billion of SRI money if it can educate investors on the social benefits of multifamily development and thereby

raise the ratio of SRI investment to that 10 percent average.

SRI takes four primary forms: social and environmental screening of portfolios, shareholder advocacy, community investment, and social venture capital. A leading example of an SRI investor is the California Public Employees' Retirement System (CalPERS), which manages more than \$200 billion in assets. It has shown leadership in virtually all the manifestations of SRI on the environmental front, and has consistently explained its investments in terms of the risks presented by declining oil reserves and global warming, and the fiduciary responsibility to manage those risks.

To date, CalPERS has committed to investing \$200 million in venture capital in cutting-edge environmental technology. It also has invested \$500 million in stock portfolios that are screened for environmental friendliness. In terms of shareholder advocacy, the fund has backed shareowner proposals that call for better corporate governance through requiring firms to address environmental impacts and report environmental risks.

Not all its investment has been environment oriented: through community investment, CalPERS has committed almost \$1 billion in equity to underserved markets in California. Most noteworthy for the real estate industry, CalPERS has committed to cutting energy use by 20 percent over five years in all the properties in its \$5 billion real estate portfolio.

Typically, investors diversify into real estate, but socially responsible investors have had trouble figuring out how to do this, and have largely



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confined their investments to a limited stream of financing for affordable housing. CalPERS, for instance, has begun to make limited but significant investments in funds directed to multifamily properties, such as the Genesis Workforce Housing Fund LLC and the San Diego Smart Growth Funds, both managed by the Phoenix Realty Group. These funds focus on workforce housing and neighborhood-revitalizing commercial properties in urban areas in California—an important though somewhat geographically limited focus.

Similarly, the Canyon-Johnson Urban Fund was created in response to a perceived lack of debt and equity capital for real estate development in urban markets. The fund has worked to create job opportunities and economic development in inner-city neighborhoods, and has been a major equity investor in affordable

housing projects in such cities as Baltimore, Boston, and Miami. However, the traditionally limited role for socially responsible property investment appears to be expanding.

The fact is, the vast majority of multifamily developments are socially and environmentally responsible when compared with the alternative of single-family housing, and provide substantial benefits to the communities in which they are located. A strong case can be made that multifamily housing is per se socially beneficial at a time when the United States needs to house its rapidly growing population in far more compact and energy-efficient ways than any single-family suburban housing development can provide.

A New Twist: Responsible Property Investing

In just the past year, academics, policy makers, property owners,

and investors have begun to focus on RPI in an effort to help social investors find real estate investments that meet their criteria.

Broadly speaking, responsible property investing takes into account social and environmental issues along with more conventional financial objectives. For example, in addition to affordable housing, development meeting RPI criteria can include mixed-income workforce housing, energy-efficient buildings, transit-oriented development, urban renewal, and, it could be argued, mainstream multifamily housing.

The key to RPI is that socially responsible investors want to make money just as traditional investors do. The difference is that they are looking for a way to do good at the same time. Traditional investors diversify into real estate because it provides good returns. Socially responsible investors would do the same if they

were provided with mechanisms to do so and proof that such investments can be financially rewarding.

The Responsible Property Investment Project—a collaboration between the University of Arizona and the Institute of Responsible Investment at Boston College—is currently surveying public and private pensions, fund advisers, real estate investment trusts (REITs), private owners/operators, foundations, and endowments to gauge the level of interest in responsible property investing. The results of the survey should be available shortly. Co-sponsors of the effort include the Building Owners and Managers Association, the Real Estate Roundtable, the National Association of REITs, and the Urban Land Institute.

Under the same project, a separate survey will go to publicly traded U.S. homebuilders to gather information on their social and environ-

mental performance and encourage a commitment to best practices. The project is also working to develop metrics that “recognize the social and environmental significance of various real estate investment opportunities,” says Gary Pivo of the Responsible Property Investment Project.

RPI is a new field, and the interpretation of what constitutes a socially responsible real estate investment is still wide open. “Responsible Property Investing,” an August 2005 paper on the principles of RPI written for the United Nations Environment Programme by Pivo and Paul McNamara, highlighted the following as important factors that make developments socially responsible:

- ▷ energy and water conservation;
- ▷ high density and mixed uses;
- ▷ an orientation toward transit;
- ▷ access to job centers for low-income neighborhoods;

- ▷ inclusion of park and recreational facilities;
- ▷ conservation of wildlife and habitats;
- ▷ superior air quality and reduced exposure to toxic chemicals;
- ▷ preservation of historic and cultural resources; and
- ▷ stakeholder participation.

To facilitate substantial investment in socially responsible developments, it will be of the utmost importance to create benchmarks at the property and/or portfolio levels—along the lines of the U.S. Green Building Council’s Leadership in Energy and Environmental Design (LEED) certification program or the U.S. government’s Energy Star program. Most multifamily development today meets many of the criteria in the Pivo and McNamara list, so the multifamily industry should pay close attention to initiatives promoting RPI and play an ac-

tive role in developing a system of RPI benchmarks.

Once a benchmarking system is in place, the capital already dedicated to socially responsible investments will be able to diversify into real estate. The \$230 billion in projected capital could quickly become available to the multifamily industry for socially responsible projects—and with risk parameters that could be more flexible than those for mainstream capital.

For example, market-rate capital might shy away from transitional urban neighborhoods, while a socially responsible investor would be more willing to finance such development. (See “Workforce Close-In Housing: Finding the Money,” September/October 2006, page 22.) Or, to address the common problem of land near public transit being more expensive than land elsewhere, socially responsible capital

might be available at below-market rates to allow construction of affordable housing near transit.

Pivo, a professor of planning and natural resources at the University of Arizona, points to the need to highlight concrete examples demonstrating that responsible property investment can provide good returns. “At this point, the evidence is mostly anecdotal,” he says. However, instances of innovative and profitable RPI exist, he says, citing the Igloo Fund, managed by Morley Fund Management in the U.K., which invests in projects promoting economic development, urban regeneration, and environmental responsibility. It has a gross asset value of roughly \$150 million and has invested in 23 projects with a total completed development value of about \$5 billion. Its return on investment is forecast at an unleveraged 12 percent per year.

Multifamily Is Responsible Property Investing

Multifamily development has already proved to be a sound investment, and a majority of well-designed and well-built multifamily housing would already qualify as a responsible investment opportunity in terms of commitment to environmental responsibility, provision of workforce housing, and adherence to smart growth development principles. By recognizing and highlighting these strengths, the multifamily industry can attract financing from socially responsible investors for projects that are appropriately designed, built, and located. Projects in emerging urban markets and targeted to provide mixed-income housing might be especially attractive.

Multifamily housing is denser than single-family development and therefore has a smaller carbon footprint per inhabitant. Furthermore,

green construction is no longer cost-prohibitive for the multifamily industry and could—and some say *should*—be adopted wholesale, both for new buildings and for retrofits, to make multifamily housing even more environmentally friendly. The importance of green building has been touched upon before in this column. (See “Sorry Kermit, It’s Easy Being Green,” July/August 2006, page 20.) According to the United Nations’ Intergovernmental Panel on Climate Change, residential buildings account for 21 percent of global carbon emissions and commercial buildings for 11 percent. Combining density with green building can make multifamily development a no-brainer for RPI.

Multifamily housing is also increasingly a component of development around transit. Since transportation accounts for a further 20 percent of global carbon emissions, proximity

to transit in mixed-use neighborhoods is another characteristic of multifamily housing that would attract RPI. Development of mixed-income housing with easy access to jobs is one more step toward the perfect investment opportunity for socially responsible investors. Furthermore, locating workforce housing in emerging urban or inner-city markets also helps spark urban regeneration.

In short, multifamily developers should certainly be able to incorporate a host of factors into projects that make them attractive to capital looking for socially responsible opportunities, which in turn would create the possibility of doing projects that are both innovative and profitable.

Bringing the Two Together

Today, there is no easy way for developers and social investors to find each other. To harness the financial

clout of socially responsible investors, the multifamily industry needs to support creation of a system for benchmarking properties in order to establish standards highlighting the positive aspects of multifamily development. Developers then need to design housing projects to match these criteria and spotlight their socially responsible elements. At the same time, mechanisms to link social investors with attractive projects need to be developed. The result should be a growing flow of flexible funds into multifamily developments that provide social and environmental benefits.

The real test of success for the new trend toward RPI will be whether the right investors can get together with the right developers to work on the right projects. **MFT**