

11 November 2003

Investing in Sustainable Developments Key Players Group:

Workshop 1 report

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Executive Summary

On 11th November 2003, Davis Langdon Consultancy, on behalf of the Department of trade and Industry (DTI), hosted and facilitated a key players workshop on ‘investing in sustainable developments’. The participants included developers, investors, researchers and consultants involved in sustainable development.

The rationale for an ‘investing in sustainable developments’ key players group arose from the work started by the Sustainability Forum (formerly known as the Sustainable Construction Task Force). The Task Force noted that, although much work had been done in identifying the social and environmental benefits of sustainability, not enough had been done to demonstrate the economic benefits, particularly for property investors.

The aims of the November 11 workshop were therefore to:

- identify the barriers to, and the drivers for, investment in sustainable development, and
- evaluate means of demonstrating to investors that sustainable developments makes good business sense.

Many questions were raised during the workshop and this report gives a summary of the issues raised at the workshop. The three significant issues that arose on the day were that there is:

- insufficient evidence and a lack of analytical tools for incorporating sustainability into investment analyses,
- a latent opportunity in upgrading existing stock to make it more sustainable, and
- need for targeted and well packaged education and dissemination of best practice, especially at the point of investment decision-making.

An overwhelming majority of those who attended were keen to see the issues developed further. Both property and construction industries need to take ownership and drive these issues forward. We are currently in discussions with the Sustainability Forum, DTI, industry and industry bodies to take these issues forward. The Royal Institution of Chartered Surveyors (RICS), Investment Property Forum (IPF), Investment Property Databank (IPD), Occupiers Property Databank (OPD), British Property Federation (BPF) would also be particularly valuable in ensuring that the recommendations are applied in industry. We envisage at least a further workshop later this year where these issues will be discussed in more detail and showcase some of the leading-edge practices in both the public and private sectors.

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1 Investing in Sustainable Developments Key Players Workshop

1.1 Agenda and structure of the afternoon

On 11th November 2003, Davis Langdon Consultancy, on behalf of the DTI, hosted and facilitated a key players workshop on ‘investing in sustainable developments’. The participants included developers, investors, researchers and consultants involved in sustainable development.

The aims of the workshop were to:

- identify the barriers to, and the drivers for, investment in sustainable development, and
- evaluate means of demonstrating to investors that sustainable development makes good business sense.

The workshop was opened with a message from Nigel Griffiths, the Minister for Construction, who encouraged the sharing of ideas and forging closer partnerships between key economic players. Sir Martin Laing, Chairman of the Sustainable Construction Task Group, set the challenge for the day by giving examples of successful private developments, such as Chiswick Park by Stanhope Developments, that are embracing sustainability and providing improved returns to investors. He noted that sustainable developments would increasingly provide superior returns, whilst less sustainable developments would become liabilities. He challenged private developers to emulate the work that the public sector had undertaken in providing sustainable developments and not to wait for legislation to oblige them to do so.

Presentations were also made by leading practitioners including Sarah Sayce, Professor at Kingston University; Dave Hampton, chair of the Construction Industry Council’s Sustainable Development Committee, Paul McNamara Director at Prudential Property Investment Managers and Jane Goodland, Senior Analyst at Henderson Global Investors. Sarah Sayce highlighted leading-edge research in sustainable development, noting that majority of the current research focused on the physical aspects of buildings and less than a handful dealing with the investment and financial aspects of sustainable property. Dave Hampton reminded the group that even though investors may be motivated by business benefits, they are people too and there is a need to win both hearts and minds if sustainable development is to be a mainstream activity. Paul McNamara emphasised that investment in sustainable developments will continue to struggle and remain limited until it becomes accepted as the natural mode of operation by investment decision-makers in property. Jane Goodland presented the perspective of an (Socially Responsible Investment) SRI fund manager and the challenges that need overcoming in mainstreaming investment in socially responsible developments.

All the speakers acknowledged that there is a growing body of evidence suggesting that sustainable developments are capable of delivering competitive investment returns in the form of quicker sales/lettings; higher sales/rental values without necessarily taking on more risks.

The presentations were followed by a plenary discussion of the various issues that had been raised. The plenary discussion was chaired by Colin Robinson of Davis Langdon Consultancy. Section 2 of this note summarises the key issues raised during the workshop.

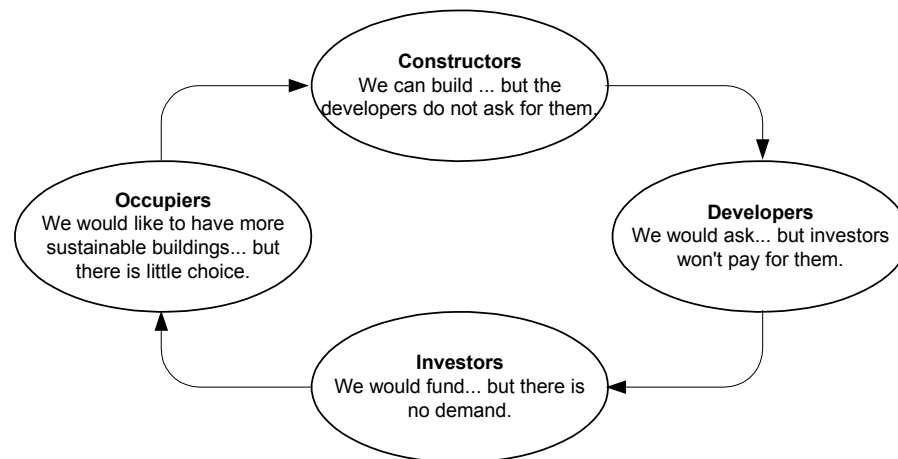
These issues are grouped as either drivers or barriers to increased investment in sustainable developments. In addition, mechanisms for mainstreaming investment in sustainable developments have also been identified. There is no clear boundary between these as it is often a matter of perspective.

At the end of the workshop, the participants were requested to complete a feedback form, the results of which are provided in the annex.

1.2 The rationale

The rationale for an ‘investing in sustainable developments’ key players group stems from the work started by the Sustainability Forum¹. The Task Force noted that, although much work had been done in identifying the social and environmental benefits of sustainability, not enough had been done to demonstrate the economic benefits, particularly for property investors. Furthermore, many of the current initiatives had focussed on ‘pushing’ sustainable development, yet the ‘pull-through’ by property investors is currently limited. This problem is depicted by the so-called ‘circle of blame’ (See Figure 1 below), whereby investors claim that they would fund more sustainable developments if the market asked for them.

Figure 1: Circle of blame²



1.3 Defining sustainable development

Sustainable development is about wealth creation, environmental protection and social justice. It is a broad and pervasive subject and attempts to define it within specific contexts, such as this workshop, often result in interesting debates. Nevertheless, the two definitions of sustainable development found to be most appropriate were taken from:

- the Brundtland Report³ - ‘development which meets the needs of the present without compromising the ability of future generations to meet their own needs’, and

¹ Sustainable Construction Task Force (2001) “Reputation, Risk and Reward: The Business Case for Sustainability in the UK Property Sector”

² Towards Sustainability – A strategy for the construction industry

³ Our Common Future (1987), “Report of the 1987 World Commission on Environment and Development. Oxford University Press

- the Pearce Report⁴ - ‘a process of ensuring a rising per capita quality of life over time’. A rising quality of life is ensured by increasing the stock of productive assets (i.e. man-made, human, social and environmental capital) in the economy since it is these assets that enable the creation of future wealth.

Having defined sustainable development, it is also important to define the equally relevant and often mentioned terms – Corporate Social Responsibility (CSR) and Socially Responsible Investment (SRI). CSR and SRI refer to investments where social, environmental and/or ethical (SEE) considerations are taken into account in the selection, retention and realization of investment and the responsible use of the attached rights (such as voting rights). SRI combines investors’ financial objectives with their concerns about SEE issues.

This workshop, therefore, focussed on two key elements of sustainable development – the property and the corporate responsibility aspects.

2 Brief summary of findings

2.1 Barriers to sustainable development

The key barriers to mainstreaming investment in sustainable developments were identified as:

- Insufficient evidence and lack of analytical tools for incorporating sustainability into investment analyses
- The complexity of property relative to other asset classes
- Disconnect between construction and property
- A low investible universe

2.1.1 Insufficient evidence and analytical tools

The philosophical argument for sustainable development has been won – the ability to deliver investment returns now needs to be demonstrated. Sustainability is difficult to measure, we think we know that some buildings are sustainable but how do we know given the lack of reliable measurement data? Currently, there is no differentiation made between good performance and bad performance in terms of sustainability. Yet, investors and fund managers need measures and benchmarks to compare the performance of sustainable versus less sustainable developments. Without this level of certainty, investors will find it hard to appreciate and indeed demonstrate the contribution of sustainability to their portfolio. This work, therefore, needs to be evidence-based. However, the expectations are that this evidence will be difficult to unearth.

In order to provide the evidence that investors require, there is need for an analytical framework and/or tools that can be used to predict and model the performance of sustainable property. There is some work being undertaken in this area already, for instance Kingston University’s Sustainable Property Appraisal Project and Sustainable Accounting Projects, but this is only scratching the surface. There is need to develop appraisal tools and indices that valuers, facilities managers and others dealing with property on a day-to-day can use.

⁴ David Pearce (2003), “The Social and Economic Value of Construction – The Construction Industry’s Contribution to Sustainable Development” nCRISP www.ncrisp.org.uk

Investors aim to maximise economic returns against a background of trade-offs subject to risk. It would be unlikely that investors will change their behaviour; therefore, we need to develop a framework for optimising sustainable performance. The risk aspect is an important driver – this needs promoting through evidence base of what risks are emerging in the marketplace.

Furthermore, investors in existing buildings are struggling to evaluate the costs and benefits of sustainability in their investment appraisals. They are aware of the growing interest and importance of these issues, but are currently ill equipped to assess their impact

2.1.2 The complexity of property

Although property competes for a finite amount of investment against other asset classes, there are major differences between equity investment and property investment. Specifically, it requires tactical management and the nature of the asset is different (i.e. illiquid, fixed in location etc). In addition, to engage equity investors requires a two-dimensional approach (i.e. investor and company), whilst property is three-dimensional as it involves landlord, tenant and building. There is need, therefore, to address this complexity and the fact that the definition of long-term for property investors is very different from that of equity investors.

There are current pressures, driven mainly by the Code of Practice for Commercial Leases, Stamp Duty Land Tax and International Accounting Standards Board proposals, to shorten then length of commercial leases. This could shift the responsibility for sustainability to property owners.

A further issue peculiar to property is on how long buildings should last. While the longevity of built assets in the UK economy appears to be a positive environmental feature – the more durable an asset is the less likely it is to be replaced, thus reducing the quantity of natural resources used in construction activity and also reducing the level of pollution associated with that activity. However, the issues are more complex and there is a balance between the environmental gains from extending product life and the potential environmental losses from doing so. Specifically, longevity locks in the prevailing technology and design of the building making it difficult to adapt to newer technologies. Furthermore, the older stock is almost certainly less energy efficient and the efficacy/benefit of retrofitting for energy efficiency is debateable. Thus, it may be easy to say that buildings should last for as long as they serve a useful purpose, however, a key question remains - is it more sustainable to refurbish the existing stock or is it more sustainable to demolish and rebuild?

2.1.3 Disconnect between property and construction

There seems to be a disconnect between property and construction, which is evidenced not only by the rhetoric used – for instance, sustainable communities, sustainable development, sustainable construction, sustainable buildings and sustainable property – but also in the focus of current work. Sustainable construction exists, however it is doubtful if sustainable property exists. Tracing back through the enormous amount of work done throughout the last decade, including Latham and Egan, the emphasis has been on sustainable construction and on cost reduction. This imbalance now needs to be redressed by covering sustainable property aspects and creation of value and worth.

There is further disconnect between investors, occupiers and the agents. It is important to engage the agents and valuers as they have a key role in influencing and informing investors and occupiers. The agents may argue that they merely reflect what the market wants, but in so doing they fail to capitalise on the opportunity to inform on, and influence the market towards, the benefits of sustainable property.

Of course, it is important that the delivery of sustainable assets is done right as it is expensive to go back to buildings and rectify mistakes, however, without a common understanding between the supply-side (i.e. construction) and the demand-side (i.e. property) there will be a mismatch of expectations.

2.1.4 A low investible universe

The message was that whilst there is a huge amount of investment available there are not enough sustainable developments in which to invest. There is need more vanguard investors and developments.

It was noted that whilst the Housing Corporation and English Partnerships had provided leadership in the social sector by stipulating social and environmental standards, large scale commercial developers and individual investors i.e. house buyers and small businesses, need encouragement, incentives and education to demand more sustainable developments.

There have been quite a number of high profile client led exemplar projects, such as Wessex Water HQ, BRE environmental office, Greenwich Millennium village and BedZED. What is now required are more speculative developments, and more normal clients taking on some of the lessons from these exemplars.

2.2 Drivers for sustainable development

The key drivers to mainstreaming investment in sustainable developments were identified as:

- The latent opportunity in sustainable refurbishment
- The economic/business imperative
- The pursuit of best/better practice
- SRI and shareholder activism

2.2.1 The latent opportunity in sustainable refurbishment

Achieving sustainability in new build is relatively easy – more effort now needs to be placed on repairs and refurbishment, which consists of more than 50% of construction output. There is also a need to re-focus on other building types, such as residential and industrial. The stock as a whole should be examined not just new developments.

However, how do you tackle the problem of the existing stock? Sustainable refurbishment is suggested as a significant opportunity to investors and developers. Examples include refurbishment of Nofton Park by Albion Trust on Edinburgh.

The slow rate of redevelopment of existing buildings means that progress towards meeting e.g. carbon reduction targets will be slow – therefore radical solutions towards new buildings may be needed. Building regulations have made an impact on new buildings and should be increasingly setting standards for the existing stock.

2.2.2 The Economic/Business imperative

‘Doing well by doing good’ is not for idealists, but an imperative that more and more business are coming to terms with. Vanguard property investors are reaping benefits by investing in sustainable developments. There is a need to re-enforce these positive business aspects especially to sceptical investors.

By far the biggest leverage on overall profitability is the impact that a quality built environment can have on the effectiveness of the people within - supporting them in their daily business (or other) activities. A tiny improvement in ‘productivity’ – derived from users enjoying a positive feeling of well being about their surroundings for example – will yield rapid returns to the business. For instance, Franklin and Andrews found that an improved internal environment can boost office productivity by up to 70%.

Furthermore, investing in sustainable developments can significantly enhance the reputation and brand of an investor. To put it more bluntly, those who invest in unsustainable developments can seriously erode their brand and reputation.

2.2.3 The pursuit of best (better) practice

Many institutional investors are keen to continuously improve their performance and they need support and information to do this properly. In order to gain engagement it is necessary to turn the Agenda from ‘best practice’ to normal practice. It should be recognised that ‘laggards’ will always exist; as will ‘vanguards’. The key now is to drive at changing ‘improvers’ to vanguards and vanguard to mainstream.

Who is in the lead – the public or private sector? The public sector seems to be driving through sustainable developments more quickly than the private sector. The private sector could learn from the public sector.

To make sustainable developments become normal practice, investors need to be convinced that investing in sustainable developments will significantly enhance the future values of their portfolios.

2.2.4 SRI and shareholder activism

Shareholder activism and government support, through changes to the Pensions Act in 2000 and the Modernising Company Law White Paper for example, have been crucial in promoting SRI and this must continue.

Nonetheless, the question arises – does SRI add value? Benchmarking studies are required to convince fund managers and measurement, information, and communication all need to be improved to allow SRI.

2.3 Mechanisms for mainstreaming sustainable developments

The key mechanisms for mainstreaming investment in sustainable developments were identified as:

- Education and dissemination of best practice
- Procurement forms that incorporate sustainability
- Engagement
- Legislation

2.3.1 Education and dissemination of best practice

Education, packaging and dissemination of existing knowledge is perhaps the greatest key to moving the agenda forward. Current knowledge and guidance needs to be consolidated and targeted to specific audiences.

There is huge amount of information on sustainability, e.g. the Laing Report on Risk Reputation and Reward and the CIC Client Guide ‘Constructing for Sustainability’ but it is not reaching investors and owner-occupiers, especially at the point of decision-making. This could be symptomatic of poor education/training and rhetoric in sustainability.

There is a need to educate all stakeholders in the process, i.e. the public, consultants/agents, investors and occupiers on the benefits of sustainable developments so that they can make informed choices.

2.3.2 Procurement forms that incorporate sustainability

There was much discussion on PFI and whether it promotes or denies sustainable development? Disappointment was expressed in that although in theory it should promote sustainability, this was not the reality. On balance, the argument seems to conclude that it tended to drive short – as opposed to whole-life considerations.

2.3.3 Engagement

Much could be achieved through better use of media power/pressure and maybe engaging the Unions and representative bodies. In the past, it has proved very difficult to engage the consultant community in the debate. This was largely because the arguments were focused on the supply chain. In particular, it is important to engage owner-occupiers, property agents and investment analysts.

There is a role here for institutions such as the RICS, BPF, IPF, CIC, OPD as well government departments.

2.3.4 Legislation

Is regulation the only way forward for unresponsive markets? Regret was expressed that regulation may be necessary. Legislation, tax incentives and grants could be an effective vehicle for driving sustainability, but these would not be sufficient. Motivation is also important. The British Council for Offices (BCO) has recently highlighted the issue of motivating the property industry, via ‘carrots or sticks’, in its report – Green Incentives⁵.

3 Conclusions and next steps

It was particularly interesting to see the combination of construction and property people, as well as researchers and practitioners, coming together to tackle the need to promote investment in sustainable developments. The delegates, many of whom are at the forefront of sustainable development, acknowledged that there is a small section of the investment community already looking at these topics but there is a long way to go before the whole of the investment community integrates these factors into their investment decision-making

⁵ BCO (2003), “Green Incentives: Policy and Practice”

process. Shareholders are asking for more sustainable developments as the growing body of evidence illustrates that they do provide:

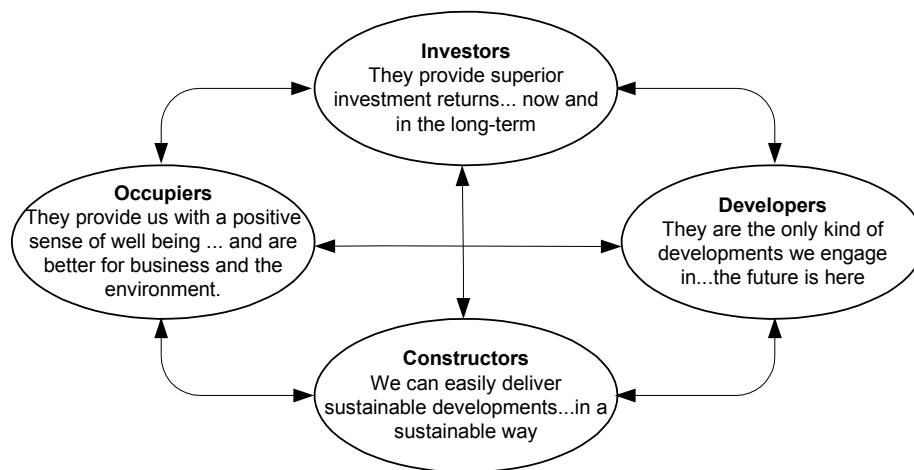
- Quicker purchase or lettings – e.g. Chiswick Park by Stanhope Properties,
- Higher sales value or rents – e.g. BedZED
- Both lower capital and running costs – e.g. Milton Park in Oxford
- What customers didn't know they needed – e.g. day lighting that makes people feel better, more productive and leads to lower maintenance and lighting bills
- An opportunity to demonstrate their SRI activities

Nevertheless, more evidence is still required, particularly with regard to:

- benchmarking sustainable buildings' investment performance
- mainstreaming sustainable development
- re-focus on repairs and refurbishment

A **virtuous circle** (see Figure 2 below) is required to pull developers, investors and occupiers towards sustainability.

Figure 2: The Virtuous Circle⁶



In summary, the three key issues are:

- insufficient evidence and lack of analytical tools for incorporating sustainability into investment analyses,
- the latent opportunity in sustainable refurbishment, and
- education and dissemination of best practice

Ninety-four percent of those who attended were keen to see the issues developed further. Should the next workshop focus on prioritising the issues and gaining further support from key players?

Kingston University, in collaboration with various industry partners, is developing an analytical tool that will incorporate sustainability factors in assessing a building's worth.

⁶ Adapted from an ABS Consulting (2003) diagram.

The results of this project should start to provide some answers to the questions raised during the workshop. Nevertheless, more work still needs to be done.

Both property and construction industries need to take ownership and drive these issues forward. The Sustainability Forum (formerly known as the Sustainable Construction Task Force) is a first choice for the construction sector. The RICS, Investment Property Forum, IPD, OPD, BPF could also be involved from the property sector. Government departments would then need to be approached with a clear strategy.

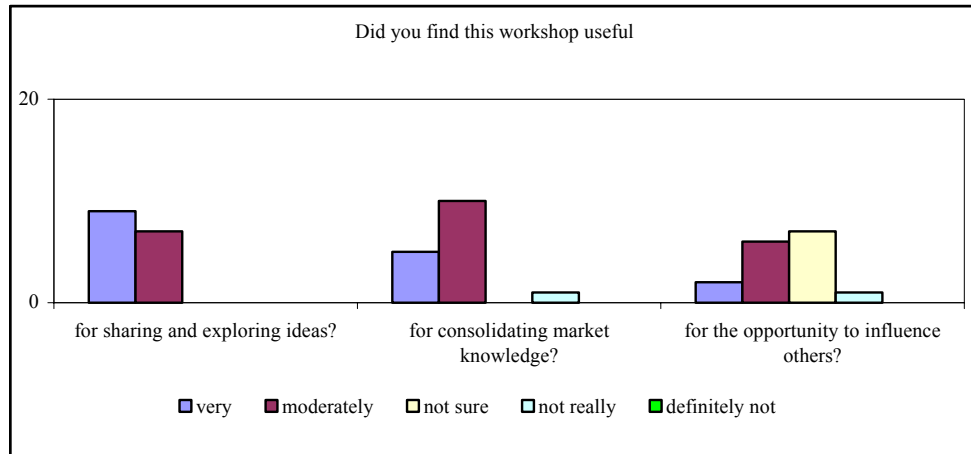
We are currently in discussions with the Sustainability Forum, Business Council for Sustainable Development (BCSD-UK) and the DTI to take these issues forward. We envisage holding a second workshop later this year to develop the ideas raised during the initial workshop and showcase some of the leading-edge practices in both the public and private sector.

Annex

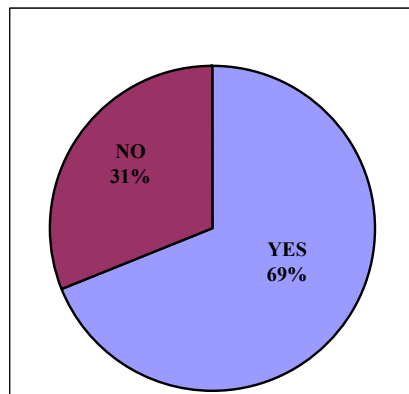
Analysis of feedback questionnaire

There were about 30 attendees and 16 responded to the feedback questionnaire. Below are the raw results.

1. Did you find this workshop useful:

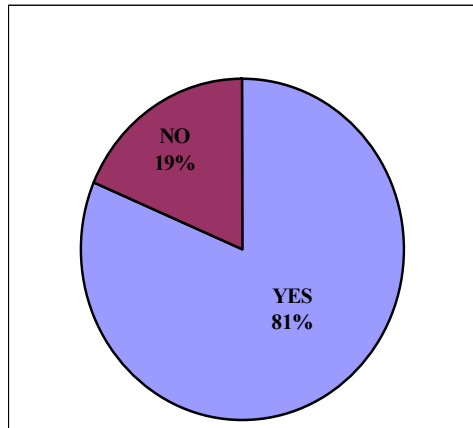


2. Do you consider it accurate generally to describe the individuals at today's workshop as 'Key Players'?

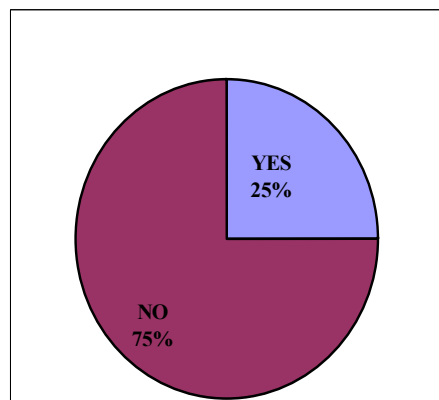


If NO, why not?

- But some missing too
- Some of the key players
- Key players in research but not presenting. Agents identified as one of the blockages. Audience made up of the converted and believers.
- For the investment community - perhaps. Little to engineering, technical, architectural etc
- However, a few more investors would have been good!
- From what I understand of who they are!
- Too junior in level of organisations. Too few contractors. No Lawyers.
- Lacking the key link - agents and client property advisers and developers.
- Some key groups missing

3. Do you feel today's group is under-represented by any particular sector/interest?**If YES, which (do NOT list your own)?**

- Property Surveyors
- Occupiers (other than each of us in our own right)
- Valuers and Fund Managers
- Sceptics. Property Agent/Developer
- Chartered Surveyors and Property Agents
- Valuers. Owners.
- Investment organisations
- Investors
- Agents and Valuers
- Valuers. Agents. Contractor/client - private-public-NHS MOD
- As Q2 - Lacking the key link - agents and client property advisers and developers.
- Agents, Valuers, FM's
- Agents, Valuers
- Valuers and Agents

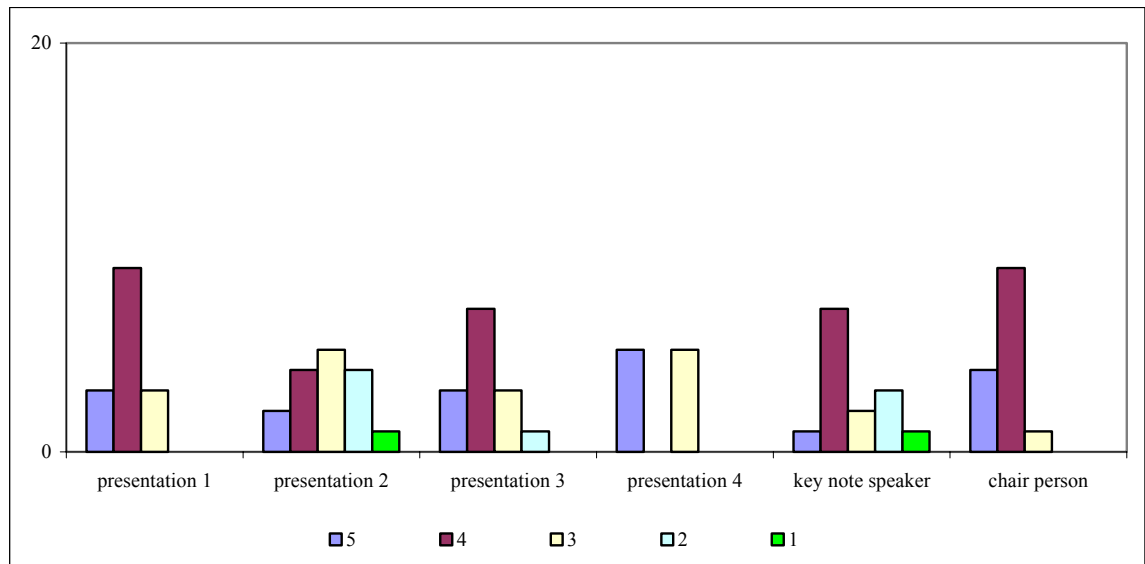
4. Do you feel today's group is over-represented by any particular sector/interest?

If YES, which?

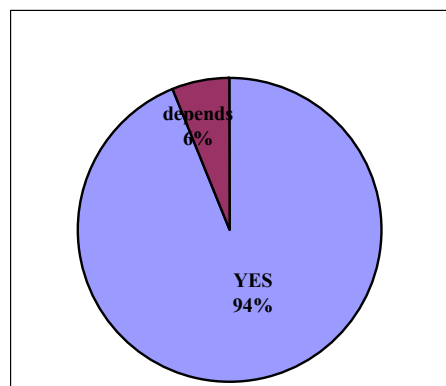
- Researchers?
- Technical side
- DTI funded researchers
- Consultants!
- Consultants

5. Rate the following presentations:

(score 1-5, where 5=excellent and 1=very poor)

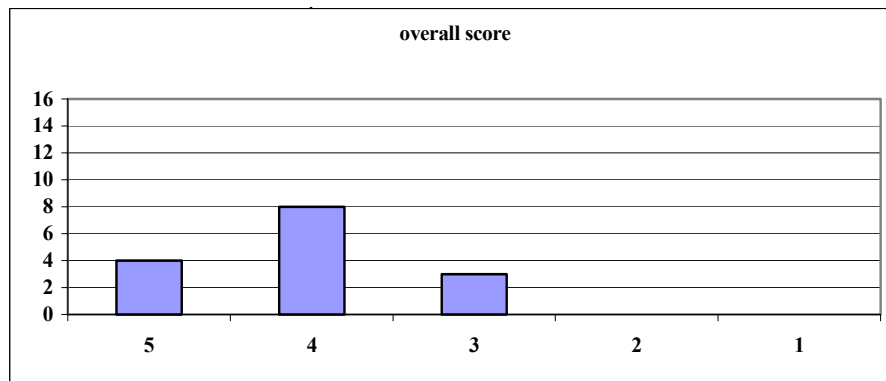


6. In your view is there merit in this or a similar group developing these issues further?



7. Finally, how would you rate the workshop overall?

(score 1-5, where 5=excellent and 1=very poor)



Other comments or suggestions

(e.g. format, venue, organisation, etc.)

- Even more sustainable venue? ("seeing is believing")
- Possibly the issues may have been too broad and focus on specific barriers might be more useful
- Scope to take identified issues forward
- An extra break!
- Should have set room up as workshop format from the start. Name badges should have had organisations noted on badges. Speakers should be asked to give name and organisation re speakers from floor.
- Should aim to actually achieve something we can take away that has potential to make a difference