Responsible Property Investment: Making a Difference

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SUMMARY

Corporate responsibility (or corporate social responsibility) is seen to be a growing force within the corporate community, with a range of policy statements available and reports into how these aspirations are being put into practice. Indeed, since July 2000, private sector pension trustees in the UK are required to report on how they take into account social, environmental and ethical considerations when they make investment decisions. Clearly, sustainability issues (however these are defined) underpin this movement.

While much has been published on the efforts to achieve a sustainable built environment through a range of development-related processes, it is only in recent years that any interest has been shown in the property investment community (and, indeed, the investment community in general). Yet it is clear that the funders of development and property acquisition are in a powerful position to influence sustainability through their operations. Thus, a socially and environmentally aware developer-occupier has the potential to reflect sustainability principles in the various investment and development choices involved in securing an appropriate property. But where the investor or the investment advisor is more remote from the asset and particularly for those large-scale investors competing for funds in the general investment market and looking for returns for their shareholders, what opportunities are there if the investor stakeholders have social or environmental concerns or are seeking to demonstrate, through investment, their socially responsible credentials?

This paper presents a background to Responsible Property Investment (RPI), what it is, where it comes from and how it is manifesting itself. Property investment is the process through which the world's built environment is funded. As a driver both for the quality and quantity of our built environment, investment has the potential to have a huge influence on a range of building and occupation characteristics. This paper reviews the principles and arguments which underpin Socially Responsible Property Investment (SRPI) and the role which valuers can play in both interpreting the market value of such practices in their valuations, and also encouraging market players to appreciate (and therefore 'value') sustainable features and practices when providing professional advice.

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1. INTRODUCTION

Corporate social responsibility (CSR) is an increasingly important driver for corporate activities, both mainstream and *pro bono*. Evidence of this includes public (often on-line) policy statements covering ethical standards and practices, as well as employee- and community-based programmes. Some of these are driven by legislation e.g. since July 2000 in the UK, private sector pension trustees are required to report on how they take into account social, environmental and ethical considerations when they make investment decisions. It is not unusual, for example, to find reports explicitly covering such issues as environment, waste, emissions, sustainability, climate change, resource and supply chain, (Spada, 2008), while others also cover community, employees and a 'Code of Business Conduct' (Prudential, 2008). Many are driven by stakeholder and public concerns, and it is clear that sustainability principles underpin this trend.

The sustainability principles within property development are well established. Minimisation of waste in construction, increased refurbishment rather than demolition (Plimmer, *et al.,* 2008), use of sustainable features in development processes, partnering and knowledge management can all be seen as sustainable-driven improvements within the development process.

However, addressing sustainability and CSR uniquely through new build is insufficient to deal with the very real environmental and social problems facing the world. Pivo (2008) notes that newly developed buildings typically replace up to 2 – 3 percent of the existing stock per annum. Clearly, if real estate is to reduce its carbon footprint, real effort must be made to ensure that the bulk of the reduction is made through existing buildings.

This paper considers how similar sustainable principles and corporate social responsibility are and can be implemented through the investment process. Specifically the paper reports on research investigating the nature and process of Socially Responsible Investment (SRI) and Responsible Property Investment (RPI) (also known as Socially Responsible Property Investment (SRPI)). It reviews what exactly is meant by these and other relevant terms; where the concept of responsible investment came from and how it is manifesting itself; and how investors can seek to achieve socially and ethically responsible outcomes through their property investments. Finally, it reflects on the role of valuers, as producers of relevant valuations and professional advisors in furthering this development.

The paper begins with a discussion of corporate social responsibility (CSR) and responsible property investment (RPI), which is followed by a presentation of relevant strategies for responsible investment. The paper ends with the argument that valuers have a major role to play in this process.

2. CORPORATE SOCIAL RESPONSIBILITY (CSR)

Socially responsible and ethically-related issues have become a major and common aspect of business management over the last decade (Roberts, *et al.* 2007: 390), yet there is much confusion surrounding what exactly is meant by such terms as Responsible Property Investment (RPI), Corporate Responsibility (CR), Corporate Social Responsibility (CSR), Social Responsibility (SR) and Corporate Governance (CG).

2.1 Definitions

As with CR, CSR and SR, there is debate surrounding what exactly SRI means, with most definitions including the social, ethical and environmental (SEE) criteria as well as the need for a reasonable return on the sum invested, assumed to be present in investment decision-making (Roberts *et al.* 2007: 344). Thus, according to Juholin (2004: 22):
The criteria of CSR are difficult to define because ... they are more or less subjective ... Absolute standards of corporate responsibility do not exist, and they may change with each generation and in terms of cultures as well. ... Furthermore the criteria of CSR may change according to the society in question ...

In contrast, there is a more straightforward definition of SRI, which:
…can be defined as the investment of capital in order to achieve an acceptable return while applying pre-determined criteria, methods or techniques which can drive, support or promote SEE issues chosen either by the person placing the investment, or a third party investment manager. (Roberts, *et al.* 2007: 394)

According to Bartel (2003):
... the aim of CSR is to protect and enhance shareholder value through a combination of innovative partnerships and initiatives and good communication leading to increased sales.

CSR is, therefore, focused largely on profitability for the company and can be distinguished from SRI, as follows:
... CSR is concerned with 'how the company conducts itself in the community and the environment it touches' whereas SRI is about 'the manner in which an investor applies its capital'. (*ibid.*)

Thus:
... SRI involves the combination of social, environmental, governance and financial goals in the application of capital i.e. the actual investment process. (Roberts, *et al.* 2007: 394)

This implies that the two concepts are related because, in practice, SRI may be seen as a component of a wider CR strategy (Rapson *et al.* 2007: 344). There is evidence that social responsibility is driving investment in equities. According to Rapson, *et al.* (2007: 345) there are more than 50 dedicated retail SRI funds in the UK worth over £4bn. According to Pivo (2005: 16) there were $2.16 trillion in SRI funds in 2003, and there is evidence from the USA that such funds are more attractive and retain investors longer than non-screened funds (*ibid.*).

There is also evidence that social responsibility is driving investment in property. Pivo and McNamara (2005: 129) define responsible property investment (RPI) as:
… maximising the positive effects and minimising the negative effects of property ownership, management and development on society and the natural environment in a way that is consistent with investor goals and fiduciary responsibility.

More recently, Pivo (2008) defines RPI as:
… property investment or management strategies that go beyond compliance with minimum legal requirements in order to address environmental, social and government issues.

2.2 Distinctions

Roberts *et al* (2007) review a range of literature to investigate the differences between CSR, SR and CG. Their paper (*ibid.*: 390) recognises the following:

- the core issues of these practices remain embryonic, but the boundaries are ill-defined and sometimes overlapping;
- SR means something, but not always the same thing to everybody;
- various management disciplines present views on CSR which are biased towards specific interests.

Citing others, they conclude that:
The lack of an "all embracing definition of CSR" and subsequent diversity and overlap in terminology, definitions and conceptual models are said to have hampered academic debate on the subject. (Roberts *et al.* 2007: 390)

This plethora of definitions may not be a major barrier to ensuring that existing standards of environmental, social and governance are raised through the appropriate use of investment vehicles and / or investment management. But it makes research into the process difficult because companies classify similar actions in different ways using the different terms interchangeably (Roberts *et al.,* 2007: 394).

It seems, however, that this has not prevented businesses across the world from embracing the concept of CSR (however it is defined by individual corporate entities) as a management concept to improve the "triple bottom line" (being economic, environmental and social outcomes; or alternatively presented as people, profit and plant) and in particular to improve the performance of their investments.

Alongside this and perhaps an intrinsic part of CSR (however it is defined) is the fundamental principle of sustainability. Juholin (2004: 22) recognises that:
… for an organisation to be sustainable it must be financially secure, it must minimize, or ideally eliminate, its negative environmental impacts, and it must act in conformity with societal expectations.

Thus, while sustainability, too is a term which is hard to define unless applied to a particular context when it can be defined to reflect relevant outcomes within that context, sustainability within the context of property investments provides a very clear focus for CSR or RPI activities.

3. RESPONSIBLE PROPERTY INVESTING (RPI)

Given the impact of buildings, their location, construction, use, refurbishment, demolition and redevelopment on the financial, social and environmental aspects of life (e.g. Dixon *et al.* 2005; DEFRA 2004; DETR 2000), the construction industry has been a major focus for both research and for the introduction of improved practices which reflect the public, government and corporate concern with corporate responsibility linked to both environmental and social sustainability.

Construction practices are increasingly reflecting the sustainability agenda, as illustrated in the trend to improve energy savings within buildings (e.g. Bell and Lowe, 2000), the improved recycling of waste (e.g. Chini and Bruening, 2003), the focus on life cycle cost analysis when deciding on materials and design features at the early stages of a development (e.g. Fuller, 2005) as well as the increasingly public debate on whether to demolish and rebuild existing properties or to refurbish them (e.g. Plimmer, *et al.* 2008).

Similarly, within the services which built environment professionals offer, it has become clear that across a range of property-based specialisms, professional expertise has a major role to play in influencing and improving sustainability outcomes which impact and reflect on CSR practices as well as on the wider community (e.g. Ellison and Sayce 2007; Egan 2004).

However, there has been less attention paid to the role of investment as a driver for sustainable practices. It is clear that the finance provided by investment funders, whether from multi-billion pound investment managers or by actual and potential owner-occupiers of individual buildings, is fundamental to the achievement of our built environment and the sustainable characteristics which it exhibits. Thus, the investment sector has, potentially, a major role to play in securing sustainable outcomes both within the built environment itself and within the policies and practices of borrowers, whether they are developers, occupiers or service providers. Investors are, therefore, in a powerful position to influence both the relatively short-term construction and refurbishment and longer-term occupational processes, by working with borrowers to encourage, require, explore, negotiate and investigate increasingly sustainable practices and outcomes which have the potential to benefit the investors, occupiers, their stakeholders and the wider community.

3.1 Historical Development of Responsibility in Property Investment

RPI grew out of the socially responsible investment (SRI) agenda, although there is some confusion as to how SRI developed historically. According to Roberts *et al.* (2007: 343-4), SRI originated in the "ethical" investment strategies of church investors during the early twentieth century, who used a criteria of excluding certain sectors (e.g. alcohol, gambling and

tobacco) from their investment portfolios. In parallel, Islamic investors developed "Shariah-compliant" investment strategies by making similar selections using the process known as negative screening.

However, Juholin (2004: 20 – 21) recognises the development of CSR as dating back to the 1800s and opines that it was not based on religious or charitable principles, but on business ideology and entrepreneurship. She also links the development of CSR with the process of industrialisation in northern Europe since the 18th century as a result of which, in order to recruit and retain the workforce, factory owners invested in accommodation, schooling and healthcare for their employees. She opines that this was motivated both by self-interest as well as a genuine desire to improve their workforce's living conditions - similar principles to those which underpin SRI today.

In the USA, the increasing popularity of SRI is recognised as reflecting the investment concerns of the so-called "Cultural Creative" Americans, individuals who place a high value on ecology, community and social responsibility and other strongly-held beliefs (Pivo, 2005: 16; see also Wheelan, 2008a).

3.2 The Case for Responsible Property Investment (RPI)

Pivo and McNamara (2005) set out the case for RPI, by recognising:

- the growth in legislation, which is increasingly holding companies to account for a range of social and environmental failures (e.g. failures in environmental management systems (EMS) which cause environmental damage and where the polluter (the class A person) cannot be called to account. (refer Jayne & Skerratt, 2003; Turner *et al.* 1994));
- development which reflects local concerns is more quickly given approval and / subsidies by local government officials;
- where resource consumption is reduced, there are opportunities to improve operational efficiencies and increase competitive advantage;
- there is an increased value to reputation; and
- responsible producers can differentiate their products in the marketplace.

However, Pivo (2005: 23) opines that:
... we do not have any systematic research on the financial costs or benefits of socially responsible real estate investing.

While the research may not be systematic, in his recent paper (Pivo, 2008), he outlines how 'the leaders' in RPI are making cost savings and improving investor performance by adopting strategies which focus on a number of (what he identifies as) ESG[1]-related issues. The issues he discusses include energy conservation, environmental protection, voluntary certifications, public transport-oriented developments, urban revitalisation and adaptability, health and safety, worker well-being, corporate citizenship, social equity and community development and local citizenship.

[1] ESG is environmental, social and governance. (Pivo, 2008: 562)

4. STRATEGIES FOR RPI

According to Lorenz and Lützkendorf (2008: 484) there is no other sector with such a great potential to contribute to a sustainable built environment as the property and construction sector. Those investing in real estate, therefore, are in a powerful position to change the way organisations develop and use their real estate, as well as how they encourage others to do so. Pivo (2005: 16) identifies three strategies applied by such investors:

- screening: this means specifically either including (positive screening) or excluding (negative screening) certain investment opportunities because of their product type, human rights, environmental records or for other ethical reasons;
- shareholder advocacy: where shareholders become involved in the process of influencing corporate activities as owners of the corporation(s); and
- community investing: in which capital is provided to communities which are poorly served by traditional financial sources.

Rapson, *et al.* (2007: 344) adds '*the engagement approach*' by which fund managers identify SEE issues across their portfolio and seek to improve performance in these areas from their targeted funds. Engagement is seen as a more positive, inclusive and supportive approach than negative screening.

These mechanisms adopt, basically, two approaches – the first (screening) involves the investors seeking out appropriate investment opportunities and rejecting those which fail to meet the standard criteria set. The other three (advocacy, community investing and engagement) all rely on the investors working with their investments to ensure improved and satisfactory outcomes. Thus, SRI does not necessarily mean ignoring unsustainable investments. It can (and some may argue that it should) involve working with companies through an investment strategy to improve SEE their sustainable processes and outcomes, while also achieving adequate returns on investment.

Having decided on a suitable strategy, Pivo (2008: 564) identifies two different approaches to implementation: the first is a 'no-cost approach' in which managers find ways to improve the social, environmental and / or economic performance of the asset at zero cost; the second involves 'value-added strategies' where relatively low up-front investment reaps huge rewards over time. As an example, a 14% energy saving was achieved in one by PRUPIM at its Mall at Cribbs Causeway. Some electrical work was necessary but it is estimated that the capital expenditure will generate a return of 40% per annum in the first 10 years (Pivo, 2008: 564). Pivo (*ibid:* 570-571) describes the results of tree planting which includes the addition of 10 – 15% to the value of office properties, 20% lower winter heating bills, and, for shopping centres, he reports on research which demonstrates that shoppers will spend about 10% more for goods and services in shopping areas with trees.

There is evidence (e.g. Wheelan, 2008a) that in the USA, "SRI real estate" is becoming increasingly popular for ethical investment funds, and that the UN is urging institutional investors to encourage their property fund managers to sign up to the six environmental,

social and governance principles of the UN Principles for Responsible Investment (Wheelan, 2008b). These principles are:

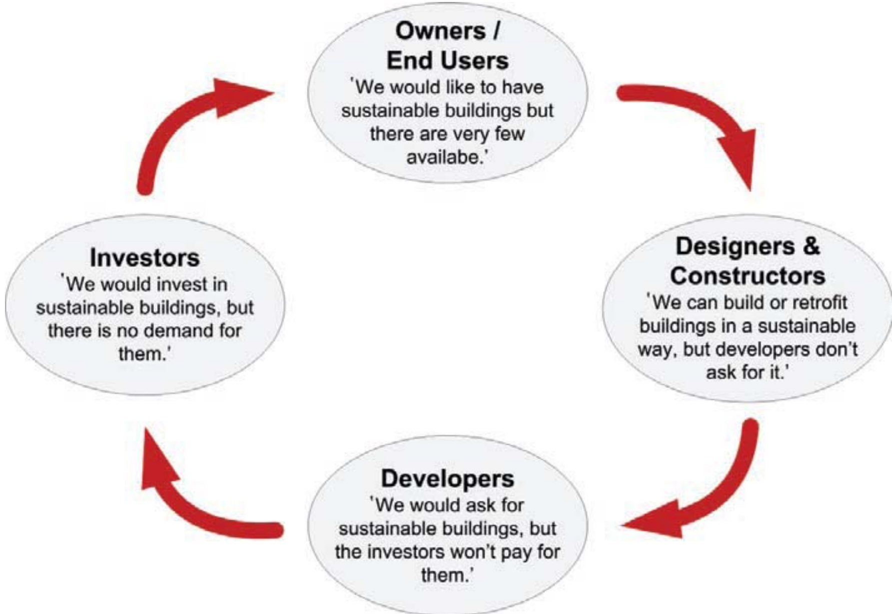
1. to incorporate ESG issues into investment analysis and decision-making processes;
2. to be active owners and incorporate ESG issues into our ownership policies and practices;
3. to seek appropriate disclosure on ESG issues by the entities in which we invest;
4. to promote acceptance and implementation of the Un principles within the investment industry;
5. to work together to enhance our effectiveness in implementing the Principles; and
6. to report on our activities and progress towards implementing the Principles. (UNEP FI and PRI 2008)

However, addressing sustainability and CSR only by focusing on new build is insufficient to deal with the huge problem of the sustainability of our built environment. Pivo, (2008) makes a very strong case "*... for concerted though and action to be given to finding ways to reduce the environmental impacts of the existing built stock.*" Investors and investment strategies are strongly placed to do this by working with borrowers and occupiers to ensure that sustainable practices in such areas as waste management, energy efficiency, and refurbishments which achieve high levels of sustainable features are negotiated and implemented.

For example, with regard to energy conservation the Investa Property Group (Australia) saved AUS$30,0000 and 363 tonnes of CO_2 per year, by auditing energy use in its buildings and diagnosing inefficiencies. The savings were achieved with minimal or no cost strategies (Pivo, 2008: 564); PRUPRIM (UK) reduced water consumption by 25% at its headquarters by installing water displacing "hippos" in all toilet tanks (*ibid.*; 566). VF Outlet (USA) reduced the costs of disposing of solid waste by 67% by introducing a recycling programme supported by its tenants, which not only saves money, but creates jobs and protects the environment (*ibid.*; 567). Research (CRiBE 2007; Brooks 2008) has found that leases can be a barrier to introducing sustainable practices for tenant occupiers, and the opportunity to negotiate "green leases", which both encourage and offer incentives for sustainable practices, is another example of how investors can improve, both the sustainability of their holdings, and also the quality of the wider built environment.

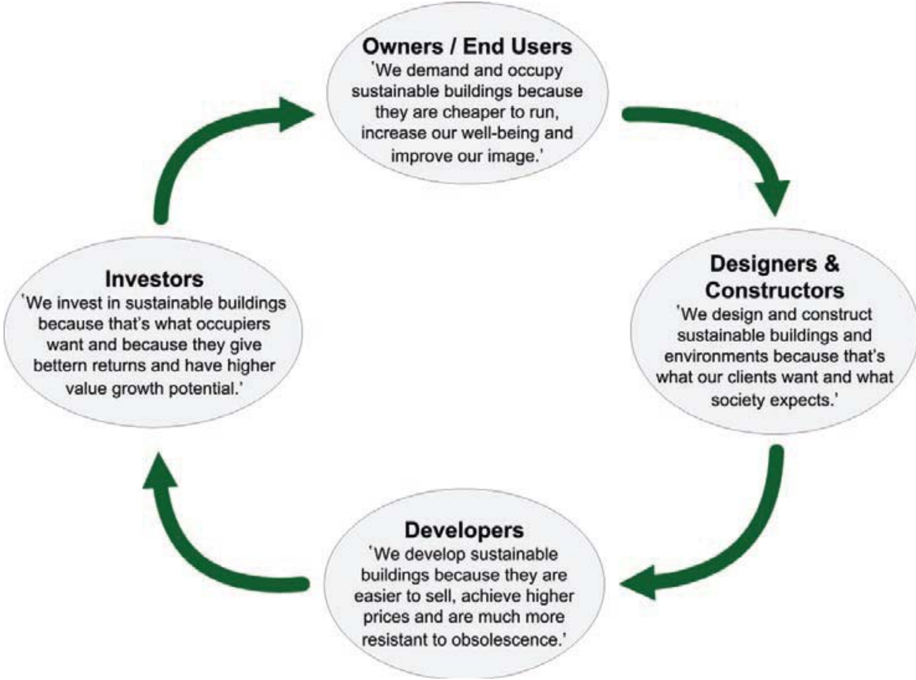
Yet there seems to be a missing link – that between the very clear and urgent arguments for achieving an increasingly sustainable built environment, particularly with regard to our existing structures, and widespread tangible changes on the ground. There is a pressing need to break the so-called 'vicious circle of blame' (refer Figure 1) and instead to create a virtuous circle (refer Figure 2).

Figure 1: The 'vicious circle of blame'.



Source, RICS, 2008: 3.

Figure 2: The virtuous circle.



Source: RICS, 2008: 4.

It is opined that there is a role for valuers in helping to break the 'vicious circle of blame' by their unique position and expertise. This is discussed further below.

5. ROLE OF VALUERS

Thus, it is clear from the literature that increasing numbers of organisations and individuals are convinced by both the moral and financial arguments which underpin responsible property investment, both from the point of view of improving the way invstors manage their real estate assets and from the wider global sustainability perspective. But, the incorporation of such features in investment practice is still at an early stage. According to Lorenz and Lützkendorf (2008: 484):
… the adoption of sustainable or socially responsible property investment practices is emerging but is not yet a mainstream activity.

They opine that the demand for sustainable buildings needs to be strengthened and they identify a number of ways of doing this, including:
… harnessing the property sector's methods and instruments (e.g. risk analysis, valuation, and transaction analysis) in order to report and communicate the advantages of sustainable buildings. (*ibid.*: 485)

The authors also recognise the potential for *a positive feedback loop* as those in the market become aware of the benefits of sustainable buildings and management systems which are reflected in the pricing of assets.

This gives valuers a pivotal role in helping to break the 'vicious circle of blame' by highlighting the available evidence and gathering supportive and reliable data to support the shift to a sustainable investment policy and thereby demonstrating the financial, social and environmental advantages of responsible investment. They are uniquely placed to do this, both as interpreters of market performance and data, and as professional advisors to those involved at various levels and stages in property investment.

However, this presupposes that the valuation profession (as a group) is convinced by the arguments and also has the necessary data and methodologies to support them in this process, and this may not yet be the case.

The basic goal of property valuation is to provide a monetary measure of the utility derived through the access to and control of property. The value of property is determined through the flow of services it is capable to provide (sic) *for the satisfaction of human needs; i.e. the increment in well-being dependent upon it, or – what is the same – the impairment of well-being that its loss must bring about.* (Lorenz and Lützkendorf, 2008: 486-487)

Valuers estimate the sale price or market value of real estate (normally) by comparing historic prices of broadly comparable properties, while allowing for material differences in attributes

and the changes in the market which result from the passage of time, between transaction dates. It must be remembered that:

... prices are social phenomena brought about by the interplay of constellations of price-determining factors. And there is nothing constant and invariable in these prices or exchange ratios. They are permanently fluctuating. (*ibid.*: 487)

Valuers therefore interpret earlier performance in order to predict how buyers and sellers will behave in the future, when relevant circumstances may well have changed. They can therefore incorporate the financial benefit of sustainable features in real estate only to the extent that market evidence or emerging trends demonstrate the relevance of sustainable features on demand. Put simply, if there is no evidence that someone will pay more for a sustainable feature in a building, then valuers are not able to increase the value of the property for it. Indeed, to do so would probably result in a case of negligence against them.

Within the provision of a valuation, therefore, there may be little opportunity to reflect the benefits of sustainable features which may be well recognised in the literature, if there is no transactional market evidence available. According to Lorenz and Lützkendorf:

… the quality and extent of property transaction data available to date does not yet allow for empirically proving and satisfactorily explaining the relationship between observed property prices and the sustainability of construction. (2008: 493)

Despite a number of research efforts to improve the availability of data (see Lorenz and Lützkendorf, 2008 for details), the lack of sufficient and appropriate property transactional evidence to allow the linkage of a building's environmental and social performance remains a significant obstacle to the integration of sustainability aspects into property valuation. (Lorenz and Lützkendorf, 2008). Nor is there widespread market acceptance within the property sector of the application of sustainability assessment tools (*ibid.*: 496). However, this opinion is challenged by UNEP FI PWG (2007: 8):

Systematic research is tending to show that green buildings can be built at the same cost as conventional properties. Survey research is also finding that occupiers may be willing to pay marginally higher rents to obtain the benefits of green buildings. Evidence is growing that green buildings increase worker productivity and lower running costs. Given this context, green buildings could become more valuable relative to conventional properties over the coming years.

6. CONCLUSIONS

Perceptions of RPI align property investment with sustainability processes and outcomes, and thus, it can be argued, put valuers at the heart of the process. While politicians certainly have a role in directing policy and ensuring a suitable regulatory framework, and researchers in providing hard data to support both RPI policy and practice, valuers, with the support of their professional institutions, should be seen as the experts in how sustainable features affect market prices and values. Thus, valuers have a major role to play in both supplying and interpreting the data from markets and working with the parties to support sustainable investment decisions which impact on our built environment.

While this is not the traditional role of "experts", there is evidence that valuers (like many other professionals in the twenty first century) are evolving from "experts" to "facilitators" (Matzdorf, et al., 2000: 95), working alongside intelligent and informed clients and helping them with their planning and decision-making processes, rather than merely taking and fulfilling their instructions. If it is true that informed clients recognise the facilitating role of valuers, then we have an opportunity to benefit our clients directly by demonstrating to them the available evidence and for discussing with them the potential for sustainable practices in their investment strategies, and thereby benefiting the rest of the community indirectly. This makes valuers potentially influential in having the opportunity to raise the profile of sustainable investment for their landlord and tenant clients, and work with them to investigate potential costs and savings.

This function is in keeping with the FIG Ethical Statement and Moral Codes of Conduct (FIG 1999) which recognises that valuers, as surveyors, have a public interest duty and that their function has "*a lasting impact on society.*" (*ibid.*) By demonstrating the evidence as it emerges of a clear social, economic and environmental case for incorporating sustainable features in properties and by discussing with clients their advantages, valuers will be serving both their clients and the wider community. The FIG Code (1999) continues *"The principles of sustainable development require surveyors to work as much for the future as for the present."* (*ibid.*) In the light of this statement, it could be argued that failure to demonstrate the evidence to support sustainable investment strategies would be a breech of the ethical responsibilities which valuers have to the global community.

By showing how the market leaders are able to make occupational cost savings which increase investment returns, they will be able to demonstrate to more and more investors (developers, occupiers and investment managers) the economic argument for sustainable features and practices within our existing building stock. In this way, market evidence to support the business case will become increasingly available and more certain, and a virtuous circle of demand for and supply of sustainable buildings (whether new build or refurbished) will result.

However, this will only work if the valuation profession is aware of and convinced by the benefits of sustainable property and, specifically, of responsibility property investment, whether for owner-occupiers, fund managers or financial institutions. Their unique position as market interpreters and advisers imposes the obligation to demonstrate clearly and reliably where sustainable features add value – both in the sense of reduced occupational costs and of an enhancement of social and environmental benefits.

To do this, valuers need to change the way they undertake and present their valuations. They need to build sustainability into their methodologies and demonstrate explicitly where sustainable features have tangible, financial benefits and thereby increase market awareness of the medium- and long-term benefits for all concerned. To do this, attention needs to turn to education, both of valuers as a profession to raise awareness of the sustainability issues, and within the valuation process to ensure that the message is both evidence-based and reliable.

The global climate provides a challenge for companies which must:
…[earn] their legitimacy, not only in doing business and making money, but also in other fields, such as economic legitimacy, natural environmental accountability, and responsibility to different stakeholders." (Juholin, 244: 22)

And within this process, they are judged by a global public with different standards, perceptions and expectations. Valuers have a major role in facilitating companies in their challenge, by encouraging realistic perceptions and expectations of sustainable outcomes, and by demonstrating the business case for sustainable investment within their valuations, so that the market supply of and demand for sustainable buildings and practices becomes mainstream throughout the world. We are not yet at the stage where we have the valuation tools to demonstrate the market value of sustainable features, but we do have the responsibility to undertake the necessary research to develop, test and implement reliable and efficient methodologies and to gather the necessary data to underpin those methodologies. Clearly this is a challenge we must accept.

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