Real Estate

Pillars of Responsible Property Investing

Connecting the dots to financial performance

There are many benefits to owning and operating energy efficient, high performing, green properties. However, proving the link between real estate sustainability and improved financial performance and value has remained challenging. We recently teamed with the U.S. Department of Energy (DOE) in a pilot study to show the link between real estate sustainability and improved financial performance and value is attainable.

As a leading manager in commercial real estate investing, we recognize the financial benefits of employing green strategies wherever feasible; it's a critical part of delivering best-in-class real estate investment management capabilities to tenants and clients alike. We also believe research is fundamental to everything we do. It defines our ability to assess the relative value of each investment opportunity, make informed investment decisions, and most importantly, help our investors achieve their target investment outcomes.

It was only natural, that when the opportunity came for us to be the sole participant in a ground-breaking pilot study by the U.S. Department of Energy (DOE) to measure the financial benefits of sustainable/green investing, we immediately said "yes". Being involved in the pilot study was a natural extension of our unequivocal research focus, but also spoke to our commitment to real estate innovation and its power to add value for our clients. As an UN-sponsored PRI signatory, which demonstrates our commitment to responsible investment, we believed our involvement in the study could benefit our own approach to sustainable investing – encapsulated in our Pillars of Responsible Property Investing Initiative. As important, we appreciate the opportunity to contribute to the broader bank of knowledge available to all investors on this impactful topic.

What's the goal?

A growing body of empirical research supports the multiple benefits of owning and operating energy efficient, high performing, green properties, including lower utility bills, higher rents, improved occupancy, and greater net operating income. However, proving the link between real estate sustainability and improved financial performance and value has remained challenging. But with this pilot study—which will serve as a foundation for the DOE's Data Lab[1] coming later in 2017—the DOE is hoping to make those challenges a part of history. The Data Lab is designed to hold information from multiple commercial real estate owners, databases, and other sources, with the objective of facilitating deeper investigation into the potential relationships between energy efficiency and financial performance of buildings, and identification of the underlying variables that drive these relationships.

What did the pilot study measure?

Our portfolio of real estate assets that formed the basis of the pilot study consisted of 131 commercial properties throughout the United States, with an aggregate area of 25 million square feet, of which 60% were defined as green[2]. The objective of the study was to identify potential correlations between a building's green status and the following six performance metrics:

- **Market value**
- **Net operating income (NOI)**
- **Operating expenses**
- **Rental income**
- **Rental concessions**[3]
- **Occupancy**

What did we learn?

1. Green properties measured stronger across all six metrics than non-green properties.

▲ **Higher** market value/SF
▲ **Higher** NOI/SF
▼ **Lower** operating expenses/SF
▲ **Higher** rent/SF
▲ **Higher** occupancy
▼ **Lower** rental concessions[3]

2. All six metrics showed potential to improve when an average non-green property converted to green.

Using linear regression analysis, the research team working on behalf of the DOE was able to estimate the potential impact of converting the average non-green property into a green property within the dataset. The following is a breakdown of those impact results[4].

Performance metric	Change from non-green average	Statistically Significant?
Market value	8.4%	No
NOI	**28.8%**	**Yes**
Rent	4.3%	No
Rental concessions	-6.9%	No
Occupancy	6.2%	No
Operating expenses	**-17.6%**	**Yes**

While the relatively small sample size of the study meant that some results were not deemed statistically significant, two very important metrics for real estate investors were —NOI and operating expenses. The strongest correlation identified was the relationship between NOI and green buildings. It is conceivable that the potential impact of green status on NOI consists of aggregated benefits generated by other variables. Increased occupancy, reduced operating expenses, lower rental concessions, and improved rental income are all components that affect NOI. When combined, they may produce a cascading effect that yields higher NOI for green properties.

3. The study helped establish a framework and proposed protocols for the Data Lab.

At first glance, this outcome does not appear as exciting as the first two results of the study. But in terms of its contribution to the existing body of evidence … our long-term understanding of the link between sustainability and financial performance … and the quality of the knowledge that we will potentially be able to glean from the Data Lab, we believe it could prove very important in the long run.

Where to go from here?

We intend to continue our partnership with the DOE, contributing to the build-out of the Data Lab and continuing to participate in their larger, ongoing research efforts. And based on our inaugural participation in the Data Lab, we will be encouraging our peers to also participate, so that together we can enhance the quality of data available to the real estate investment community at large.

Closer to home, we have initiated the next phase of research within our own portfolio, focusing on the relationship between green buildings and tenant satisfaction. We will be carefully analyzing the results of our annual Kingsley Tenant Satisfaction surveys to isolate correlations and linkages between these two important variables. And, as with all our research, we will share those findings with our investors and the wider market to further increase everyone's bank of knowledge on sustainable investing.

Want to look further into the data and methodology? The full results from the DOE can be found in their paper, "Utilizing Commercial Real Estate Owner and Investor Data to Analyze the Financial Performance of Energy Efficient, High-Performance Office Buildings."

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[1] Commercial Real Estate Data Aggregation & Trends Analysis lab.

[2] Properties were classified as green if they showed an ENERGY STAR score of 75 or higher, or they had achieved LEED Certification

[3] For properties where rental concessions existed, green properties had lower concessions.

[4] Note: while the study identified correlations between green buildings and financial performance, its analysis was not designed to distinguish causation or the underlying source of the improved performance.