

HOW TO MANAGE THE TRUE COSTS OF SUSTAINABILITY AND REALISE ITS VALUE

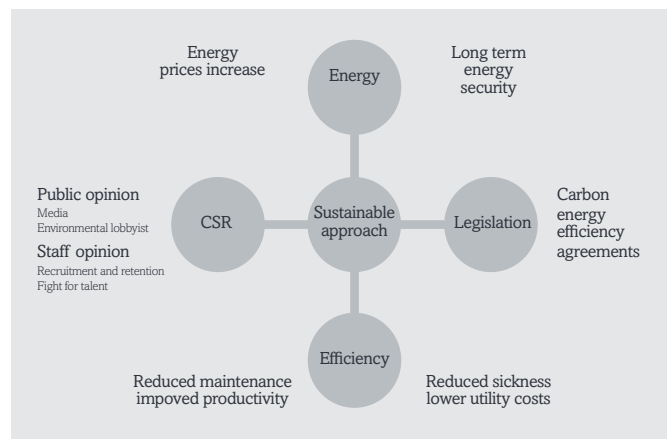


“The UK and Western Europe has started to experience differentiation in the market between sustainable developments and those that are not with the former attracting greater values. There is evidence that this is starting to spread east. An internationally recognised sustainability accreditation will become key to future development values.” Matt Fulford - Head of Sustainability

The requirement for sustainability in built assets is set to increase in the next two years. The key issues that will require solutions will be: successfully managing the sustainability requirements during the creation or refurbishment of an asset, how to realise value of a green asset to deliver greater returns, and what to do with the existing stock.

Background

The requirement for sustainable built assets has increased dramatically over the last two years in the UK and Western Europe and we are forecasting this trend to continue for the next 10 years and spread east, due to a variety of coincident factors. In addition to the changing public opinion (shifting customer, staff and shareholder attitude), the increasing international legislation due up until 2019 will shift the perception of what ‘good’ looks like in the property market and ‘good’ will almost certainly be ‘green’.



Drivers for a sustainable approach

The drive to a sustainable approach brings with it a multitude of issues, but some of the most critical ones affecting property are:

- The successful management of sustainability requirements when creating assets, including managing any additional costs
- Finding and realising the additional value in sustainable assets, in order to maintain and increase revenues
- How to respond to the sustainability agenda with existing non-sustainable ‘brown’ stock.

Managing sustainability - the issues

When dealing with sustainability, clients have previously included a general requirement for projects to be ‘sustainable’ to their consultant teams. This provides an ill-defined requirement which is frequently interpreted by different team members in divergent ways and fails to deliver value.

The future value of sites is likely to be a function of that site’s ability to generate, or have directly supplied to it, renewable energy within its boundaries. However, due diligence and site evaluations are frequently failing to review this issue.

With existing stock, the recent introduction across Europe of Energy Performance Certificates allows occupiers and investors to readily review the performance of an asset. A market-demand benchmark of a C rating is emerging. Over time it is anticipated that assets rated below this could see increased voids, rapid obsolescence and a consequent reduction in value.

When attempting to realise greater value for ‘green assets’ the market is typically failing to quantify and sell the benefits to the occupiers. This is the result of the market not possessing the tools required to realise this value. Furthermore, the in-built efficiency of the energy supply (and generation) within a green building is often being sold with the accommodation part of the asset for little or no additional value. It is possible to separate these two parts of the asset, but in order to realise this value certain issues have to be overcome, as the supply of electricity is heavily regulated.

Adding value

In order to provide a solution to reduce the additional costs of sustainability and deliver value, the above issues need to be considered early, at the master-planning and feasibility stage. The design team need to be co-ordinated and supported to deliver a design, procurement and contract solution that delivers best value; both in terms of reducing the cost of sustainability solutions and in realising higher end market values, through accessing green funding and by demonstrating occupier benefits.

Cost benefits

The most obvious benefit to an occupier of a sustainable asset is that of reduced utility costs (both energy and water); in an era of increasing oil prices this benefit can be expected to increase. The European introduction of Energy Performance Certificates (EPCs) provides potential occupiers with the ability to review how well a built asset performs in this regard. Analysis of the bandings show that a mid C-rated building will have energy bills that are £18 per m² per year lower than that of a mid F-rated building.

The less obvious, but more important benefit is that studies are beginning to show that ‘green buildings’ offer improved health and well being of the staff, resulting in reduced sick days and increased productivity.

The benefits are typically expressed in percentage improvements, however, if one reviews these in terms of €’s saved by the occupier in a year, then the true financial benefit can be reviewed. On a typical office building with staff on an average Western European consultancy practice wage the financial savings of occupying a green building could be in the region of €900 per m² per year expressed in the table below:

Energy saving (EPC D to B)	€24/m ² /year
Water saving (Part L to BREEAM VG)	€1/m ² /year
Sickness reduction (39% reduction) ¹	€180/m ² /year
Productivity improvement (5% increase) ²	€690/m ² /year
TOTAL	€895/m²/year
Other benefits	Brand, CSR, Recruitment and retention
Other benefits to investor	Marketability, longer life, stable cashflows

As future owners and occupiers of the asset are made aware of the reduction in operational lifecycle costs then the possibility of obtaining higher values is opened.

In addition to this, areas such as grants, taxation and other fiscal benefits need to be considered, to ensure all financial benefits from building green are realised.

¹ Based on Post Occupancy Studies from 500 Collins Street, Melbourne
² Based on Post Occupancy Studies from CH2, Melbourne

There is the ability to provide an ESCo type solution (a 'Micro ESCo') to offer and operate efficient or renewably fuelled energy centres installed within buildings to meet legislative demands. The energy centre creates an additional revenue-based asset separate to the accommodation. This Micro ESCo can be owned in whole or part by the developer, in order to provide them with a revenue generation stream and a business asset capable of being sold on the market.

Within existing portfolios, asset managers need to understand the current sustainability performance: How this can be undertaken by utilising existing measures such as EPC's or using assessment methods such as the new BREEAM In Use. The key output of this should be a strategy to prioritise recommendations for improvements that can deliver best value for both the asset and the occupier. A full strategy for improvements needs to be linked to the tenure of the asset, future legislation and anticipated changes in market attitude.

The benefits

Correctly managing the sustainability requirements on a project can bring down the capital costs.

On a well-managed commercial project with early input on sustainability, additional project costs aimed at achieving a sustainability accreditation (BREEAM/LEED) rating can be reduced from in excess of 10% down to 3-5%. Expert experiences from other projects and wider industry knowledge need to be applied to deliver greater value.

In the future, market values are going to be significantly affected by the sustainability rating. Evidence has started to suggest of decreased voids, increased rental values of 3-8% and higher sales values of 5-10% for internationally accredited sustainable buildings.

Creating a Micro-ESCo approach to an energy centre enables stakeholders to generate more value and revenue from a fixed asset and thus generates revenue from low carbon energy rather than cost. It also provides the developer with revenue funding to off-set capital expenditure required to meet increasing sustainability requirements. Moreover, it has the potential to attract tenants through beneficial fixed-price energy deals which is becoming increasingly important, in an era of rising energy prices.

A review of current performance in terms of sustainability can provide a measure of environmental credibility in the market. This should be benchmarked internally and externally to add to portfolio values and to protect against devaluation. At the same time a strategy to improve current portfolio performance needs to be determined in terms of:

- i. Future investment prioritisation and portfolio management
- ii. Legal compliance
- iii. Reduced service charges
- iv. Improved values
- v. Reduced obsolescence.

EC Harris is able to offer expert advice on sustainability matters including undertaking due diligence for investors, advising occupiers and investors on how to 'green' their current portfolio and advising developers on how to build in a sustainable manner while maintaining value.

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