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2.2% Decrease in number of larger businesses established in Germany in 2018

The real estate industry is key to reducing carbon emissions. Ridhima Sharma reports

Property in the front line of war against global warming

Sustainability in real estate is not only a question of returns, but also the responsibility and potential of the real estate industry to reach climate and environmental sustainability targets.

At COP21, the Paris climate conference that took place in December 2015, 195 countries adopted the first ever agreement which sets a target for reducing negative effects from climate change by limiting global warming to well below 2°C.

The World Bank estimates that the real estate sector has to reduce CO_2 emissions by 36% by 2030 to support staying within the 2°C threshold. If the world's nations do not reduce global warming quickly, temperatures may increase dramatically in the coming decades.

The World Economic Forum states in their report *Environmental Sustainability Principles for the Real Estate Industry* that the real estate sector consumes annually over 40% of global energy; and that buildings originate 20% of global greenhouse gas emission and use *ca* 40% of raw materials, respectively.

The results of runaway global warming are predicted to include: scarcity of food and fresh water; the spread of diseases; and rising sea levels, which will flood coastal cities and submerge many island nations.

The United Nations Intergovernmental Panel on Climate Change (IPCC) estimates that a 1.5°C average rise may put 20-30% of species at risk of extinction.

In addition, increasing extreme-weather events like storms and floods are likely to affect the property industry and infrastructure having a major impact on economies and investment performances.

According to Richard Peiser, the Michael D. Spear Professor of Real Estate Development and director of the Master in Urban Planning Program at the Harvard Graduate School of Design and Thomas Wiegelmann, managing director of BLUE Asset Management, Honorary adjunct professor at Bond University and member of the Harvard Alumni Real Estate Board: "In a rapidly urbanising world, the real estate industry lies at the centre of an unprecedented level of growth and activity. Investors, occupiers, cities as well as governments can and have to play a key role to achieve a reduction of greenhouse gases in the context of the construction and operation of real estate.

"Governments and cities shall further proceed in establishing and adopting sustainable and comprehensive long-term policies incentivising real estate investors to collaborate and support such initiatives. This implies that the real estate sector will remain a prime target for policy action. This presents new challenges and opportunities for the real estate industry with profound implications for both owners and occupiers," they add.

DECISION MAKING

For industry practitioners at all points of business, weaving climate and sustainability considerations into key decisions is a responsibility. But what many do not yet realise is: guiding market decisions toward sustainable, climate-friendly outcomes will actually generate financial and economic payoffs for the real estate industry and for investors, especially in the medium and long terms.

Peiser and Wiegelmann comment: "Sustainable property investments have developed from a niche concern to a mainstream product for new real estate developments and investment products over the past decade. Green buildings represent a significant share of

global development projects, which is expected to further grow."

When financiers invest into new development projects, they are increasingly selecting those that have or qualify for a sustainability rating.

"In order to achieve the reduction in CO_2 emissions necessary to preserve the environment for future generations, the industry also has to increasingly consider sustainability-minded retrofits and renovation of existing buildings," they state.

This process is bound to be burdensome in the short term – certain sustainability-driven features pay for themselves, while others do not at this time – but it is nevertheless a reasonable cost-efficient way to achieve the reduction in CO_2 emissions that has been deemed necessary.

When underwriting existing property, energy efficiency is an important component of commercial due diligence as well as capital expenditure requirements for green retrofit and renovation of existing stock.

Peiser and Wiegelmann say: "We are convinced, that many existing properties will be rated as not 'future-proof' and will successively fall behind when competing for customers and occupancy rates and investors in the mid to longer term future.

"As a result, we expect that for those properties a significant discount for a lack of sustainability (grey discount) will have to be considered in the future. Mindful investors anticipate and understand the impact of such developments and trends to reduce exposure to long term risks," they further add.

THE CHALLENGES OF INVESTING IN MORE SUSTAINABLE BUILDINGS

The causal chain between the effects of cost-spending on sustainability investments and the resultant effects and benefits tend to be diffuse, but a number of data points and case studies illustrate key and pivotal trends, and suggest the factors that will play increasingly weighted roles in long-term costs and values.

In the absence of one fully uniform certification system, it is still difficult to measure, standardise and compare monetary valuation of sustainability aspects. Standards include, *inter alia*, LEED, BREEAM , HQE, DGNB , Green Star and CASBEE.

Higher initial costs for sustainability features are particularly obstructive when short amortisation periods and high yield expectations are at the centre of investors' attention. Investments into sustainability characteristics are expected to "pay off" in the medium and long run.

It is also to be noted that from the perspective of owners and investors, sustainability costs are not symmetric with resulting energy savings.

In other words, energy-saving measures require significant one-off capital expenditures typically to be borne by owners and investors, but the resulting reduction of operating costs usually occurs over time and benefits mostly tenants.

SUSTAINABLE BUILDING PRACTICE EFFECT

The core challenge for many investors still lies in the frequently diffuse causal chain between the effects of costs and the resultant effects of benefits of investments into sustainability measures.

Research has illustrated that property pricing is increasingly distinguishing between properties and portfolios that exhibit different sustainability-related features and resulting performance. Also, evidence shows that more sustainable properties correlate positively with higher rental premiums.

Furthermore, green buildings tend to have lower vacancy rates as well as lower operational costs. At the same time, there is still a need for enhanced empirical evidence of causality between sustainability and performance/ value.

It is important to further develop "business cases" for sustainability in a transparent way. Life-cycle assessments and resulting life-cycle cost considerations are becoming increasingly important and turn the focus on the long-term benefits of sustainable real estate.

And not to forget, technology is undoubtedly playing an important role in providing cutting edge solutions to monitor, in close to real time, the performance of buildings. ■