RESPONSIBLE PROPERTY INVESTING: A Survey of American Executives

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with a Forward by Geoffrey Dohrmann

in collaboration with
Institutional Real Estate, Inc.

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The Urban Land Institute

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Acknowledgements, Credits and Disclaimers

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This report was written by Professor Gary Pivo of the University of Arizona who also conducted the survey. He can be reached at gpivo@u.arizona.edu. Names and contact information for respondents were furnished by Institutional Real Estate, Inc. and NAREIT®. The views and conclusions contained in this report are solely those of the author and do not necessarily reflect the views of the members or officials of BOMA, NAREIT®, RER, ULI, IRE, Inc., or the University of Arizona. Any errors are solely those of the author. This document may be reproduced and cited with appropriate attributions. A full-length paper on the survey is available at http://www.u.arizona.edu/~gpivo/.

On the cover: The world headquarters of Swiss Re (center-left) in London, as seen from the Tower of London. Opened in 2004 and widely known as "The Gherkin", it was London's first sustainable tall building. The photo taken in 2006 by the author.

Forward

> *Man really is the only animal that builds his terrarium around him as he goes and real estate is really the business of building that terrarium. So we have a tremendous ethical content, tremendous social purpose.* James A. Grasskamp, former University of Wisconsin-Madison professor and pioneer of modern real estate studies.

Professor Gary Pivo is to be congratulated for taking the lead amongst a growing number of professionals who are focusing on the economics of responsible investing, and for conceiving and executing this research project.

The findings of this report are important. For the first time, they help illustrate both what already is being done in the area of responsible investing, as well as what additionally can be done to enhance the execution of real estate investing for the benefit of all of us who inhabit this planet.

Fiduciaries, of course, are held to a higher standard when making investment decisions on behalf of the individuals or institutions they represent. But they live, work, play, and raise families in the same world, and the investment decisions they make every day have a significant impact on that world.

As fiduciaries, of course, they have an obligation to place the financial interests of their beneficiaries ahead of their own. The good news is, the object of investing in a way that enhances the quality of community, ecology and justice in the world is not in opposition to placing the financial interests of those they represent first. In fact, as this report will demonstrate, many investors already are incorporating responsible investing principals into their investment objectives and practices, and most find that the adoption of many of these actually can serve to enhance the long term financial performance of their investments.

There can be a cost associated with acting responsibly, of course. Implementation of many of the existing green building standards the industry has developed require the payment of a two to three percent premium over the cost of more traditional, less-responsible investment and development practices. But in almost all cases, the return on cost from energy savings and operational economies, let alone the benefits to the community and tenants who utilize these new spaces, more than compensates the investor or developer for making these kinds of investments.

My colleagues and I have been delighted to be a supporter of this project, if only in a very small way. We hope you will join us in our quest to lead rather than wait for outside forces to impose a more responsible approach to investing on the real estate investment business. Acting responsibly now isn't just the right thing to do, in most cases, it is the financially most appropriate thing to do as well.

The message here is clear: Each of us can make a difference. The key is knowing how, and then, taking the appropriate action. The results of this survey should help point the way.

Geoffrey Dohrmann, President and CEO,
Publisher & Editor-in-Chief
Institutional Real Estate, Inc.

Introduction

For the past two years, leaders of the real estate and socially responsible investment industries have been thinking about how corporate social responsibility and sustainability should apply to property investing. A series of meetings have been held to discuss the subject at both the international and national levels.

In 2005 and 2006, real estate and responsible investing was the subject of sessions held at SRI in the Rockies, the annual meeting of the socially responsible investment industry. It's also been the focus of the University of Arizona/Boston College Responsible Property Investment Project, which has convened two national meetings on the topic.

Meanwhile, at the international level, the UN Environment Programme Finance Initiative has launched a global conversation on the topic through its new Responsible Property Investment Working Group. The Group emerged from efforts to create the Principles for Responsible Investment, which encourage investors to incorporate environmental, social, and governance issues into their decision making. To date, the Principles have been endorsed by over 180 organizations with over $8 trillion in assets under management. The Property Working Group includes leading property investment management organizations in the US, Europe, and Australia.

Together, these efforts have put a spotlight on what's come to be called Responsible Property Investing; something the *Wall Street Journal* has declared "real estate's latest movement".

In a nutshell, Responsible Property Investing (RPI) means portfolio, asset, or property management activities that go beyond compliance with minimum legal requirements to better manage the risks and opportunities associated with environmental, social, and governance issues in property investing. It encompasses a variety of efforts to address ecological integrity, community development, and human fulfillment in the course of profitable real estate investing. The motivation is to reduce risk and pursue opportunities while helping to address the challenging issues facing present and future generations.

RPI is not philanthropy or altruism. Today there are investment funds focused on brownfields, green buildings, affordable housing, urban revitalization, historic preservation, and other strategies that have social and environmental merit and generate competitive returns. Meanwhile, asset mangers with more conventional portfolios are implementing eco-efficiency strategies, fair labor practices, and stakeholder engagement programs without harming, and sometimes even helping, the bottom line.

This survey explores the extent to which RPI practices are taking hold in America's property investment organizations. The findings are striking and reveal that in many ways U.S. property investors are indeed doing good *and* doing well.

Notes on the Survey Methods

The target population for the survey was chief executive officers at US pension funds, foundations, and endowments (with real estate assets), REITs, REOCs, fund managers, and development companies. The sampling frame (the list of potential respondents assumed to be characteristic of the target population) was a database of 1,478 names maintained by Institutional Real Estate, Inc., supplemented by NAREIT® for REITs.

Everyone on the list was emailed an invitation to participate in an on-line survey, which required 5 minutes to complete. Four reminders were sent every 2 to 3 weeks. A total of 189 surveys were returned from November 2006-January 2007. The total response rate was 15%. Weighting was used to make sure the organizational mix in the final sample matched the target population.

Non-response bias can occur in any sample survey when respondents differ from non-respondents. To check, late and early respondents within each type of organization were compared, on the assumption that late respondents were more like non-respondents in their views. No differences were found, indicating a lack of non-response bias.

The reliability, or accuracy, of the survey instrument was tested by using a conventional technique that measures the internal consistency of responses. The level of consistency exceeded that normally considered acceptable by social scientists.

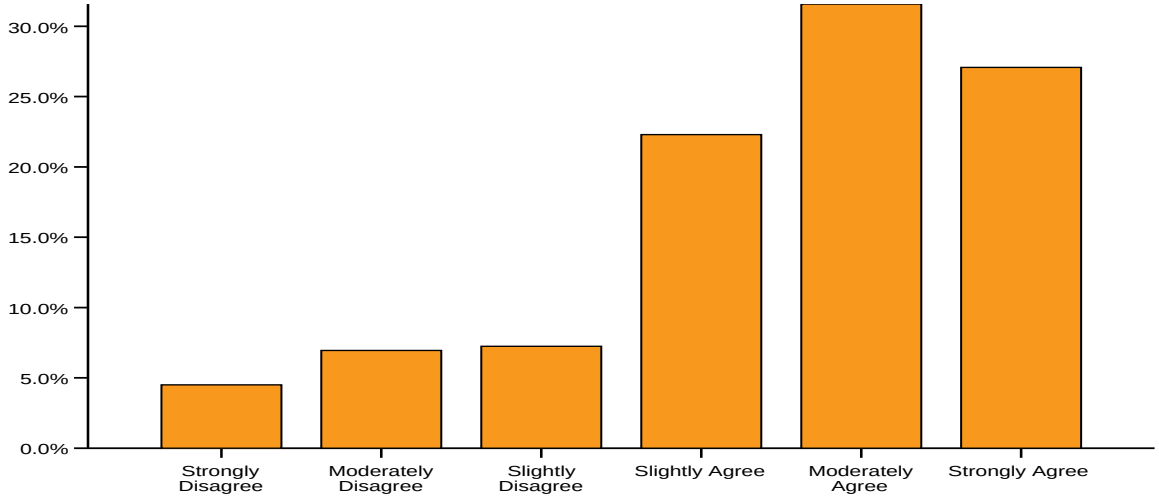
Ninety percent confidence intervals were computed for all findings. These are the ranges above or below the reported results in which we can be 90% sure the true values lie for the whole population. Unless otherwise noted in the text, this range is plus or minus 3 to 6% throughout the report.

Beyond Compliance – Today and tomorrow

"My organization goes beyond minimum legal requirements to address social or environmental issues."

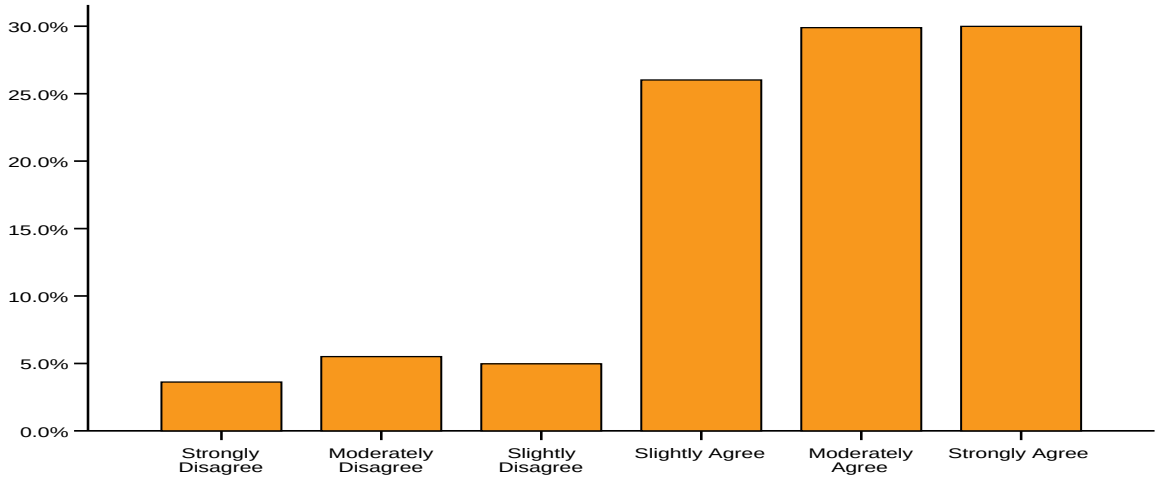
Going beyond compliance is a basic tenet of RPI. Over 80% of the CEOs slightly, moderately, or strongly agree that their organization goes beyond compliance. Ninety percent agree it will be more important in the future.

Beyond compliance today



"This activity will be more important in the future."

Beyond compliance tomorrow



Management Strategies

"Which statement best describes your use of the following?"

The following management strategies are used by organizations implementing RPI. They are listed from most to least prevalent. Conservation is most widespread, implemented by 57% the nation's investment organizations.

There is one notable difference by type of organization. Conservation is being implemented by only 40% of the fund managers, pension funds, foundations and endowments, compared to nearly 75% of the REITs, REOCs, and developers (± 10-13%).

Readers who want to know what to do to implement RPI can use this list as a reference point for their own activities.

Use of RPI Management Strategies

	Not Done	Planned or Under Consideration	Implemented
Conservation: Promoting energy conservation, water conservation, or recycling in your assets.	21%	22%	57%
Stakeholder Engagement: Conferring with stakeholders that are affected by your properties, such as neighborhood organizations, labor unions, or environmental groups.	41%	12%	47%
Value Statement: Mentioning community, human resource, or environmental issues in your credo, values, vision or mission.	37%	19%	44%
Strategic Planning: Paying attention to social or environmental issues in your strategic planning.	34%	23%	43%
Women or Minority Owned Businesses: Supporting these types of businesses.	51%	13%	37%
Responsible Contractor: Asking contractors and subcontractors who work on your properties to provide fair wages and benefits to their employees.	50%	15%	35%
Social or Environmental Accounting: Monitoring the performance of your assets using social or environmental indicators (e.g. safety record, energy consumption, etc.).	57%	15%	28%
Committee for Sustainability or Corporate Social Responsibility: Having a committee actively working on these issues.	67%	13%	20%
Disclosure: Publishing information on the social or environmental record of your organization.	64%	19%	18%
Learning/Management Systems: Linking strategic social and environmental objectives to management actions via tools such as the Balanced Scorecard, performance metrics or environmental management systems.	54%	31%	15%
Targets and Benchmarks: Comparing your social or environmental performance to norms and objectives.	68%	20%	13%

Property Investments

"Which statement best describes your involvement in the following?"

The following types of properties produce social or environmental benefits. Anywhere from one- to two-thirds of the executives say they're invested in them. The sizes of the investments were not investigated.

Here again, there are some significant differences by type of organization. Just 17% (± 8%) of the pension funds, foundations and endowments are invested in green buildings, compared to 61% (± 15%) of the developers. And just 14% (± 7%) of the pension funds are invested in brownfields, compared to 51% (± 15%) of the developers.

This is another way for those interested in implementing RPI to compare themselves to industry norms.

Investments in RPI Property Types

	Not Done	Planned or Under Consideration	Invested
Urban Infill or Revitalization: Properties in older areas.	21%	16%	63%
Transit Oriented Development: Properties in a mixed-use area within walking distance of a transit stop that mixes residential, retail, office, open space, and public uses in a way that makes it convenient to travel on foot or by public transportation.	32%	15%	53%
Green Buildings: Properties designed to conserve natural resources and improve human health.	33%	31%	36%
Brownfields: Properties on sites complicated by environmental contamination.	51%	16%	33%

Other Activities

"Please list any other investments or management activities by your organization which you view as sustainable or socially responsible."

Other activities voluntarily reported by executives include the following:

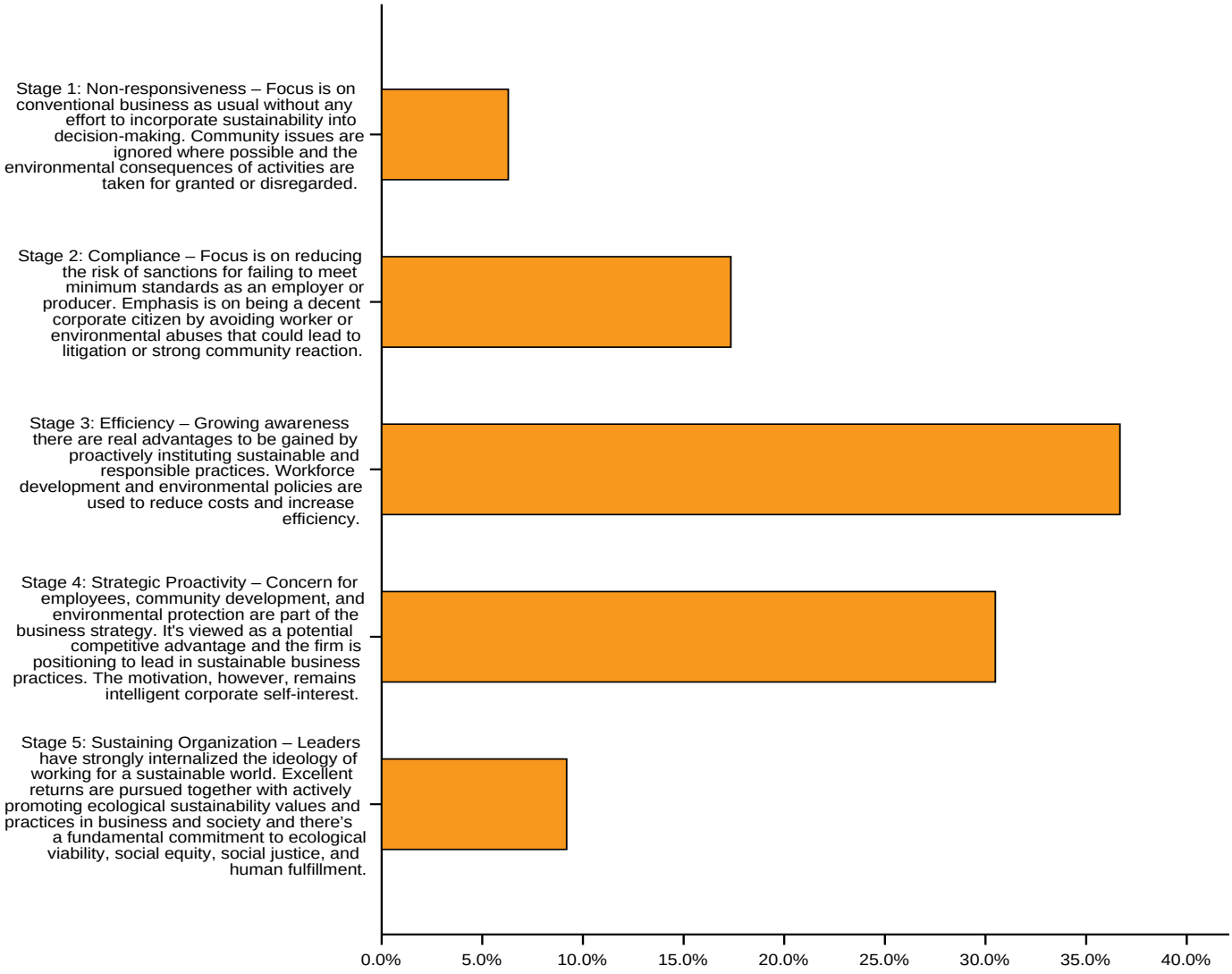
- Affordable housing bonds
- Flex-time for parent employees
- Charitable giving
- BOMA Go Green partnership
- Charter school construction
- Service on non-profit boards
- U.S. Green Building Council program participation
- Ethics standards for company managers
- Occupation of green office space
- Engagement on RPI issues with investments owned

Stages of Responsible Property Investing

"Where would you place your organization according to these stages of RPI?"

The largest group of executives places their organization at Stage 3 in this framework, aware of the efficiency gains from RPI. For more than a third, however, RPI is part of their business strategy. No significant differences were found by type of organization.

Real Estate Investors by RPI Stage (adapted from Dunphy *et al*, *Organizational Change for Corporate Sustainability*, 2003.)

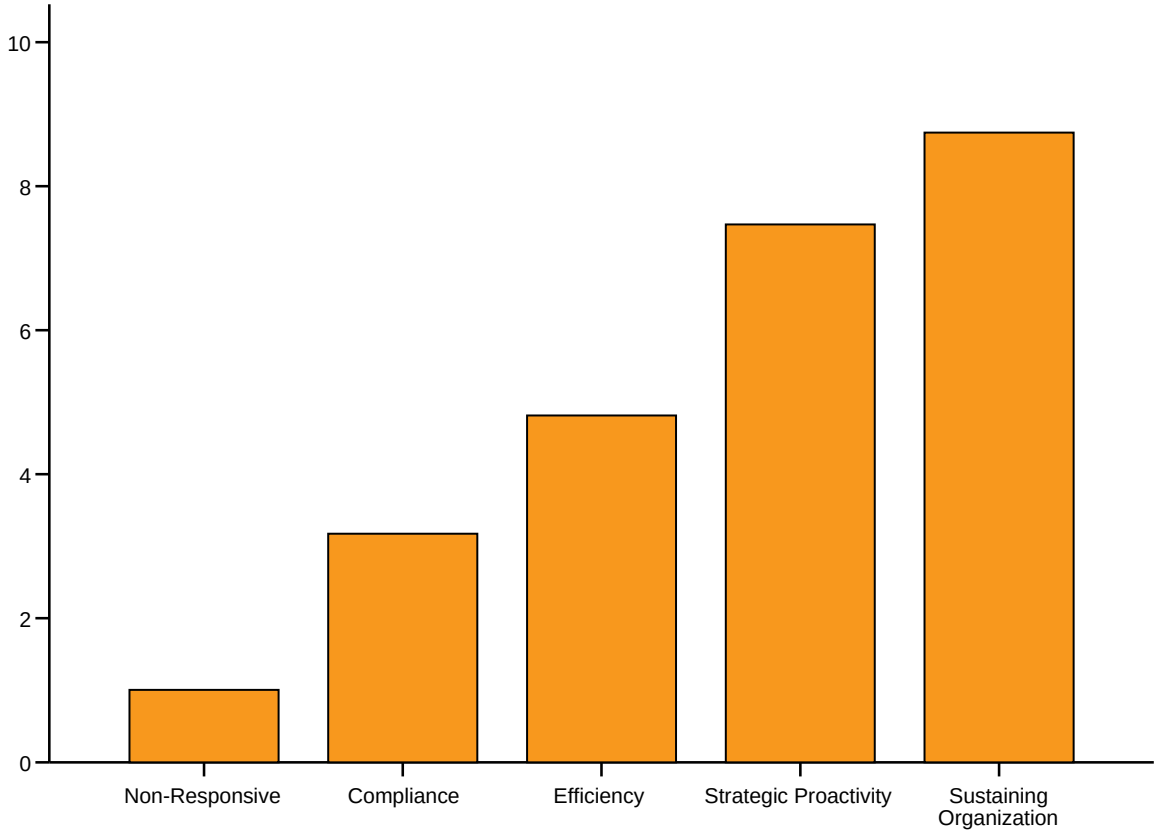


Do higher stage organizations really do more?

To test whether RPI stage predicts an organization's RPI activity, the average number of strategies and investments implemented was computed for the organizations in each RPI stage. As the chart shows, higher stage organizations report implementing more activities. The RPI stage model seems to be a good predictor of how many different RPI activities are being implemented in an organization.

These results give readers another way to benchmark their own organization's RPI activity level, depending on where they would place themselves in the RPI stage model. For example, if readers think their organization is at the Efficiency stage and moving toward Strategic Proactivity, then to fit national norms, their organization should have already implemented 5 of the RPI management strategies or investments and should be moving to implement 2 or 3 more as part of its transition to the next stage.

Average Number of RPI Strategies and Investments Implemented by RPI Stage



Drivers and Barriers

"Please rate the following as drivers and barriers to RPI in your organization."

The strongest drivers of RPI are conventional business considerations such as concern for risk and return and opportunities to outperform. However, moral sensibilities, voluntary codes of behavior, and internal leadership also are significant drivers.

Business concerns lead the list of impediments as well, followed by a need for more investment products and information. Perceived legal restrictions and internal resistance are more modest restraints.

Pension funds see fiduciary duty as more of a barrier to RPI (mean = 4.8) than do other types of organizations (mean = 2.6 to 3.2). But legal research by Freshfields Bruckhaus Deringer indicates that RPI probably can be integrated into institutional investing if it is motivated by proper purposes and does not adversely affect the financial performance of the entire portfolio (See *A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment*, 2005.)

Drivers

	Mean 1 = no driver 6= major driver (90% C.I. = ± 0.2)
Concern for risk and return	4.6
Opportunities to outperform	4.3
Business advantage	4.2
Moral responsibility	4.1
Voluntary codes of behavior	3.9
Internal leadership	3.9
Cost avoidance	3.9
Customers	3.7
Employee recruitment/retention	3.2
Investors	3.1
Peer activity	2.8
Stakeholder pressure	2.7

Barriers

	Mean 1 = no barrier 6= major barrier (90% C.I. = ± 0.2)
Insufficient financial performance	3.9
Insufficient tenant demand	3.7
Lack of products to invest in	3.4
Lack of information	3.3
Incompatible with fiduciary duty	3.2
Legal Restrictions	2.7
Internal resistance within your organization	2.4

Interest in Information and Services

"How much to you agree with the following statements?"

Over half of all executives moderately or strongly agree that they'd like more information on RPI investment opportunities and the merits of their current activities. Many also agree they would probably increase their allocation to RPI if it met their investment criteria. Most are not, however, interested in joining a working group or paying extra for data, although many do support the idea of a conference on the topic.

Use for Information and Services

	Strongly Disagree (1)	Moderately Disagree (2)	Slightly Disagree (3)	Slightly Agree (4)	Moderately Agree (5)	Strongly Agree (6)	Mean Score
It would be useful to have more information about RPI investment or management opportunities.	2%	3%	5%	33%	42%	15%	4.6
It would be useful to know more about the social or environmental merits of our activities and investments.	3%	2%	5%	35%	38%	16%	4.5
We would probably increase our allocation to RPI if it met our risk/return criteria.	5%	3%	9%	40%	32%	11%	4.2
There should be a conference on RPI.	3%	9%	13%	44%	20%	11%	4.0
We'd be interested in joining a working group on RPI.	17%	21%	19%	32%	9%	2%	3.0
We'd pay up to $2,000 per year for data on the social and environmental merits of our current and/or future real estate investments.	25%	28%	16%	23%	8%	1%	2.6

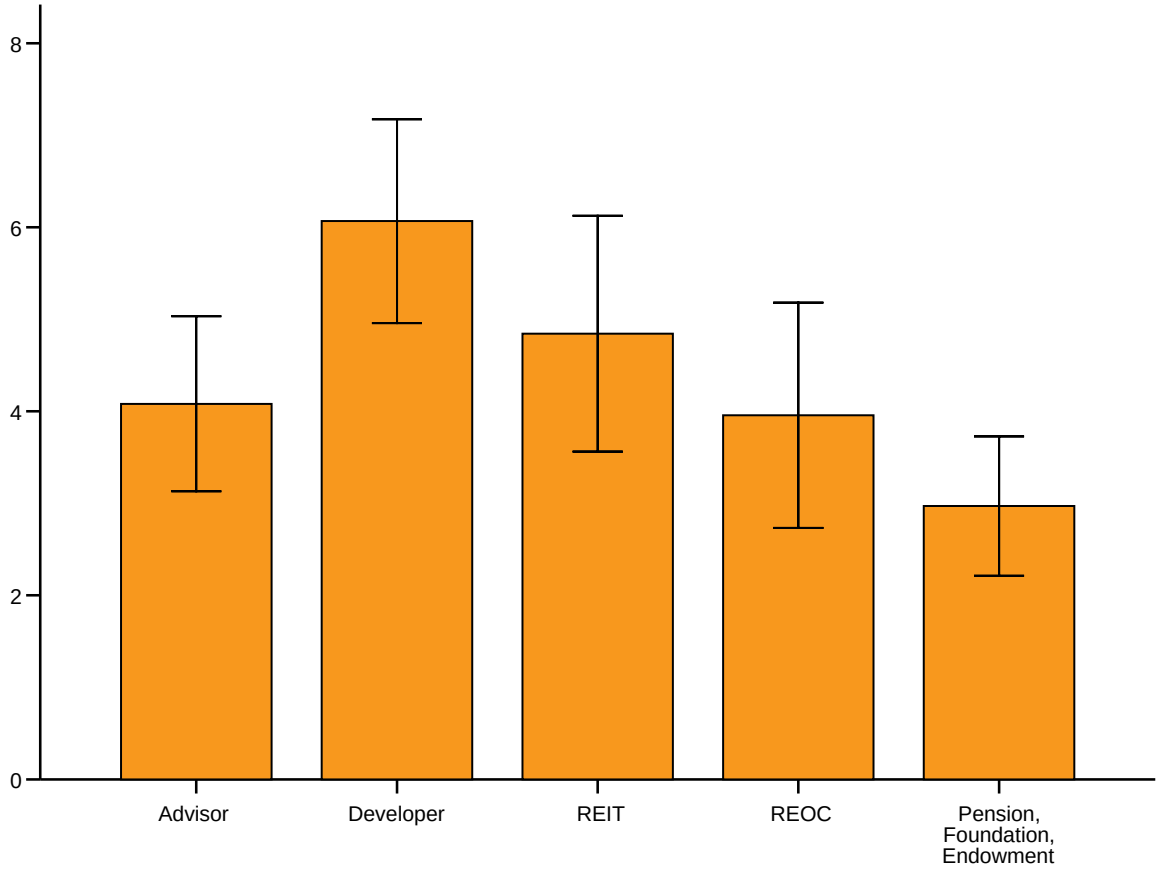
Summary and Comparisons

What is the overall level of activity and interest in RPI?

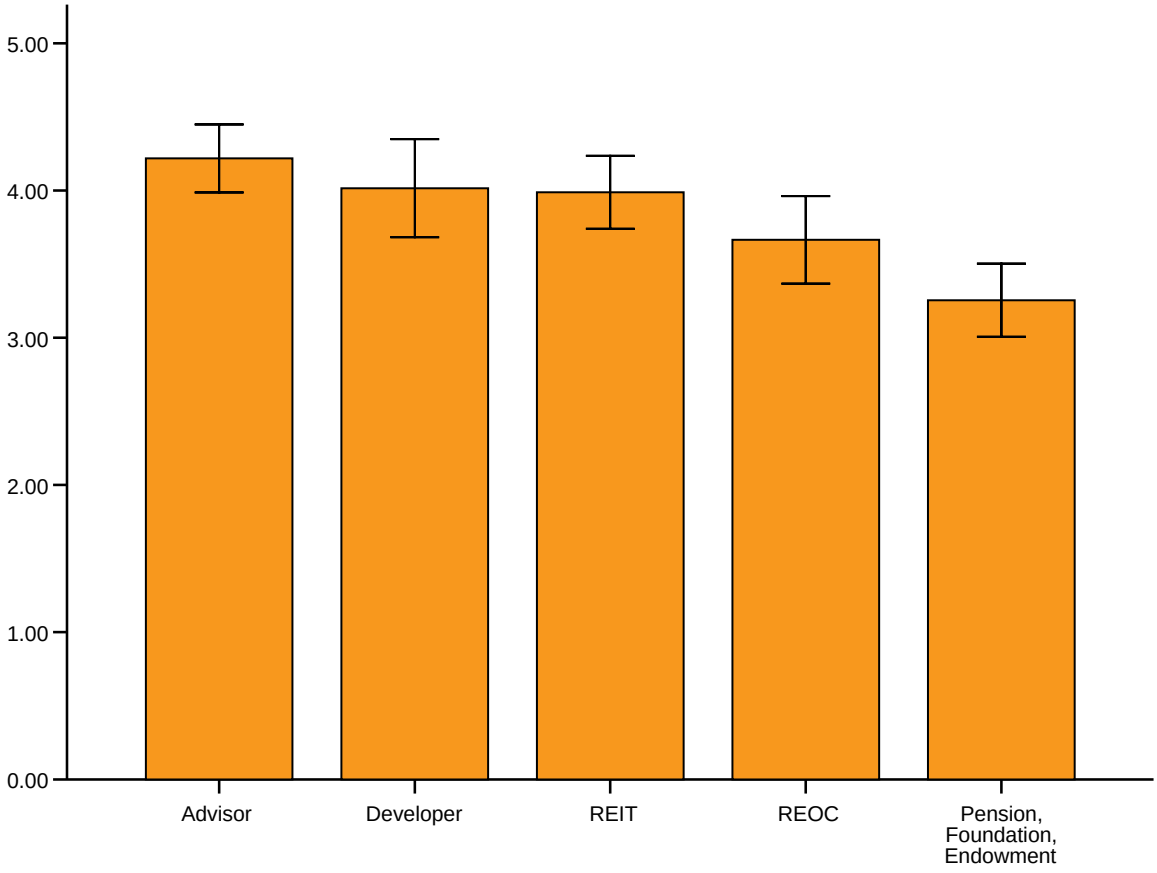
The sum total of the responses given to all the questions about strategies, investments and interests, broken down by type of organization, provides a summary of the findings. In these charts, error bars give the ranges in which we can be 90% sure the true values lie for the whole population. If they overlap, then differences by type of organization are highly unlikely.

The pensions, foundations, and endowments are the only group that varies significantly from others. They are implementing fewer strategies and investments than developers and are less interested in RPI information and services than all others but REOCs. This may well reflect uncertainty about the compatibility of RPI and fiduciary duty.

Average Number of Strategies and Investments Implemented by Type of Organization



Average Interest in Information & Services (1= Strongly Disagree, 6 = Strongly Agree)



Conclusion

According to this survey, there is considerable interest and activity in RPI in America's real estate investment organizations. It reflects the commitment to sustainability and corporate social responsibility that appears to be taking hold in the business world at large. As CoreNet Global put it in the introduction to their recent conference on sustainability and real estate, "The trend toward taking the Triple Bottom Line approach to business continues to accelerate, and we have reached a tipping point – sustainability of people, planet, and profit is now a mandate for multinational companies operating in a global economy. What does this mean for practitioners of real estate and workplace strategy?"

We are beginning to see what it means in these results. Most property investment executives say they're going beyond minimum legal requirements to address social or environmental issues. Many are promoting the conservation of energy and other natural resources, engaging with their stakeholders affected by their work, and recognizing sustainability and social responsibility in their strategies and value statements. A third or more say they're invested in socially and environmentally beneficial properties like urban infill, green buildings, brownfields, and transit oriented development. More than a third say their organization recognizes the efficiencies associated with RPI. Another 30% go farther, saying it's in their self-interest to make it part of their business strategy. And 10% report being Sustaining Organizations that are fundamentally committed to RPI and actively promoting it in business and society.

What's driving this apparent transformation? According to our nation's top executives the primary drivers are business concerns: avoiding risks associated with environmental or social problems that could harm returns and seeking opportunities associated with consumer interest in health, community, equity, and ecology. Although ethics and volunteerism are also at play, the importance of business motivation in the process bodes well for the future of RPI. For if it is good business to be a responsible property investor, RPI has an excellent chance of thriving in modern American society.