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Interest in the responsible property investment field is an outgrowth of the increasing awareness that real estate development lies at the juncture between pressing environmental and societal challenges.

### Doing Good—and Doing Well

By Melissa Floca and Gary Pivo

Land use and development decisions both contribute to and are affected by social and environmental issues. A response to this realization, a real estate investment trend called responsible property investing (RPI) is gaining traction among institutional investors, private real estate funds, and developers.

RPI is not philanthropy or altruism. It means doing good—and doing well. The RPI movement may be defined as maximizing the positive effects and minimizing 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 responsibilities. [See “Responsible Investing,” *Urban Land Green*, Spring 2007, page 108.]

In recent years, social responsibility as a strategy in securities investing has been touted on the pages of mainstream business magazines such as *The Economist* and *Fortune*. Real estate is at an inflection point and the industry will increasingly come to be measured by the same yardstick. “Triple bottom line” accounting—taking into account social, environmental, and financial returns—will be applied to property investment. The rationale behind RPI is that real estate investors and developers can go beyond legal requirements to increase the positive social and environmental externalities associated with development and ownership, without sacrificing financial returns.

“The RPI movement represents the logical extension and application to the real estate industry of a widely used investment strategy known as socially responsible investing [SRI], which numerous individual and institutional investors have applied to selecting public and private companies in which to invest,” according to Steve Blank, ULI senior fellow for finance. Socially responsible investors have made investments totaling more than \$2.3 trillion—representing one in ten dollars under professional management—since 1995, according to a recent report issued by the Social Investment Forum, a Washington, D.C.–based organization dedicated to promoting SRI. That could mean over \$230 billion for the RPI sector, assuming that about 10 percent of that capital would like to be allocated to real estate.

Although RPI is only beginning to be formulated as an explicit real estate investment strategy, there already are many examples of property investment that are illustrative of RPI. For example, the state of California unveiled an investment initiative in 2004 called “Green Wave” that seeks to create jobs and help the environment, while also increasing financial returns for public sector state pension funds. Investment in real estate makes up one of the four pillars of the initiative, as a part of which the California Public Employees’ Retirement System (CalPERS) has committed to cut energy use by 20 percent in its \$5 billion core real estate portfolio by 2010.

Recently, the related concerns of global warming and volatile energy prices have catapulted green building, energy efficiency, and Leadership in Energy and Environmental Design (LEED) certification

into the limelight. But RPI is more comprehensive and promotes a definition of sustainability and responsibility that goes beyond smart growth or green building. It includes those goals but seeks to integrate them into investment practices. It also recognizes as responsible any efforts to continuously improve, rather than setting standards achievable by only the most highly rated properties or portfolios. RPI ranges from transit-oriented development to historic preservation (see figure), and a responsible investor might seek to be an employer of choice (i.e., an employer who strives to be an employer that people want to work for), to improve neighborhoods, to conserve natural resources, or to promote a more just society.

Urban regeneration is another key component of RPI, and the Morley Igloo Regeneration Fund provides an example. Morley, a real estate fund manager in the United Kingdom, created the Igloo Regeneration Fund in 2002 because it determined that the urban regeneration market in the U.K. was misunderstood and, therefore, mispriced by institutional investors who considered it to be of high risk and low return. The fund's investments have created around 8,500 homes and nearly 10,000 jobs on about 250 acres (101 ha) of brownfield sites.

The Igloo Fund has pursued a three-pronged investment policy for urban regeneration projects that strives for high-quality design, environmental excellence, and community input and support. In all of its investments, Igloo also endeavors to enhance its image as a good partner for the public sector. "As a result of this investment strategy, we win 80 percent of the projects we compete for and 50 percent of our projects are acquired off the market, greatly reducing our transaction costs," says Chris Brown, Igloo's asset manager. Urban regeneration projects require patient capital, but over its 15-year life, the fund is expected to provide an internal rate of return (IRR) of 12 percent per annum.

There are numerous examples of real estate investors who are achieving competitive returns while also pursuing social and environmental objectives. There is also a widespread understanding across the real estate industry of the need to incorporate social and environmental responsibility into the development and management of properties. In a recent survey of real estate executives conducted by the University of Arizona and cosponsored by the Urban Land Institute, more than 80 percent of respondents said their organization goes beyond minimum legal requirements to address social or environmental issues. Approximately 90 percent of respondents agreed that pursuing social and environmental goals as a business strategy will be more important in the future.

Despite the interest in including social and environmental goals in property investment, there are concrete steps that need to be taken to move the field forward. As the field matures, it will be possible for RPI to become a niche in real estate investing. To do so, it will be necessary to achieve consensus on what RPI encompasses and how to create a system of metrics that can help investors define and identify responsible property investments.

A system of benchmarking must take into account the significant differences in developments across the real estate industry, from multifamily housing to boutique hotels to office parks. Furthermore, there is a need to differentiate between RPI portfolios—which might focus on issues such as workforce housing or green building—and RPI asset management, which might be more geared toward eco-efficiency.

It will also be necessary to develop the RPI field in such a way that benchmarking not only compares relative social and environmental responsibility, but also measures continuous improvement on conventional properties or portfolios. For instance, it may not be financially feasible for an old industrial property to achieve the same energy efficiency as a new office building, but increases in efficiency through retrofitting should nevertheless be recognized. Currently, efforts are being undertaken by two of the world's leading for-profit property data organizations, the London-based Investment Property Databank and the Bethesda, Maryland-based CoStar Group, to explore ways to add sustainability information to their data products.

With the goal of moving the RPI field forward, Boston College and the University of Arizona recently held a second annual conference on developing the RPI sector. More than 50 institutional investors, real estate funds, developers, and other real estate professionals attended the conference. At the conference, participants discussed efforts to measure the financial, environmental, and social impacts of property investment such as internal audits of private real estate fund portfolios and the use of public data to measure REIT portfolios. David Wood of the Center for Corporate Citizenship at Boston College explained an upcoming effort to gather social and environmental information on the 12 largest public homebuilders through a survey of their sustainable development practices.

Efforts to arrive at a definition of RPI and a system of benchmarking have also helped to identify RPI financial instruments and to look for opportunities for new financial activity and innovation in the field. While there is significant capital that is invested in socially responsible securities and some that is moving into real estate, there remains the need to create financial instruments that will allow that capital to diversify into real estate on a large scale. The Center for Corporate Citizenship recently unveiled a database that includes information on 105 companies with RPI policies and the investment products they offer.

RPI provides investment opportunities for private and public equity through examples such as workforce housing funds (private equity) and REIT funds (public equity). On the debt side, there also are opportunities for RPI; Bank of America recently unveiled a program that will give borrowers a reduced interest rate for buying energy-efficient homes. In terms of publicly traded debt, opportunities exist to buy debt in affordable housing or community development projects such as the Community Capital Management CRA Qualified Investment Fund.

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 while also generating competitive returns. Meanwhile, asset managers 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. “RPI is just beginning to take off,” according to Blank. “The array of investment alternatives will continue to widen and deepen as increasing numbers of investors and real estate investment managers begin to focus on RPI.”

Interest in the RPI field is an outgrowth of the increasing awareness that real estate development lies at the juncture between pressing environmental and societal challenges. Energy use in commercial and residential buildings and for transportation accounts for the majority of total global production of CO<sub>2</sub>. In addition, real estate development can address social issues such as crime and joblessness through fostering economic development in inner-city neighborhoods.

The challenge of starting the flow of capital into RPI is threefold. It will require reaching consensus on a comprehensive definition of RPI, instituting a system that can benchmark the level of commitment of a property or portfolio to social and environmental standards, and creating investment alternatives that will facilitate the matching of RPI capital with appropriate investments. Meeting that challenge will require innovation and leadership, but the potentially large and growing market for RPI will undoubtedly spur developers, investors, and tenants alike to step forward and become leaders in this emerging field. UL

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## Ten Dimensions of Responsible Property Investment

- Less auto dependence (e.g., transit-oriented development)
- Energy conservation (e.g., retrofitting of lighting)
- Worker well-being (e.g., child care on premises)
- Urban revitalization (e.g., infill development)
- Corporate citizenship (e.g., sustainability disclosure)
- Environmental protection (e.g., recycling)
- Local citizenship (e.g., stakeholder engagement)
- Social equity (e.g., affordable housing)
- Credentialing (e.g., green building certification)
- Health and safety (e.g., property security)

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