**Real Estate**

Sector Report - 7th in a series

This Eurosif sector report has been compiled by Dutch Sustainability Research, on behalf of SIRI Company. It describes the major social and environmental challenges facing the European real estate industry and the associated risks and opportunities these pose for long-term financial returns.

### Real Estate Overview

- Main real estate segments comprise commercial property (including office buildings, industrial buildings and shopping centres) and residential property. Activities of companies in the sector include: renting property to tenants, facility management, property management & development, asset management, and property trading.

- The total Pan-European investment market value increased by about 7% to a total value of €1360 billion at the end of 2006. European direct real estate investment volumes have increased by €160 billion (39%) to a total of €242 billion by the end of 2006. Property companies, REITs (Real Estate Investment Trusts) as well as specialist property fund managers linked with insurance companies, and pension funds are the biggest players in the market.

- European all-property gross returns in 2006 totalled 23%. Most of this return has been generated by increases in the value of property driven by yield compression in the market. This is now generally believed to be easing and returns are expected to be lower going forward.

- As of May 2007 there were 317 publicly listed European companies in the ICB (Industry Classification Benchmark) Real Estate Holding and Development and REITs subsectors. These companies represent a total market capitalisation of around €275 billion.

#### Real Estate Trends

- Cross-border investments in Europe have significantly increased recently and are expected to continue to grow. As a percentage of direct real estate investment they have grown from 37% in 2000 to 62% (€110 billion) in 2006. By expanding their investment horizons to new markets, real estate companies have access to new growth opportunities, less competitive (and more profitable) markets and further risk diversification. Areas of interest include Central and Southern Europe as well as emerging markets.

- Divestment of direct property by institutional investors and the substitution of much of this exposure through reinvestment in indirect property vehicles are also occurring in this sector. Retail investors have been utilising listed and unlisted property vehicles to enter the real estate market in great numbers. REITs have been adopted in several EU member states and are planned in others (e.g. Germany and Italy) offering tax transparency to investors and an enhanced liquidity of real estate. There is also a burgeoning market in property index based derivatives, as well as a growing use of Commercial Mortgage Backed Securities.

- The search for high yields and low risk and the increasing emphasis on customer relations, is leading companies in the industry to diversify their portfolios and provide extra services such as catering, security and information technology services. This can add value for users and improve client satisfaction.

- Sustainability issues in the real estate sector are rapidly gaining more attention and are emerging as significant concerns for both investors and developers in European real estate markets. However, there appears to be a gap between the awareness phase and actual concrete actions regarding sustainability from many companies in the sector.

- The real estate investment market is becoming increasingly transparent. Countries with the highest levels of cross-border investment activities are found to be the most transparent markets when it comes to sustainability reporting.

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**PRUPIM 'Improve Portfolio'**

A Sustainable Property Investment Initiative

PRUPIM has set up an innovative project called the Improve Portfolio – to examine ways it can reduce a typical property portfolio’s carbon footprint while maintaining or even enhancing investment returns. This portfolio consists of a sample (€500 million) of assets taken from its two main life funds (Life Fund and SAPP) with an aim to decrease their environmental impact. Given the desire for this exercise to be a general learning experience capable of providing lessons for wider application across all PRUPIM client funds (€19 billion), assets for the portfolio have been drawn from across the full spectrum of asset types.

Once the subject properties were identified, a ‘base-line’ environmental audit was carried out on these properties. This base-line will be used to measure changes in environmental terms and assess how much the impacts of the buildings have been reduced progressively and cumulatively since the inception of the initiative. A plan of action to reduce environmental impacts will be drawn up for each asset. At the end of each year, for a proposed experiment period of five years, the original base-line environmental audit will be repeated on each property to identify how much improvement has been made.

**Eurosif wishes to acknowledge the support and direction provided by the Real Estate Sector Report Steering Committee:**

**Researchers:**

Dutch Sustainability Research

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**British Land Encourages Responsible Property Design**

In late 2004, British Land issued a ‘Sustainability Brief’ for its development department that encourages its property designers to consider a host of social and environmental questions such as how to reduce waste in construction, whether it is possible to use reusable building materials, and how best to consult local interests. This has been applied to one of British Land’s developments, Ludgate West, an 11,800 square-metre office complex in central London, which has a design brief that lists 89 separate areas where sustainability is now being considered. These range from regeneration and local economic impact to energy use and noise pollution. Each area has a sustainability objective, target and completion date. By the time Ludgate West opens in late 2007, it will feature a sanitation system that uses harvested rainwater, sustainably sourced timber throughout the building and even 152 square metres of vegetation on the roof.

Source: www.britishland.com

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**Triodos Bank: Sustainable Real Estate Fund**

In 2004 Triodos Bank launched the Triodos Vastgoedfonds nv (sustainable real estate fund), which exclusively invests in sustainably constructed business premises and monuments. The investment fund was the first sustainable real estate fund in Europe. The methodology used for the selection of the premises was developed for the fund by Triodos Bank in exclusive cooperation with SenterNovem (Dutch Organization for Energy and the Environment). Triodos Bank, which bills itself as a pioneer in sustainable banking and green banking, says that this will set a market standard for sustainable real estate in the Netherlands. The fund stimulates more careful use of building materials, raw materials, energy, materials and water and invests in the most innovative sustainable offices and shops, as well as in existing buildings that are subsequently renovated and managed in a sustainable manner.

In addition to sustainable buildings, the fund has special interest in investments in historical buildings that have been officially designated as monuments due to their beauty, their scientific significance or their cultural/historical value.

Source: www.triodos.nl

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**CASE STUDIES**

Eurosif sector report has been created with the support of the European Commission.

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3 A REIT is a vehicle under which investment can be directed in a tax efficient manner into the real estate sector.

4 www.bneec.eu/solutions/beneficial.

5 Values in Central and Eastern Europe are not directly linkable to €1.2 billion in 2006.
SOCIAL & ENVIRONMENTAL ISSUES

According to the European Commission, some 40% of the total final energy consumption in the EU is related to buildings. A 2004 study found that electricity causes almost half of the environmental impact during the life-cycle of an office building. The European Commission estimated that 30% to 50% of GHG emissions, energy consumption, and air pollutants from major offices, shopping centres and recreation areas could be saved by using state-of-the-art systems and technologies. In 2006 the EU introduced the European Energy Performance of Buildings Directive (EPBD) that aims to reduce the energy requirements by 30% by 2010 and CO2 emissions for the buildings sector. The building stock of the original 15 EU countries accounts for 6.7% tons per year of CO2 emissions. The EPBD directive is expected to reduce CO2 by 40% per year by 2030, when applied to non-residential buildings. All buildings greater than 10,000 m² will have to implement the directive into their national legislation. The legislation is seen as an important part of the EU’s strategy to comply with the Kyoto protocol. It can be expected that in the future, legislation on energy efficiency of buildings will be further tightened.

Sustainable buildings are designed to have a minimal impact on the environment during their construction, operation and demolition. They make use of sustainable building materials, use energy and water saving technologies, and are located close to public transportation and social infrastructures such as schools and health care facilities.

Sustainable Buildings

Brownfield development can improve the environment, the quality of life and bring greater prosperity, especially to poorer communities.

Of the 27 European companies in the sector researched by SIR Company, 23% have a publicly disclosed policy on construction and social issues and 22% have a monitoring system to ensure contractor compliance. Furthermore, only 17% have a publicly disclosed formal policy on bribery and corruption.

Among the most significant developments in the field of service and building design, PROBE (Post-occupancy Review of Buildings and their Engineering) studies have shown that occupier satisfaction is higher in energy efficient buildings.

According to the UK Occupier Satisfaction Index 2007 occupants want a more innovative approach to be taken by the property industry, and they believe strongly that property owners should at least share the costs of meeting the new standards.

KEY CHALLENGES

Climate Change

The extension of European green house gas (GHG) legislation to the real estate market, which could mean new GHG maximum quotas on buildings and occupiers, may be costly for energy consumers in this sector.

Energy prices have increased in recent years and are expected to stay at relatively high levels. High prices have raised awareness of energy costs and provide a stronger incentive for end-users to reduce energy consumption.

Companies in the real estate sector can reduce the environmental impact of their existing property holdings by minimising energy and water consumption, recycling used materials, increasing their use of renewable energy and by performing life cycle assessments (LCAs) when developing new property. By actively applying these measures, companies can decrease operating costs and differentiate themselves from competitors. Given that new developments represent only around 2% of built property stock, reducing the impact of existing property buildings is considered by many to be the most important issue facing the real estate industry.

Top performing companies in the sector that have an active dialogue with their tenants and other stakeholders about ways to reduce their buildings’ environmental impacts can reduce their energy costs. Office occupiers recognise the benefits of such buildings and would even be prepared to pay more for them. A study of industrial occupiers said they would pay 4% higher rent and rates for a ‘green’ building, but only if it brought them much lower running costs. Green properties will also protect asset values better against new risks and avoid exposure to accelerated depreciation of traditional real estate.

There are several initiatives to promote sustainable buildings. In Europe these include: Eurosac, GreenBuilding, UNRIP FL, REER SBS and the WRBSS EER project. Real estate companies can join these initiatives to proactively contribute to sustainable developments in the sector.

In 2008 Energy Performance Certificates will be introduced in Europe. The most frequently used property environmental assessment standards for certification are BREEAM in the UK, HQS in France and LEED in the US. Having property certificates could create a competitive advantage and mitigate the risk of environmental liabilities.

Company principles and policies on sustainability can create community commitment by stimulating tenants to hire local procurement staff and introduce programmes to improve the social environment of their property. Community regeneration provides tenants and visitors of properties with a safe, clean and accessible environment. This helps protect and increase the value of the property, as it improves client satisfaction, prevents vacancy and increases rental income.

Community Regeneration and Consultation

Supply Chain and consulting.

Customer satisfaction is perceived as an important issue in the sector even though there is a lack of visibility as to steps actually taken to promote high standards.

Occupier Satisfaction

Investors could play a role in exerting pressure on their suppliers to act responsibly in order to reduce fraud. Strong business ethics standards will also shield companies from potentially costly lawsuits and reduce risk of project delays.

Involving local communities will increase acceptance of their projects and can also reduce planning and project development time, thereby reducing costs. Effective community programmes can also provide a stimulus for local economies and thereby protect property value.

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12. Based on the largest companies in the HCRK World Index. 5% represent over 2000 stock-listed companies.
13. BREEAM, Energy Efficiency in Buildings (www.breeam.org)
14. The Building Research Establishment’s Environmental Assessment Method (www.bre.co.uk)
15. Health & Safety Environmental Management System and EEM Training (www.breeam.org)
17. The United Nations Environment Programme Sustainable Initiative (www.unep.org)
19. The Building Research Establishment’s Environmental Assessment Method (www.bre.co.uk)
22. More information on these studies can be found at: www.usgbc.org.
23. www.greenbuilding.org

MATERIAL RISKS & OPPORTUNITIES

Climate Change

Leasing companies have implemented environmental due diligence procedures when purchasing new property to ensure that potential environmental risks are properly assessed and managed and to avoid a potential increase in insurance costs for the properties.

In Germany, France, the UK and the Netherlands, new legislation is being introduced for the construction of green buildings. The buildings are required to have an energy certificate indicating their energy consumption. The introduction of this legislation will raise awareness of tenants and occupiers and could be a market opportunity for energy efficient properties.

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Some clients may also be willing to pay higher rents for buildings with strong environmental standards, as these may be important for their own clientele and reputation. With more and more organisations committing to become fully carbon neutral, demand for energy efficient office buildings, retail space and industrial sites is likely to increase.

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Source: www.prupim.com

Eurosif wishes to acknowledge the support and direction provided by the Real Estate Sector Report Steering Committee:

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● The real estate investment market is becoming increasingly transparent. Countries with the highest levels of cross-border investment activities are found to be the most transparent markets when it comes to sustainability reporting.6

1 www.ajdplc.com.
2 www.landlord.co.uk.
3 A REIT is a vehicle under which investment can be directed in a tax efficient manner into the real estate sector.
5 Valuations in Central and Eastern Europe more than doubled to €102 billion in 2006.

1 242 billion by