How green buildings can cut emissions and increase returns

The property sector is one of Australia's largest carbon emitters, contributing more than 20% of Australia's greenhouse gas emissions. In fact, the buildings we live and work in are responsible for half of all global energy use.

That places property trust (AREIT) investors, and the property sector as a whole, in a quandary. How can emissions be reduced without it costing the earth, and impacting returns?

It sounds like an impossible trade-off, but evidence is now emerging that suggests investing in sustainable properties can actually lead to higher returns.

Carbon emissions are linked to population and economic growth. Over the next decade, Australia's population is expected to increase by an average of 1.6% a year, one of the fastest growing advanced economy rates in the developed world. That means many more buildings to house our growing population, consuming ever more energy and higher levels of carbon emissions.

Fortunately, management teams no longer face a trade-off between delivering sustainable buildings and meeting investor objectives.

The Morgan Stanley Institute for Sustainable Investments recently conducted a study of over 10,000 mutual – what we call 'managed' – funds. The survey found that 84% of large asset owners worldwide are pursuing or considering pursuing ESG integration into their investment process. In 64% of the time periods studied sustainable-focused equity funds exceeded the median returns of traditional equity funds.

The reasons are twofold. First, the debt used to finance a sustainable building can be raised more cheaply than conventional developments. Second, a sustainable building has lower operating costs.

In 2012, Deutsche Bank published Sustainable Investing: Establishing Long Term Value and Performance. It examined over 100 sustainable investing studies, finding that high environmental, social and governance ratings correlated with a lower cost of capital in every case.

In 2014, Australian investors got to see a local example when Stockland successfully issued a EUR300 million 7-year green bond, the first of its kind by an Australian company. It enabled the company to build on its commitments to long-term environmentally sustainable developments. The issue resulted in a reduction in debt costs and an extension to debt maturity. Both demonstrated the group's ability to tap more cost-effective debt markets.

But developing sustainable buildings isn't just about cheaper debt and lower emissions; they also play a key role in attracting and retaining high quality talent and lowering operating costs.

A 2015 Oxford University study showed that in 88% of instances studied, good ESG practices result in better operational performance, a result of happier employees, reduced energy consumption and lower waste. All are positive for company profits. This shouldn't be a surprise. Many property organisations and tenants understand that workplace productivity is linked to the quality of the built environment. Access to natural light and fresh air can have a beneficial impact on productivity, staff retention and workforce costs.

Likewise, a recent ESG survey completed by Macquarie in December 2018 revealed that There is also a strong relationship between revisions to ESG scores as a signal for future performance. In fact, of the 227 Australian-listed companies surveyed, the companies with the highest ESG scores outperformed the bottom basket since the inception of the survey in 2011.

The benefits for investors are obvious; sustainable buildings attract higher quality tenants, lead to lower vacancy risk and outperform lower quality buildings over the long term. Not to mention the good impact such actions make on our fight to reduce climate change!

This has prompted a shift in the approach to sustainability and the day-to-day operation of most Australian property landlords. Industry leaders such as Stockland, Mirvac and Dexus excel in their adoption of sustainable business practices and are recognised with world class sustainability rankings.

In 2018, Stockland was again named the world's most sustainable real estate company by the Dow Jones Sustainability Index. Stockland is targeting a 60% cut in carbon emissions in its commercial properties by 2025 and is well-advanced in the roll-out of solar installations across its retail portfolio.

Dexus, meanwhile, is building a sustainable portfolio with over 700,000sqm of office space, attaining a 5-star NABERS energy rating. The company has committed to net zero emissions by 2030 through improving energy efficiency and an increasing use of renewables. Both companies are holdings in APN's AREIT Fund.

Considering ESG factors as part of the investment decision-making process provides us with greater insights into potential risks and opportunities that may impact the value and performance of our investments.

To further signify APN's commitment to sustainable investing, we have now joined the Responsible Investment Association Australasia which will give us access to leading sustainability research, practises and enable us to be part of the global community who are making sustainability focussed investment decisions.

But the matter is bigger than just that. Investing in sustainable buildings is one of those rare situations when everyone really does win. The evidence is clear; better buildings lead to happier employees, lower operating costs, reduced carbon emissions and higher investor returns. You might also be doing something good for the future of the planet!

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Established in 1996, APN's listed on the ASX and manages $2.8 billion (as at 31 December 2018) of real estate and real estate securities. APN trades on the ASX under the code 'APD'.

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