

CONFERENCE REPORT

Real Estate and Socially Responsible Investment: New Products, New Investments, New Value

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Tucson, Arizona



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Socially responsible investors can promote their ideals and portfolio efficiency by making real estate investments.

Real Estate and Socially Responsible Investment: New Products, New Investments, New Value

On February 28-March 1 representatives of the real estate and responsible investment business sectors met at the Hacienda del Sol Guest Ranch in Tucson, Arizona. It was, as far as we know, the first-ever formal meeting between these two communities. The thirty five attendees included real estate investors and developers, pension fund managers, social investment money managers, researchers, financial advisors, academics, and foundation professionals.

The goal of the gathering was to open communications among those interested in real estate projects that deliver financial, social and environmental returns, such as financially successful, green affordable housing in urban enterprise zones. During the meetings, participants discussed:

- the current state of responsible property development and investing,
- ways to measure and report their financial, social, and environmental dimensions,
- new investment products focused on responsible real estate, and
- how to develop this field through new research, standards and vocabulary.

The State of Responsible Real Estate

We began by considering the following excerpt from a paper on Responsible Property Investing¹ by Pivo and McNamara written for the Principles for Responsible Investing Project of the UN Environment Programme Finance Initiative:

“It is probably apparent to anyone who thoughtfully considers real estate that it can both contribute to and be affected by many of the social and environmental issues that face the world’s societies. Until recently, however, most real estate investors would likely have said that while they are sympathetic, such issues are really for government to address and not of direct concern to their investment practices. But today, a new view is emerging, based on a growing awareness among real estate professionals that various social and environmental issues can have significant material consequences for their investment portfolios. Shifting consumer behavior, worsening environmental hazards, tougher government regulations, expanding legal liabilities, increasingly expensive resource and material inputs, and greater pressure from affected stakeholders are all converging to make it both financially risky to ignore social, environmental, and governance concerns and financially beneficial to address them in the process of real estate investing.”

Responsible real estate or property investing (RPI) is a way of responding to this view. It can be defined as voluntary actions by property owners, managers, and insurers that go beyond minimum legal requirements to increase the positive and reduce the negative social and environmental effects of real property, consistent with their fiduciary responsibilities.

Much work is needed to extend and refine this definition. For example, specific criteria and benchmarks could be adopted that specify what responsible property investors should aspire to achieve with respect to property siting, energy and water conservation, fair labor practices, and other social and environmental dimensions. Research should also focus on how these actions might affect financial returns and other aspects of fiduciary responsibility.

¹The full paper, entitled “Responsible Property Investing,” by Gary Pivo and Paul McNamara, was published in 2005 by International Real Estate Review, v8, n1, pp. 128-143. It is available online from the Oxford Institute for Sustainable Development, International Lands Market Research Group, Research Report Series at <https://www.brookes.ac.uk/schools/be/oisd/ilm/workingpapers/index.html>.

Fortunately, innovators in the real estate industry do exist who can be looked to for best practice guidelines. From land-conservation projects to brownfield redevelopment, green buildings, smart growth, urban reinvestment, affordable housing, transit oriented development, Energy Star properties, and full-scale sustainable master planned communities, responsible property investing has been a part of the real estate scene for some time.

The scope of RPI is broad. It includes, for example, “deep-green” projects that focus on poor communities or environmentally fragile areas, energy-efficient buildings that offer clear financial advantages through reduced heating and lighting bills, and affordable housing projects that draw upon local tax credits or regulatory incentives. A discussion of the field, therefore, must use vocabulary that is flexible enough to allow for a variety of financial, social, and environmental advantages, and still able to differentiate responsible property investing from more conventional real estate projects.

Attendees spoke about their specific experiences developing innovative projects that went beyond compliance with minimal legal requirements to produce various kinds of benefits to society and investors alike. They discussed using only union labor, brownfield redevelopment, housing integrated with social services in distressed neighborhoods, and comprehensive energy efficiency programs. During the course of the meeting, conferees came to see how these various sorts of activities could be thought of under a single conceptual umbrella as responsible property investing, allowing their financial, social, and environmental advantages to be viewed in a more integrated way and creating a sense of momentum that could spur both innovation and investment in the field.

There is considerable interest in responsible real estate within the \$2+ trillion Socially Responsible Investment (SRI) industry. Research indicates that efficient portfolios should allocate 10-20% of their assets to real estate, suggesting that SRI investors should hold real estate investments.² Moreover, real estate is linked to issues of concern to SRI investors. Therefore, SRI investors can promote their ideals by making real estate investments. For example, climate change is a major SRI issue, and according to the United Nations, commercial

²See “Home Ownership and the Decision to Invest in REITs,” Doug Waggle, Don T Johnson, *Journal of Real Estate Portfolio Management*, vol.10, issue 2, pg. 129, May-Aug, 2004.

and residential buildings plus the transportation between them account for 54% of global carbon dioxide emissions.³ SRI investors could mitigate global warming by promoting energy efficient, transit-oriented properties.

A robust RPI sector could have a considerable impact on the real estate industry. For example, a real estate portfolio equal in size to 10% of the SRI universe would be nearly three-quarters the size of the entire US public REIT universe. Moreover, progressive real estate developers report being limited by a lack of investors who share their vision. RPI investors could help solve this problem for RPI developers as well.

One point emphatically made and agreed to by the experienced property investors around the table was that investors can make money with responsible property projects. Their experience with urban revitalization, green buildings, union labor and other elements of responsible property investing have shown them that in the hands of a skilled real estate professional, RPI need not be dilutive or less than competitive. On the contrary, it can offer opportunities that conventional investors may be missing.

Attendees noted the paramount importance of investment returns in any consideration of responsible real estate. The first priority for property investment must be an acceptable rate of return for its investors. The point was made several times that RPI has the potential to improve returns by utilizing property design or management strategies that both add value and produce social or environmental returns. One common example is reducing energy consumption, ever more important with increasing energy prices. But RPI can add value in other ways as well. For instance creative, responsible land use planning can significantly increase the value of development by creating positive externalities throughout a large project. And responsible property development can lead to lower operating costs and vacancy rates, faster and more reliable construction by using skilled union labor, higher rents and capital appreciation, more streamlined permitting and public incentives, greater customer loyalty, better reputations for owners, investors, and developers, and fewer long term risks.

³Intergovernmental Panel of Climate Change. *Climate Change 2001: Working Group III: Mitigation*. 3.3 Buildings and 3.4 Transport and Mobility. UNEP and WMO, 2001. Available online at http://www.grida.no/climate/ipcc_tar/wg3/o89.htm

Indeed, risk management is a central element in all property investing and is touched upon by a number of issues in this field. For instance:

- Tenant churn can lead to severe costs for rental properties: property investments that make a community more livable hedge against that risk.
- Projects that focus on community engagement and environmental protection can mitigate entitlement risks, since local governments may be more open to projects that do not externalize their costs.
- Union labor and fair labor practices can lower the risk of poor workmanship and delays in the timely completion of projects.
- And the risk of future legal exposure, for instance to poor indoor air quality or water runoff liability, is something that responsible property by its nature helps to avoid.

Responsible property investments can also offer financial value to so-called “universal owners,” such as pension funds or index fund owners, who have positions across virtually the entire economy and therefore must be concerned that externalities spilling over from one area of their portfolio do not reduce returns in another. Because of the sizeable impact that real estate can have across all segments of business, society, and the environment, universal investors may find special value in property projects that mitigate external impacts.

As to the question of where one goes to find responsible property investments, it was noted that there are no “perfect” property investments: conservation subdivisions may lead to more commuting, fair labor practices may not extend all the way down the supply chain, urban revitalization may produce gentrification, and so on. Moreover, minor advances in, say, energy efficiency across large scale auto dependent projects – such as big box retailing – could outweigh the benefits from smaller, greener projects.

While there is no fixed answer to the vital question of where to go to find responsible property investments, and while the working group acknowledged the need for research in this area, initial suggestions were as follows:

- In the first place, responsible investors could look for REIT managers, real estate fund managers, and developers who take environmental and social outcomes seriously by employing a more comprehensive approach to analysis, benchmarking, and reporting. With notable exceptions, most real estate

investment managers disclose little or no information on the social and environmental performance of their companies or portfolios. We hope this will change in the future.

- Second, RPI investors should look for companies that are making an effort to continuously improve, and not merely use environmental and social performance to screen out projects, funds, or trusts that do not meet their minimum criteria for investment.
- Third, responsible investors would benefit from case studies that detail successful models of responsible property investing in order to help them encourage similar approaches by managers of property investments they already own.
- And finally, members of the group reiterated the need for a flexible, comprehensive set of tools to evaluate property investments, so their impacts can be evaluated and, as importantly, made comparable.

Assessing Investment Opportunities

Investors have generally not taken a comprehensive approach to assessing financial, social, and environmental performance in the real estate sector. Consequently, there are no standard metrics that can be used to inform those interested in responsible property investing. Nevertheless, there are some efforts already underway to determine standards and guidelines for real estate portfolios. Responsible property investors should not reinvent the wheel, but synthesize and capitalize on these various efforts.

A good place to start is with the property investment policies and criteria used by the California Public Employee Retirement System (CalPERS). They cover a spectrum of responsible property issues, with an emphasis on four areas: urban investing, energy conservation, fair labor practices, and diversity. Other existing sources for guidance include the following:

- Green building standards and guidelines from the US Green Building Council and the National Association of Home Builders.
- US EPA industry partnership programs such as Energy Star, Best Workplaces for Commuters, and WasteWise that provide benchmarks for measuring the environmental performance of properties.
- The Building Owners and Managers Association Energy Efficiency Program and the National Association of Real Estate Investment Trusts Leaders in the Light program, which promote energy conservation.

- An analysis of big box retailing by Domini Social Investments and Christian Brothers Investment Services that identifies social and environmental issues involved in store siting.
- Performance data collected by the Community Development Financial Institution sector on which to base the assessment of community development investing.
- Prior efforts to evaluate real estate companies for inclusion in responsible investing indices, such as the Domini Social Index, the Calvert Social Index and the Dow Jones World Sustainability Index.
- Reports produced by property companies for the Global Reporting Initiative and their own sustainability or corporate social responsibility reporting programs.
- Efforts by property firms under the International Standards Organization 14001 environmental management standards.
- Various declarations on urban development goals such as the UN Urban Environmental Accord, the Equator Principles, or the statement of principles by the Congress for New Urbanism.
- Projects in the UK to rate the performance of major British house builders.
- Ongoing academic research from around the world on sustainable property ownership, management, appraisal and construction.
- Conventional real estate data collection and reporting activities, such as that of the National Association of Real Estate Investment Fiduciaries, the National Council of Real Estate Investment Trusts and private real estate research firms and data providers.

Each of these activities, and perhaps others like them, provide ideas for a coherent means of evaluating RPI investment opportunities. However, six considerations will be important in deciding how to synthesize them into a successful RPI assessment program.

- 1) Existing data, benchmarks, reporting methods, and standards for responsible investment should be used to the greatest extent possible in order to reduce paperwork for property companies wishing to participate.
- 2) Many property investors have no immediate shortage of capital sources and are therefore unmotivated to respond to special requests from SRI investors for information and reports. Consequently, such requests should be made easy to accommodate.

- 3) Because the ultimate goal is to encourage positive behavior that moves property investors toward responsible management practices, assessments should be designed to motivate, encourage, and reward.
- 4) Real estate asset managers vary along several dimensions including whether they are public or private, large or small, specialized or integrated, and in terms of the types of properties they own. Therefore, their capacity, willingness and obligation to share information, as well as the type of information that is relevant to them, will vary.
- 5) The users of SRI information will also vary in how they weight different criteria and whether they want their information summarized in overall ratings or disaggregated for individual interpretation. As such, tools are needed that can produce information about property investments in both disaggregated and digested forms.
- 6) Socially responsible investment analysts do not currently have fully developed expertise in assessment procedures that are unique to the real estate sector. Therefore, new organizational capabilities may be needed that blend real estate and social analysis.

Obtaining needed information is a major concern. Socially responsible investors rely on the openness of public securities to gain access to the information they require. However, private real estate projects and funds may be less willing or able to share information publicly. Public property investment vehicles, such as REITs, while more transparent, are not necessarily the most innovative companies when it comes to RPI. For this reason, it may be difficult to assess best practices across the full range of real estate investments that could fall under the RPI heading.

Part of this information barrier may be reduced simply through education and communication - perhaps an institutional forum that brings together RPI investors and private real estate investment managers. But, given the complexity and requirements of investing in private funds and projects, there may also be opportunities for new investment vehicles that can ease the flow of capital

into responsible property investments.

New Product Development

A number of ideas surfaced around the potential for new investment products for individual and institutional investors:

- Funds of funds could offer opportunities for investments across a range of products while diversifying risk and increasing liquidity.
- Private or public REITs could offer tailor-made products, although the front-end costs pose substantial barriers.
- Private co-mingled funds with progressive investment strategies could create new portals for other than institutional and high net worth investors.
- Systematic research on the social, environmental, and governance records of existing public REITs could create investment opportunities for responsible investors and catalyze more responsible practices in the field.
- A fund taking advantage of tax credits might be constructed so as to offer smaller investors the opportunity to gain regulatory advantages from specific investment types.

Each of these potential new products, and others like them, could capitalize on the fact that responsible property investments may offer opportunities that are not necessarily captured in traditional investment analysis. For instance, investors focused on quarterly returns may not be willing to wait for social and environmental advantages to turn into financial gain – but long-term investors can potentially see significant returns. What may be needed are new methods, not only to analyze property projects, but also to refocus the time horizons of investment portfolios and help investors evaluate the potential to gain advantage from longer term returns on their investments.

Attendees, especially social investors from the mutual fund and financial advising communities, noted the lack of product currently available for their clients, suggesting a potential demand for new products. As social investing becomes more widely practiced, it is possible that these investors may seek to diversify their holdings across different asset classes. Currently, although a reasonable selection of domestic equity opportunities exists - and a range of offerings for international equities and fixed income investing is gradually emerging – only a handful of “responsible” real estate products, companies or REITs are avail-

able to investors interested in exposure to the real estate world.

Next Steps

Attendees agreed that the RPI field has potential for development. A number of ideas for further practical action grew out of the discussion:

- 1) A field definition and a coordinating set of ideas that cover the range of financial, social, and environmental considerations that distinguishes, and adds value to, responsible property investment, should be developed.
- 2) The particularities of RPI call for a survey of the types of investment opportunities that now exist, organized by social or environmental concern, with specific case studies to give concrete meaning to the different categories.
- 3) An assessment methodology should be developed to capture the impacts of particular property investments, especially property portfolios, across financial, social, and environmental vectors.
- 4) A catalogue of responsible property investment, benchmarks, and related assessment methods, should be created and made available to the working group.
- 5) An institutional forum addressing the field of responsible property investment should be created.
- 6) Dialogues should begin between some socially responsible investors and REITs, property developers, property managers, and other relevant companies of interest.

Immediate work, some attendees agreed, should focus on producing a field definition paper and an assessment methodology in order to help investors identify responsible property investment opportunities.

Conclusion

There was general consensus that the Tucson meeting provided a much-needed first step in developing communications between the progressive property development and responsible investment communities. The attendees agreed that a Responsible Property Investment Working Group should be established under the aegis of the Institute for Responsible Investment at the Center for Corporate Citizenship at Boston College. The goal of the RPI Working Group would be to pursue the next steps identified during the meeting. There was also agreement that a second convening should be held within the year, probably in conjunction with a real estate or social investing conference in the fall of 2006.

Appendix 1: Attendees List

1. **Carol Atwood**, Spartacus Capital
2. **Colin Coyne**, CFO, Melaver, Inc.
3. **Stu Dalheim**, Manager of Policy and Advocacy, Calvert
4. **Brian Doherty**, Industry Development, Bricklayers and Allied Craftworkers
5. **Alfonso Fernandez**, Senior Portfolio Manager, CalPERS
6. **Arthur Fleming**, Executive Vice President and Chief Lending and Investment Officer, Opportunity Finance Network
7. **Jim Haley**, CFO, Noisette Co. LLC
8. **Jim Hawley**, Transamerica Professor in Business Policy and Strategy, Center for the Study of Fiduciary Capitalism at St. Mary's College of California
9. **Tom Hicks**, Vice President of LEED, U.S. Green Building Council
10. **Ken Ho**, Senior Associate, Cherokee Investment Partners, LLC
11. **Rick Imperiale**, President and Portfolio Manager, Uniplan Real Estate Advisors, Inc.
12. **Garvin Jabusch**, Vice President, Forward Management, LLC
13. **John L. Knott, Jr.**, CEO and President, Noisette Co. LLC
14. **Joy V. Jones**, Trustee, Calvert Social Investment Fund
15. **Lisa Laird**, Senior Consultant, Watson Wyatt Investment Consulting
16. **Robert Lapidés**, Managing Member, Pico Bonito LLC and Principal, Robert L. Lapidés LLC
17. **Michael Lent**, Branch Manager and Principal of the New York Office, Progressive Asset Management
18. **Steve Lydenberg**, Chief Investment Officer, Domini Social Investments

19. **Jeff MacDonagh**, SRI Portfolio Manager, Domini Social Investments
20. **Debbie Nisson**, Senior Vice President and Portfolio Manager, Amalgamated Bank
21. **Gary Pivo**, Professor, Natural Resources and Planning, University of Arizona
22. **Roger Platt**, Senior Vice President and Counsel, The Real Estate Roundtable
23. **Ron Roberts**, Executive Vice President and Principal, Kennedy Associates Real Estate Counsel, Inc.
24. **Ted Rouse**, Real Estate Partner, Struever Bros., Eccles and Rouse, Inc., and President, Healthy Planet LLC.
25. **Steve Schueth**, President, First Affirmative Financial Network
26. **Diloshini Seneviratne**, Investment Officer, CalPERS
27. **Kendra Stensven**, MS Student in Real Estate Development, Columbia University
28. **Nathan Taft**, Jonathan Rose Companies LLC
29. **Julie Tanner**, Corporate Advocacy Coordinator, Christian Brothers Investment Services
30. **Brenna Walraven**, Executive Director, National Property Management, USAA Realty Company and Vice Chairman of the Building Owners and Managers Association (BOMA) International
31. **David Wood**, Senior Research Associate, Institute for Responsible Investment, Center for Corporate Citizenship at Boston College
32. **Betsy Zeidman**, Director, Center for Emerging Domestic Markets, The Milken Institute
33. **Adam Zoger**, Principal and Fund Manager, Pacific Coast Capital Partners, LLC

The Center for Corporate Citizenship at Boston College, a membership-based research organization, is committed to helping business leverage its social, economic and human assets to ensure both its success and a more just and sustainable world. As a leading resource on corporate citizenship, The Center works with global corporations to help them define, plan and operationalize their corporate citizenship. Through the power of research, executive education and the insights of its 350 corporate members, The Center creates knowledge, value and demand for corporate citizenship.

The Center offers publications including a newsletter, research reports, and white papers; executive education, including a Certificate program; events that include an annual conference, roundtables and regional meetings; and a corporate membership program.

The Institute for Responsible Investment, a project of the Center, works with investors, corporations, public sector organizations, research institutes, and related parties to coordinate thinking and action around issues of strategic importance to long-term wealth creation for shareholders and society.

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