

Changing priorities in investor decision-making: Preliminary Stage 1 results

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Introduction

- ❑ Momentum driving the Sustainability Agenda is increasing
- ❑ Notable policy and legislative changes:
 - EU directives – 2009 and others
 - UN Global Compact (world's largest corporate sustainability initiative)
 - RICS (2015) *Advancing Responsible Business Practices in Land, Construction and Real Estate Use and Investment*
- ❑ Policy goals:
 - To embed sustainable and inclusive practices in the global economy
 - To create a sustainable built environment at its centre
 - Embrace human rights, labour, **environment** and anti-corruption principles

Investors

- ❑ Identified as key stakeholder group by RICS (2015)
- ❑ Responsibilities span across all three phases of the life-cycle of real estate assets
 - Development; Use; Recovery
- ❑ Important/strategic role in pursuing more sustainable strategies and practices for land and buildings
- ❑ Yet, little known about their attitudes/behaviour or if/how sustainable strategies and targets shape their decision-making

What we do know ...

❑ Corporate responsibility has been developing and is being embraced in investment strategies

→ Socially Responsible Investment (SRI) strategies:

“characterise the behaviour of investors who not only focus on the mere economic aspects of an investment but also follow ethical principles and take into account environmental and social aspects” (Lorenz and Lützkendorf, 2008, p. 483)

“efforts that go beyond compliance with minimum legal requirements to better manage the environmental, social, and governance issues associated with property investing” (Pivo, 2008, p. 235)

... and in practice ...

User markets:

- Sustainable buildings no longer seen as “inconveniences”
 - Can ↑ productivity and ↓ costs
- US: Energy Star/LEED Star rating attracts rent premia (Eichholtz *et al.*, 2010; Fuerst and McAllister, 2011; Wiley, 2010)
- Australia: Green Star ratings yield higher rent (Newell *et al.*, 2011)
- Netherlands: lower EPC = lower rents (Kok and Jennen, 2012)
- UK: less clear
 - Fuerst and McAllister (2011) no evidence (but appraisal data)
 - Chegut *et al.* (2012) 23-30% for BREEAM rated buildings in London
 - Fuerst and van de Wetering (2015) BREEAM 23% to 26% higher (across UK but year dependent)
- Overall: magnitude of premia varies (3% to 30%), office sector common focus

... and in practice ...

Investment markets:

- ❑ US: CV premia (6%-29%) for green-rated offices (Eichholtz *et al.*, 2010; Miller *et al.*, 2008; Pivo and Fisher, 2010; Fuerst and McAllister, 2011)
- ❑ Australia: Newell *et al.* (2011) find 12% premia
- ❑ UK: Chegut *et al.* (2011) find 27-43% premia for BREEAM rated buildings
- ❑ Fuerst (2015) – tentative evidence that REITs return-on-asset and return-on-equity increase as sustainability rating increases

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- Some evidence of improved occupancy rates (Pivo and Fisher, 2010; Fuerst and McAllister, 2011)
- Some evidence of reduced operational costs (Pivo and Fisher, 2010)
- Little (formal) progress on appraisal methods

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- Overall: if rental premia priced by market, what are investment drivers?

Research Question

- ❑ Sustainability agenda:
 - Two elements: (i) management & policy
(ii) implementation & measurement
 - Latter “is a vastly more significant and more powerful driver of financial performance” yet Europe scores comparatively low (Fuerst, 2015, p. 13)
- ❑ Alignment of financial returns / environmental concerns?
- ❑ No substantive evidence on investors’ responses in practice

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Sustainability agenda:

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Alignment of financial returns / environmental concerns?

No substantive evidence on investors’ responses in practice

Do investors’ preferences and behaviour align with policy and stated sustainability objectives?

Research Design

Mixed methods approach:

□ Stage 1 - Conjoint Analysis/Questionnaire

- Simulate complex decision-making process
- Replicate heterogeneous nature of real estate assets
- Additional contextual questions
- Observe behaviour

□ Stage 2 – Focus Groups

- 2 to 3 meetings with key stakeholders, semi-structured
- In-depth → views, experiences, policies, drivers for/ barriers to implementation

Conjoint Analysis

Choice-Based Conjoint (CBC) Analysis

Primary data collection

Temporal - 2006/07 and 2016

2016 online

Method

- Choice between two real estate assets (or choose neither)
- Eight property attributes
- Each asset comprises randomised levels of each attribute
- Tasks repeated
- Opportunity to segment and control for sector and economic outlook

Attributes	Levels
Credit worthiness	1) Minimum risk of tenant default
	2) Lower than average risk of tenant default
	3) Higher than average risk of tenant default
	4) High risk of tenant default
Single or multi-let	1) Single let property
	2) 2 to 5 tenants
	3) More than 5 tenants
Rent review clause	1) Rent set annually, linked to index or turnover
	2) Rent review every 2 to 3 years, upwards only clause
	3) Rent review every 4 or more years, upwards only clause
	4) Rent review every 2 to 3 years, no upwards only clause
	5) Rent review every 4 or more years, no upwards only clause
Period to expiry/break	1) Less than 5 years
	2) 5-10 years
	3) Over 10 years
User/Assignment clause	1) Restrictive user/assignment clause
	2) Standard user/assignment clause
	3) Relaxed or no user/assignment clause
Location	1) Town or city centre, prime pitch
	2) Town or city centre, secondary pitch
	3) Suburban location, close to existing public transportation
	4) Suburban location, no existing public transportation
	5) Out of the town/city, close to existing public transportation
	6) Out of the town/city, no existing public transportation
BREEAM rating	1) Pass
	2) Good
	3) Very Good
	4) Excellent
	5) Outstanding
	6) Not known
Economic and functional obsolescence	1) High spec and flexible internal configuration
	2) Average spec and internal configuration
	3) Low spec and inflexible internal configuration

Analysis

□ Counting analysis

- Relative impact of each attribute level
- Identify main effects and interaction effects
- Simplistic (but useful) method

□ Multinomial logit estimation

- Relative importance of attributes
- Difference each attribute could make to the total utility of asset
- Estimate the utility (part-worths) of each level of each attribute

□ Hierarchical Bayes (HB) estimation

- More robust - (part-worths) calculated for each respondent (Count & ML averages)

Samples

	2006/07 Funds	2016 Funds
Return Objective		
Income return	9.8%	31.7%
Capital growth return	9.8%	2.4%
Income & capital return	76.5%	58.5%
Other return objective	3.9%	7.3%
Vehicle Style		
Core/Core+	49.0%	80.5%
Value added	15.7%	4.9%
Opportunistic	15.7%	4.9%
Other style	17.6%	9.5%
Benchmark Objective		
Track	3.9%	2.4%
Outperform	58.8%	58.5%
Split	11.8%	0.0%
Absolute return	0.0%	31.7%
Other objective	3.9%	7.3%
Type of Fund		
Open-ended	76.5%	73.2%
Closed	21.6%	26.8%

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Type of Fund		
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Closed	21.6%	26.8%

	2006/07	2016
Gender		
Male	90.2%	92.7%
Female	9.8%	7.1%
Experience in current role		
0 to 5 years	21.6%	39.0%
6 to 10 years	17.6%	34.1%
> 10 years	60.8%	26.8%
Highest qualification		
BSc/BA or equivalent	52.9%	65.9%
MSc/ MA or equivalent	31.4%	29.3%
PhD/Mphil	3.9%	2.4%
Other	11.8%	2.4%
Total No Respondents	51	41

Main Effects (Count Analysis)						
			2006/07	2016		
					2006/07	2016
Location					BREEAM rating	
	In town or city centre	0.52			Pass	0.34 0.09
	Town or city centre, prime pitch		0.43		Good	0.30 0.15
	Town or city centre, secondary pitch		0.18		Very Good	0.37 0.20
	Suburban, close to existing public transportation	0.38	0.25		Excellent	0.32 0.34
	Suburban, no existing public transportation	0.19	0.08		Outstanding	0.35
	Out of the town/city, close to existing public transportation	0.38	0.19		Not known	0.30 0.10
	Out of the town/city, no existing public transportation	0.18	0.08		Within Att. Chi-Square	3.83* 88.01
	Within Att. Chi-Square	90.66	117.34			
Single or multi-let					Period to expiry/break	
	Single let property	0.22	0.19		Less than 5 years	0.26 0.17
	2 to 5 tenants	0.37	0.20		5-10 years	0.32 0.21
	More than 5 tenants	0.4	0.21		Over 10 years	0.40 0.23
	Within Att. Chi-Square	33.86	0.55*		Within Att. Chi-Square	16.13 3.98*
Economic and functional obsolescence					User/assignment clause	
	High specification and flexible internal configuration	0.47	0.29		Restrictive user/assignment clause	0.30 0.20
	Average specification and internal configuration	0.34	0.21		Standard user/assignment clause	0.34 0.20
	Low specification and inflexible internal configuration	0.18	0.11		Relaxed or no user/assignment clause	0.35 0.21
	Within Att. Chi-Square	80.09	41.27		Within Att. Chi-Square	3.31* 0.09*
Rent review clause					Credit worthiness of the tenant	
	Rent set annually, linked to index or turnover	0.34	0.21		D&B 5AA rating for tenant(s)	0.38
	Rent review every 2 to 3 years, upwards only clause	0.37	0.21		Minimum risk of tenant default	0.29
	Rent review every 4 or more years, upwards only clause	0.36	0.19		D&B 3AA or 4AA rating for tenant(s)	0.37
	Rent review every 2 to 3 years, no upwards only clause	0.27	0.21		Lower than average risk of tenant default	0.25
	Rent review every 4 or more years, no upwards only clause	0.29	0.19		D&B 1AA or 2AA rating for tenant(s)	0.33
	Within Att. Chi-Square	8.91*	1.07*		Higher than average risk of tenant default	0.17
					D&B AA or BB or CC rating for tenant(s)	0.32
					D&B DD or lower rating for tenant(s)	0.25
					High risk of tenant default	0.10
					Within Att. Chi-Square	12.17 44.98

Chi-Square statistics are significant at less than 0.05%; unless * to denote insignificant at 0.05%.

Attribute Level Utilities and Preferences (based on ML Estimation) Across the Total Sample

	2006/07	2016		2006/07	2016
Location			BREEAM rating		
In town or city centre	0.99		Pass	0.00*	-0.66
Town or city centre, prime pitch		1.31	Good	-0.16*	0.07*
Town or city centre, secondary pitch		-0.04*	Very Good	0.28	0.43
Suburban, close to existing public transportation	0.33	0.41	Excellent	-0.01*	0.22*
Suburban, no existing public transportation	-0.77	-0.78	Outstanding		0.32
Out of the town/city, close to existing public transportation	0.36	0.02*	Not known	-0.11*	-0.39
Out of the town/city, no existing public transportation	-0.91	-0.93			
Single or multi-let			Period to expiry/break		
Single let property	-0.56	-0.04*	Less than 5 years	-0.29	-0.20
2 to 5 tenants	0.2	-0.01*	5-10 years	-0.01*	0.02*
More than 5 tenants	0.36	0.05*	Over 10 years	0.3	0.18
Economic and functional obsolescence			User/assignment clause		
High specification and flexible internal configuration	0.69	0.51	Restrictive user/assignment clause	-0.22	0.02
Average specification and internal configuration	0.16	0.04*	Standard user/assignment clause	0.07*	0.00
Low specification and inflexible internal configuration	-0.84	-0.55	Relaxed or no user/assignment clause	0.15	-0.02*
Rent review clause			Credit worthiness of the tenant		
Rent set annually, linked to index or turnover	0.05*	0.00*	D&B 5AA rating for tenant(s)	0.33	
Rent review every 2 to 3 years, upwards only clause	0.35	0.02*	Minimum risk of tenant default		0.57
Rent review every 4 or more years, upwards only clause	0.18	-0.05*	D&B 3AA or 4AA rating for tenant(s)	0.14	
Rent review every 2 to 3 years, no upwards only clause	-0.25	0.06*	Lower than average risk of tenant default		0.41
Rent review every 4 or more years, no upwards only clause	-0.33	-0.04*	D&B 1AA or 2AA rating for tenant(s)	0.10*	
NONE	0.28	1.48	Higher than average risk of tenant default		-0.21
Consistent Akaike Info Criterion	1832.01	1482.89	D&B AA or BB or CC rating for tenant(s)	0.00*	
Chi Square	380.6	519.27	D&B DD or lower rating for tenant(s)	-0.57	
Relative Chi Square	15.22	19.97	High risk of tenant default		-0.77

Chi-Square statistics are significant at less than 0.05%; unless * to denote insignificant at 0.1

Attribute Preferences (based on HB Estimations)

	Location	Credit worthiness	BREEAM rating	Economic and functional obsolescence	Rent review clause	Period to expiry/break	Single or multi-let	User/Assignment clause
All	26.33	18.48	16.56	11.18	7.91	7.55	6.55	5.44
Core/Core+	27.50	17.76	15.63	13.00	7.38	8.50	4.73	5.49
Value Added	20.35	23.15	16.93	8.36	7.51	16.50	4.08	3.12
Opportunistic	11.79	16.65	14.96	12.18	15.30	11.12	11.43	6.58
Other	16.56	24.52	15.68	3.83	14.94	4.58	11.07	8.83
Retail	22.51	13.63	22.35	11.15	9.01	11.21	4.63	5.49
Office	27.15	18.15	13.44	8.97	12.53	7.24	5.72	6.79
Industrial	19.11	13.53	13.79	20.33	10.59	11.86	7.61	3.17
Residential	19.22	20.76	13.89	14.68	14.92	4.25	4.36	7.92
Mixed	19.95	26.38	11.85	11.71	11.27	3.20	3.87	11.77

Findings

Ranking of key parameters

- Location still top priority
- BREEAM rating rising to third place
- Credit worthiness
- Economic and functional obsolescence dropped
(level of spec and flexibility of internal configuration)
- Period to expiry/number of users/user clauses & rent review clauses are all insignificant

Differs depending on fund style and property type

Most preferred BREEAM rating: 'Very Good'

Conclusions ... so far

- Results seem to conform to our a priori expectations
- But need to disaggregate further: e.g. impact of economic outlook

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In terms of sustainability:

- There seems to be a turn in perceptions/preferences
- Is this linked to fund strategy?
- Why is 'Very Good' most preferred? Does this change if we disaggregate the sample?
- When ranked by importance to achieving **target returns**
 - **Sustainability rating is 6.74 (out of 8)**
- When ranked by importance to achieving **risk mitigation**
 - **Sustainability rating is 6.43 (out of 8)**