

RESPONSIBLE PROPERTY INVESTMENT: SIMILAR AIMS, DIFFERENT MANIFESTATIONS

**An Article by UNEP Finance Initiative's
Property Working Group**

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EXECUTIVE SUMMARY

This article prepared by UNEP FI's Property Working Group, presents the essential differences between Responsible Investment (RI) in asset classes and in direct property. This practical note should help investors apprehend why and how Responsible Property Investment (RPI) is uniquely different to other "regular" assets.

In particular, it explains that, whilst the same principles can be applied to property as equities with regards to RI, the unique nature of direct property as an investment type means that there are a number of practical differences in how to implement them.

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INTRODUCTION

The aim of the UNEP FI Property Working Group (PWG) is to encourage sustainable practices in property finance. Among its goals, the PWG has a desire to raise awareness of the nature and importance of Responsible Property Investment (RPI), especially amongst the fund and investment management community.

In support of this goal, the following brief paper, which focuses exclusively on direct investment in commercial and retail property, seeks to clarify the various approaches that RPI can take and how those approaches relate to the more established forms of Responsible Investment (RI) practices seen in the equities market.

By doing so, it is hoped that responsible property professionals can (a) better situate what they do in relation to similar work carried out by responsible equity professionals; and (b) better articulate why, despite having common aims and purposes, they tend to focus more on some approaches and activities rather than others.

It is further hoped that the paper will help responsible equity professionals understand more about the nature of property investment and how the characteristics of property as an investment asset largely determine which responsible investment approaches are most appropriate and effective.

IN WHAT WAYS IS DIRECT PROPERTY DIFFERENT TO OTHER ASSET CLASSES?

Definitions

Mansley (2000) defines RI as:

“(i)investment where social, ethical or environmental (SEE) factors are taken into account in the selection, retention and realisation of investment, and the responsible use of the rights(...) that are attached to such investments.” (pg.3)

This definition should apply equally as well to responsible investment in property as it does to responsible investment in equities. However, we need to be clear from the outset that property rights, which define the essence of direct property as an investment asset, are very different in nature to rights held by equity investors and, as a consequence, the activities that constitute RPI are likely to be very different to those seen in responsible equity investment.

Direct property is usually characterised as a large lot size, mostly indivisible, heterogeneous and illiquid asset class that is typically highly circumscribed by legislation and government policy. In most mature market economies, property is “commodified” in the sense that, despite being a natural resource, rights in land and property have been packaged in a way that they and the properties they relate to, can be readily traded. It is also usually the case that an owner of a property will either occupy the property directly or, in essence, ‘sell the right’ to occupy that property to a tenant through some form of leasing structure.

These lease structures are almost always negotiated and agreed to prior to tenant occupation. In a lease, the nature of the relationship between landlord and tenant is articulated through a mutually agreed set of rights, responsibilities, and requirements that govern what each party is able or expected to do through the course of that lease. The rights enshrined in these leases typically evolve over long periods of time and as such are strongly socio-culturally determined, and can vary from country to country. Despite some evidence of global convergence, in mainland Europe, a typical lease is for three years, with a tenant’s right of renewal for a further two periods of three years. In Asia, leases are typically 3 to 5 years in length, while in North America they are typically 5 to 10 years. In the UK, leases are often between 10 to 25 years, with many stretching over much longer periods.

Given even this simple description of the nature of direct property investments, we can immediately see at least five significant differences between direct property and equity investments as assets which might impact the way in which responsible investment objectives might be pursued by investors. These differences are as follows.

Differential Relationship between Investor and Invested Asset

The first difference between equities and property lies in the nature of the relationship between the investor and the invested asset. Typically a direct property investor owns an invested asset outright (or, at least, in some limited joint ownership arrangement). As such, the investor is ostensibly materially in control of the management of that asset. However, by selling occupation rights to tenants, the landlord effectively relinquishes a considerable amount of control for the duration of the lease over the way in which the property is used. Where a landlord does retain control over a property or a part of it, as for example in the 'common parts' of a shopping mall or a multi-tenanted office block, then substantial freedom to take direct responsible action is also retained. However, in the areas occupied by tenants, that freedom is severely constrained.

This compartmentalisation of property rights is very different to the rights held by 'shareholders' in the equity of a company. Here, as the name implies, the equity investor is a joint owner of the company concerned and, as such, has a measure of control over aspects of company activity broadly commensurate with the proportion of ownership rights held.

We shall see later how the very different relationships between the investor and the invested asset which occur in property and equities strongly determine how investors pursue responsible investment objectives in the two asset classes.

Property as a 'Binary' Asset

A second difference between property and equity investments is the 'binary' nature of the former compared to the 'singular' nature of the latter. A responsible equity investment describes the interaction between an investor and (the management of) a company. By contrast, a responsible property investment could describe the interaction of an investor with either or both a building and the tenants who occupy it.

As we shall see, the binary nature of direct property investment helps expand the range of activities a responsible property investor might undertake.

Property as a Concatenation of Time-limited Investment

A third difference between direct property and equity investments is that, the contractual nature of a lease means that the return from direct property is derived from a concatenated series of time-limited leasing episodes. Properties are let for pre-specified periods of time and then need to be re-let. By contrast, providing the company remains economically viable, an equity investment is not usually time defined or punctuated from the outset.

What this means in practice for RPI is that, from time to time, a direct property investor can regain full control over the invested asset. By contrast, equity investors perennially retain a level of control broadly proportionate to their shareholding for the length of time the shares are held.

Again, we will see that this difference noticeably affects the nature of the responsible activities the two different types of investor can undertake.

Differential Liquidity and Transaction Cost

Fourthly, it should be recognised that the legal complexity, the relative information scarcity (compared to the equity market), the 'lumpy' lot sizes, and the heterogeneity of properties and the economic activities that occur within them, all mean that direct property investment often requires substantial due diligence and, related to this, substantial time to transact. In some jurisdictions, this relative illiquidity of property investments can also be accompanied by high transaction taxes.

As such, it is generally not as quick, cheap or easy to move capital around the direct property market as it is around the equity market. This, in turn, means that exercising choices and moving capital away from undesirable assets towards more responsible investments, is more costly, more difficult, and takes longer to achieve.

Property as Legacy Asset

Finally, companies are always in competition with each other and, as a result, evolve organically over time to meet new challenges such as, say, an increased focus on energy efficiency. By contrast, properties are fixed in location, substantially constrained in form, and tend to obsolesce both physically and functionally over time. While property investors can invest to 'reposition' an existing property to again compete in its market place, the original built structure will last for decades, even centuries, before total or partial replacement.

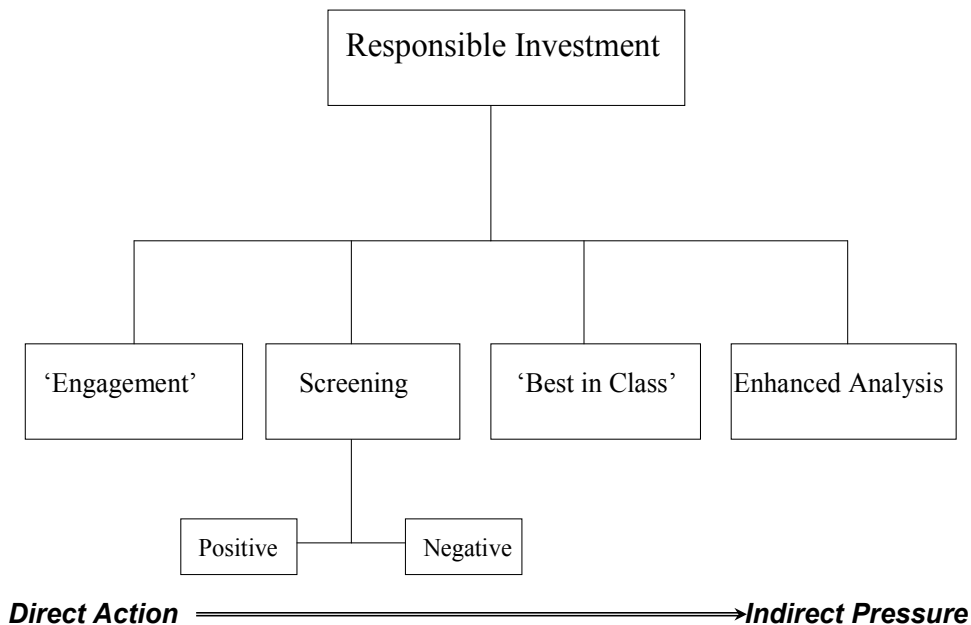
This means that, at any given time, equity investors are choosing between a universe of organically evolving and constantly 'refreshed' investable assets, whereas property investors are generally investing in a pool of 'legacy' assets of different vintages that remain, in terms of form and function, reflective of their date of construction and are very expensive to 'retro-fit' and modernise. This relative fixity in asset characteristics can constrain what a responsible property investor is practically able to achieve with an invested asset.

Having identified some crucial differences in the nature of property investments compared to equity investments, the following section introduces the main approaches to RI adopted by equity investors. This is followed by a review of the extent to which these RI approaches can directly or otherwise be transferred to RPI and how they manifest themselves when they are.

RI APPROACHES TO EQUITY INVESTMENT

Sullivan and Mackenzie (2006) offer one of the best contemporary reviews of RI approaches to equity investment. They identify a range of approaches that have evolved over recent decades. We will use their findings to list the main approaches to RI. We can then take use this list and explore the applicability and adaptability of each for RPI. Figure 1 presents the various forms of RI activity we shall cover and has ordered them, left to right, by reference to the level of direct intervention by the investor in the environmental and social impacts of the invested asset.

Figure 1: The approaches to responsible investment :



(It should be noted from the outset that responsible investors do not usually depend upon a single approach to pursue their aims but will use a combination of all of the methods listed. This is as true for responsible property investors as it is for responsible equity investors.)

Engagement

The first approach listed by Sullivan and Mackenzie (2006) is 'engagement'. In line with the quote from Mansley (2000) presented above, this approach can involve investors using the rights attached to their investments, such as voting rights at company meetings, to influence company policy, company board composition, director remuneration and approve or otherwise the company annual report. Occasionally, there may even be a chance for responsible investors to table resolutions that affect ongoing company policy.

However, a more common form of engagement is for responsible investors to attempt to influence company activities through active and constructive regular critical dialogue with company directors.

Almost as a form of screening (see next section) by stealth, the ultimate form of engagement or 'shareholder activism' is to 'disengage' and sell the shares already held in a company that is not reacting to pressure to behave in a preferred manner. The theory goes that if sufficient numbers of shareholders do likewise, then the share price of the company falls and the cost of capital to the company rises. This, it is argued, will ultimately affect company behaviour through impacting upon company performance and director remuneration. The counterargument to this is that, to sell the shares of a company is to relinquish all leverage to influence company activity and, as such, is the antithesis of engagement.

Screening

The second approach to RI, and one that has been at the heart of ethical investment for many decades is that of 'screening'. Screening is a process by which an investor filters the universe of investable assets either 'positively' or 'negatively', to select investments and bias the constitution of a fund either towards or away from companies deemed to be acceptable (however defined) or not. Positively screened funds might, for example, orient themselves towards green technology companies, social housing providers or medical equipment manufacturers whereas negatively screened funds might orient themselves away from, say, arms manufacture, tobacco-related products or gambling companies.

By restricting the investable universe, it is felt by some that 'screening' introduces additional systematic risk to an investment portfolio. Others argue that, by screening out controversial sectors and activities, screening helps to limit exposure in the portfolio to other forms of risk.

Best in Class

A third approach to responsible investment is called 'best in class'. This approach is based on a belief that, irrespective of their sector, those companies more actively engaged in tackling social, environmental and economic issues in a constructive way tend to be better managed generally and, as such, are likely to outperform in the medium to long term.

In contrast to 'screening', which can result in an entire company sector being excluded from an investment portfolio, a 'best in class' approach allows investment to be made in all sectors. As such, it facilitates better portfolio diversification even though the 'best in class' investments in some sectors are not necessarily good performers in terms of RI.

Investors using this approach to make stock selection decisions, sometimes make use of independent assessments of company performance against various governance criteria (often from published sources like the FTSE 4 Good). Other responsible equity investors undertake bespoke analyses to determine who they believe to be 'best in class' companies.

Enhanced Analysis

One final 'approach', albeit of a slightly different nature to the other approaches, referred to in Sullivan and Mackenzie (2006) is called 'enhanced analysis'. Here, the likely implications of a changing investment context, driven amongst other things by evolving consumer attitudes, social mores, and government policy, are analysed qualitatively and quantitatively, to assess their implications for the 'fair value' of investments. If, on the basis of such analysis, the worth of an investable share is estimated to be below that observable in the market, the share will be deemed 'expensive' and sold; if worth is perceived as greater than price, the share will be bought. In this sense, environmental, social and governance issues are treated as added variables in the analysis of investable assets.

As with the above discussion on 'engagement', if sufficient numbers of investors conduct such analyses and, as a result, dispose of a given company's shares on the grounds that the company is poorly 'future proofed', then its share price and cost of capital will be affected. It is suggested that this will eventually affect the behaviour of less well future proofed companies

and encourage them to improve their environmental and social performance to better meet the changing investment context.

Arguably, this approach could be considered as different to the other approaches in that action is encouraged by objective analysis of the prospective risks and returns available from a company, and it is the accumulated logical actions of the market that place vicarious (rather than direct) pressure on the company to change its behaviours.



RI APPROACHES FOR DIRECT PROPERTY INVESTORS

This section will examine if, how, and in what ways RI equity approaches can be translated into meaningful practices for action in the direct property market. To do this, we will review each of the RI equity approaches listed in the previous section and identify the issues and opportunities that arise when they are viewed in terms of property investment.

Engagement in Direct Property Investment

From the description of the characteristics of a typical property investment provided earlier, two things become clear immediately with respect to engagement in direct property investments. The first is that, given the 'binary' nature of the relationship between an investor and an invested property asset, there is scope for the responsible property investor to engage with both the physical structure of a building and the tenants occupying the building.

The second is that the existence of the contractual relationship between an investor and a tenant as expressed through a lease is such that the scope for engagement by a responsible property investor is largely constrained to those parts of the building over which the investor retains rights and those times when such engagement can occur. When the tenant is in occupation and the lease is in force, a responsible landlord considering active engagement with the physical structure is largely limited to the areas and parts of the building not occupied by the tenant. However, when the lease comes to an end and the property is vacated, the investor regains complete control over the built structure and can engage very actively with all parts of it.

Engagement with the Built Structure

If we consider the ability of an RPI investor to 'engage' with the physical fabric of a building, there are at least three clear forms of engagement that can be followed.

First, and easily the most emphatic form of engagement, occurs through the construction of a new building. It is here that an investor/developer has the greatest freedom to create a responsible investment. This freedom and the pressure placed upon all developers currently to make responsible use of it, probably explains why the literature on 'green property' is so

overwhelmingly dominated by advice and instruction on responsible forms of construction and development. However, as we have already noted, new buildings form only a small part of the built stock at any given time and, on any given site, they occur infrequently. New developments are therefore a high impact but low frequency form of engagement.

A second and somewhat similar form of engagement occurs through refurbishment, which occurs when an existing building undergoes material works and capital expenditure to reposition it in its occupational market place to attract or maintain tenants. Commercial buildings can experience several refurbishments over the course of their lives. As such, refurbishment occurs more frequently than (re)development. However, given that refurbishment is carried out within the constraints of the existing envelope of a built structure, the responsible property investor is left with a more limited set of options to improve the environmental and social credentials of a building. Refurbishments often occur when properties are empty, between leases. This is because this is one of the rare occasions when an owner can obtain complete control over an asset.

Thirdly, for all or part of the buildings over which he has control, an investor can carry out a wide range of property management activities, many of which can contribute towards reducing the ongoing environmental impact of an existing built structure. This is high frequency, low impact form of engagement with many of these small scale activities capable of being carried out while tenants are in occupation.

One crucial issue with respect to landlord engagement with the built structure is that the benefits of any landlord expenditures can often accrue to the tenant. Unless an adequate economic return can be obtained by the landlord, through tenants paying higher rents or showing a greater propensity to remain in occupation of the property longer, there is little incentive for a landlord to invest in measures to, say, lower energy bills or improve security for a tenant. By contrast, in equities, if a company improves its product or its energy efficiency, the shareholders benefit directly. Even when an investor gains full control of and refurbishes a property, that expenditure still needs to be justified by the generation of a higher value.

Looking to the external environment in which a building is situated, one building characteristic that can not be engaged with directly is its physical location. In the same way that buildings are legacy assets, the spatial organisation of land uses in, our cities evolves only slowly. As such, an auto-dependent location now is likely to remain so going forward. However, there is still

scope for a landlord to engage with such issues; for example, by the landlord providing some form of public transport to, say, relieve auto-dependency.

In summary, with respect to engagement in direct property investments, there is a range of potential responsible activities that might be pursued by responsible property investors. These range from major but infrequent interventions like (re)development and refurbishment, to minor but potentially very frequent interventions, like property management. However, the timing, scale and the nature of such interventions are materially affected and punctuated by the contractual aspects of any leases in place.

Engagement with the Tenant

The totality of the environmental and social impact of a building relates to the collective actions of both its landlord and its tenants. In most cases, as the main users of a building, it is the tenants that have the greatest impact. Some types of property, such as shopping centres or mixed use offices, do have common parts which can be managed responsibly by the landlord but, even here, the clear majority of space is under the control of tenant. Indeed, in most forms of property, tenants occupy nearly all the contained space and there is little, in terms of the environmental performance of the building that an owner can influence directly.

As such, the tenant is crucial to the environmental and social impact of a property. It, therefore, makes great sense for a responsible investor to engage with tenants when seeking to manage invested assets responsibly. However, again, the rights afforded to the landlord and the tenant through the negotiation of the original lease contract greatly determine the scope for tenant engagement.

Clearly, lease provisions are negotiable and, as such, reflect the social mores of their time and jurisdiction. Typically, in most mature property markets at least, a lease grants a tenant substantial freedom to occupy a property and make beneficial use of it. As such, the greater the level of restrictions or obligations placed upon a tenant by a landlord, the less attractive a building could become to that tenant. This in turn could ultimately lower the level of rent a tenant is willing to pay. Not surprisingly then, landlords are likely to be wary about placing too many controls and restrictions on leases pertaining to their properties.

The relative novelty of 'sustainability' issues means that relatively few leases currently place environmental obligations on tenants or on landlords. This means that responsible landlords

are typically only able to resort to 'informal engagement' with tenants. As with equities, albeit without the benefit of 'voting rights' as leverage, this often amounts to a face to face dialogue with tenants to persuade or educate them on how to utilise their premises in a more environmentally responsible way. For example, landlords could provide tenants with information on how they might achieve energy (and cost) savings.

Not surprising, given the extent to which a lease determines the way in which a property is subsequently operated by both tenant and landlord, a considerable amount of thought and effort is now being spent on how best to create 'green leases'. Green leases generally contain certain obligations on both tenant and landlord, agreed at the outset of a lease, which can then be enforced throughout the term of the lease. Such leases, for example, might require both parties to the lease to behave in environmentally responsible ways or use best endeavours to utilise environmentally friendly materials of process in the operation of the building. They might also require the different parties to the lease to provide information on energy and water usage to each other.

However, without such provisions in a lease, an uncooperative tenant can in most markets easily resist the overtures of a responsible landlord. In such circumstances, the potential for a responsible property investor to improve the environmental performance of a building through improved tenant behaviour, is severely limited.

To summarise, there are a number of ways in which an investor can 'engage' with a direct property investment. However, these are highly circumscribed by the longevity of the original built structure and the nature of the leases put in place.

Screening in Direct Property Investment

Given that screening is conducted prior to capital being expended then, as with the selection and deselection of companies in the equity investable universe, a responsible property investor can similarly positively or negatively screen property investments.

In this regard, the heterogeneity and multifarious features of property would allow responsible property investors to screen properties using a variety of asset characteristics. However, it is most likely they will screen with respect to the relative location of properties, the physical attributes of buildings, and/or the attributes (especially the activities) of tenants occupying the building. We will review each in turn.

Investors can screen both positively or negatively with respect to property location. For example, some funds might exercise a preference for properties in close proximity to public transport nodes which obviate the need for those visiting to use private motor transport. Conversely, other investors may negatively screen out investments which take up virgin land in favour of investing and re-using 'brown-field' sites in existing metropolitan areas.

Similarly, some investors may apply a screening filter and invest only in 'environmentally friendly' buildings. These might be defined as those having achieved a certified level in a prevailing 'green' building standard (such as a LEED, BREEAM, Green Star etc).

Finally, and very much akin to screening in equity markets, some property investors could apply exactly the same logic used by their equity counterparts to screen tenant companies such that they provide accommodation only for those engaged in activities of which they approve and deny it to those whose activities they disapprove of.

General Discussion on Screening in Direct Property

On initial examination it would seem there is substantial scope for RPI investors to adopt screening strategies. However, we shall see that, on closer inspection, the specific characteristics of direct property investments discussed earlier create a number of problems for those seeking to screen property investments.

The first major difficulty for any property investor seeking to screen positively for, say, environmentally friendly buildings, is that there are still relatively few of them. Given the 'legacy' nature of the built stock of properties mentioned earlier, and given that only around two per cent of new stock gets built each year in mature economies (albeit higher in emerging economies), the vast majority of the investable stock open to RPI investors is of historic vintage. Almost by definition, few existing buildings would readily pass stringent modern environmental testing in most mature property markets. Those that did would most likely be modern office or residential units - although increasing numbers of industrial and retail properties are now being built to high environmental standards. As such, RPI 'screeners' are faced with a very small and rather uniform investable universe. Such uniformity and the concomitant small number of investable assets creates risk for investors seeking fund diversification. There could also be a problem if excess investor demand pursues this relatively

tiny set of assets. If this happens, prices for 'green' assets could become inflated with subsequent returns commensurately reduced (see Pivo and Fisher, 2008).

Some property investment funds could, as with equity funds, attempt to screen by type of tenant. However, setting aside the usual issues surrounding how one defines an 'acceptable' tenant, there are many practical difficulties with tenant screening by property investors - some of which parallel issues for equity screeners. For example, would the presence of one unacceptable tenant in, say, a multi-tenanted shopping mall or large office complex, be reason enough not to buy it? If not, then what percentage of unacceptable tenants would there have to be to deter a responsible property investor from buying it? This is analogous to what some equity screeners face when investing in large conglomerates within which some companies are energy efficient and others are not.

Under many jurisdictions, and expressly for the protection of tenants' rights, it is often not easy for a landlord to remove an unacceptable tenant from occupation without litigation or substantial compensation. Clearly, there is an opportunity at the end of a lease for an RPI investor to refuse to re-let to an undesirable tenant but, even here, there can be legal complications in some jurisdictions.

However, setting aside the existence of tenants' rights to continue occupation, a decision not to re-let an asset to a sitting tenant and to hold out for a 'more acceptable' tenant could well result in an investor receiving no income from an investment on which capital has already been expended. Such a screening policy would be especially risky in properties or locations that are less desirable and where it might generally take longer to re-let anyway. In such instances, the impact on investment returns could be very material.

Even when a responsible property investor does manage to secure an acceptable set of tenants for a building, the right exists in many countries for a tenant to sub-let or assign (effectively sell on) a lease to another tenant. Typically when this occurs, the only basis upon which a landlord might oppose a sitting tenant seeking to assign a lease would be that the sub-tenant or assignee was not of a similar financial standing – not whether the activities of the new tenant were socially acceptable or not. Hence, an investment bought with an acceptable tenant in place can become less acceptable over time without the landlord being able to do very much about it.

One further issue with screening in direct property relates to data availability. Whilst responsible property investors could use the same sorts of information used by responsible equity investors to review tenant credentials, the amount of data available to screen buildings is still remarkably thin, even in mature commercial property markets. Whilst new buildings are increasingly commonly being 'rated' by independent building grading services (e.g. CASBEE in Japan, HQE in France, LEED in the US and elsewhere, BREEAM in the UK), there is very little information anywhere in the world by which a property screener could readily screen existing stock. In Europe, under governmental pressure, the Energy Performance Certificates (EPCs) which landlords must provide to prospective tenants and purchasers of their assets, may go some way to fill this void. However, for large parts of the world, there is no such readily available data.

To sum up, while property investors can try and screen assets positively and negatively, using a variety of asset attributes, there are some material and practical issues that emerge when they attempt to do so.

Best in Class Approach in Direct Property

The concept of 'best in class' investing is equally as applicable to investment in direct property as it is to investment in equities. However, given there are many more investable properties than there are companies to invest in, there is likely to be an even greater dependence on external measures of buildings' environmental impacts.

To identify such assets in direct property, investors will probably need to refer to industry-wide asset rating systems (such as Energy Performance Certificates issued in Europe) and building standards guidelines (such as LEED, BREEAM, Green Star, etc). However, as mentioned in the previous section, these grading regimes tend to relate primarily to new buildings, with very little information available to identify best in class existing stock.

As with equities, an RPI investor pursuing this approach might seek to create a well diversified portfolio but, in so doing, select only well-rated assets in each land use sector or geographical market. This would be done in the belief that such assets, being better 'future proofed', were less exposed to a variety of risks and would deliver superior returns over the longer term. As capital is increasingly weighted towards these better assets (and away from the worst), the theory goes that this should affect both the pricing and performance of such assets differentially. In turn, this would influence investor attitudes and behaviours towards a

preference for particular types of assets and the asset management strategies they adopt towards properties.

In summary, it seems possible for RPI investors to pursue a 'best in class' approach. However, as we saw with 'screening' above, there is currently only a limited amount of information available to help investors make their asset selections in this way. Furthermore, unlike equities markets, property investors can only obtain such 'acceptable' property assets if they are for sale and known to be so.

Enhanced Analysis in Direct Real Estate

As an analytical technique rather than an RI approach, "enhanced analysis" is clearly just as relevant to the analysis of property investments as it is to the analysis of equities. However, as is generally the case with property when compared to equities, the data upon which to perform the analysis is far more scarce and difficult to assemble.

Responsible property investors should be equally as keen as responsible equity investors to understand how the characteristics of buildings or the actions of their tenants are likely to affect the risk premium, the required return and the prospective net income growth from their investments. However, the links between building characteristics and the drivers of investment value are hard to discern and harder still to parameterise. For example, if the cost of electricity rises and increases the costs of office occupation, how does this translate into increased tenant resistance to future rental rises, and, if so, to what extent? If the cost of petrol rises such that customers at shopping malls have less money to spend when they get there, how does this feed into tenants' increased resistance to rental rises, and how material an impact might it be?

In the absence of the minute by minute volumes of transactional and performance data available in the equity market, there is little scope currently for property investors to assess such impacts quantitatively. Ellison and Sayce (2006) made an early attempt to do so using expert assessment. Elsewhere, econometric studies have recently been published to look at the impact of building quality gradings on the rental and capital performance of high quality office buildings (Kok et al, 2008, Pivo 2008, and Fuerst and McAllister 2008). However, in truth, the data to perform such studies and come to firm conclusions is, and is likely to remain, painfully thin.

CONCLUSIONS

This brief paper has reviewed how readily the approaches adopted by RI investors in the equity market are transferable into the direct commercial property market. Predictably perhaps, the main finding is that because property is a very different asset class to equities in terms of (a) the rights it affords an investor, (b) the relationship between the investor and the invested asset, (c) the legal circumscription of the asset, and (d) the time-bound nature of the investment, there is no straightforward translation of RI equity approaches to the world of RPI. As such, whilst all of the main approaches used by RI equity investors, namely, screening, engagement, 'best in class', and enhanced analytics, can be applied to a greater or lesser extent by RPI investors, the form which they take needs to be amended to be effective with property investments.

Interestingly, the nature of property means that in certain ways at certain times, the responsible property investor can do more than responsible equity investors to improve the environmental and social impacts of held assets. This is especially so when the property investor has complete control over the asset and can engage in an unfettered way with it. However, at other times, a responsible property investor has far less influence over the environmental performance of an investment than an equity investor, often needing to fall back on informal engagement and the education and persuasion of sitting tenants during the course of a lease, rather than utilising the leverage that voting rights can afford an equity investor.

From our high level review, it would seem that the greatest scope for responsible property investment lies in engagement-based approaches rather than screening-based or 'best in class' approaches. Through development, refurbishment, and the less dramatic but potentially crucial property management process, the responsible property investor can engage actively with buildings throughout their life cycle. Green leasing is also now evolving rapidly and will, in the future, offer far greater scope for responsible property investors to also engage positively with tenants. Engagement also offers the greatest chance to improve the environmental and social impacts of the existing built stock and, thereby, address sustainability issues directly across the major part of the market.

Screening and 'best in class' approaches are more likely to work better with respect to built structures rather than tenants. However, even here, there is so little information available upon

which to make judgments and so few investments that currently might be described as 'responsible', that such approaches are naturally more difficult to operationalise at any material scale.

Similar problems with data availability and the ability to parameterise the effects of emerging sustainability issues, policy responses, and related social and market attitudes on asset valuation and performance, also make 'enhanced analysis' very difficult to operationalise in the direct property investment market.



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