Redefining Sustainable Real Estate Investment

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The importance of the social aspects of real estate investment is very much understated. The notion tends to be interpreted along economic lines. Measuring and reporting the social sustainability of real estate has the potential to not only influence investment patterns, it also impacts on what a real estate is ultimately worth. More importantly, it can help change community perceptions about what we value most about modern society.

Sustainability is increasingly being viewed as a non-negotiable added extra that comes at a price, although it can offer financial rewards, particularly over the longer term. These rewards are measured in micro (energy efficiency, recycling etc.) and macro terms (greenhouse gas reducing, less resource depleting etc.), and are nearly always environmentally-based. The social aspects of sustainability (productivity, well-being etc.) must also be seriously considered. However, financial rewards from investment in this area are less understood. As a result, the measuring, valuing and reporting of social sustainability is significantly less developed. Demonstrating that social sustainability is identifiable, desirable and value adding is essential if it is going to really matter to real estate profiles any time soon.

“[b]uildings in cities are … the physical basis for social networks. The ‘hardware city’ of infrastructure and buildings is interrelated with the ‘software city’ of habits, traditions, networks, markets and social relationships.”

Hall and Pfeiffer (2000:98)

Introduction

Social sustainability tends to be viewed as the ‘softer – politically correct’ component of sustainable development. This is a poor, yet widely-held misreading of the very tangible benefits social sustainability can bring to a real estate, or as is the focus here, investment in real estate. Much greater clarity of the influence of social sustainability in what is all too often a short-term focus on quick returns on is urgently required. More precise measurement and reporting of social sustainability will greatly advance this understanding of its importance and will help to progress the arguably marginalised second component of the Brundtland definition of sustainability – the rights of future generations to enjoy equal opportunity to current global citizens.

This paper doesn’t outline how to measure and report social sustainability. This task has already been undertaken by the author and presented elsewhere (see Kimmet and Wikstrom 2005). The much less ambitious objective of shoring up the case for such measurement frameworks is all that’s attempted here. Arguably though, this is at least as important as how to do it, given that many real estate investors will want to evaluate potential investments in their own way once it is clearly understood what social sustainability is, and why it should be taken seriously.
The first section of the paper tackles the question of what social sustainability is in terms of real estate, and argues that it is more about socially progressive objectives that are neatly accommodated by physical infrastructure than the other way round – i.e. socially sensitive places that explicitly require pre-designed social inputs. This is not a case of superficial semantic juggling. It is instead about implicitly laying a foundation for change in investment profiling which cost-effectively enables real estate investors to begin the journey towards discovering the power and profitability of sustainability dynamics.

The evidence connecting social sustainability with profit and value building is presented in the second section and supports research the author presented at a previous PRRES conference (Kimmet 2006). This is vital support for justifying the understanding, and ultimately measuring, the social sustainability component of real estate. Finally, conclusions about capitalising on redefined sustainable real estate that values social aspects equally with economic and environmental components are drawn.

Social Sustainability

Social sustainability emerges from ideas about good corporate citizenship and social responsibility. When used in conjunction with triple bottom line frameworks, the term implies that humans matter at least as much as economics and the environment. It is concerned with the durability and function at 3 levels: the broad scale of social networks, the more intimate level of relationships, and the individual quantum of well-being. All 3 of these levels feed into the productivity mix. Moreover, a major implication of sustainability is that a balance of these 3 dimensions will result in more durable productivity than incongruent levels over the longer term.

What investors must realise is that despite their intangible nature, the most valuable aspects of real estate assets are those that provide the best possible human outcomes into the future. These benefits build demand and result in higher and more sustained returns. This alone elevates the importance of social sustainability in the real estate mix, and is bringing a particular focus to construction and management standards as a major factor in improving the worth of asset holdings. Understanding what actually makes up desirable real estate therefore underpins an appreciation of social sustainability within a property context. Properties alone are only part of the equation. How humans interact with the space, and how the space itself facilitates interaction between its users and investors as stakeholders in common is just as important.

Sustainability is a powerful buzzword for good reason. It is strongly connected to notions such as endurance, flexibility, quality and alternative thinking – all of which are increasingly emerging as building blocks of financially successful enterprise. And real estate that has incorporated these aspects clearly is increasingly acquiring a competitive advantage over other product in the market. Sustainability then, as far as real estate is concerned, is about the more durable processes and practices of the humans that interact with the property. Implicit in this sustainability approach to real estate investment is the exercise of greater social responsibility in terms of equity, access, and community engagement within the confines of what at least some enterprises are realising are natural systems constrained by limits. So while the real estate market may at first glance appear to have little to do with sustainability objectives, given the nature of property, the way markets function has become crucial to the advancement of the sustainability agenda.
A considerable amount of research has already been undertaken attempting to establish links between good corporate citizenship and financial performance (Gottsman and Kessler, 1998; Austin et al., 1999; and SustainAbility, 2001). However, despite an increasing amount of anecdotal evidence, studies such as these fail to statistically prove there is a significant correlation between ethical real estate investment and increased prosperity. For instance, in terms of business studies, Gottsman and Kessler (1998) compared the financial returns of the S&P 500 against three sub-samples based on four measures of environmental performance. They divided firms into the top 75%, 50%, and 25% of environmental performers across all industries and found no statistically significant differences in financial performance between the three categories. More promising is the study by Austin et al. (1999) which placed firms into “green” and “brown” categories to test differences in environmental performance, and sorted firms into “black” and “red” groups, according to financial performance. They then used regression analysis to find a significant relationship between financial and environmental performance but couldn’t identify which direction the causality ran.

Nevertheless, it has been demonstrated that in individual cases, environmental performance can increase shareholding value. For instance, after controlling for variables traditionally thought to explain corporate financial performance, Konar and Cohen (2001) demonstrate that a significant reduction of a company’s toxic chemical emissions can result in a sizeable increase in market value. What is more difficult to demonstrate though is the value added from pro-active sustainable development investments. A good deal of research associated with the ‘Natural Capitalism’ approach that has emerged from the Rocky Mountain Institute and like-minded think tanks has no problem proving the profitability of renewable resource-based industry, but this is largely positioned within a niche market framework (Hawken et al., 1999: pp.38-9). This leaves mainstream real estate investment largely unstudied. Nevertheless, a study prepared for the Business Council of Australia (BCA, 2004) suggests that we are less than a decade away from the imperatives of sustainability, economic growth and social progress becoming aligned to the extent that the dichotomy between economic growth and environmental protection is largely laid to rest. And as international politics is squarely focussed on climate change as we move towards the end of the first decade of the millennium, this prediction appears to be very realistic.

An argument worth considering though is that conferences such as this that point to a more sustainable real estate investment climate emerging are really only picking up on Stern report-type predictions that sustainability, understood as greenhouse gas reduction initiatives, provide growth and prosperity opportunities while lowering exposure to risk (Stern 2006). Deegan et al for instance looked at why some Australian companies have markedly improved the disclosure of information in their annual reports, and found that it can quite clearly be traced to major social and environmental incidents (Deegan et al, 2000). Likewise, Owen and Lehman argue that “management considers annual reports to be a publicity device that may reduce the adverse perceptions of some sections of the community toward modern corporations” (Owen and Lehman, 2000:2).

The central assumption of this paper is that most real estate investments will continue to compromise social and environmental objectives in the pursuit of financial returns, regardless of how much triple bottom line reporting is undertaken or greenhouse gas reduction targets are embraced. Profit remains the universal language of real estate investment and will continue to do so. Net-positive social and environmental outcomes are increasingly welcomed, but their traction for decision making relies on a well-greased financial drive-train.
This is precisely why economic incentives that target social and environmental progress are so important for advancing sustainable real estate investment.

**Real estate and sustainability**

Complicating the idea of sustainable real estate investment are arguments taken seriously here that all Greenfield property development is ultimately unsustainable, regardless of what it produces or how it’s performed. From this perspective, the only sustainable real estate investment is that which retires unsustainable assets and usages, and re-engineers them along lines that reflect natural processes that observe system limits. This is perceived as the development of self-perpetuating benign frameworks that essentially de-commodifies real estate as a medium for acquiring profit surplus. This of course is the counterview of what is commonly held to make good real estate investment sense. Such an approach rethinks the premise that growth sustains profit, and challenges the arguably dominant idea that sustainability is essentially the task of making resource and waste-intensive practices obsolete through technological change. Instead it recognises the embodied energy of existing brownfield improvements, and aims to redesign, re-use, reconnect and incrementally adapt these assets to human processes and interactions that reflect the natural environment. And the argument made here is that the only way to usher in this take on sustainability is to use the medium which is the unquestioned driver – financial inducements, or more precisely, the explication and dissemination of the profitability of this ‘radical’ sustainability perspective.

This view of obsolescence is one purported by McDonough and Braungart in their popular work “Cradle to Cradle” (2002). However, it seems the only way to make this type of structured obsolescence and rebirth work is to embrace a number of ‘carrot and stick’ financial incentives. And the community is perhaps more ready than ever to accept a major reconstruction of the property product that structured obsolescence implies. Such an argument is based on the observation that the community is increasingly exercising its role as a stakeholder, and becoming a more courageous, eloquent and opportunist as an advocate for rights and the environment. However, while there is a gradual redistribution of power measured by the increased visibility of community at the negotiating table, it is limited what organised communities can achieve in a society that is clearly captured by the desire to make money. For the empowerment of community to continue, either money will need to be demoted in our thinking, or it will need to be demonstrated that profit making that also encourages stronger environmental and social performance can be achieved. This latter approach appears to be infinitely more feasible.

What profit-building and obsolescence incentives can do is reinforce attitudes which suggest that wellbeing and the environment are not negotiable. This is after-all the over-arching message of the sustainability agenda. It is attitudes that drive behaviour change amongst consumers and investors, which in turn determines the nature of the real estate product. And examples of attitudinal change are clearly emerging. The green building phenomena is sufficient proof of this, despite its dependence on technological advancement in preference to natural system adaptation of existing stock. The step beyond more sustainable real estate investment to individual and community-wide life-style adjustments such as diminished private vehicle use, and more efficient and healthy eating, working and recreation still awaits many of us. Meanwhile though, if sustainable choices can be encouraged concerning the most important investment that many people make – their own home – attitudes towards real estate investment generally can begin to change at the grassroots. And this would appear to be a
relatively simple thing to do using a suite of well-targeted financial incentives and disincentives.

Incentives actually counter-act market failures such as the law of diminishing returns, which applies to much of what humans do. Nowhere is this law more evident than in the utilisation of the earth’s resources. The explosion of wealth since the advent of the industrial revolution has been underwritten by resource extraction, which inevitably finds expression in growth of all sorts. For two centuries this growth has also produced externalities that have been largely subsidised by communities of plants, animals and humans. However, it is news to nobody that natural stocks are not being replenished at the rate they are being absorbed. And with human stocks increasing on a number of levels – numerically, educationally, and economically – a crisis point is rapidly being reached. The point being made here is that over time, the accumulation of this social capital will inevitably result in a re-evaluation of natural stocks and the services they underwrite, together with a realignment of priorities and definitions of wealth. It is up to policy makers to facilitate this transition as efficiently and expeditiously as possible. Viewed in these terms, incentives are actually a risk reduction initiative that could well help us to avoid the worst elements of the looming crisis stemming from the outfall of climate change, peak oil and the like.

The beauty of obsolescence incentives is that those who choose to continue to invest in unsustainable real estate assets will actually find themselves disadvantaged in the market place. Investors who do embrace a ‘robust’ sustainability will begin doing better than non-ethically based investors in the short and long terms. Markets may be expanding, but so are market choices. Over time an empowered and increasingly aware community can be expected to make choices in their own interests. Those firms that understand this and begin to incorporate community and ecologically inspired visions into their real estate investment plans will be the first to take advantage of this market shift.

Incentives and the Market

A fundamental problem stalling the emergence of a culture of sustainable real estate is that investors typically are hesitant to purchase non-mainstream property until they have a clear idea of how the market is likely to respond to the product over time. This is compounded by the relative absence of economic models that clearly demonstrate the profitability of sustainability in a broader sense. And even when investors take sustainability seriously, they have little way of demonstrating how their acquired assets are creating value, even if efficiencies are meticulously measured. This is largely because it is inherently difficult to describe what sustainability actually looks like, and to picture the profitable images that it can be conclusively linked to. Moreover, the key performance indicators (KPIs) selected in order to benchmark sustainability are often inadequate proxies for the messages owners are attempting to disseminate.

Complicating the issue of reporting on the sustainability of real estate assets is the assertion that sustainability clearly means different things to different people. This is despite the positive images conveyed by heart-warming images such as dolphins, pandas and koalas used in prominent environmental agency logos. It is however aggregated in a more quantified sense through environmental system tools such as energy rating stars for whitegoods and eco-labelling for buildings (Blum et al. 2001), while being loosely associated with the colour green. As such, sustainability usually ends up being marketed as a consumer choice rather
than as a stamp of validation, and the greenwashing of product without substantive attention to sustainability detail is a common practice.

Rampant greenwashing is occurring within a context of increasing investment in brand building, as it is commonly held that brand is key to acquiring and maintaining market share. It makes sense then that embracing and reporting the take-up of sustainability incentives, and better still, an integrated process-based approach to sustainability, is an effective way of helping to build brand. It can do this by recognising the connection between initiative and outcomes, and providing a degree of rigour to what can otherwise be criticised as idle claims that pay lip-service to environmental concerns. And importantly, incentives provide a level of financial assurance for new sustainability initiatives relating to real estate, helping with economic modelling and risk management, which is a fundamental part of business case assembly.

Canvassing various incentives is beyond the scope of this paper, although this is the subject of research I have presented elsewhere (Kimmet 2005). What is worth mentioning though is that in the area of commercial property at least, there are as yet no identifiable incentives being sponsored by many governments beyond a few token awards that are handed out from time to time.

What is focussed on here though is the best-equipped institutional frameworks for advancing and administering incentives. I have argued elsewhere that the regulative or ‘stick’ approach to sustainability sits comfortably within the auspices of government (2003). While clearly important, regulations are inevitably minimalist by design, they do ensure that everybody observes the ‘rules of the game’. The complementary ‘carrot’ incentive strategies are not so effectively facilitated by government, which is reflected by the dearth of incentives usually offered. This may suggest that incentives are better distributed by real estate industry experts themselves. The resultant peer review which is almost inevitable in this approach can also help to facilitate the movement towards commonly accepted goals. This process holds a great deal of promise with respect to bringing about wholesale shifts in the way things are understood and done. Industry representative bodies are well-placed to encourage members to see themselves as stakeholders with a vital role to play in building a more sustainable society, and not just consider their own real estate interests (Kimmet 2007). As Tillett explains in his analysis of the work of C.I. Barnard:

“The equilibrium of the organization is not based on the individual alone but also on other organizations, and the larger society. Thus, any kind of social change, in the economy, the distribution of power in society, or the labour market, will alter the organization, even though the goals of the organization may not formally change. The relationship of the organization to the environment is not static but a functional one” (1970:314-315).

This suggests that the organisation, as the instrument of real estate marketing and investment, can be, and perhaps can only be, re-oriented towards sustainability by changes within society itself. This echoes Robert Putnam’s observation that “economics does not predict civics, but civics does predict economics, better even than economics itself” (1993:6). And as our current society is so caught up in making money, it is the prospect of making even more of it that is most likely to generate real change in the mainstream.
Indeed, it is the rationality of money making that helps to explain why there is a tendency in real estate investment to interpret economic sustainability to mean sustaining a profit surplus. This is despite such a conception defying the obvious limits to the prolific use of non-renewable resources by modern society. True, much scope remains for accumulating wealth by means of renewable resources (Hawken et. al. 1999). However, the distribution of wealth and its ultimate conversion into goods and services inevitably builds pressure on finite natural capital stocks. This realisation is forcing legislators to respond to these limits, contributing to a politics that is presiding over the establishment of an institutional infrastructure that will potentially enable utility to begin usurping money as the overarching goal of real estate investment. However, money is likely to remain the means, if not the ultimate goal, for the foreseeable future.

**Institutionalising Incentives**

At around the time that many changes in the political ecology agenda were being set in motion by the 1972 UN Conference on the Human Environment held in Stockholm, J.K. Galbraith identified three possible strategies for environmental protection (1973:305). Two of these he dismissed as impractical or irrelevant. One was ‘neo-classical solutions’, and the other was ‘limits to growth’. The third solution, which he pointed out was already being done, was legislative control, a “remedy which circumstance and the absence of a more acceptable alternative are forcing upon the modern state” (1973:307). And a by-product has been the emergence of a broad spectrum of institutions, bound together by the various strands of environmental regulation (Stavins 2004).

However, one thing that has become increasingly clear over the last 3 decades or so of focussed international pressure is the limits of this environmental regulation. Even when information is rich, well managed and navigable, it does little in itself to drive behaviour change. It must be couched in the underlying value system, which is clearly material and consumerist. This is why financial incentives modelled on a micro-economic approach to investment has such a significant role to play. Indeed, it is argued here that such an approach can promote the multiplier effect in sustainable development and management in the property sector in the same way as expansionary monetary policy encourages investment and employment growth in the wider economy.

The implication from these developments in society in terms of attempting to sell the profit-building/obsolescence hybrid model is that incentives need to likewise become institutionalised. In a practical sense this means that industry representatives and policymakers alike must embrace the premise that profits cannot be insulated from externalities if sustainability in any meaningful way is going to be pursued. This realisation, it is argued here, can only possibly grow out of a politics of social responsibility, which sees sustainable real estate beginning to trade on its comparative advantage in a market informed by champions and advocates for society and the environment. But these champions must in the first instance trade-off profits for public good outcomes, and it is only financial incentives that will allow them to do this both realistically and successfully. A supporting politics will also be needed to persuade government and the property industry to support an innovative approach to real estate investment that reduces the externalities of transactions, and internalises the societal and environmental costs that remain.

It is further argued that reporting real estate performance as it is currently practised is simply inadequate for progressing toward a sustainable real estate future. Everett and Neu point out,
for instance, that Environmental Accounting (EA) focuses on win-win, technocratic and procedural solutions to problems created by slavish devotion to capital accumulation. From this perspective, EA is merely a ‘bandaid’ on a festering crisis created by economically structured flaws in corporate and social relationships relating to the environment. They argue that EA links up with a dominating discourse assuring us that progress is being made with social and environmental solutions, while it “distracts us from asking the difficult questions regarding the role of environmental accounting in perpetuating unequal and exploitative social relations” (Everett and Neu, 2000:5).

Everett and Neu’s argument positions ‘sustainable development’ as a real estate opportunity to expand into emerging markets, possibly make short-term profits, and most certainly assist survival in an increasingly competitive market place (Howes and Singh, 1999). Such motivations clearly further encourage the ‘greenwashing’ of real estate entities. As Everett and Neu (2000:6) point out, “the end result [of EA] is often similar to that which Neimark observed regarding the ‘real estate of ethics’: that ‘the official discourse of real estate ethics reassures us that the system is working’” (1994:85). Furthermore, Everett and Neu’s reasoning that the calculation of the economic values of nature is ‘enumerating’ the environment in monetary terms, and is therefore a form of economic rationalism. It follows that sustainability reporting sits comfortably within neo-liberal discourses appealing “to voluntary action and market mechanisms, which come to be seen as a means of enhancing rather than undermining environmental quality” (Everett and Neu, 2000:9). And what Harvey says about ecological modernisation appears to also apply:

“As a discourse, ecological modernization internalises conflict…It is reformist in its objectives…but…poses no deeply uncomfortable questions to the perpetuation of capital accumulation, though it does imply strict regulation of private property rights. Such a discourse can too easily be corrupted into yet another discursive representation of dominant forms of economic power” (1998:343).

McDonough and Braungart agree that sectors such as the property industry “assess their health as they always have – economically – and then tack on bonus points for eco-efficiency, reduced accidents or product liabilities, jobs created, and philanthropy” (2002:153-4). However, they see a significant difference when sustainability becomes the main driver rather than considered as an afterthought (2002:154). This is aligned with the emerging literature associated with resource efficiency and cleaner production, neatly captured in the title of the book *Natural Capitalism* (Hawken et al, 1999), notwithstanding a large preceding body of research dating back to Aldo Leopold’s publication of *Game Management* in 1933. This literature underscores the importance of measuring and valuing the environment for the purpose of schooling industry in the art of environmental friendliness, and assumes the sustainability of systems of capital exchange enlarged by human, social and moral criteria. But the point made here is that these capital exchange systems are currently biased against resource optimisation and renewal, effectively subsidising inefficiency and waste, as long as nominal efforts are made to curb excesses. Financial incentives that favour social and environmental systems are needed to re-balance the three-sided, triple bottom line equation.

As Paul Greenfield and Tor Hundloe (2000:5) further explain, capitalism “encompasses the variety of institutions and behaviours that go to form a society”. They point out that “some types of institutions and arrangements tend to work better than others in promoting social harmony and, as a consequence, greater economic and environmental well-being” results
And if harnessed skilfully by means of well targeted incentives, the institution of self-interested profit-making stands out above the pack as an instrument for harmonizing industry with its human and natural environment.

Conclusion

If we are to assume, as I argue in this paper that we should, that real estate investment is fundamentally focussed on profit making, the question for those concerned about sustainability must surely be ‘profit for whom, how, and for how long?’ If sustainability implies profit-sharing in a public good sense, then all proceeds must somehow meaningfully account for the net effect of producing and consuming these profits on the Earth’s finite natural stocks. Clearly all forms of sustainability accounting need to factor this in to their calculations. But this is a reactive response that is open to abuse from those who seek to pursue ‘investment as usual’. It is better to be governed by pro-active policy that makes a genuine attempt to ‘upset the apple cart before it goes to market’.

Incentives do get reflected in ‘market politics’ simply because they are attempts to correct market failure. And feeding the dynamism caused by well-targeted incentives back into the real estate industry – investment community conduit, is increasingly arguably what will sustain the property system over the longer term. And it can do this by sustaining profits, the planet, and people in what amounts to an engineered equilibrium lubricated by money. It may be true that sustainability is usually not embraced for pure profit motives. However, the main point of this paper is to stake the claim that the negligible scale that sustainability is being taken up reflects the hesitancy to celebrate radical sustainability as a profit driver. And it is argued that as the economic potential of sustainable real estate investment becomes more clearly understood, it appears inevitable that financial incentives that help facilitate a fundament transition into why and how we invest in property will become more common place. Earlier implementation of financial incentives could only speed up this process.

References:


