ASSESSING THE LINKAGES BETWEEN CORPORATE SOCIAL RESPONSIBILITY AND A-REIT PERFORMANCE

GRAEME NEWELL
University of Western Sydney

HSU WEN PENG
National Taipei University

and

SHARON YAM
University of South Australia

ABSTRACT

Corporate social responsibility (CSR) has taken on increased significance in the property sector in recent years. This paper assesses the level of CSR practices by A-REITs across the environmental, social and governance dimensions of CSR and compares this to other ASX sectors. A number of unique CSR A-REIT performance indices are developed for A-REIT investors committed to the principles of CSR, and their added-value assessed via risk-adjusted performance analysis and their portfolio diversification benefits. Importantly, these CSR A-REIT indices do not significantly under-perform the conventional A-REIT indices, as well as providing portfolio diversification benefits. The CSR A-REIT investment implications are also highlighted.

Keywords: Corporate social responsibility, A-REITs, benchmarking, CSR A-REIT performance index, risk-adjusted returns, portfolio diversification

INTRODUCTION

Corporate social responsibility (CSR) has taken on increased importance in recent years (Capaldi, 2005; Sparkes and Cowton, 2004), across the three key CSR dimensions of environment, social and governance issues. This has seen socially responsible investment (SRI) become an integral part of mainstream investment practices and markets, accounting for over US$11 trillion globally (Eurosif, 2010). In

Australia, SRI accounts for approximately $100 billion, with both traditional investors (eg: AMP, BT, Challenger, Vanguard) and specialist ethical investors (eg: Hunter Hall, Australian Ethical, Warakirri Charitable).

Catalysts to CSR at a local and global level include the Kyoto Protocol, UN Principles of Responsible Investment, UN Environment Program Finance Initiative, Global Reporting Initiative, and the Institutional Investors Group on Climate Change. At a property level, this has been supported by the establishment of Green Building Councils in over 25 countries (including Australia), and the implementation of responsible property investment (RPI) and socially responsible property investment (SRPI). This has been supported by both tenant demand and investor demand; as well as Australian government legislation, including mandatory disclosure of energy efficiency (2010) and building energy efficiency certificates (2011) and the establishment of the Green Building Fund for retrofitting existing commercial buildings.

Importantly, as well as the risk reduction and future proofing benefits, international evidence has recently emerged regarding the business case for green buildings, with a demonstrated green premium seen for US commercial property (Eichholtz et al, 2009, 2010; Fuerst, 2009; Fuerst and McAllister, 2009, 2011; Miller et al, 2008, 2009; Pivo and Fisher, 2010). These developments in CSR and SRPI have been actively supported by the leading property investors in Australia and internationally (eg: Lend Lease, Land Securities, British Land, PruPim, Hermes and Prologis). In particular, many REITs in Australia (A-REITs) have actively supported CSR and SRPI; often being world leaders in this area (eg: GPT, Stockland).

This CSR and SRPI momentum has seen recent CSR and SRPI research largely focused on:

- assessing the added premium for green buildings (eg: Demisi, 2009; Eichholtz et al, 2009, 2010; Fuerst, 2009; Fuerst and McAllister, 2009, 2011; Miller et al, 2008, 2009; Pivo and Fisher, 2010)
- identifying CSR and SRPI drivers (eg: Ellison et al, 2007; Falkenbach et al, 2010; RREEF, 2010)
- identifying CSR and SRPI best practice strategies by property companies in various countries (eg: Newell, 2008, 2009b, c; Newell and Manaf, 2008; Pivo, 2008)
- assessing CSR and SRPI performance (eg: Newell, 2009a; Rapson et al, 2007)
- assessing the corporate governance of REITs (eg: APREA, 2010; Bauer et al, 2010; Bianco et al, 2007; EPRA, 2009; Hartzell et al, 2006).

Given the stature of A-REITs as major property investors and their overall strong commitment to CSR and SRPI, it is important to assess whether this commitment to CSR is matched by investment performance. As CSR A-REIT performance indices are not commercially available to assess this issue, this research develops three unique CSR A-REIT performance indices (environment, social, governance) and empirically assesses the risk-adjusted performance and portfolio diversification benefits of these CSR A-REIT indices in a mixed-asset portfolio in Australia over August 2005-July 2010.

SIGNIFICANCE OF CSR IN THE A-REIT SECTOR

A-REITs are the largest property investment sector in Australia, as well as being the 2nd largest REIT market globally (Macquarie Securities, 2011). In 2010, A-REITs had over $140 billion in property assets under management, consisting of over 3,800 properties in Australia and internationally, covering diversified and sector-specific portfolios (PIR, 2010). The leading A-REITs include Westfield, Stockland, GPT, Mirvac and Goodman. Importantly, A-REITs overall have shown a major commitment to CSR (Newell, 2008) and some A-REITs are recognized as global leaders in CSR and SRPI; particularly concerning CSR reporting (eg: GRI format), CSR strategy, CSR performance reporting (eg: NABERS ratings, GreenStar) and CSR implementation at all levels. This section highlights the stature and significance of A-REITs concerning CSR.

Figure 1: Dexus CSR report: 2010

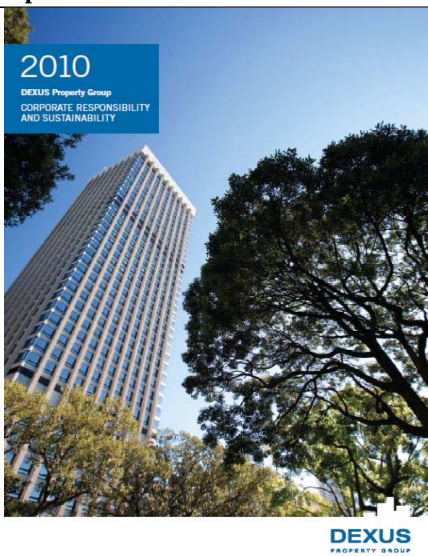
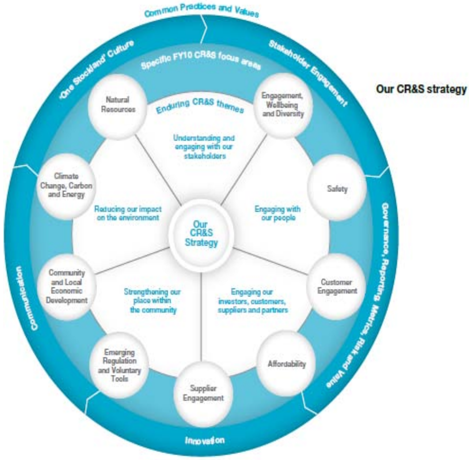


Figure 2: Stockland CSR strategy: 2010

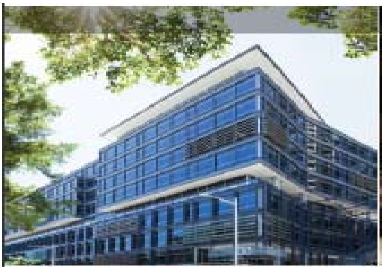


Many A-REITs produce significant CSR reports (eg: see Dexus CSR report at Figure 1), as well as having clearly articulated CSR strategies (eg: see Stockland CSR strategy at Figure 2). This sees many A-REITs having significant portfolios of highly-rated NABERS and GreenStar commercial properties (eg: see major commercial properties in Dexus and GPT portfolios in Figure 3).

Several A-REITs are also key constituents of the various global CSR performance measures (see Table 1); including the FTSE4Good Index, the Dow Jones World Sustainability Index (DJWSI) and the Global 100. In each case, they figure prominently and well above their percentage contribution to the Australian companies and global property companies included. In particular, GPT is rated the #1 property company in the real estate sub-sector of the DJWSI (see Figure 4 for GPT CSR profile in DJWSI), as well as the Global 100 having Stockland, GPT and Dexus rated as the #24, #47 and #97 most sustainable corporations globally.

Figure 3: Major sustainable properties in A-REIT portfolios

Dexus:



The Bond, Sydney, NSW

Dexus:

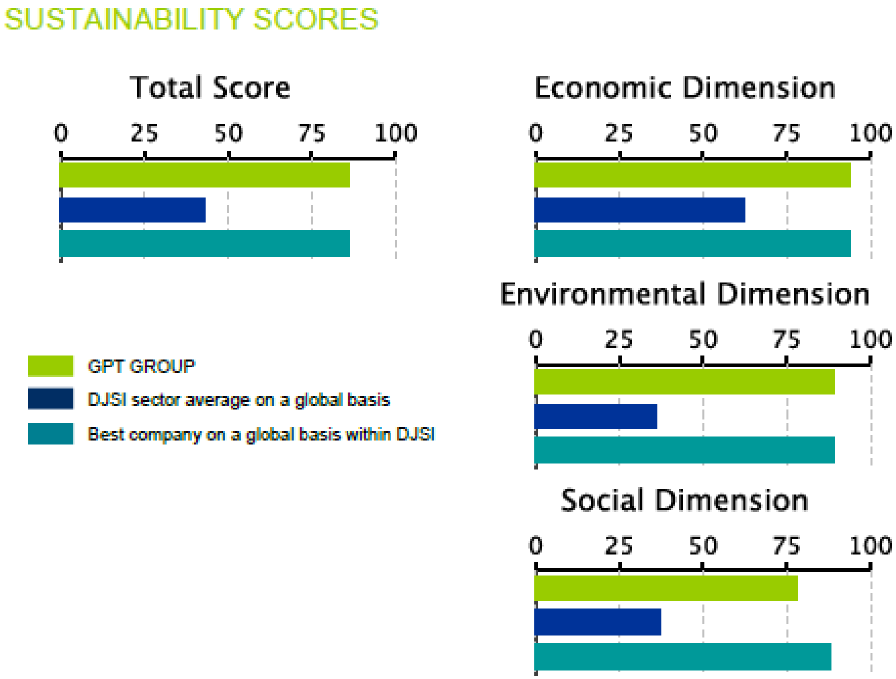
1 Bligh Street, Sydney, NSW

GPT:

One One One Eagle Street, Brisbane, QLD

workplace⁶, Pyrmont, NSW

Figure 4: Dow Jones World Sustainability Index profile: GPT



Source: DJWSI (2010)

Table 1: A-REIT significance in global CSR performance measures: 2010

FTSE4Good Index

- comprises 657 listed companies, with total market capitalization of US$11.4 trillion
- number of Australian companies: 34
- number of property companies globally: 29
- number of A-REITs: 8
- contribution by A-REITs to Australian component: 8/34 = 24%
- contribution by A-REITs to property companies component: 8/29 = 28%
- eight A-REITs included are CFS Retail, Charter Hall Office, Commonwealth Property Office Fund, Dexus, GPT, Mirvac, Stockland, Westfield

Dow Jones World Sustainability Index

- comprises 318 listed companies, with total market capitalization of US$9.2 trillion
- number of Australian companies: 18
- number of property companies globally: 20
- number of A-REITs: 6
- contribution by A-REITs to Australian component: 6/18=33%
- contribution by A-REITs to property companies component: 6/20=30%
- six A-REITs included are CFS Retail, Commonwealth Property Office Fund, Dexus, GPT, Mirvac, Stockland

Global 100 Index

- 100 most sustainable corporations globally
- number of Australian companies: 9
- number of property companies globally: 5
- number of A-REITs: 3
- contribution by A-REITs to Australian component: 3/9=33%
- contribution by A-REITs to property companies component: 3/5=60%
- three A-REITs included are Stockland, GPT, Dexus

Sources: Corporate Knights (2010), Dow Jones (2010), FTSE (2010)

Other measures of A-REIT stature in CSR performance measures include:

- GPT, Stockland and Commonwealth Property Office Fund being ranked 1st, 3rd and 5th respectively of the 211 listed property companies globally assessed for environmental management practices and implementation in the Environmental Real Estate Index developed by the European Centre for Corporate Engagement (Kok et al, 2010)

- Commonwealth Property Office Fund, Mirvac, Stockland and Westfield are included in the Australian Carbon Disclosure Leadership Index (Carbon

Disclosure Project, 2009), which assesses carbon risk management practices and procedures, with A-REITs comprising 13% of companies in this CSR index

- A^+ ratings for their Global Reporting Initiative compliance (GRI, 2010) with A-REIT CSR reports; eg: Stockland, Dexus,

with several A-REITs also figuring prominently in the various property industry CSR awards (eg: PCA, API, UDIA, ULI) and government awards (eg: DECC). This has seen those A-REITs with a strong CSR mandate actively supported by the various ethical investors and SRI funds; eg: AMP, BT, Challenger, ING and Vanguard.

This commitment to CSR goes beyond just those leading A-REITs mentioned above. The A-REIT sector overall has shown a strong commitment to CSR in recent years. This will be clearly demonstrated in a subsequent section in this paper where the A-REIT sector is benchmarked for CSR practices against the other main subsectors on the Australian stockmarket.

All of the above aspects highlight the stature of A-REITs regarding CSR, and reinforces the need for CSR A-REIT performance indices to be developed for investment decision-making to assess their CSR commitment and the link to the corresponding A-REIT investment performance.

METHODOLOGY

UBS produce a range of benchmark A-REIT performance indices, representing the office, retail, industrial, stapled securities and international A-REIT sub-sectors (UBS, 2010). No CSR A-REIT performance indices are currently available for investment decision-making by A-REIT investors committed to the principles of CSR, despite the strong commitment and achievements to CSR by A-REITs. Similarly, equivalent CSR REIT indices are also not available in other REIT markets (eg: US). This section outlines the methodology used in constructing these unique CSR A-REIT indices to be used in these analyses.

Corporate Monitor is an independent research organization with over twelve years experience in rating and monitoring the environment, social and governance responsibilities of the major Australian companies. Corporate Monitor has Australia's most extensive database available on the non-financial performance of Australian companies. Corporate Monitor (www.ethicalinvestor.com.au) produces CSR ratings for all ASX200 listed companies, with ratings given for the environment, social and governance dimensions of CSR on a 1-5 star rating scheme. These ratings use a wide range of information sources to gain a full perspective on the environmental impact, social engagement and corporate governance for these ASX200 companies; this includes company reports and third party reports (eg: regulators, NGOs). The rating criteria for these three CSR dimensions are given Table 2, with the interpretation of the 1-5 star rating schemes also given in Table 2. These Corporate Monitor CSR ratings have not been used previously in property research publications. Sixteen (16) A-REITs were included in the ASX200 at June 2010, are CSR-rated by Corporate Monitor and form the basis for this CSR analysis[1].

Table 2: Corporate monitor CSR rating criteria

Environmental rating factors

- Environmental impact of products and services
- Environmental reporting
- Environmental management
- Penalties for environmental non-compliance
- Environmental awards
- Pollution levels to air, land and water

Social rating factors

- Community relations and philanthropy
- Human rights
- Indigenous issues
- Involvement in weapons and defence equipment
- Products associated with social problems (eg alcohol, tobacco, gaming)
- Employee relations

Governance rating factors

- Board/committee structure and independence
- Legal compliance (eg corporate governance, trade practices, fair trading)
- Instances of organised shareholder activism
- Governance awards
- Executives, directors and auditors remuneration levels

Interpretation of CSR rating system

Rating	Environment	Social	Governance
★	Adverse	Adverse	Questionable
★★	Developing	Disengaged	Patchy
★★★	Compliant	Responsive	Compliant
★★★★	Sustainable	Engaged	Proactive
★★★★★	Best practice	Best practice	Best practice

While a 3-star rating or better is considered a proactive level by Corporate Monitor for each of the three CSR rating dimensions, A-REITs were required to have a 4-5 star

[1] While 43 A-REITs are listed on the ASX, only those in the ASX200 are given CSR ratings by Corporate Monitor

rating to be included in the CSR A-REIT indices developed in this research. This ensured only A-REITs with a strong demonstrated commitment were included in the respective CSR A-REIT indices. Based on this eligibility criteria, the following numbers of the sixteen A-REITs assessed by Corporate Monitor were included in these CSR A-REIT indices:

- A-REIT environment index: 7 A-REITs included, comprising 45% of the ASX200 A-REIT market cap.

- A-REIT social index: 6 A-REITs included; comprising 43% of the ASX200 A-REIT market cap.

- A-REIT governance index: 4 A-REITs included; comprising 34% of the ASX200 A-REIT market cap;

Table 3: A-REIT constituents in CSR A-REIT indices

A-REIT	Environment	Social	Governance
CFS Retail	✓	✓	
Charter Hall Office	✓		
Commonwealth Property Office Fund	✓	✓	
Dexus	✓	✓	✓
GPT	✓	✓	✓
Mirvac	✓	✓	✓
Stockland	✓	✓	✓

with the specific A-REITs included in each index shown in Table 3. This saw four A-REITs included in all three CSR A-REIT indices; namely Dexus, GPT, Mirvac and Stockland, reflecting their strong leadership in the CSR agenda. The remainder of the 16 A-REITs in the ASX200 not included in each of these three CSR A-REIT indices were included in the respective non-environment, non-social and non-governance A-REIT indices; comprising 9, 10 and 12 A-REITs respectively[2].

Using the individual A-REIT returns from Datastream, the three resulting CSR (and non-CSR) A-REIT indices were established as monthly market-cap weighted total return series over the five-year period of August 2005 – July 2010. This five-year period was chosen as it represents the timeframe when CSR was an increasingly important agenda item in the A-REIT corporate mandates. For a comparison of these CSR A-REIT series with the major asset classes, the equivalent benchmark ASX200

[2] Inclusion in these non-CSR A-REIT indices does not infer the A-REIT does not have a CSR mandate; it simply infers they are not in the top-level A-REITs rated in these three CSR dimensions.

shares series and 10-year bond series were also used. Risk-adjusted returns were assessed, as well as inter-asset correlations used to assess the portfolio diversification benefits of these CSR A-REITs in an Australian mixed-asset portfolio. Direct property (eg: IPD) was not included in this analysis, as it is only available quarterly over this period.

RESULTS AND DISCUSSION

CSR A-REIT performance comparison

To further validate the stature of A-REITs across the three CSR dimensions of environment, social and governance, the average Corporate Monitor star ratings for the three CSR A-REIT sectors were compared to the other main sub-sectors in the ASX200. These CSR performance comparisons are shown in Table 4. In each case, the average rating for the CSR A-REIT index constituents were above that seen for all other ASX sub-sectors. The average performance of all ASX200 A-REIT index constituents was also comparable to the other leading CSR sectors on the ASX (eg: financials, telecommunications); further demonstrating the commitment to CSR by the overall A-REIT sector, not just those leading A-REITs included in these CSR A-REIT indices.

Table 4: CSR A-REIT performance comparison

Environment rating comparison	
A-REITs (Env. index): 4.14	Healthcare: 3.27
A-REITs (Non-Env. index): 3.00	Industrials: 2.81
A-REITs (all): 3.50	Information technology: 3.00
Financials: 3.50	Materials: 1.98
Consumer discretionary: 3.00	Telecommunications: 4.00
Consumer staples: 2.63	Utilities: 3.25
Energy: 2.33	
Social rating comparison	
A-REITs (Social index): 4.00	Healthcare: 3.18
A-REITs (Non-Social index): 2.50	Industrials: 2.61
A-REITs (all): 3.06	Information technology: 2.50
Financials: 3.54	Materials: 2.47
Consumer discretionary: 2.27	Telecommunications: 4.00
Consumer staples: 3.00	Utilities: 2.75
Energy: 2.56	
Governance rating comparison	
A-REITs (Gov. index): 4.00	Healthcare: 2.55
A-REITs (Non-Gov. index): 2.75	Industrials: 2.64
A-REITs (all): 3.06	Information technology: 3.50
Financials: 3.25	Materials: 2.55
Consumer discretionary: 2.41	Telecommunications: 2.67
Consumer staples: 3.13	Utilities: 2.50
Energy: 2.50	

Risk-adjusted returns

Table 5 presents the CSR A-REIT risk-adjusted performance analyses over August 2005 – July 2010, with all sectors clearly impacted by the global financial crisis; evidenced by reduced returns and higher risk. The CSR A-REIT sectors delivered comparable returns to the equivalent non-CSR A-REIT sectors, showing no evidence of significant under-performance by these CSR A-REIT indices. Higher risk was evident in each of the CSR A-REIT sectors compared to their equivalent non-CSR A-REIT sector, with this reflecting the relatively small number of index constituents in each case (ie: 7, 6 and 4 A-REITs respectively) and the significant impact of the GFC on the A-REIT sector. On a risk-adjusted returns basis, comparable risk-return ratios were evident for the environment and social A-REIT indices, with lower risk-adjusted returns seen for the governance A-REIT index. Importantly, A-REIT corporate governance has been a key issue to emerge from the GFC for A-REIT recovery and ongoing success; particularly focused on the role of the board of directors, the role of independent directors and the issues of disclosure and transparency in corporate decision-making. Shares and bonds out-performed all A-REIT sectors (both CSR and non-CSR) over this period, reflecting the more significant impact of the GFC on A-REITs than shares (Newell and Peng, 2009).

Table 5: CSR A-REIT risk-adjusted performance analysis

Index	Average annual return	Risk	Risk-return ratio
Environment	1.04%	24.88%	23.92
Non-Environment	1.14%	20.45%	17.94
Social	1.20%	24.53%	20.44
Non-Social	1.13%	20.66%	18.28
Governance	-2.94%	30.73%	-10.45
Non-Governance	2.03%	19.34%	9.53
Shares	4.90%	16.23%	3.31
Bonds	5.86%	7.24%	1.24

Portfolio diversification

Table 6 presents the CSR A-REIT inter-asset correlation matrix for August 2005 – July 2010. Some degree of portfolio diversification benefit was evident in each of the CSR A-REIT sectors with the equivalent non-CSR A-REIT sectors; ie: environment (r=0.74), social (r=0.75) and governance (r=0.70). Comparable diversification benefit was seen for each of the CSR A-REIT sectors with shares compared to the non-CSR A-REIT sectors with shares; namely environment (r=0.66 versus r=0.62), social (r=0.64 versus r=0.64) and governance (r=0.65 versus r=0.63). Comparable portfolio diversification benefits were seen for each of the CSR A-REIT sectors with shares (r=0.66, r=0.64 and r=0.65).

Table 6: CSR A-REIT inter-asset correlation matrix

	Environment	Non-Environment	Social	Non-social	Govern.	Non-Govern.	Shares	Bonds
Env.	1.00							
Non-Env.	0.74*	1.00						
Social	0.99*	0.74*	1.00					
Non-Social	0.76*	0.99*	0.75*	1.00				
Govern.	0.98*	0.68*	0.98*	0.69*	1.00			
Non-Govern.	0.78*	0.99*	0.77*	0.99*	0.70*	1.00		
Shares	0.66*	0.62*	0.64*	0.64*	0.65*	0.63*	1.00	
Bonds	0.10	-0.10	0.10	-0.10	0.11	-0.08	-0.01	1.00

*: significant (P<5%)

CSR A-REIT dynamics

To examine the dynamics of CSR A-REIT performance over this period, rolling three-year analyses were done over August 2005 – July 2010, with the dynamics of CSR A-REIT risk and correlation with shares assessed. The changes in the CSR A-REIT risk over this period are shown in Table 7, with all sectors experiencing increases in risk due to the impact of the GFC on A-REITs. These increases in risk were more evident in the CSR A-REIT indices than for the non-CSR A-REIT series; again, likely to be influenced by the smaller number of A-REITs in the respective CSR A-REIT indices.

Table 7 also presents the dynamics of the CSR A-REIT correlations with shares over this period. Each of the CSR A-REIT series showed consistent correlations with shares over this period; namely environment (r=0.68 to r=0.68), social (r=0.67 to r=0.66) and governance (r=0.69 to r=0.66), reflecting consistent portfolio diversification benefits. In contrast, each of the non-CSR A-REIT series showed increased correlations with shares; namely non-environment (r=0.60 to r=0.67), non-social (r=0.61 to r=0.69) and non-governance (r=0.59 to r=0.68), reflecting some loss of portfolio diversification benefits by these non-CSR A-REIT sectors.

Overall, this has seen the CSR A-REIT sector take on more risk relative to the non-CSR A-REIT sector over this period, with this being offset by enhanced portfolio diversification benefits by the CSR A-REIT sector with shares relative to the non-CSR A-REIT sector with shares.

Table 7: CSR A-REIT dynamics: August 2005-July 2010*

Rolling risk analysis

- Environment: 18.2%→30.6%: 68% increase
- Non- Environment: 16.3% →24.3%: 49% increase
- Social: 18.4% →30.1%: 64% increase
- Non-Social: 16.3% →24.7%: 52% increase
- Governance: 20.6% →38.4%: 86% increase
- Non-Governance: 16.0% →22.9%: 43% increase
- Shares: 13.1% →19.2%: 47% increase

Rolling correlation analysis

- Environment: 0.68 →0.68
- Non-Environment: 0.60 →0.67
- Social: 0.67 →0.66
- Non-Social: 0.61 →0.69
- Governance: 0.69 →0.66
- Non-Governance: 0.59 →0.68

*: values given in table show changes in risk and correlations over this 5-year period, with the first value for August 2005-July 2008 and the second value for August 2007-July 2010

A-REIT AND CSR IMPLICATIONS

With an increased role by CSR at all levels in investment practices, and an active leadership role in CSR at the local and international level by many A-REITs (eg: GPT, Stockland, Dexus, Mirvac), this paper has been the first empirical analysis to assess the risk-adjusted performance of A-REITs with a significant CSR mandate and achievement track record. In particular, the first CSR A-REIT performance indices were constructed, and their risk-adjusted returns and portfolio diversification benefits assessed over August 2005 – July 2010; being benchmarked against other A-REITs, shares and bonds. These are also the first CSR REIT indices to be developed internationally. Whilst being adversely impacted by the effects of the GFC on A-REITs, this analysis showed that CSR A-REITs did not significantly under-perform non-CSR A-REITs, with evidence of portfolio diversification benefits for CSR A-REITs versus non-CSR A-REITs.

With the expected increased significance of CSR in the property sector in the future, these unique CSR A-REIT indices will take on more significance as effective and objective benchmarks of CSR A-REIT performance for A-REIT investors committed to the principles of CSR and SRPI. As the A-REIT sector recovers from the impact of the GFC, this will provide a longer perspective to effectively monitor the performance of CSR A-REITs and assess their strategic contribution to a mixed-asset portfolio.

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Email contact: g.newell@uws.edu.au