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Environmentally sustainable real estate attracts higher prices

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Buildings with better sustainability credentials are achieving markedly higher capital values and rents, global real estate consultant JLL has revealed.

JLL's Sustainability and Value – London Offices Investment report provides a hedonic analysis of almost 600 transactions in a five-year period. It demonstrates that the market is increasingly attaching higher prices to more sustainable assets, in anticipation of higher returns and lower risks. The data also shows that this is resulting in improvements being made to the environmental performance of London's office stock.

The research from JLL examined 592 'pure' office investment deals that took place in Central London between January 2017 and December 2021. Development, refurbishment and portfolio deals were excluded. Deals were matched for age, size and location, and both Building Research Establishment Environmental Assessment Method (BREEAM) and Energy Performance Certificate (EPC) status. A 'hedonic pricing' model means the impact of environmental accreditation can be isolated from other effects, such as building age.

JLL's results show that both BREEAM and EPC certification produce a clear premium for most measures. Capital values were on average 20.6% higher as a result of BREEAM certification, with a single step improvement in EPC ratings producing a corresponding premium of 3.7%. Similarly, the average increase in rents associated with BREEAM certificates and a step improvement in EPC were 11.6% and 4.2% respectively.

According to JLL sustainable buildings are likely to drive greater interest from occupiers on account of the reduced operating and energy costs. As more businesses sign up to net zero targets, the demand for sustainable buildings will increase, with BREEAM buildings likely to need less investment to reach required targets.

For investors, sustainable buildings should be considered less risky. Government regulation will continue to tighten on non-sustainable buildings as energy efficiency issues remain paramount. Exit yields for different grades of sustainable stock will also continue to widen, increasing the potential returns.

Jon Neale, head of UK research, said; “Considering the Central London office investment market is among the largest, most diverse, most liquid and most internationalised in the world, it offers a perfect laboratory in which to study an evident premium for ‘green’ real estate. This research demonstrates that there are now clear financial benefits associated with environmental certification.”

“With standards around buildings tightening, including stricter provisions in the Minimum Energy Efficiency Standards regulations this year, we have seen some funds introducing their own environmental targets to move ahead of regulation. It therefore pays to be on the front foot and invest in the green building sector now, rather than run the risk of facing ever-tighter regulation on non-compliant stock in the future.”

Emma Hoskyn, UK head of sustainability at JLL, added: “Our analysis clearly shows there is a financial, as well as environmental and social, benefit in refurbishing buildings so that they meet more rigorous criteria. As regulation and market demands increase, buildings that meet these criteria will be a safer and more rewarding investment than those that do not. With buildings accounting for close to 40% of global carbon emissions, investing in sustainable stock is key for decarbonising the built environment and meeting net-zero ambitions.”

Julian Sandbach, head of Central London office markets at JLL, concluded: “This research endorses what we have been witnessing in occupational and investment markets within Central London for some time, namely buildings with strong sustainability credentials will lease for premium rents and sell for premium yields.

“The strong trend of pre-letting, that has been such a feature of the London leasing market over the past few years, demonstrates that occupiers have adopted a meaningful shift in the types of buildings they want to operate their businesses from. They are cognisant that this is reflective of their strong social and governance credentials to their marketplaces. As we move forward in the decade, investors will only narrow their focus on the types of building they will buy and recognise that they will need to pay premiums for assets with strong sustainable fundamentals but equally expect that they will perform better. Developers and funding partners recognise that the creation of high quality, sustainable assets is likely to deliver out performance in the longer term, helping to mitigate some of the risks associated with ground up development.”