# EPCs and Beyond – A Property Industry Perspective

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# Introduction

REAL ESTATE
INVESTMENT
MANAGEMENT

- Introduction to PRUPIM
- How PRUPIM has prepared and implemented  a strategy for EPCs
- Threats and Opportunities for the future

# Introduction to PRUPIM

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- A Top 20 global real estate investment manager
- Over £15 billion invested in UK property
- Over 1000 properties under management
- Manages properties on behalf of client funds

# PRUPIM's Experience of EPCs

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- Established a guaranteed transaction service through Ascent Insurance Brokers using the expertise of Royal & Sun Alliance and Charterhouse
- Made provision for energy audits and operational ratings (DECs)
- Trialled methodology on selected properties
- Established priorities for and commenced advance certification of standing stock
- Drafted a budget
- Reviewed internal property transaction process to identify trigger point
- Now planning for EPCs in Scotland and air conditioning system surveys over 250kW

# Future Threats and Opportunities

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- Threats to asset value
  - "Non-Green" stock performing poorly compared to "Green"
  - Non-Green Buildings will experience
    - higher risks (a higher risk premium)
    - lower net income growth (lower rental growth / higher depreciation)
    - lower rents

# Future Threats and Opportunities

REAL ESTATE INVESTMENT MANAGEMENT

- Opportunities
  - Use the EPC and its recommendations in transaction negotiations
  - Incorporate EPC findings into Asset Management Plans
  - Use the operational energy performance of a building (eg via DEC or LES-TER) to put the EPC into context
  - Foster closer working between the investment specialists and those responsible for operational property management
  - Raise the importance of energy performance as a KPI for FM teams

# Carbon Reduction Commitment

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- Strategic Issue
  - All commercial landlords with annual electricity consumption over 6000MWh through HH Meters
  - 2009 consumption baseline year
  - 2010 Carbon Trading begins
  - Must identify and declare **ALL** energy consumed (95% accuracy)
  - League Table
  - Requires co-ordinated response and integrated services – utility bureaux, additional automatic meters, meter reading services, data base for storing/sharing landlord tenant consumption, Carbon Traders, energy suppliers, reduced energy consumption
  - Potential regulatory and bureaucratic minefield!!!

# EPCs and Beyond

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Thank You

# End of Presentation

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A further 4 slides follow which are intended to illustrate the potential effect on asset value of “Green” verses “non-Green”.

Courtesy of PRUPIM’s Head of research, Professor Paul McNamara

# Being ‘Non Green’ could affect Asset Value in a Number of Ways

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- Non-Green Buildings will experience
  - higher risks (a higher risk premium)
  - lower net income growth (lower rental growth / higher depreciation)
  - lower rents

# Hypothetical Differences between Green and 'Non Green' Buildings

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| | (Green) Property A | (Non Green) Property B |
|---|---|---|
| **Risk Free Rate (Rf)** | 5.50 | 5.50 |
| **Risk Premium ($R_p$)** | 2.25 | 2.40 |
| **Lower Net Income Growth (G)** | 2.25 | 1.95 |
| **Rental Income (10,000sf @)** | £30psf | £28.50psf |
| **Rent (p.a.)** | £30,000 | £28,500 |

# A Crude Establishment of 'Yield' – the Gordon's Growth Model



**Yield = Rf + Rp – G**

Property A, Yield = 5.50 + 2.25 – 2.25 = 5.50%

Property B, Yield = 5.50 + 2.40 – 1.95 = 5.95%

# Calculating Capital Values and Thinking about Future Relative Performance



**Capital Value = Income / Yield**

Property A, Capital Value = 30,000 / 0.055 = £545,455

Property B, Capital Value = 28,500 / 0.0595 = £478,992

**Property B is 88% of Property A.**

**If this is not reflected in current prices and rents but evolves over time, the 12% difference will emerge as underperformance of Property B over time, as its price 'corrects' to its new level as 'green' issues do become priced in.**