



REPUTATION, RISK AND REWARD:
The Business Case for Sustainability in the UK Property Sector

A report by the Sustainable Construction Task Group

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Summary

As one of the largest and most powerful industrial sectors in the UK today, the importance of sustainability for property and construction cannot be overstated. Companies within the UK property sector have managed to evade the sustainability agenda for quite some time. The property sector needs to change. Making a move towards corporate sustainability will mean ditching the cynicism that has defined the property and construction sector to date and recognising that the business environment has changed significantly in recent years.

A mixture of legislative pressure, market forces, investor concern and client demand requires that business strategies be reassessed. Companies will have to identify and report on their environmental and social impacts. They will have to grapple with the far-reaching implications of climate change. They will need to communicate with a wider group of stakeholders. Community engagement will become more important; resource efficiency will have to become standard practice. Demonstrating care, concern and good practice in all of these areas will protect and build companies' reputations. As is becoming clear, the reputation of both the property and construction industries is not good in many quarters. And reputation matters, as this paper will show. Ignore sustainability and your reputation is on the line.

The extent to which the property industry moves towards greater levels of sustainability lies squarely in the hands of the executives and directors of the UK's property developers and property management companies. Those chief executives and opinion formers within the sector who move quickly and dynamically to embrace the corporate, social and environmental challenge documented here will be more than just champions for a 'good cause'. As this paper details, in the years ahead they will reap the very tangible rewards that sustainability can offer and will leave their competitors standing. The benefits will be felt far beyond the worlds of property development and construction. A more sustainable property market will have a vital part to play in ensuring that the UK itself faces a healthier, more competitive and sustainable future.

Purpose

This paper is addressed primarily to chief executives, board members and senior managers in property development and property asset management; as their business partners and key suppliers, it should also be of interest to executives in the construction sector. The purpose of the paper is to demonstrate that sustainability is an issue that business leaders can no longer afford to ignore or treat as immaterial. This paper aims to demonstrate that sustainability issues are of critical and strategic importance to business. For companies in the property sector it will outline the business case for high-level strategies and policies designed to address the risks and opportunities posed by sustainability.

While a significant amount of material is available on how to design, build and benchmark more sustainable buildings, this paper focuses on an area that has been little addressed: the strategic management challenges facing business leaders in the property and construction sectors. We hope that it will inform the debate on sustainability in government and non-commercial quarters.

Introduction

'It's in the City's interest to take this (sustainability) on board. Sustainability underpins future profits.'

Sir Neville Simms, Chairman, Carillion, April 2000

The extent to which the property industry moves towards greater levels of sustainability lies squarely in the hands of the executives and directors of the UK's property developers and property management companies. However, very few business executives in these sectors seem to believe that sustainability is a critical issue for their businesses; Sir Neville Simms is an exception. This paper aims to demonstrate why his assertion is right, and why chief executives and company directors should embrace the so-called sustainability agenda.

The UK property market was valued at £176 billion in 1999¹. Those companies that control the property market, developers, managers and their advisors, can either play a pivotal role in bringing sustainability to the heart of UK property or they can stand in the way of progress.

While some corporate executives in these sectors might believe that they already adequately address environmental and social issues related to their business, the evidence tells another story.

The impacts of the property and construction sector

It is hard to define sustainability exactly, but arguing over definitions does not advance the debate. Concern over the sustainability of the world we pass on to future generations will continue to grow. A more sustainable future will mean a cleaner environment, a safer, more cohesive and inclusive society and will be economically more successful and resourceful. These key concerns represent the three legs of the sustainability 'stool' – environmental, social and economic: it will fall over without any one of the three.

Economic contribution

The property industry and associated professional services make a significant positive contribution to the economy and GDP. The financial value of companies in the real estate sector listed on the UK FTSE All Share Index stood at £24 billion in July 2001; the value of the property portfolios of the top 25 UK property asset managers stood at £72.3 billion. The construction, building materials and associated professional services together account for between 7% and 8% of GDP².

Clearly, companies in both the property and construction sectors have enormous financial power but they also account for a very large proportion of resource use and environmental damage in the UK, and have an enormous impact on people's lives. Many, therefore, argue that they have a responsibility to minimise their negative impacts on society and the environment, and to maximise their positive contribution.

Environmental impacts

Globally, the construction industry is arguably one of the most resource-intensive and environmentally damaging industries in the world. Construction accounts for 40% of the total flow of raw materials into the global economy every year – some 3 billion tons³. The majority of these materials are stone, gravel, sand, clay, iron ore and other quarried products. Their production and processing impacts heavily on the landscape, and can cause air pollution, toxic runoff into watercourses and loss of forests and agricultural land. Construction and the operation of buildings also account for 25% of all virgin wood use, 40% of total energy use, 16% of total water withdrawals and generates enormous quantities of solid waste.

There are a number of impacts associated with construction, some of the most significant include, annually, in the UK:

- 6500 ha of land converted from rural to urban use
- 260 million tonnes of minerals extracted
- 72 million tonnes of construction and demolition waste generated, representing 17% of total UK waste⁴.

The industry is also responsible for:

- 20% of all commercial and industrial noise complaints (1999/2000)
- the greatest number of water pollution incidents (21% in 1999) of any sector (Environment Agency, 2001)
- around 60% of all UK timber use with most of this being imported
- 0.7% of the UK's total emissions of greenhouse gases, and the occupation and operation of buildings is responsible for a further 49%⁵.

These impacts offer a glimpse of the dramatic problems the construction and development industries pose for our natural environment. Each new development carries with it a new and unique set of impacts that, if sustainability is to be factored in, must be mitigated and minimised.

Human and social impacts

Achieving sustainability in the UK property sector means more than just reducing its environmental impacts. Property developers and constructors are perfectly placed to become active partners in social progress, community regeneration and initiatives for 'a better quality of life'.

The construction sector employs approximately 1.5 million on-site workers; including all other associated employees puts that figure closer to 2.3 million. With a steadily rising UK population, and the Government projecting a rise in the number of households between 1996 and 2021 of 3.8 million, property development looks assured of a healthy future⁶.

On the downside, however, the construction sector accounts for 9% of deaths and major injuries at work⁷. Improved health and safety can help encourage new recruits into the industry. Construction workers in England suffer eight times more fatal injuries and three times more non-fatal injuries than those in other industrial sectors. The Health and Safety Council reported a 34% increase in British worker fatalities during 2000/2001 compared to the previous year and of the 295 fatalities reported, a massive 106 were in the construction industry⁸.

With a total UK workforce of 35 million, concern over the health of workers is growing, especially as the effect of buildings on health and productivity is becoming better understood. The World Health Organisation has recognised 'sick building syndrome' (SBS) for over 10 years and estimates that 30% of offices, hotels, institutions and industrial premises has the syndrome. SBS causes a wide range of illnesses and can be linked to a higher rate of absenteeism, increased staff turnover, low morale, and the waste of industries' most important assets – their people⁹.

The challenge facing property companies, therefore, is to provide good returns to shareholders, maintain their critical, positive contribution to the economy while at the same time minimising resources use and environmental damage, and contributing actively to reducing or solving social problems. In other words, to become net contributors to sustainable development.

But how much should they do? How important and material are these issues to business success? We hope to answer these questions below.

Changing business context

Fifty-one of the 100 largest global economies are now multinational corporations; only 49 are countries. With business taking on the leading role in the world economy, parliamentarians, the media, the public, pressure groups, academia – almost everyone in fact – is beginning to ask what role business should play in delivering environmental and social benefits to society.

The so-called Battle in Seattle, Carnival Against Capitalism in London and similar demonstrations that are becoming commonplace are the public and very noisy face of the heightened concern felt by ordinary citizens about globalisation and the growing power and impact of the corporate sector. As a result business is faced with an enormous range of influences trying to pressure, nudge, cajole, force and encourage it to play a much more proactive role than in the past in protecting the environment and fulfilling its' social responsibilities.

To deflect demands to be more socially responsible, some executives are fond of quoting Milton Friedman's statement of 40 years ago, 'There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits'. That, however, is only half the story. Friedman added an important proviso, '...so long as it stays within the rules of the game'.

The rules of the game have certainly changed. One business executive that understands this very well is Sir John Browne, Chief Executive of BP. In a speech in April 2001 he said,

'A company's ability to fulfil its purpose (to make profits) depends on the decisions and choices made every day by all the people with whom they do business – governments, other companies, staff and, in our case, the 10 million or so people who buy things from us around the world every day. Our ability to do business is determined by our capacity to meet the needs of those people.'

Business is gradually losing the trust that its customers and employees once placed in it. A recent survey by Edelman¹⁰ showed that NGOs (non-governmental organisations) are the new 'superbrands'; more people look to the likes of Amnesty International and WWF than to industry or government for information on key environmental or social issues. In Europe only 15% of respondents trusted industry; 33% said they put greater trust in pressure groups or NGOs. We have, therefore, moved from a 'trust me' world, and beyond even the 'show me' world, (where business had to explain what it was doing to the wider world) to a 'convince me' world.

This new world is one in which rhetoric and eloquent commitments from corporate executives about environmental and social issues must be backed up by hard evidence of companies' action. As Sir Geoffrey Chandler, former Shell executive and former Chair of Amnesty International Business Group, has said,

'Inaction is no longer an option. The choice lies between the exercise of corporate leadership in developing appropriate company policies, or being forced by public opinion to bring corporate practice into line with the values of society.'

Property sits at the heart of the UK economy and with economic strength and power comes responsibility. Change is on the way. Investor pressure, regulation and simple good business practice are just some of the pressures that look set to force the UK property sector to adopt the good ideas and good solutions already championed by the better firms within the sector.

Evidence suggests that in the sustainability ratings, both the property and the construction sectors can perform better. The fifth Business in the Environment (BiE) Index, a survey of the UK's top companies that analyses their environmental and social engagement, saw a big improvement for the construction sector with participation amongst those eligible up from 20% to 68%. Though construction and property under-performed in areas such as transport and waste, those companies that participate did score well for allocating board level responsibility for environmental issues.

This is a significant improvement. Only 20% of construction companies in the FTSE350 participated one year earlier, and only 21% of real estate companies similarly took part. These sectors also posted some of the poorest scores on environmental performance of all sectors. In 2001 participation and performance had improved, but these sectors are far from being seen as leaders on sustainable development issues by many sustainability and business analysts¹¹.

Evidence is also mounting that good corporate governance of environmental and social issues, and good performance in these areas enhances companies' shareholder value, or, at the very least, protects their fragile and highly valuable reputations. 'Our reputation,' wrote Warren Buffet, the US investor, in one of his famous memos to the staff of Berkshire Hathaway, 'is our only asset. Without it, we are worthless.'

Shell is one company that, faced with several environmental and human-rights-related public relations disasters in a row some years ago, has now repaired much of the reputational damage it then suffered. It went through an extensive process of identifying its key environmental and social impacts, and consulting its stakeholders to understand which issues they cared about most. It has put in place an impressive array of policies on corporate social and environmental sustainability, set itself tough targets, and publishes comprehensive information on its progress. As a result it now features at the top of many corporate social responsibility surveys and indices. Many other companies would do well to heed this lesson, and not wait for a disaster to strike them before taking action.

Sustainability-linked drivers of business

Pressures on businesses to respond to the sustainability agenda are building on many fronts. Environmental, social, governmental and investment sector drivers are all important.

Environmental crises and natural resource shortages

Climate change

The general international consensus now is that climate change is occurring and that humankind has had a very real part to play in this change through the release of greenhouse gases.

Our climate is changing, according to the widely respected International Panel on Climate Change (IPCC). The 20th century was the warmest century since records began. The 1990s was the warmest decade in the century, and 1998 broke all previous annual records. Atmospheric carbon dioxide (CO₂) has increased by 31% since 1750 and the present concentration of CO₂ has not been exceeded during the last 420,000 years and potentially during the past 20 million years. As a result, global temperatures are set to increase during the next 100 years by between 1.4°C and 5.8°C¹².

The UK Government, leading international scientists and most multinationals now recognise that climate change is a vital issue for our collective future, and that they must work together to mitigate its potentially enormous negative global consequences. The Government introduced the Climate Change Levy on 1st April 2001 as a means of trying to achieve a reduction of the UK's greenhouse gas emissions by 12.5% below 1990 levels by 2008-2012, the commitment it made under the Kyoto Protocol. Energy costs are likely to increase by 10-15% – a large increase for any energy user to absorb, even with the offsetting reduction of 0.3% in employers' National Insurance (NI) contributions taken into account¹³.

Property developers, materials producers, contractors and owner-occupiers are all likely to be impacted. But by how much? How can the impact of the Levy be minimised?

The best available strategy for UK property is not to ignore the risks of climate change but to plan more effectively and introduce the proven designs and solutions that can withstand more extreme futures. If these solutions are not employed income streams and rental value will be hit and properties will depreciate more quickly.

The threat posed by climate change for the UK property market has already been dramatically illustrated in the floods of Autumn 2000 when an estimated £1 billion of property damage was caused through the kind of flooding that is going to be much more likely in the years ahead. According to a recent report from the Building Research Establishment (BRE), climate change could lead to dried out soils and subsidence which will cost £400 million in maintenance costs. Higher winds are likely to damage up to one million buildings per year.

Flooding will be a recurring problem for UK property. At present 1.85 million homes and 185,000 commercial properties are at risk of flooding and more are being built, incredibly, in risk areas. In 1996, 4,000 new homes were proposed in flood plain areas, and in 2000 around 20,000 such homes were proposed. Planning permission is still being granted in spite of Environment Agency warnings. In 1998 planners ignored Environment Agency flooding advice in 38% of cases¹⁴.

With around £35 billion of property at risk, according to the ABI, the danger is that in years to come some properties may become uninsurable, particularly in low-lying coastal areas or alongside rivers, and property values could be wiped out. Already in some areas that suffer from consistent flooding insurance is hard to come

by, and it is becoming harder still to sell properties and move on. Property developers will come up against a number of key challenges in the face of flood risk. In particular, their future strategic plans, the value of existing land banks, and potential changes in planning regulations will be key issues for business in the future.

Efficient use of natural resources

The property and construction sectors consume a vast amount of natural resources, as statistics already cited demonstrate. Construction consumes minerals, fossil fuels and other materials. It uses water and energy and generates waste. When buildings and developments are demolished, some materials are recycled but the rest goes to landfill sites or incineration, causing pressures on land and pollution. Because of the environmental damage caused by mining and quarrying, the combustion of fossil fuels and crises in waste management, pressure is mounting to ensure much greater efficiency in the extraction, use and disposal of natural resources.

Decreasing availability of land

Population and economic growth is fuelling ever-greater demand for residential and commercial property. In the UK 6,500 hectares of land is converted from rural to urban use every year. Greenfield sites are therefore becoming more scarce and more costly. Clearly, this trend cannot continue indefinitely; in fact, alternative approaches to development need to be found in the near term. A legacy of poor environmental management in the past, and our industrial heritage, has left the UK with an estimated 50,000 contaminated land sites totalling approximately 300,000 hectares¹⁵. The Government, among others, is encouraging planners and developers to utilise this untapped source of land, to relieve pressure on greenfield development. The specific target is for 60% of new housing to be on brownfield land.

Waste generation and management

Construction site and demolition produces 72 million tonnes of waste each year, representing 17% of the UK's total waste burden. Commercial waste from business totals 30 million tonnes, a further 7% of the UK total. Each year poor design and site management leads to 10 million tonnes of materials being delivered to development sites and then going unused, a clearly avoidable form of waste generation¹⁶.

The shrinking availability of landfill sites, national and international pressures to increase recycling rates, and a recognition of benefits of recycling and reusing greater quantities of waste is gradually spurring the industry to look at ways of reducing its waste streams.

Key questions for corporate executives

- What are your key environmental impacts?
- How will these environmental crises and natural resource shortages affect your business in the short, medium and long term?
- Is your land bank secure?
- What changes to business strategy are you making in light of climate change, the Levy and associated schemes?
- Are you considering greater development on brownfield sites?

Social pressures

Steady population growth and other social pressures can have a strong influence on how and where property is developed. As the sector that more than any other shapes the built environment around us, UK property developers are uniquely affected by, and influential upon, society.

Urban redevelopment

Many social problems are most intensely focused and felt in inner city areas; for example, it has been reported that Britain's top 20 cities have lost 500,000 jobs since 1981 whilst other areas have gained 1.7 million predominantly in the non-manual sectors. Whilst this shift is mirrored to some degree by population movement, unemployment in inner cities is more than double the rate elsewhere and in many cases continues to grow. Joblessness and social exclusion inevitably then lead to higher crime rates and poverty.

The Government is keen, as laid out in the 'Towards an Urban Renaissance' report in 1999, to redevelop inner-city areas to provide living and working opportunities to deprived communities and create more cohesive, safer neighbourhoods. City development also avoids the need to develop ever-scarcer greenfield sites, builds a stronger, mixed economic base by encouraging inward investment and can often be supported by the existing transport infrastructure.

Improving a poor environment can make a lasting difference to people's lives. The last survey of English housing found that 13.4% of households were in housing that could be classed as 'poor'. Regenerating urban areas can transform those communities. Some in the property development sector are responding to this changing picture of society, others apparently not.

Growing households and housing demand

The Government predicts that our changing population, moving toward more single-person households, will lead to the creation of 3.8 million extra households between 1996 and 2021, a 19% increase that creates an enormous need for new housing¹⁷. Again, the question facing the property development sector and the Government is where to site this development and how to provide much-needed high-quality housing that is affordable and accessible.

Creating attractive employment opportunities

A key challenge for the UK property sector as a whole is attracting the right employees, with the right skills. This is particularly pertinent to the construction industry. A relatively poor reputation and a perceived lack of job security in the construction industry is contributing to its difficulty in attracting and retaining staff. The Construction Industry Training Board (CITB) estimates that there will be an annual shortfall of 6,500 tradespeople in the building trades between now and 2005. This is fuelling interest in innovative construction techniques including prefabrication. In total, some 370,000 new employees need to be recruited and trained if the UK property sector is to grow successfully¹⁸.

The shape of the UK workforce is changing rapidly. Manual jobs are decreasing whilst service sectors are increasing. In addition, part-time employment is growing rapidly both in the male and female workforce.

According to the CITB, a reduction in the number of apprenticeships on offer and the mobile nature of industry contributes to skills shortages that appear regularly within specific areas of construction. Many of the larger companies within the industry have evolved beyond the building site into property development and facilities management and as a result the pressure to develop the industry's core skills is being increasingly felt by smaller contractors. Developing skills takes time, and short-term, contract-constrained projects can hinder concerted efforts to develop productive skills development programmes. Recent shortages recorded by the Employment

Services Large Organisations Unit include electricians, bricklayers, welders and more basic core skills such as scaffolders and demolition staff.

The UK property sector has, to its credit, already played an important part in the Government's New Deal programme, which has helped bring new employees into the industry. A dedicated construction task force has been set up within the New Deal, chaired by Sir Neville Simms, the Carillion chairman and made up of employers, CITB, major construction clients such as BAA, and representatives of small to medium-sized businesses and trades unions.

Key questions to corporate executives

- Which of these social pressures impact your business?
- How are you responding to them?
- How will they affect your business in the short, medium and long term?
- Are you contributing to urban regeneration?
- Are you explicitly addressing the social impacts of your business?
- How do you address your stakeholders' concerns?

Governmental and legislative pressure

Government initiatives

The Prime Minister recently challenged the top 350 UK businesses to report on their environmental impacts by the end of 2001. His call reinforced a letter sent by Michael Meacher last year to the 30 FTSE100 companies ranked bottom in an independent survey on environmental reporting conducted by PIRC (the Pensions and Investment Research Consultants Ltd.). The survey asked them why they did not report and urged them to do so in the future.

A Pricewaterhouse Coopers (PWC) survey of parliamentarians published in April 2000 found that 80% of MPs believe that business is not doing enough on corporate social responsibility. Forty-four percent think that global companies now have more power than Government; 90% of the MPs surveyed believe that it is important for UK companies to be seen as socially responsible; and 86% of MPs think that corporate social responsibility will have a positive impact on the global economy.

Changing legislation

The property and construction industry is used to operating within a heavily regulated business environment. However, the Government is responding to concern about environmental and social issues by introducing new legislation and regulation. How these new regulations and requirements will impact on property and construction must be clearly understood by companies in those sectors.

The Climate Change Levy

As noted above, energy costs are likely to rise between 10% and 15% due to the Levy. For property developers, owners and tenants alike solutions do exist to reduce or avoid the impact of the Levy, particularly through introducing energy-efficient design features and renewable energy technologies into new building plans. Developers are increasingly likely to be asked by clients for energy-efficient buildings; their architects and contractors too will need to respond.

Part L of the Building Regulations

New rules aimed at conserving power and fuel use in buildings, which includes increasing the energy efficiency values of the fabric of buildings (their U-values) are due to be implemented through Part L of the new Building Regulations. These new rules are expected to come into play in April 2002 and are likely to have far-reaching effects on construction methods and materials. There has been some debate over how dramatic a difference the new rules will make, given that buildings account at present for 49% of the UK's CO₂ emissions and that some estimates have suggested that Part L of the Regulations will reduce these emissions by only a few percent. Future initiatives designed to significantly improve energy efficiency are therefore likely.

European energy efficiency proposals

As well as the UK Government's initiatives to support energy efficiency in the property sector, the European Commission is also proposing a new directive that seeks to improve the energy efficiency of new buildings by 22% by 2010. This is likely to have significant ramifications for building codes and practices.

The principal aims of the draft directive include minimum energy standards for various building types covering insulation, heating, ventilation, lighting, orientation, heat recovery and renewable energy technologies. The standards will cover new buildings and buildings over 1,500 square metres in size that are due to be renovated.

Landfill Tax

The UK Government introduced the Landfill Tax in 1996 to provide a fiscal incentive to minimise waste as well as to identify opportunities for dealing with waste in a more productive way. When launched, for active waste the cost was set at £7 per tonne while inactive waste attracted a tax of £2 per tonne. In 1999 the rate for active waste was increased to £10 per tonne and through an annual escalator this higher rate will grow to £15 per tonne by 2004. Such taxes continue to add costs throughout the industry, and are best avoided.

Tax breaks for developing brownfield sites

Though yet to be confirmed by ministers, in the 2001 budget the Government announced plans to abolish stamp duty on redevelopment in certain disadvantaged areas and a reduction of VAT to 5% on properties that have been empty for more than three years. The Finance Bill 2001 also offers an accelerated tax credit (up to 150%) to cover the costs of cleaning up contaminated land.

Corporate manslaughter legislation

Within the next year new legislation is expected that will enable the identification and conviction of those responsible for corporate manslaughter. Company directors and boards may be able to be held criminally responsible personally for deaths among their employees; punishment will most likely be in the form of fines and imprisonment. Given the particularly high level of injuries and deaths in the construction sector, this is a particularly important development for construction companies, and possibly, for property companies too.

New transport guidance

New guidelines were introduced in March 2001 that require developers to produce Transport Assessments of the modes of transport that will serve new developments. In short, the Government is likely to be supportive of developments that utilise public transport and existing transport infrastructure, and that offer alternatives to private car use and parking.

Key questions for corporate executives

- What are the implications of this and other environmentally or socially based new legislation for your business?
- How have they been factored into your business strategy?
- Were you aware of the strong views of MPs on these issues?
- What are you doing to address those?
- Are you aware of the calls from Blair and Meacher on environmental reporting?
- How are you responding?
- Do you have plans to publish an environmental/sustainability report?

Investor pressure and environmental, social and business probity

Sustainable business practices represent more than just good corporate citizenship; sustainability can pay real dividends. The new FTSE4Good Index series includes only those companies with high standards of environmental performance, human rights and stakeholder engagement. Although 14 out of 32 listed real estate companies qualified for inclusion in the first publication of the index, only four out of 36 constructors did. Back-testing shows that the UK top 50 FTSE4Good companies would have outperformed the conventional FTSE 100 by 15% over the last five years.

The Dow Jones Global Sustainability Index (DJGSI) similarly tracks the performance of the world's most 'sustainably managed' companies. From 1994 to 2000 the companies on the DJGSI would have outperformed the standard Dow Jones Global Index by 15% per year were the index to have been created seven years ago¹⁹.

This connection between sustainability and business performance is being reinforced by a wealth of new research emerging from around the world that is increasingly being taken into account by institutional investors. For investors, sustainability means good business, in every sense.

Investor pressure

FTSE4Good and the DJGSI cater for the ever-growing market for 'socially responsible investment' (SRI). SRI now represents around £250 billion of institutional investment in the UK alone, showing a dramatic growth over the last 18 months.

The pressure for SRI will continue to grow. The 1999 Pensions Act now requires all occupational pension funds to explain in their Statement of Investment Principles (SIPs) the extent to which they factor social and environmental issues into their investments.

Two surveys of the impact that this new act was having were carried out in 2000. In June 2000 Environmental Resources Management (ERM), a leading environmental consulting firm, surveyed the largest 25 UK pension funds that collectively represent 35-40% of the £800 billion UK pension fund assets. The survey indicates that 21 out of the 25 largest UK pension funds intend to implement SRI principles in their statement of investment policies (SIP). They collectively invest £120-150 billion in UK equities, representing 7-10% of UK stocks²⁰.

ERM concluded: 'The key message from this survey is that pension funds managers and financial analysts will increasingly look for companies whose shareholder value is enhanced – or at least protected – by good management of environmental and social risks.'

Similar research was carried out by the UK Social Investment Forum later in the year. This research confirmed that of the 171 occupational pension funds that responded (representing £302 billion total assets), 48% want their fund manager to take account of financial implications of ethical, social and environmental issues. These funds represent 69% of the assets of those responding to the survey (i.e. £210 billion).

Friends Ivory and Sime, the asset manager for Friends Provident, has adopted an SRI policy across all of its equity investments. Morley (part of the CGNU Group), one of the largest UK fund managers, also has a social responsibility policy and plans AGM votes against all FTSE 100 companies that fail to publish environmental reports. The implications of the rapid and groundbreaking adoption of environmental and social issues by the investment community are that property and construction companies will increasingly be required to demonstrate their credentials on these issues to secure investment.

Good governance

Another factor driving fundamental changes in the management of UK companies stems from the publication of the Turnbull Report. The Turnbull Committee published guidance in 2000 on the application of certain elements of the Combined Code of the Committee on Corporate Governance.

The Combined Code now requires companies to establish systems to identify, evaluate and manage their business risks. Certain non-financial risks are explicitly mentioned: 'legal, health, safety, environmental, reputation and business probity issues'. Fund managers will therefore be increasingly assessing companies' implementation of the Turnbull recommendations as part of their standard review of Governance and the quality of management.

The ongoing Company Law Review also looks set to require greater levels of disclosure on 'non-financial' issues.

The Association of British Insurers (ABI), a body representing around £1 trillion of institutional assets in the UK, issued guidance in October 2001 dealing with environmental, social and ethical issues, asking members to support best practice on corporate governance and reporting of 'non-financial issues' – i.e. on implementing Turnbull. ABI members are likely to routinely ask companies in which they invest to comply with these guidelines, and ask then about their position on environmental, social and ethical issues²¹.

Key questions for corporate executives

- Have you considered environmental, social and ethical issues in your Turnbull review of business risks?
- Which 'non-financial' issues are most critical to your business?
- Are you ready to answer questions on these issues from shareholders?
- Do you provide information on social and environmental issues to shareholders and brokers?
- Do you qualify for inclusion in FTSE4Good or the DJGSI?

The increasing demands of clients

The pressures of new legislation, socially responsible investment and public opinion are keenly felt by business today and most of the UK's largest companies are developing comprehensive corporate social responsibility (CSR) policies and codes of practice.

As large occupiers and clients of the property sector, they are increasingly requiring their suppliers, contractors and business advisors to take their sustainability policies into account. Sainsburys, Shell, BP, Marks & Spencer, BT – to name but a few – are companies that have strong commitments to minimising their environmental impacts and contributing positively to society, commitments they want to pass down the supply chain and take into account when they build or manage offices, warehouses, stores and other facilities.

In other words, they are becoming more demanding clients and tenants.

The Government is responsible for 40% of the total UK construction industry output and has set itself targets to improve the sustainability of buildings it commissions in the Government Construction Clients Panel (GCCP) Sustainability Action Plan. This establishes firm three-year targets for environmental procurement using the BRE Environmental Assessment Method for Buildings (BREEAM) alongside the Considerate Constructors scheme. High levels of performance are required by 2003 and this will have a significant effect on the construction industry²².

Homebuyers' awareness of the environmental agenda is growing too. Recent surveys have shown a strong growth in more ethical purchasing, from organic to fair trade foods, to Forestry Stewardship Council (FSC) certified forest products, greener electricity tariffs, diesel and petrol. It would be short-sighted indeed to assume that future demand will not stimulate more 'green' mortgage packages that require higher levels of environmental performance across the wider UK property sector. In the year 2000 the Ecology Building Society, one of the earliest providers of 'green' financial products, recorded a 16% growth in new mortgage business.

Leading socially responsible asset managers with significant property portfolios, such as Friends Ivory & Sime and the University Superannuation Scheme are beginning to put in place sustainability policies for their property portfolios specifically. Their contractors, suppliers and professional advisors are likely to be asked to comply with these policies, and work collaboratively with the asset managers to reduce the environmental footprint of their property portfolios.

Key questions for corporate executives

- How actively are you discussing these issues with your clients/suppliers?
- Are you able to respond to your clients' demands for more environmentally sustainable buildings?
- How well positioned are you to take advantage of 'green building' opportunities?

Benefits of good management of sustainability issues

Many companies in sectors other than the property sector have been working for some time to understand and make the most of the threats and opportunities posed by sustainability issues. As the evidence from the FTSE4Good Index and the Dow Jones Sustainability Index (see above) shows, in many cases their efforts have been rewarded in tangible financial terms; in others, the rewards have been harder to quantify as they relate to protecting intangible assets, but are nevertheless of vital importance.

There are many specific examples, from a wide range of industries around the world, of the significant financial benefits companies have accrued due to their adoption of more environmentally sound business practices. Well-publicised initiatives by major players like Georgia Pacific, Lucent, Anheuser-Busch, Baxter International, DuPont, Volvo and Nokia are but a few examples highlighted in the report 'Uncovering Value: Integrating Environmental and Financial Performance' (Aspen Institute, 1999). This report is one of hundreds published recently demonstrating the positive links between environmental performance and shareholder value. Within these reports examples of companies from the property and construction sectors are unfortunately few and far between. To make a major commitment to sustainability, any executive management team are understandably going to want a tangible sense of the benefits it will reap.

Good management of sustainability issues offers many strategic benefits to companies in the property and construction sectors. These include:

- avoiding reputation damage and risk due to adverse publicity over performance on environmental, social and business probity issues
- improving the management of risk within and across the whole business, building an integrated approach to corporate governance and corporate social responsibility
- improving ratings with some investors leading to a lower cost of capital and insurance
- avoiding legal risks and penalties, e.g. 'corporate killing' due to poor health and safety performance and reducing costs such as injuries compensation
- assisting in meeting compliance requirements and the risks of not identifying and keeping up to date with future legislation and regulation of relevance to business
- minimising the financial impact of new requirements
- helping to maintain a company's 'licence to operate' by demonstrating a thorough understanding and responsiveness to customer and local community concerns
- improving reputation with stakeholders
- improving relationships with suppliers, contractors, sub-contractors and associated professions
- improving the ability to attract and retain the best employees
- better ratings in industry-led or Government surveys such as BiE, or Environment Agency leagues and leading to a preferential status on bids
- enhancing status with respect to peers, particularly through mechanisms like the FTSE4Good again offering increased access to capital

- differentiating a company and delivering a competitive advantage over other companies not yet addressing these issues
- positioning a company for future success as the business environment evolves, and sustainability issues assume greater importance.

There are a number of specific operational benefits available to companies that manage sustainability issues effectively:

- Cost savings can be achieved through greater material efficiency, for example by making greater use of recycled materials.
- Energy efficiency and optimal energy use strategies can result in energy bills being reduced and a reduction in greenhouse gas emissions leading to reduced liabilities for owners and occupiers under the Climate Change Levy as well as future regulatory and compliance schemes.
- Landfill disposal costs are reduced through more efficient use of materials and increased recycling.
- Transport costs are lower through using local suppliers, maximising fleet efficiency.
- Fines for water, land, air and noise pollution incidents can be avoided through more effective environmental management systems.
- The site acquisition process can be enhanced.
- Become more attractive to those clients with corporate responsibility policies, or that offer preferential bid status to companies with good environmental management policies and practices.
- Potentially generate shareholder value, earnings and market share.
- Produce more attractive, flexible properties, with quicker or higher value rent-up of space, higher occupancy rates and/or lower operation and maintenance costs.
- Opportunities for new businesses, e.g. environmental consulting.
- 'Future proof' investments in property, which leads to increased revenues over time.

Conclusion

Why should senior executives take the messages in this report seriously? In essence the rapidly shifting nature of the modern business environment holds the key. Environmental and social issues are growing in importance across the business community, in the eyes of Government, investors, pressure groups, consumers, clients and the media. Understanding these issues, and their potential strategic implications for business, is critical to companies' future financial success.

Climate change is a pertinent example here. If you continue to build on flood-prone land your risks are greatly increased and the value of your property stock could be dramatically reduced. To ignore the implications of the new Climate Change Levy for your own business, or that of your clients and tenants will leave you exposed and uncompetitive. To build high-energy-use buildings is not the best route to future business success and such buildings do not represent the future product demanded by clients, they represent the past.

No-one ever said sustainability was simple and tackling the wide-ranging issues covered in this paper could be viewed as an insurmountable task by executives pressurised to improve bottom line performance and deliver shareholder value.

But that is precisely why sustainability matters. As an ever-growing influence on business it has the power to fuse previously pigeon-holed and marginalised areas of concern together into a powerful strategy for business growth which sits at the heart of a company's future corporate plans and objectives. Bottom line performance and shareholder value have been shown, time and again, to be enhanced for those companies that take their environmental and social responsibility seriously.

As investors and the media particularly take up these issues, and ask ever more informed and searching questions about property and construction companies' performance in these areas, how well will you be able to respond? More importantly, will your competitors be in a stronger position when those questions are asked? Will they see their clients more satisfied? Will they secure new contracts and new development opportunities if they can clearly demonstrate a greater commitment to sustainability?

For the UK property sector corporate sustainability offers the key to enhanced reputation and reduced risks. It is a more efficient and responsible way of doing business and, importantly, it holds the prospect of ample rewards for those smart enough to take up the sustainability challenge.

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