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CoStar Study Finds Energy Star, LEED Bldgs. Outperform Peers

Demand in Marketplace for Sustainability Creates Higher Occupancy Rates, Stronger Rents and Sale Prices in 'Green' Buildings

A new study by CoStar Group has found that sustainable "green" buildings outperform their non-green peer assets in key areas such as occupancy, sale price and rental rates, sometimes by wide margins.

The results indicate a broader demand by property investors and tenants for buildings that have earned either LEED® certification or the Energy Star® label and strengthen the "business case" for green buildings, which proponents have increasingly cast as financially sound investments.

According to the CoStar study, LEED buildings command rent premiums of \$11.33 per square foot over their non-LEED peers and have 4.1 percent higher occupancy. Rental rates in Energy Star buildings represent a \$2.40 per square foot premium over comparable non-Energy Star buildings and have 3.6 percent higher occupancy.

And, in a trend that could signal greater attention from institutional investors, Energy Star buildings are selling for an average of \$61 per square foot more than their peers, while LEED buildings command a remarkable \$171 more per square foot.

Andrew Florance, president and CEO of CoStar, called the findings a "strong economic case for developing green buildings" at a recent seminar hosted by the District of Columbia Building Industry Association (DCBIA) where he presented results from the CoStar study last month.

"The information we've discovered is very compelling. Like all good science, we discovered it by accident," Florance said. "Green buildings are clearly achieving higher rents and higher occupancy, they have lower operating costs, and they're achieving higher sale prices."

Florance conducted the study with Jay Spivey, CoStar's director of analytics, and Dr. Norm Miller of the Burnham-Moores Center for Real Estate at the University of San Diego. The group analyzed more than 1,300 LEED and Energy Star buildings representing about 351 million square feet in CoStar's commercial property database of roughly 44 billion square feet, and assessed those buildings against non-green properties with similar size, location, class, tenancy and year-built characteristics to generate the results.

"We wanted to take each and every one of these green buildings in our database and compare them to the buildings they directly compete with in the submarket," Florance said at the seminar.

One factor for the "green" premiums would appear to be the constricted supply of green buildings, which account for just a fraction of the total U.S. building stock (less than 1 percent of space in CoStar's database.) The study indicates that while the number of LEED-certified and Energy Star buildings continues to grow, the supply has not kept pace with demand.

CoStar began tagging green buildings in its database about two years ago with the help of the U.S. Green Building Council (USGBC), the nonprofit trade group that created the LEED certification system, and the U.S. Environmental Protection Agency (EPA), which administers the government-sanctioned Energy Star label.

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Although often lumped together under the 'green building' moniker, LEED and Energy Star address distinct -- if not related -- goals.

LEED, which stands for Leadership in Energy and Environmental Design, indicates a property's overall sustainability by awarding points for just about any sustainable feature imaginable, from bike racks and rainwater collection and reuse systems, to energy-efficient lighting and low-flow plumbing fixtures. It is comprised of specific programs tailored for new buildings, existing buildings and tenant build-outs, and awards different tiers of certification such as Silver, Gold or Platinum, the highest.

Over the past few years, LEED has emerged as the industry's de facto sustainable property rating system and become nearly synonymous with the term 'green building'. So much so, "There's a bit of urgency now that the value of buildings could be affected if they are not LEED-certified," says Mark Bennett, a senior attorney with law firm Miller Canfield who specializes in green building and climate change issues.

Bennett recently chaired the National Green Building Finance and Investment Forum, a conference involving financial sector and property investment leaders held in San Francisco, where he says LEED was a matter of discussion for many of the nation's top institutional investors. "In large part, they were referring to LEED certification as a component in the definition of a Class A office building," he said. "They basically said, 'If you're building today without LEED, you're building in obsolescence.' "

Many would pitch the same argument for EPA's Energy Star program, an energy-benchmarking tool and a flag for the nation's most energy-efficient properties. The program largely bypasses the bells and whistles of LEED by targeting simpler and highly cost-effective strategies for improving energy efficiency in buildings, such as installing energy efficient windows, turning off computers at night and adding motion sensors to control lighting. The program has worked to great effect: buildings that have earned the Energy Star label use an average of almost 40 percent less energy than average buildings, and emit 35 percent less carbon.

In fact, according to EPA, as many as 500 buildings out of the 4,100 or so total commercial buildings that have earned Energy Star use a full 50 percent less energy than average buildings. And many of those efficiency practices, such as upgrading light bulbs or office equipment, pay for themselves in energy cost savings.

On top of that, premiums that the market is willing to pay for Energy Star buildings, as indicated in the CoStar study, are a clear demonstration of the overall impact of energy efficiency on property value, says Stuart Brodsky, national program manager for the Commercial Properties division of Energy Star.

"The business case for energy efficiency is indisputable," Brodsky told CoStar. "The business case is so strong that the financial results can be applied to asset value, through increased NOI [net operating income], or leveraged to pursue other aspects of green buildings that do not show as strong of a financial rate of return."

But the benefit of Energy Star extends beyond asset value. Aside from the actual Energy Star designation, which owners may choose to pursue by demonstrating energy reductions, the program also serves as a stand-alone energy benchmarking tool: an energy report card, so to speak, and the type of environmental transparency in the industry Florance has routinely called for.

"For a lot of people, it's where the rubber meets the road," Brodsky says of the benchmarking aspect, which saw participation jump by more than 175 percent from 2006 to 2007. To date, almost 8 billion square feet of U.S. property has been benchmarked through Energy Star.

One sharp contrast between Energy Star and LEED is where the responsibility for implementation falls. With LEED, where three-fourths of all certified projects to date fall under the program's flagship brand -- LEED for New Construction (LEED-NC) -- the burden for certification is largely on architects and engineers at the design stage.

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But with Energy Star, which looks exclusively at energy consumption in existing assets, responsibility shifts to property managers. Demand for Energy Star buildings is a "quantifiable indicator of superior management practices across the property, which may otherwise be intangible," Brodsky says.

Other contrasts are closer to the surface. Energy Star is often seen as just one piece of the sustainability puzzle, while LEED buildings, especially those certified under LEED-NC, don't always correlate to high levels of energy efficiency (USGBC has, perhaps in response, re-tooled its building operations platform, LEED for Existing Buildings (LEED-EB)).

But in many ways, those differences have benefited both programs, allowing them to serve the same customers without becoming direct competitors. Several big commercial real estate service providers, including CB Richard Ellis and Transwestern, run Energy Star and LEED programs concurrently across their managed portfolios.

So does Kennedy Associates Real Estate Counsel LP, an Energy Star partner since 2005 and one of only a handful of U.S. institutional investment advisors recognized as an early adopter of green strategies.

"We think of Energy Star and LEED in concert with each other," says Bob Ratliffe, an executive vice president of portfolio management with the Seattle-based firm, which also has broad development operations. "LEED and Energy Star come up in every investment we make, they come up in the investment committee, they come up in asset management committee meetings. Both are part of our fabric."

Under its Responsible Property Investing (RPI) platform, which promotes energy conservation, sustainable development and responsible contracting across its portfolio of more than \$9 billion in assets under management, Kennedy's LEED and Energy Star activities are extensive. It has about \$325 million in LEED-certified assets, as well as another pool of buildings valued at around \$1.5 billion that are either pre-certified for LEED or planned for certification. In addition, the firm recently identified more than 45 office buildings for enrollment in the LEED-EB portfolio pilot program.

Its portfolio also includes 35 Energy Star-labeled buildings, a number that includes more than 60 percent of all Energy Star-labeled warehouse facilities to date. The firm's benchmarking efforts currently include more than 160 buildings totaling 22 million square feet of office and industrial space.

Kennedy says it sees higher occupancy and rent rates, as well as quicker lease-up and better tenant retention, in its LEED and Energy Star buildings due to a number of factors, including market demand. "If we lease buildings faster and hang on to tenants longer, that adds to the economic equation," says Preston Sargent, an executive vice president and principal with Kennedy who oversees the firm's largest client, the Multi-Employer Property Trust (MEPT).

"And obviously, if you're selling a building at a lower cap rate, that's additional icing on the cake," he said.

But the benefits extend beyond that, Ratliffe says. "Our investors recognize we are a national leader in [sustainability] and put a value on that. And as they assess their advisors, they see the leadership we're taking in RPI and give us points, if you will, as they assess us amongst our competitors. And that's good for business," he said.

In large part, Kennedy is able to balance Energy Star and LEED because the programs fit well with each other. "They're complementary," says Christian Gunter, a LEED-Accredited Professional and assistant vice president of Kennedy's RPI program, who points out that LEED-EB buildings must achieve a certain Energy Star score as a prerequisite for certification.

"In a recessionary environment there's more than one way to cut costs," Ratliffe says, referring to the energy and operational efficiencies emphasized under Energy Star and LEED-EB. "It's not just cutting employees."

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