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## October Webinars

Decarbonising existing offices in London to avoid the 'brown discount'.



# Decarbonising existing offices in London to avoid the 'brown discount'

## Andrew Baum



### Summary

- Chairman, Newcore Capital.
- 30 years of combined experience in academia and business.
- Emeritus Professor at University of Oxford.
- Investment Committee Member at CBRE. Investment Management.

### Previous roles include:

- Honorary Professor of Real Estate Investment, Cambridge.
- Professor of Land Management, Henley Business School, University of Reading.
- Non-Executive Director, Grosvenor.
- Author: Real Estate Investment: A strategic Approach (Fourth Edition).
- Graduated with Investment Management Degree in 1994 from London Business School.
- Graduated with MPhil and PhD, Real Estate in 1989 from University of Reading.

## David Hourihan



### Summary

- Programme Leader for the MSc Real Estate at UCEM.
- 17 years of commercial real estate experience across the UK and Ireland.
- Specialist in investment, office agency, retail asset management and valuation.
- Previous positions with international firms including JLL and Colliers International.
- Acquisition and asset management instructions for clients including Société Générale, Metzler Bank, Mobil Oil, Scottish Widows, Aviva and British Land.
- Fellow of the Society of Chartered Surveyors Ireland and Royal Institution of Chartered Surveyors.
- RICS Governing Council geographical seat holder for the UK and Ireland.
- Visiting Professor, Ecole Supérieure des Professions Immobilières (Paris Campus).
- Graduated with an MSc in Property Investment from UCEM in 2008.
- APC Chairman / Assessor for SCSi and RICS.
- RICS Inspire Ambassador.

# Decarbonising existing offices in London to avoid the 'brown discount'

## Real Estate Investment - Current Global Sentiment:

- Rising costs of debt and volatility in indices.
- Lender sentiment much more cautious.
- Increased focus on recession risk.
- Significant level of asset re-pricing over last 12 months from peak values in 2022.
- Direct investment (H1 YoY): Americas – 59%, EMEA - 55%, APAC – 24%.
- Office Investment sector: *'Office pricing and liquidity are under pressure amid weak global sentiment from investors and lenders. The uncertainty over future office demand persists given slow economic growth and the adoption of hybrid working policies, and investors and lenders alike are focused on existing office exposure.'*
- Property sector bifurcation ongoing.

Sources: Global Research – Global Real Estate Perspective – Highlights (JLL 2023)

## London Office Sector – Q2, 2023 Stats/Trends:

### Lettings:

- Demand has become polarised:
  - Secondhand space continues to dominate supply in Central London.
  - Older, lower quality space continues to take longer to lease.
  - Focus on high-quality space with 4 largest deals in the quarter as pre-lets.
  - Prime rents remain at record levels, led by the West End at £145 psf.
- 'Banking' and 'Finance' sectors dominated the market, followed by the 'business services' and 'professional' sectors.
- Take-up 34% below the 10-quarterly average.
- 25.5m sq ft available. Well above 10-year average of 16.6m sq ft.
- Vacancy rate at 8.5%.

Sources: Research Q2 2023 – Central London Offices (CBRE) / London Offices Snapshot Q2 2023 (Colliers) / BNP / Carter Jonas / Cluttons IM.

### Investment:

- Negative occupational sentiment towards secondary offices with poor ESG credentials is still a leading case for the outward movements in yields.
- Central London investment volumes fell by 26% qtr-on-qtr, totalling £1.2bn in Q2 down from £1.7bn the previous quarter.
- H1 investment volumes totaled £2.9bn, down 52% on the long-term H1 average.
- Slow down due to cost of debt remaining high.
- Overseas investors continued to dominate the London market accounting for 60% of the quarterly total. Asian investors led the overseas investment activity.
- Lack of Core/Core Plus product is forcing demand to 'Value-Add' investments.
- West End prime yields now stable at 4% while City prime yield (sub £1bn) have risen to 5.25%, representing a quarterly increase of 15 bps and 50 bps respectively.

# Decarbonising existing offices in London to avoid the ‘brown discount’

## What is decarbonisation?

- Decarbonisation is the permanent removal of carbon emissions from an organization’s value chain by implementing sustainable, clean energy systems and a low-tolerance approach to residual emissions.

## Decarbonising Commercial Real Estate – Why is it important?

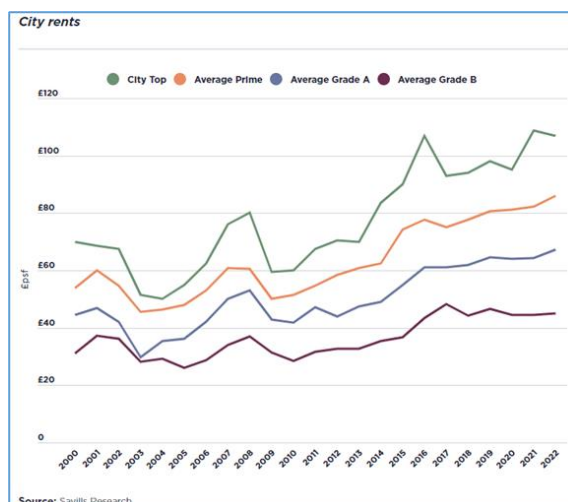
- Worldwide, buildings account for 37% of global carbon emissions and 34% of energy demand.
- Other environmental impacts of buildings include resource depletion, air, water and land pollution and biodiversity loss.
- The effects of climate change is clear, and stakeholders are demanding that business plays an active role in reducing their carbon footprint.
  - Consumers are now prioritising environmentally conscious brands.
  - At a time of skills shortages in many sectors there is a war on winning talent. Employees know this and are more likely to accept jobs from sustainability aware employers.
  - Many governments are making carbon-reduction commitments and regulators are introducing legislative changes.
  - Investors are seeking evidence that companies are prioritizing decarbonization.
- Failure to drive decarbonisation could soon become a business liability – and contribute to global; socio-economic and environmental risk. Reducing environmental impact is therefore a priority for companies across the world.
- Commercial real estate owners, occupiers and businesses quickly need to develop plans to decarbonize portfolios, and at scale.
- ‘There’s a very high level of non-compliance buildings out there, which suggests either a lack of awareness or clearly a lack of response to what’s coming’ (Carter Jonas).

Sources: Decarbonizing Commercial Real Estate (CBRE), Energy efficient buildings: the value-add of long-term strategy (Carter Jonas).

# Decarbonising existing offices in London to avoid the ‘brown discount’

## What is ‘Brown discount’?

- This is the effect that obsolescence is having on older buildings that fail to get retrofitted.
- The bifurcation between the ‘best’ and the ‘rest’ in City of London office rents is becoming increasingly pronounced (Savills).



## Target

- In the UK - an EPC rating of ‘C’ minimum is expected for non-domestic properties by April 2027 and an EPC rating of ‘B’ minimum by 2030.
- Commercial property in the UK will need to be net zero by 2050.

## Challenges for Investors / Landlords

- Between 70-80% of buildings that will be in use in 2050 have already been built. Therefore, almost all buildings have a high risk of obsolescence in the shift to a zero-carbon economy.
- Transparency: Investors need detailed data on the performance of individual assets.
- Data impacts on the valuations of assets, their attractiveness in the market, and their ability to access green loans.
- The resulting transparency will enable real estate owners and investors to better differentiate how net zero could impact valuations in property.
- Hard to extrapolate how ‘green’ features influence value. ‘Investors encouraged not to look at ESG initiatives as a ‘bolt on’ for their assets but a reflection of an approach to responsible investment, as well as a proactive approach to longer term risk management and asset resilience’ (IPE).

## Strategy to decarbonize your portfolio

Decarbonising will require clear strategies, targets and roadmaps:

- Establish your decarbonization strategy.
- Continuously improve energy efficiency.
- Electrify real estate and transportation.
- Transition to renewable energy and carbon-free fuels.
- Decarbonizing your supply chain.
- Offsetting your carbon balance.

Sources: Decarbonizing Commercial Real Estate (CBRE), Net zero, valuation and stranded assets (IPE), Landlords ‘kept in the dark’ over EPC changes, says BPF (EGi), City Office Market Watch – January 2023 (Savills).



# BAYFIELD

## THANK YOU FOR ATTENDING

### Upcoming Property Webinars:

- Sensitivity Tables in Real Estate: Do they need a makeover?

31st October 2023 | 12:00pm GMT

- An Introduction to Affordable Housing

Date TBC



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