THE HIGH PERFORMANCE PORTFOLIO:
SUSTAINABILITY AND THE ACQUISITIONS PROCESS

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SUMMARY

Most owners know that incorporating sustainability practices in their operations and purchasing decisions can increase profitability, but they still fail to include sustainability considerations in their acquisitions process. Sustainability is a key factor in an asset's financial health, and by understanding a building's sustainability profile prior to possession, investors can better position themselves to maximize profits. Use the tips below to learn how to boost your profits and enhance your overall investment strategy by considering a building's sustainability during the initial screening, due diligence, and financing phases of the acquisition process.

Making changes to your existing aquisitions process

The acquisitions process will vary from investor to investor – not only the steps included, but also the speed and sophistication with which they are executed. To evaluate where to make changes to your existing acquisitions process, it's important to ensure that you understand it completely. Obtain existing documentation of your company's acquisitions process. If none exists, create a flowchart or timeline showing all the steps.

With your existing process well defined, identify the decision points in your process, where it could be beneficial to have an enhanced understanding of the building's sustainability characteristics. Consider the risks of missing those points. For example, you may decide that you should have some knowledge of the building's existing systems prior to putting money in escrow. Understanding the sustainability features of the property sooner can help you avoid surprises.

IN-DEPTH

CONSIDER BROAD METRICS IN THE ASSET IDENTIFICATION STAGE

The sooner in the acquisitions process you begin to incorporate sustainability metrics, the greater your advantage. However, your company may review thousands of potential investments each year, so any steps you add to the initial, asset-identification stage will also increase your costs. Determine what information you can use for a quick assessment – Are there specific metrics or levels of performance that interest you? Do you want properties to have an ENERGY STAR® or LEED certification?

Consider the overall regional market, and how well positioned the building is from a marketing standpoint. Is the region dense with high-performing buildings, and could your green building have difficulty getting noticed? Does it need to become greener just to stay competitive? Alternatively, does the building stand out as one of the few high-efficiency buildings in the area? Could it?

The more important sustainability is to your marketing and investment strategy, the more carefully you should review these aspects prior to purchase. A different investor may decide that they don't need to know as much about the sustainability until later in the process, but you need to consider what works best for you.

ESTIMATE PERFORMANCE IMPROVEMENTS TO REFINE YOUR OFFER

When an asset meets the owner's general investment goals, a more in-depth financial analysis is performed. This includes developing a detailed economic model of current and future cash flows in the building and analyzing seller documents such as rent rolls and expenses. The models and financial analyses are used to estimate cash flow and appreciation, which define the value of the asset.

Buildings that are greener tend to have higher occupancy and lower operating expenses. Both of these factors mean that increasing a building's resource efficiency will increase its value. Further, sustainability enhancements can increase a building's competitive profile and reduce risks.

In a seller's market, identifying that you can significantly improve a building's operations will permit you to bid higher, potentially giving you an edge over other bidders. Alternatively, in a buyer's market, understanding the barriers to efficiency that a building faces will allow you to negotiate a better deal and make an informed offer. In either case, spotting these "diamonds in the rough" and evaluating what it will take to polish them will help you grow your green-building empire for less.

There may not be time during the offer period to invest in a full-scale investigation of building systems, but learning as much as you can about the building's current and potential energy performance will increase your advantage. At a minimum, analyze metrics such as energy intensity, energy cost per square foot, and ENERGY STAR score to estimate and adjust income forecasts for the property. Compare the metrics with regional averages and with other buildings that you own in the region. If your other properties are performing more efficiently, then there are likely opportunities to boost the property's value through operational or equipment improvements. Energy cost and intensity will vary by location, so the more experience you have with the local market, the better.

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SHARE YOUR ASSUMPTIONS WITH YOUR LENDER

Lenders will decide the terms of your loan based upon factors such as debt-service coverage ratio and loan-value ratio, both of which depend on net operating income. If you anticipate a reasonable energy performance improvement through improved operations, share your assumptions with your bank and encourage them to use the improved performance in their financial models. If your lender signs off on your assumptions, your loan may qualify for better terms.

Sustainability considerations at Unico Properties

Unico Properties recently acquired a property in Denver, where they have a number of other assets. Prior to the initial offer, the acquisitions team identified that the building's energy costs per square foot were above average for the region and above the average for Unico's other Denver-area properties.

Investigating the opportunities, the team identified that updating the lighting technologies installed offered the greatest opportunity for improvement. They devised a plan to retrofit the lighting and calculated the annual savings – after utility rebates – and the effect on the overall asset value. The lighting retrofit would increase overall value by 2.5% of the purchase price.

Similar analyses were done for other building systems, including an EMS upgrade, HVAC scheduling and programming, potential VFD installations, and an envelope scan. After indentifying which projects were most feasible, the acquisitions team was able to justify outbidding other potential buyers and purchased the property.

VISIT THE PROPERTY DURING DUE DILIGENCE

The acquisitions process can be fast-paced up until the final offer, but it slows down for due diligence investigations prior to official takeover. It is a critical opportunity to reduce risks, evaluate the existing property management team, and ensure that you understand the asset you are getting. Take advantage of this opportunity and evaluate the building's sustainability potential thoroughly.

The due diligence phase can encompass a broad assortment of evaluations and formalities. It may or may not include establishing final partnership or ownership arrangements, reviewing budgets and existing agreements, and making final revisions to the loan agreement. What it should always include is a visit to the property.

Visiting an asset prior to purchase provides an opportunity to conduct a thorough evaluation of the physical structure, equipment, and systems design, and to identify opportunities

for improvement. A site visit also allows you to get feedback from the existing property management team and possibly tenants, and to understand the property's shortcomings.

Increasingly, however, purchases are happening without a person from the acquiring firm ever visiting the property. Due diligence investigations are outsourced to third-party organizations – including engineers, sustainability consultants, and investment advisors – and they often are too cursory to identify potential risks.

Ensure that the individuals visiting the building understand both the technical issues and the overall market. They should have a good understanding of your organization's strengths and weaknesses, and they should be able to validate the assumptions about potential energy savings that you made during the bidding process. Due diligence is your last chance to identify additional risks before the transaction is complete – the importance of a comprehensive site visit cannot be overstated.

Evaluating the people with the asset

Throughout the acquisition process, consider the reputations of the other organizations that have been involved with the building. Is sustainability important to the current tenants, and/or can you convince them to be receptive to your anticipated improvements? Does the current owner have a reputation for being green? Was the property built by a reputable and trustworthy development company?

Tenants, previous owners and management, and developers who have failed to focus on sustainability issues can all create hidden barriers to improving energy performance. Recognizing these issues early allows you to temper your expectations and plan accordingly.

The due diligence process is a chance to understand not only the building, tenants, finances, and economics of the asset, but also the team that is currently running the building. One of your first decisions as owner will be whether to retain the existing team, and you can use their sustainability performance as a proxy indicator of their overall management performance.

Ask for read-only access to the building's ENERGY STAR Portfolio Manager data, and perform a comprehensive review. Also review the building's control system while you are onsite. Building schedules that do not align with tenant hours, outdated or incomplete ENERGY STAR Portfolio Manager data, or a lack of performance improvement should raise concerns about the team's commitment to sustainability.

PERFORM A SUSTAINABILITY ASSESSMENT TO CONFIRM YOUR ASSUMPTIONS

Final review and inspection should include an in-depth, professional sustainability assessment, such as an ASHRAE Level 1 and Level 2, or a similar evaluation. The property condition assessment (PCA) should be enhanced with specific guidance to inspect sustainability items.

Potential items to add to your PCA checklist are meter configuration for energy and water; the details of the Energy Management System (EMS) including age, what it controls, and operational settings; roof type; building envelope R-value and general integrity, including stack effect; lighting controls for all areas of the building; HVAC and lighting operating hours; lighting and HVAC technologies; ventilation controls for the garage and building interior; water fixtures and flow-rates in restrooms; irrigation system controls; recycling and composting options; transportation options and commuter amenities such as shower and parking; and existing sustainability programs and initiatives that are ongoing at the property.

REVIEW ANY AVAILABLE BENCHMARKING DATA

In addition to a physical review of the property, ask for read-only access to the building's ENERGY STAR Portfolio Manager data to perform a comprehensive review. Does the data look up-to-date and accurate? If the building is not certified, what is the building's rating, and how difficult would it be to achieve ENERGY STAR certification? Similarly, how difficult would it be to earn a LEED certification? Are there anomalies in the data or barriers to achieving a certification?

THE BOTTOM LINE

- Many owners have incorporated sustainability metrics in their operations but do not include them in the acquisitions process.
- Before changing your acquisitions process, become familiar with the existing process and assess why things are done as they are.
- Identifying critical decision points throughout the process will allow you to tailor the process to suit your needs and to leverage sustainability information to your advantage.
- Making better-informed investment decisions can boost your profitability

ADDITIONAL RESOURCES

Top Four Savings Opportunities
http://www.betterbricks.com/building-operations/tools/common-opportunities-0#TheTopFourSavingsOpportunities

Energy Efficiency and Appraisals
http://www.betterbricks.com/graphics/assets/documents/EEAppraisals_Final.pdf

Value Beyond Cost Savings
http://www.greenbuildingfc.com