

# Winning the Competition for Capital

Sustainable Renewal is Long Term Investment

By William (Bill) Roth



**REAL PROPERTY TOUCHES** the lives of every Canadian. We live, work, play, learn and heal inside buildings. With aging infrastructure, heightened expectations for the indoor environment and increased awareness of the environmental impacts of buildings, the job of the real property professional has entered a period of unprecedented change.

The strongest real estate cycle in recent history is in progress, but, at the same time, finding good quality, investment-grade assets, is becoming increasingly difficult. Many of the major markets show strong fundamentals. Yet a combination of aging buildings, increasingly strict regulations and legislation, heightened tenant awareness and expectations for the quality of the indoor environment, a movement towards sustainability, and ever tightening financial pressures, requires strict discipline from real estate professionals.

## WHOLE ASSET APPROACH

A whole asset approach to asset and property management ensures the most appropriate allocation of capital to a building or across a portfolio. But, with constantly shifting squeaky wheels screaming for precious capital, where should you start?

In any complicated situation it is always best to start with first principles. Without a clear and consistent understanding of the condition of the buildings, all other strategic initiatives will be subverted by the unexpected, unplanned system of component failure.

With a solid capital plan based on good quality assessment data, assets can be benchmarked within a portfolio. Given the

recent trend of deferred maintenance and the age profile of most Canadian assets (most buildings are at or beyond the expected useful life of most major building systems), in many cases the required capital will likely exceed the available funding sources. To secure additional funding from the CFO, government funding agency or board of directors will require a clear, easily understood, defensible capital plan.

With an understanding of the capital required simply to keep buildings operating as is, managers are then in a much stronger and defensible position to look for ways to align the portfolio with the organization's business and sustainability goals.

## POTENTIAL REGULATORY SPEED BUMPS

Whether it is the shadow of Sarbanes-Oxley legislation in the United States or an increasingly demanding environmental regulation, unexpected changes in regulatory compliance have the potential to disrupt even the best thought out strategic asset management plans. Unfortunately, as with all aspects of business today, the only constant is change. As such, it is impossible to avoid or plan for future regulation changes.

The best approach is to expand professional networks to receive warning as early as possible of potential changes to relevant compliance requirements. In most cases, draft for discussion versions of new legislation is released. This was the case in Ontario when a draft version of the Regulation respecting Asbestos on Construction Projects and in Building and Repair Operations (Regulation 838) was released to the public for comment. Many companies and

industry associations were given the opportunity to provide comments and therefore potentially influence the proposed changes to the regulation.

At a minimum, being aware at an early stage of changes to compliance requirements, particularly those that carry significant capital cost, allows for more proactive planning and budgeting. Companies that plan ahead and strategically implement solutions will almost always do so in a more cost-effective manner than those that wait until the last minute and reactively respond.

One of the most difficult compliance issues that real estate companies face is when a regulator reinforces a commitment to a regulation and begins enforcing what had been a toothless regulation. One such case of this again comes from Ontario, where the provincial government recently recommitted itself to the 3Rs legislation (Ontario Regulation 102/94 – Waste Audits and Waste Reduction Work Plans and Ontario Regulation 103/94 – Industrial, Commercial and Institutional Source Separation Programs) that has been in place for more a decade. With heightened fines of up to \$6 million for a corporation, and increased enforcement – stop work orders for non-compliant projects have been issued – industry is being forced to react quickly with unexpected capital expenditure.

## BEGIN WITH BENCHMARKING

Within the real estate sector, sustainability has been discussed for many years. Even so, it has only been recently that it has become the "it" topic. Instead of being a

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small discussion in a concurrent session at a conference, it is the focus of many of its own conferences and seminars.

It is true that if done haphazardly sustainability can become a capital drain. However, when its principles are implemented strategically and in alignment with an organization's vision, sustainability can be used to reinforce capital expenditures and assist in overcoming the competition for capital.

Implementing a sustainable renewal plan for a portfolio of existing buildings should start by combining a sustainability benchmarking assessment – using either of the common sustainability ranking systems, LEED-EB or Go Green Plus – to determine where the buildings in a portfolio currently rank in terms of energy and water efficiency, resources, emissions, indoor environment, etc.

With an understanding of where a building is green and where it is lacking, the truly synergistic aspect of the process begins. By first looking at the capital plan (things that really must be done), identifying related projects associated with regulatory compliance, and identifying the sustainability gaps, decision makers can

start to identify opportunities to improve the performance of a building, in addition to simply keeping it operating.

There are two shades of green that any sustainable project, strategy or initiative must meet in order to achieve buy-in throughout an organization. Firstly, the plan or program must meet the requirements of environmental sustainability.

## ALIGNMENT WITH BUSINESS PRIORITIES

However, for the measures to be truly successful, they must also be in alignment with corporate goals (financial, corporate responsibility, occupant-driven, etc.). Selling a sustainable strategy within an organization will be much easier to do if it has been created to align with the overall business strategy.

Not all sustainable buildings are created equal. Sustainability is like a smorgasbord of choices, all founded on the principles of minimizing the impact on the environment. To truly leverage the power of sustainability for a portfolio, managers must first decide what their sustainability priorities are.

Generally, energy efficiency is the easiest principle to get buy-in from an organi-

zation. Upgrades to the HVAC, lighting, controls, etc. are able to show very quick return on investment and can start to divert additional money into company accounts.

Recreating a traditionally constructed building as a sustainable building cannot be done overnight, especially if there is a need to maintain operations of the facility. Sustainable renewal is a longer-term investment that will take years to fully leverage. Think of it as mutual funds for your portfolio. As such, those early adopters that begin the journey today will have a competitive advantage over those who are late to the game.

With a more financially strong portfolio, with a reduced impact to the environment, and happy more productive tenants (the triple win) building owners will be prepared to thrive in the increasing world of the competition for capital. ■■

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