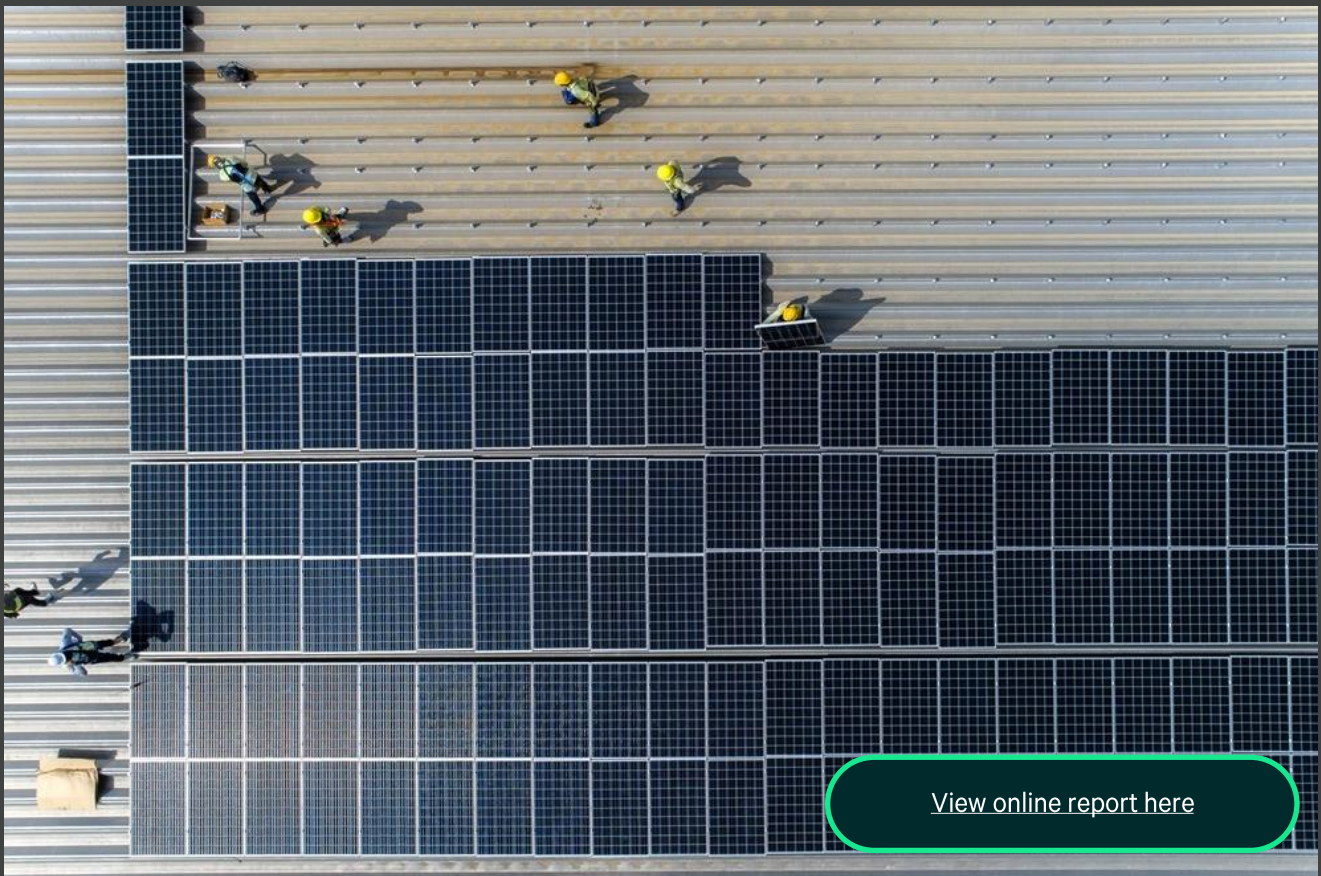


The value of sustainable distribution centres

December 2022



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— Preface

The role of sustainability in the logistics industry is set to grow in the years to come. This is due to stricter legislation (see text box below) as well as the growing demand from consumers and tenants. The initial yield from BREEAM-certified buildings is therefore lower than the yield from non-certified buildings. This analysis describes the impact of sustainability on the value of logistics real estate.

We are witnessing a growing interest in sustainability among consumers: the purchase of eco-friendly products is on the rise, and therefore the role of 'green' transport is growing too. These changes require a sustainable logistics chain as well as sustainable logistics real estate.

Sustainability is growing in importance among financiers, too, on the back of tighter legislation. Rising energy prices are also a factor: a sustainable building consumes less energy, which means lower energy costs. These are all trends that investors must take into consideration.

With its Sustainable Finance Action Plan (SFAP), the EU has set up a strategy to accelerate sustainability. They are doing so by introducing new policies for financiers, among other things. Important aspects of this include:

- The Sustainable Finance Disclosure Regulation (SFDR): investors must be able to demonstrate how they integrate sustainability risks and objectives into their policies, and how they reflect sustainability in their financial products. Objective: more transparency.
- The Corporate Sustainability Reporting Directive (CSRD): major corporations (> 250 members of staff and a turnover of €40 million plus) are obliged to report on sustainability and the social impact of their business operations. This information has to be verified by accountants.
- EU Taxonomy: this system categorises the measures mentioned above. This is necessary to improve comparability across the industry, and to combat greenwashing.

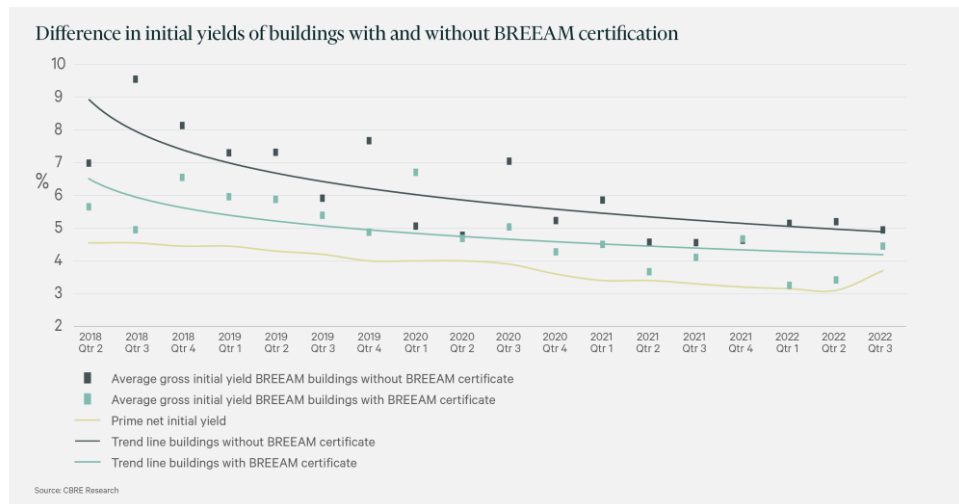
The BREEAM effect

To determine what – and how much – impact sustainability has on real estate values, you could, for instance, examine the prices of buildings with and without a sustainability certificate. We used BREEAM for this analysis, which is the label used the most in the Netherlands. This certificate not only takes the relationship between energy consumption and real estate into account; it also looks at aspects like land usage and ecology.

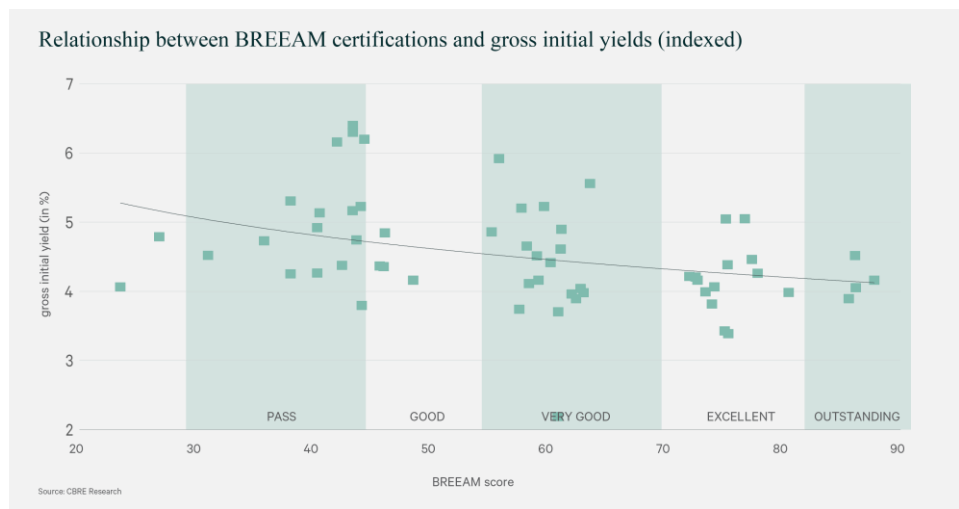
Lower initial yield

We examined more than 560 logistics real estate transactions carried out over the past four years. Of these, 110 had a BREEAM rating; so almost 20 per cent is certified. A further 50 are registered for certification – we have not included these in the analysis.

An examination of investment transactions reveals that, when buying logistics properties with a BREEAM certification, initial yields are generally lower than for real estate without this certification.



There is a correlation between BREEAM ratings and the level of the initial yield. Because we focused on transactions carried out during the past four years, the initial yields have all been indexed to current levels. Although the spread is quite wide, there is a trend: the higher the BREEAM rating, the lower the gross initial yield. That said, the higher the rating, the less sharp the fall in yield.



Evidently, sustainability has a value, but it falls slightly as the rating goes up. On average, investors are willing to pay 25 basis points more for a 'good' rating compared to a 'pass' rating. With an average investment volume of around €50 million in the dataset we used, this amounts to €2.7 million. The increase in basis points falls to an average of 15 in the step from 'excellent' to 'outstanding'.

Sustainability premium: difficult to measure, but noticeable

The higher the BREEAM rating, the lower the initial yield, or so Figure 2 demonstrates. Yet that is not the full story given that we only compared the BREEAM ratings to one another. That raises the question of whether investors are paying sustainability premium at all. It is difficult to give a cut-and-dry answer to that question. Generally, certified buildings are newer and are therefore better in terms of standards, which may also be the reason for the lower initial yield. Similarly, many other factors are involved, such as the remaining term of the lease at the time a building is purchased. That is why it is difficult to determine precisely what the effect of certification is.

Despite this, we are witnessing a trend. To explain this, we compared the initial yields of certified buildings with the prime initial yields at the time that the transaction actually took place. This comparison showed that some BREEAM-certified buildings were sold under prime yield. The median for the premium is 18 basis points. In Europe and the UK combined, it is 25 – so the premium in the Netherlands is slightly lower than average.

Reason for the premium

Tighter legislation and increasing demand from financiers are encouraging investors to pay a premium. They must be transparent about the sustainability of their funds, and certificates like BREEAM help with this. So sustainability is a positive factor in financiers' considerations, given that they are more inclined to fund sustainable buildings. The consequence? A better competitive edge and more lucrative funding conditions – which may include a lower interest rate. In that case, it is cheaper for investors to borrow money, and in turn that means that they can offer just that little bit extra when purchasing real estate.

Opportunities for rental growth

There is another reason for investors to pay a premium: rising energy prices. Sustainable buildings generally consume less energy, and so energy costs are lower. Some end users are prepared to pay more in rent in exchange for lower energy bills. This brings with it just as many costs below the line, or perhaps even less. Advantages: stable overheads because you are less dependent on fluctuations in the energy market. And that means you run less risk.

In addition, more and more tenants are keen to prove to their customers that they are taking steps in terms of protecting the environment. And that is why investors are inclined to go for sustainable distribution centres. It is not only a suitable way to promote your sustainability policies, it is also worth more.

Use the generated energy locally

Many effective green steps have already been taken: solar panels have been fitted on many distribution centre roofs and some business parks have wind turbines. This positive trend has one disadvantage: the electricity grid is at maximum capacity in many places. It is up to the grid management companies to solve this problem.

Property owners together with users can be part of the solution. The energy generated can be used locally, for example for appliances in your building, or to charge electric trucks and cars. Whatever is left can be stored in big batteries. That way, owners can offer integrated accommodation and energy. A recent example of this is WDP, which raised funds from investors to upscale their 'Energy as a Business' strategy. Other organisations, like Prologis, also offer this kind of service. As a real estate owner, you can also opt to outsource renewable energy generation to a so-called energy service company (ESCO).

Time for a new standard

Renewable energy is set to take off even more, especially since the government is expected to make solar panels obligatory from 2025 onwards. This will be an important measure, particularly if we intend to reach our sustainability targets and keep the planet liveable. Sustainable distribution centres will contribute to this. As it stands now, investors are still paying a premium for these buildings, but ultimately it will be the standard. We are expecting that there will be a discount for buildings that are not sustainable. In other words: their value will decrease. As a real estate owner, you don't want to fall behind.

The value of sustainability

In this analysis we examined the impact of sustainability on the value of real estate. Our conclusion is that sustainability definitely has a value, although it does diminish as the BREEAM rating increases.

The amount of the sustainability premium that investors pay is difficult to measure because of many other factors, but it is noticeable. Tighter legislation, increasing demand from financiers and rising energy prices are encouraging investors to pay a premium. Ultimately, sustainable distribution centres will become the standard, and buildings that are not sustainable will fall in value.

[1] Some owners decide not to certify their building, because applying for a BREEAM label costs time and money. A building may well be sustainable but it may not have a certificate, and it will therefore not be included as a certified building in this analysis.

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Do you have questions about the content of this publication? Feel free to contact the people who created the report. Our Dutch and international experts and research colleagues are willing to answer your questions. Below you will find their contact details.



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