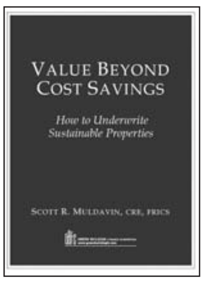
RECOMMENDED READING

Value Beyond Cost Savings: How to Underwrite Sustainable Properties

by Scott R. Muldavin, CRE, FRICS (©March 2010, Green Building Finance Consortium, 306 pages)

REVIEWED BY MAURA M. COCHRAN, CRE



"The final key conclusion is that the biggest challenge to sustainable financial analysis is not the modeling, but the integration of sustainability considerations into the determination of the input assumptions." —SCOTT R. MULDAVIN

WHEN IS UNDERWRITING real estate different from underwriting sustainable real estate? Why is it different? What makes a building sustainable? What are the issues? In the new text, *Value Beyond Cost Savings: How to Underwrite Sustainable Properties*, Scott Muldavin, CRE, FRICS, leads readers through the quagmire of underwriting commercial and multifamily residential properties, and provides the logic to understand how to correctly modify old tools for "green" underwriting.

First, some background. Muldavin is a recognized expert in underwriting. In the early 1980s he developed the first commercial mortgage risk-rating system for Standard & Poor's. At Deloitte & Touche, and subsequently in his own practice, he worked with financial institutions and Fortune 500 companies to improve their underwriting and risk assessment. He has written more than 250 articles on financial topics and is in demand on the lecture circuit for his insights and commentary. Muldavin became intrigued with "going green" in its earliest years. Based on work with clients, he was increasingly hearing about concerns pertaining to investing in these new buildings or the retrofit of existing properties. He was fascinated with how to quantify the impact of these initiatives in a pro forma. This led to his creation in 2006 of the Green Building Finance Consortium (GBFC). GBFC's work is funded by the real estate industry, select government and non-governmental organizations, The Muldavin Company, and by the efforts of unpaid contributors. The Consortium's mission is "to enable private investors to underwrite sustainable property investment from a financial perspective."

To accomplish this mission, GBFC has developed the underwriting methods and practices required to independently assess sustainable property investment. This book is the result of the GBFC's efforts including CREs Theddi Wright Chappell, Tim Lowe and Andy Fusscas, who are on the Implementation Team; CREs Brent Palmer and Peter Korpacz, who are members of the Board of Advisors; and CREs Roy Schneiderman, Steve Grant, Steve Navarro, and Rick Tannenbaum, who have offered advice and assistance.

About the Reviewer

Maura M. Cochran, CRE, SIOR, *joined Bartram & Cochran in 1987 and has worked in the commercial real estate industry for more than thirty years. She practices both national and local consulting and project implementation, including due diligence analysis, adaptive reuse studies, marketing plans and corporate relocation assignments. Her active involvement with The Counselors of Real Estate (CRE) and the Society of Industrial and Office Realtors (SIOR) gives her excellent access to market information nationwide.*

In writing the review, I communicated with Muldavin to get more background on the creation of the book. He said: "The most interesting story about the book is its title. For nearly two years since I decided to write a book in 2008, it was called *Underwriting Sustainable Property Investment*. While completing a series of presentations in late 2009 about the findings of my book, just prior to its release, it became clear to me that besides being boring, the title failed to convey the key purpose and contribution of the book—to enable investors to calculate and consider the value of sustainable property investment beyond savings from energy costs. Despite a growing recognition of the health, productivity, recruiting, and related benefits of sustainable property investment, there was little guidance on how to assess these potential benefits and incorporate them into decision-making. Accordingly, the industry has been stuck, with most investment limited to that which can be justified by immediate cost savings over a short-payback period. With significant increases in the demand for sustainable properties by regulators, space users and investors, incorporating *Value Beyond Cost Savings* will not only enable substantially larger investments in energy efficiency and sustainability, but investors to maximize profitability from their investments."

I found myself fascinated with the Consortium's work. This book reviews the basics of underwriting: strategic decisions lead to tactical decisions, which lead to being property-specific, regardless of whether the property is "green." Once the basics are dealt with, the text provides data on the rent and sales premiums that tenants/investors will pay (or not pay) for a sustainable building. It notes that sales price premiums ranged from 5.8–31 percent for ENERGY STAR® properties and 9.9–35 percent for LEED®-certified properties. That is exciting, until clarified that "due to severe statistical, methodological and data problems in the sales price analysis, the Consortium places little confidence in these specific numerical results." What does a reader do with that information? We now know that there is a premium that purchasers will pay, but there is no absolute number. There is a range, and a sensitivity analysis is required. It also demonstrates that these buildings are viewed favorably, which is not an insignificant matter.

What is the demand for "green?" From March 2006–2008, 14 percent of law firms surveyed by CoStar Group® reported signing leases in sustainable buildings. At the low end of the spectrum, manufacturing and retailers/wholesales report one percent of leases being "green;" transportation came in at zero percent. How has that changed in the last three years? Lack of current data is part of the rub. With the financial world "on hold" for the past two years, there have been few building sales and a reduced volume in leasing transactions. Getting current data for underwriting is difficult in 2010, and "green" data is even more limited. The basics of underwriting come back to the forefront: understanding the tenants and the market in the context of the property.

The book cuts to the chase: discounted cash-flow analysis is well suited to address the financial implications of sustainability. The key to successful underwriting is in the logic and understanding of this new product or it will be easy to overshoot or undershoot the mark. This is where the book really hits its stride. The cost-benefit checklists are very helpful. But even more useful are some of the war stories and examples of what works and what doesn't. A bike rack helps get LEED points, but does it really add to the bottom line? Do waterless plumbing fixtures add or detract from the value because of maintenance issues? Understanding these issues provides confidence in knowing what to ask for in the due diligence process.

The book follows the axiom "Tell them what you are going to tell them. Tell them. Tell them what you told them." The topical index at the beginning of the text leads you through the 13 chapters. Each chapter outlines in more detail what is going to be covered, and the end of each chapter summarizes key points (a Cliff's Notes version for those in a hurry).

Muldavin related the following story in Chapter Four, which is interesting. "I began the research for Chapter Four because of my belief that real estate capital providers care less about the five cherry-picked "case studies" that describe successful outcomes, and are more interested in understanding investments that failed or underperformed. I initiated the "Failure and Underperformance in Sustainable Property Investment" study with high hopes, but quickly found that few of the people with substantial experience in the industry were interested in being associated with such a study. Accordingly, I renamed the study "Sustainable Property Performance" and got great response from the industry and a chapter that provides critical insights in translating performance information into financial analysis and valuation."

The entire book is really the tip of the iceberg, with more detail on each topic available online at *www.greenbuildingfc.com* which will be a great way of enabling the text to be continuously updated. The eight appendices are 130 pages long, with useful bibliographies, cost-benefit checklists and sample discounted cash-flow analyses.

The text concludes: "Underwriting properties with sustainable features does not involve a fundamental change in existing methods and practices. However, underwriters need to enhance their education of sustainability and learn some new techniques, and dust off some old ones, to effectively identify, price and mitigate sustainable property risks." Amen.

Muldavin's book deserves a place on your bookshelf; the electronic version should be bookmarked on your computer. The book, as well as complementary resources of the Consortium, can be downloaded from its Web site at *www.greenbuildingfc.com*; hardbound books are available for $35 from that same source. The author also has granted authority to include direct links to the book and other resources on your own Web site, and/or you can make the book's PDF directly available. ■