New research shows that more energy efficient assets had better investment performance over the last 12 months.

What is the Sustainability Index?
CBRE has analysed over 1,000 regularly valued properties to create an index of investment performance based on their energy efficiency ratings. Using data from Q1 2021 to Q2 2023, we examined the investment returns for efficient and inefficient properties. Energy Performance Certificates (EPCs) are the basis for our energy efficiency ratings.

While we do not seek to prove a causal relationship between energy efficiency and investment performance, we do illustrate how they correspond, both at an All Property level and for three main sectors of the UK commercial real estate market.

Key findings
Better energy efficiency appears to correspond with greater resilience to market downturns. In the context of falling values during the 12 months to Q2 2023, the index shows that efficient properties in the Office and Industrial sectors experienced smaller declines in total returns than inefficient properties.

Since the start of the index, efficient assets in the Office and Retail sectors experienced higher cumulative total returns. In contrast, there was little differentiation between total returns for efficient and inefficient assets in the Industrial sector over the same period.

Total returns for efficient buildings, 12 months to Q2 2023
-16.0% All Property
-11.5% All Offices
-13.6% All Retail
-22.8% All Industrial

Total returns for inefficient buildings, 12 months to Q2 2023
-17.2% All Property
-14.7% All Offices
-12.1% All Retail
-24.0% All Industrial

Source: CBRE Research
Energy efficient Offices have delivered higher total returns and more resilient performance during the recent downturn.

Energy efficient Offices have delivered better total returns since the start of the index, with stronger rental growth and smaller declines in capital values relative to inefficient Offices. Annualised total returns for efficient Offices since index inception have been -1.4%, compared to -4.6% for inefficient Offices. Over the same period, rental values for efficient Offices increased by 10.9% overall, and by 4.2% per annum, compared to 7.4% (2.9% per annum) for inefficient Offices.

Capital values for both efficient and inefficient Offices have fallen since index inception. This reflects the general market downturn during the last 12 months. However, capital values for inefficient Offices fell by 14%, more than twice as far as efficient Offices (-6.2%). These trends arguably reflect the two-tier state of the UK Office market. There is an oversupply of outdated and energy-inefficient secondary stock, for which demand is low and CapEx costs are high. In contrast, the demand for good quality, energy efficient offices is high, with tenants increasingly motivated to occupy energy efficient space due to corporate net zero targets.
In the Retail sector, energy efficient assets have recorded stronger total returns than inefficient assets. Annualised total returns for efficient Retail assets from Q1 2021 to Q2 2023 were 2.6%, compared to -0.6% for inefficient assets. Despite this, rental value growth since the start of the index has been 1.8% (0.7% per annum) for efficient and inefficient Retail assets alike.

Efficient Retail assets have exhibited weaker total returns over the last 12 months, driven by a larger fall in capital values. The values of efficient assets declined by 15.3%, whereas inefficient assets only saw a decline of 13.8%. However, efficient Retail assets have recorded positive capital growth of 2.4% since the start of the index. This compares to a 5.6% fall in value for inefficient buildings.

These patterns are influenced by the mix of assets in the efficient and inefficient samples. The all Retail efficient sample is more weighted towards Retail Warehouses, and the inefficient sample towards High Street Shops. This contributes to the large difference in efficient versus inefficient capital growth, with efficient performance reflecting the stronger performance of Retail Warehouses over the 10 quarters covered by the index.
Industrial

Little difference in investment performance to date between efficient and inefficient Industrial assets

Energy efficient Industrial assets delivered slightly weaker investment returns compared to assets over the period covered by our index. The annualised total return for efficient Industrial assets since index inception has been 3.0%, compared to 3.5% for inefficient assets.

Inefficient Industrial assets delivered stronger rental growth. Over the 10 quarters covered by the index, inefficient rental values increased by 25%, and by 9.3% per annum. This compares to 19.7% (7.5% per annum) for the efficient assets. Over the same period, capital growth was stronger for inefficient Industrial assets, at 5.7%, compared to 4.3% for efficient Industrial assets. However, capital values for efficient Industrial assets fell slightly less (22.8%) during the last 12 months, compared to inefficient assets (24.0%).

The reason that greater energy efficiency has not been reflected in better investment returns is likely because other, stronger forces have been driving performance in the sector. Demand has been high for Industrial space, while supply to date has remained constrained. Therefore, energy efficiency is not yet valued to the same degree as in Offices, and pressures to upgrade existing assets that would entail capital costs have been more limited.
Sample characteristics

EPC distribution for CBRE sample reflects overall commercial stock across England and Wales.

Composition of the index

The sample used for the CBRE Sustainability Index comprised over 1,000 property assets with a combined capital value of £17.7 billion, and rental value of £1.2 billion, as at Q2 2023. The sample size can change from quarter to quarter, but investment performance in an individual quarter is always calculated based on a consistent sample of assets.

As at Q2 2023, the index sample (by asset count) comprised of 23% Office assets, 25% Retail, 34% Industrial, and 18% assets of other property types. Overall, 23% of the assets in our sample were classified as efficient, and 77% were classified as inefficient at Q2 2023, based on their aggregated unit level energy efficiency ratings.

The EPC count of our sample at unit level closely matches the distribution of all non-domestic EPCs in England and Wales, as recorded on the Government database. For this reason, we believe the index findings are broadly applicable to the market in general.

Source: Department for Levelling Up, Housing & Communities, CBRE Research.

Sample characteristics as at Q2 2023 (England and Wales EPCs issued between January 2018 to present).

England and Wales EPC distribution compared to CBRE sample (unit level)

Sample characteristics as at Q2 2023 (England and Wales EPCs issued between January 2018 to present).

Source: Department for Levelling Up, Housing & Communities, CBRE Research.
Further information

To create the Sustainability Index, Energy Performance Certificates (EPCs) at the unit level were aggregated into an asset level EPC rating. This was done using a weighted average. Unit level EPCs were weighted according to their share of floorspace in the whole asset. We only used assets valued at a quarterly or monthly frequency and where EPCs were available for more than 80% of the total floor area recorded for that asset. We then defined efficient assets as those with an aggregate EPC of B or higher, and inefficient assets as those with an aggregate EPC of C or lower. Our definitions of efficient and inefficient are consistent with those used by the Sustainable Finance Disclosure Regulation (SFDR) in principle adverse impact 18. EPC ratings for asset valuations prior to Q1 2022 were applied using the aggregated asset level EPC ratings calculated for assets from Q1 2022 onwards.

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