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Developers agree green building finally becomes financially sustainable

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Among developers, a significant paradigm shift is taking place.

Just a decade ago, when government and environmental groups started promoting "Building Green" and encouraging Leadership in Energy and Environmental Design (LEED) certification, most developers grouched.

It's a fad. It's not practical. It's never going to pencil out financially, because tenants are never going to pay the higher lease rates to make up for the higher materials and construction costs.

But, now -- within the last year -- the grouching has all but stopped, said Tom Parsons, senior vice president of real estate developer **Opus Northwest**.

The 2007 Green Building Survey conducted by Penton Custom Research for the National Real Estate Investor backs him up. In the national survey, 84 percent of corporate tenants and 77 percent of all developers that were surveyed expect to own, manage or lease at least some green properties within the next five years.

Parsons believes his colleagues in the Northwest have an even higher regard for green.

"I'd say 80 percent [of developers] today are involved in evaluating whether they will build their project green," he said. "Three years ago it was probably 50 percent."

To be sure, LEED certification -- which has become the standard for green buildings -- is a point-based system where points can be gained for a variety of different improvements. Thus, the paths to becoming LEED certified are varied and so are the outcomes in efficiency. And, the variety of types of sustainable buildings is reflective of the ways in which developers are embracing the concept. Still, developers are going green.

Why the change of heart? Simple. Green buildings are beginning to bring in greenbacks for developers.

Large corporate tenants are demanding LEED-certified buildings, green building materials and processes are less costly than they were several years ago, and soaring energy prices are making energy-saving practices in green buildings look better and better.

"Developers are smart guys, so they aren't going to build green if they can't make it up on the back end," said John Powers of **Colliers International**.

When the concept of building environmentally sound buildings in accordance with LEED certification was first introduced, recouping the costs of "green" improvements could take developers five to 10 years, Powers said.

"Now it's a matter of instant payback," he added, with "instant" in developer terms being 18, 24 or 36 months.

Much of that is due to market conditions.

"The cost to build green has come down, in part because a little of the veil of black magic as been removed," Parsons said. "As little as three to four years ago, 25 to 30 percent of the costs to build green were purely administrative, because few people understood LEED and they could command a high price for those services."

Materials, too, have become more affordable, said Douglas Howe, CEO of **Touchstone Development**.

Five years ago, there were very few options and very few suppliers of high-efficiency paints, plumbing and other building materials, Howe said. Now there are many.

"You get better products and the price comes down and we get smarter how to do this," he said. "To achieve LEED gold certification today is substantially less than it was five years ago.

In fact, Parsons estimates, "We're seeing a cost of 1 percent to take a building from noncertified to silver or gold LEED certified," he said.

A-p Hurd, a member of Touchstone Development's executive team, said developers at the **National Industrial and Office Properties** (NAIOP) first green-building conference discussed the price premium to build LEED-certified facilities. What she learned was that Seattle is one of a handful of areas in the U.S. where market forces have converged to eradicate the price premium and make it financially feasible to build green.

"In California, Seattle, Manhattan and Washington, D.C., there wasn't a significant premium to build green," she said. "In other parts of the country, there was a 5 percent premium or higher."

Parsons said the Pacific Northwest is among top-tier regions in terms of sustainable development, a trend driven in large part by city, county and state government.

In Seattle, the city now requires municipal buildings larger than 5,000 square feet to meet a minimum of LEED silver certification. In 2001, in collaboration with **Seattle City Light** and **Seattle Public Utilities**, the city also introduced a LEED Incentive Program, with incentives of more than \$2 million for energy conservation, more than \$2 million for natural drainage/water conservation and more than \$300,000 for design and consulting fees for LEED projects. Total funding levels were \$15,000 for basic LEED certification and \$20,000 for LEED silver or above.

In January 2007, 26 projects within Seattle's city limits had achieved LEED certification, representing more than 8.1 million square feet and more than \$2 billion in capital investments. Colliers International's Vision 2020 report shows that Puget Sound region as a whole has 33 LEED-certified buildings, representing 9.5 million square feet and more than \$3 billion in capital investments.

Even with the incentives, developers agree that without tenant demand and willingness to pay for the extra services, building green wouldn't happen.

"For the first time, just in the last 12 months, we're actually seeing tenant proposals for space where they're asking the question, 'What are your sustainability ratings?'" Howe said. "You're starting to see major corporations say, we're green, we're sustainable. And now their shareholders and the NGOs and such are asking what they're doing about it. So the corporations are stepping up."

Government and Fortune 500 companies are among the leaders. IBM, Toyota, Bank of America, KPMG International, Tishman Speyer and Adobe have all made commitments to housing their operations in green office buildings.

Companies that own their buildings are among those who invest in building green.

Corporate users expect that the amount of green facilities they own or lease will more than double from 9 percent to 21 percent in the next five years, according to the Green Building Survey.

"To date and still today, it's easier for a long-term user -- a foundation, a government, an owner -- to make a larger up-front investment," in the buildings, Howe said.

These types of tenants can take longer to recoup all of their costs and realize the full potential of energy and water savings and improved air quality, explained Touchstone's Hurd.

But the majority of tenants are still not willing to pay a big premium to lease an office in a sustainable building, Parsons said.

He estimated that 10 percent to 15 percent of private business owners actually demand green office space, while another 30 percent or 40 percent would go green if they didn't have

to pay extra for it, and about 25 percent don't care one way or the other if they are in a green building.

"Five years ago, I would have said 75 percent didn't care," he said.

"What we're seeing is that most tenants are seeing green as a tie breaker," Parsons said.

"They think if I could be in this building and pay \$20 a square foot, or I could be in a gold LEED building and pay \$20 a square foot, I'll go with the LEED building."

According to Howe, "developers still resist change and innovation until they're forced to recognize it and deal with it -- until their customers demand it. So, we're at the tipping point right now."

Still, developers say they must balance building green with seeing a return on their investment.

Touchstone became silver LEED certified for its 9th and Stewart building in Seattle and expects its West Eighth office tower to become gold LEED certified. Howe said the company made a commitment early on to put money toward sustainable practices where it can realize a return -- specifically in energy and water savings.

Opus NW, which built the first gold LEED-certified industrial property in Portland, Ore., for Honda of America, also is recouping its investment in green building, Parsons said. "We believe in sensible sustainability. That means we believe in incorporating sustainable building practice into all of the projects, and the level of green is driven by the market and the tenant. Not everybody has the same need. It's really picking the things that will pay off in the end."

As investors are evaluating buildings, they're looking for LEED certification just as tenants are, Parsons said.

The Responsible Property Investment Center counts more than 25 private equity funds and institutional investors among its members. Based on results from a recent survey of real estate executives co-sponsored by the Building Owners and Managers Association, the National Association of Real Estate Investment Trusts, the Real Estate Roundtable and the Urban Land Institute, the survey concluded there is considerable interest and activity in responsible property investment among America's real estate investment organizations.

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