

The 17th Annual International Land Policy Forum

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"Sustainable Real Estate Investment"

Lecture record

Jon Collinge [A Practical Approach to the Implementation of Sustainability in Investment Management]

Good afternoon. My name is Jon Collinge. I'm Sustainability Manager for Lend Lease's investment management division in Australia. Before we get too far into this so I should just say I'm an engineer and definitely not finance guy so when you direct a question accordingly later on.

Before we start. I'd like to make special thank to the Ministry of Land, Infrastructure, Tourism and Travel for welcoming me today. It's an honor and a privilege to be able to represent Lend Lease in this forum. And in front of such a distinguished audience as well.

I'm here to talk to you about the practical implementation of 'sustainability' in investment management and, in particular, the application of sustainability in the property investment sector. In this presentation I'll be describing the sustainability journey that Lend Lease Investment Management has been on for last few years. I'll also be confirming how that journey will be continued to be into the future.

With reference to Dr. McNamara's presentation I can proudly say that we are green fund managers and not managers of green funds.

But first, I should add some background information of what Lend Lease is. So founded in 1958 and listed on the Australian Stock Exchange, Lend Lease is an international property group that creates, enhances and manages real estate assets around the world. Our vision is to be the leading global property company.

The company is headquarter in Sydney, Australia in our highly sustainable office building- 30 The Bond. And that is really great place to work I have to say. It's a very good quality building. Globally, we have approximately A\$10.1 billion dollars of Funds under management in the property sector. And we have well this equates about 800 billion yen.

Please take a look at this slide, Lend Lease creates value for our customers and shareholders by being capable of providing a full spectrum of property services. I let you digest that yourselves. We have 58 track records of designing and developing high

quality property. Here are few examples of what we owned and we also built and developed. And some cases we actually design them in house as well. To that building I'd like to point out.

First one is the Summerset house in Singapore the bottom there. That's the Leed platinum rated shopping center which is an absolutely fantastic property for the company. Also, the Gauge at Victoria Harbor that's a mammoth favorite buildings cause I was one of the designer. That was the first six stars building in Australia so actually follow to improve that actually was capable of doing what we say it was going to do during the design phase. That's a really good achievement for us.

Sustainability is a core operating principle at Lend Lease. This is demonstrated not only through the properties we develop but also through our participation in globally recognized sustainability initiatives such as Dow Jones Sustainability Index, the Clinton Climate Change Initiatives to which I think we have two or three properties signed up for that, three development I should say. And also through our involvement with Green Building Council.

We were in an inaugural member of both the United Kingdom and Australian Green Building Councils and delivered the first five and six star building in Australia. Indeed, Lend Lease has now mandated green building certification on all developments.

So bit on investment management division. Globally, we manage 11 unlisted property funds consisting of 91 assets and over 120 institutional investors.

In talking to you about the sustainability journey that Lend Lease Investment Management have been on over the last few years, there are 3 factors that are the keys in the delivery of sustainable investment management. They are leadership, business systems, and stakeholder engagement.

It is no coincidence that these key factors happen to be three of the main pillars of change management. Why change management you ask that's why I'm here to talk about sustainability. I also truly believe that the practical implementation of sustainability in investment management is no different to any corporate change management process.

When moved into my current role having previously worked as a design consultant, you may as well forget about everything you know about sustainability and start learning about change management. It is a shame that sustainability should be thought of in this context, but it's a necessary truth.

Importantly if I could leave you all with one message following this presentation, it would be that all three factors are inextricably linked. Although you may need to apply more effort to one area at different times, focusing in one area alone will not drive

change.

Leadership is the major factor in implementing sustainability. Without true commitment from the senior leadership team and the board it would be very difficult to implement successful change. In this section of the presentation, we will look at why we may want to commit to sustainable investment management, who in the business needs to commit. Or who in the business needs to provide leadership and what form a commitment to sustainable development or sustainable investment management might take.

The first stage in developing this commitment is to convince yourself and your business that it is the right thing for the business to do. We need to determine why we want go green in a first place. What are the drivers for your business?

We need to show how we want to proceed to the goal clearly. But this is not always the way the world works unfortunately. Without the right business drivers change at a corporate level is difficult to implement.

We at Lend Lease develop commitment by constantly reviewing what our tenants and investors are demanding and ensuring that we always know what the legislative horizon looks like. In fact, whenever possible we try and take an active role in emerging registration. We also like to keep an eye on our direct competitors to make sure we are not falling behind. Finally, due to the nature of the Lend Lease, we have to consider the direction in which the corporation is heading. So it's not just about the investment management department. It's also about whale corporation.

However, in our opinion the property sector sustainability value proposition is simple...the benefit be they, financial and environmental, social or health well been related create the demand for green buildings communities and precincts, which subsequently provides value for tenants, occupants, building owners, fund managers, investors and the like.

There are three key drivers of this value proposition for the property market. Tenant Demand, Future Proofing Asset Value, and Sustainable Responsible Investment trends.

When we look at sustainability value proposition, finance considerations can be measured either directly based on financial return on investment criteria or criteria that influences the valuation of the asset. In most cases, both are influenced to various degree.

If the sustainability investment opportunity meets any of the financial investment decision making criteria - such as capital budget, target internal rate of return, or first year yield the decision becomes a no-brainer.

But in many cases, the cost and benefit sustainability goes beyond simple financial equations and opportunity cost and long term value potential becomes a key

consideration.

At the end of the day, we acknowledge that it may not be a case that green buildings will achieve a rental premium, instead, it will be those buildings that do not achieve the desired environmental performance that will become redundant and obsolete....and who can really afford that.

To demonstrate that sustainability is becoming increasingly important to our investors, I will give you an example of some of the questions we have to respond to in our investor and investment consultant surveys.

Does your company have a sustainability group?

Do you consider there to be a link between environmental performance and investor returns?

Does the fund target green rating?

Do you have Environmental Management System?

This is just a few examples. One major survey we completed recently had nearly 20 sustainability focused questions. We feel that having to respond negatively to any of these sustainability related questions, or having poor performance in these surveys can only erode the pool of potential investor into our Funds - not something we take lightly.

Once it's been agreed that you are ready to commit to sustainability, it is obviously important that everyone at a senior level is committed. Employing a sustainability manager, like me, will certainly not automatically result in a sustainable organization. Sustainability needs to be entrenched in everything we do. This takes commitment from board level to asset managers and accountants even secretaries.

We believe that leadership can be demonstrated in many ways. For example, you may choose to become a signatory of the United Nations Principle of Responsible Investment or a local Responsible Investment Association. We feel that it is most clearly demonstrated through the generation of a well researched and achievable sustainable responsible investment policy.

This is a picture of our one page sustainable responsible investment policy. I don't wish to read it all, but I would like to give you a flavor of the content. The opening line reads as follows.

"As a fund manager, we have a duty to act in the interests of our investors. In this fiduciary role, we believe that environmental, social governance (ESG) and safety factors form an integral part of the management process in our property portfolios; acknowledging that continually improving the sustainability performance of our assets and developing sustainable investment products will deliver long-term value for our

investors, the environment and our local communities.”

It very strong words, I’m sure you’d agree.

Within the policy we also commit doing following.

We commit to formally evaluating the impacts and risks of environmental, social and safety issues in our decision making processes. We commit to measuring and reporting on sustainability metrics, not just environmental; so also committing to safety and other aspect of sustainability. We commit to developing and implementing Fund Specific Sustainability Strategies across each of our Funds to clearly articulate the sustainability aspirations and performance targets for assets and Funds. We will talk about these later. We also commit to using green building rating tools where they exist and engaging and sharing knowledge with stakeholders on ESG and safety issues. We also commit working with industry bodies and government on tools and incentives which promote improved environmental social and safety performance in the property and investment industries.

That is what we commit to, and that is what my board required me to report against an annual basis.

It’s really important to note that the leadership component doesn’t happen overnight. Our formal commitment to sustainability began in 2006 when Lend Lease Corporation mandates that a sustainability manager should be employed to specifically service the investment management division. It wasn’t our choice.

As you can imagine that first sustainability manager - it wasn’t me - and he was forced to face a great difficulty. We got off to a relatively slow start within our business. There were few supporters but significantly more people with no interest in sustainability because, of course, the perception was that sustainability equates to cost. It will affect our fund performance and our investors would never accept it. That was the thought.

The first step we undertook was to have wide sustainability workshops. It was quite successful so that we could increase the levels of engagement. Unfortunately, those who were most important to the process meaning the leaders were least committed attend these workshop. Importantly I should know that they have since been revolutionized.

In 2007, which we consider to be our tipping point for sustainability, we sponsored a major sustainability conference and hosted a number of investor workshop with Professor Gary Pivo who I believe spoke at this forum last year. This is where dawning realization came that sustainability was important to our investors to our business I suppose.

2007 also saw that release of our first Sustainable Responsible Investment Policy and the first Fund Specific Sustainability Strategy, which was completed for one of our

commercial office funds. This was considered necessary due to demands of our tenants and drive for tenancies in energy efficient buildings, so what we just spoke about. Particularly from the government department in Australia that was the main driver.

In 2008 we became signatories to the UN PRI. And revise our Sustainable Responsible Investment to suit this commitment.

We have since been building on this platform.

Shown on the slide are some of the successes that our investment management division has had in the area of sustainability.

I don't intend to talk to them all. You can read at your leisure. I just wanted to add here that importantly as company Lend Lease has a serious commitment to operating incident and injury free in all of our operations. This is our number one priority - everybody should have the right to go home the end of the day. Everybody should have allowed to home healthy at end of the work or after visiting one of our shopping center or asset.

I'm now going to talk about some of the business systems that we incremented. By business system, I don't just mean IT system. I mean systems and processes that can be used across the business to deliver sustainable outcomes. Without good systems it is not possible to make progress in this area.

In this presentation I will describe 4 key business systems that we utilise to drive the sustainability agenda through our business.

The first is the Fund Specific Sustainability Strategies that I mentioned a second ago.

The second is the Environmental Management System. We feel that this will underpin the way we do business.

The third system is our data collection systems that we use.

Finally I'll discuss some of the reporting that we undertake, and the various levels at which sustainability information is reported.

This is an example of one of our Fund Specific Sustainability Strategies. These documents are perhaps the most critical of all our systems in terms of the application of sustainability outcomes at the asset level. They are targeted at all stakeholders and must be understood by our investors, whilst being detailed enough to be useful to our property managers and their consultants.

As you can see, this document has been written for our Australian Prime Property Fund - Commercial. This is the fund that contains much of our premium office buildings which attract the blue chip and major government tenants. This document is the 2010 update - unbelievably the industry has moved so far since first released the document in 2007 that we have to update. The level of presentation of this document demonstrates

that we take them seriously. Importantly, they are written by the Fund managers through engagement with our property managers and consultants and then endorsed by our board before being finalized.

Intentionally, all of our Sustainability Strategy follow the same format. We first ask the fund managers to set the context. What are the market considerations? What does the legislative environment look like? What are the specific issues associated with this sector or investment theme? This section not only educates the users of the document, it also forces each fund to undertake research and fully understand the environment in which they are operating.

A sustainability vision for the fund is then set from which delivery strategies and pathways are determined. Importantly, strategies for static assets development projects and acquisition opportunities are established.

We are also very cognisant of our responsibilities as investment managers. As such, the final section of the main document typically notes that we have a fiduciary responsibility to our investors and includes any specific hurdles or considerations that each fund may have.

Finally, what I think one of the most important sections of the document, is located in the Appendix. This is where we specify asset specific target as you worth and way in circle. I now provide some examples.

We believe that fund specific sustainability vision is very important, particularly as it is not generic corporate objective and is determined by the actual managers of each fund rather than their superiors such as the managing director or the board. As such, the fund managers have complete carriage of the strategy for the fund.

Like any vision, the sustainability vision should aim to be inspirational and memorable. Something the fund team and our service providers can easily remember without having to constantly return to the documents.

The vision for our premium, open ended office portfolio is as follows.

...’to be recognized as the leading environmentally sustainable commercial office property fund in the Australian marketplace.’

Similarly, the vision for our open ended regional shopping centre portfolio is:

...’to be the sustainable retail investment product of choice in the Australian unlisted property market, responding to the unique aspects of retail design, development and operation to create positive triple bottom line outcomes for investors, retailers, customers, and community.’

Interestingly, this vision acknowledges that the retail centres we own play a very important role in our communities.

One of the closed end funds chose a far more practical vision statement.

... 'to deliver smart, cost effective sustainability solutions across the portfolio.'

They obviously considered that due to the short term nature of the fund, major investments in sustainability without fast returns on investment were not to factor in their strategy. As a sustainability idealist, I find this quite disappointing. But we have to acknowledge that different funds have different mandates. They can't all be the sustainable investment vehicle of choice. Only time will tell whether their strategy is successful, particularly given the predicted 42 % increase in energy costs during the life of the fund.

I'm now going to give you some examples of the strategies we set across each fund.

The fund level initiatives are relatively similar across the investment management division but very depending upon the sector and also the quality of the building in a portfolio.

Major focus for us is improving our ability to monitor how energy and water flows around the building. Without this information it is difficult to establish where inefficiencies lie and also to ensure that implemented initiatives are actually performing as predicted. Unfortunately, measuring and monitoring is not seen as one of the valuable or interesting sustainability initiative as there is nothing to see, and no easily calculated return on investment when you put these systems in. But these systems are critical to any building with serious sustainability targets. You can't manage what you can't measure.

We also tend to include a commitment to continuous improvement, tenant engagement, and optimised waste management and community initiatives. Safety or 'incidents and injury free' as we like to refer to it, and is of course no brainier.

One of the safety initiatives we have rolled out across our shopping center portfolio is the installation of automatic defibrillator. These units in the hands of Lend Lease employees, have already responsible for saving 3 lives in our shopping centers.

Another consideration in any property investment management business that property flow in and out of the business all time. As part of our sustainability strategies, we have developed the very comprehensive checklist that is completed during the due diligence of all asset acquisitions. Whilst environmental issues may not specifically prevent the acquisition of asset, sustainability initiatives are costed into the commercial evaluation. Once the asset is brought into the business, the budget required to implement the sustainability initiatives such as energy and water metering, rainwater recycling and necessary plant improvements. They have already been included in the commerce so it's not a battle once we get the asset into our business basically.

Finally perhaps most importantly, we set our asset specific energy, water, and waste targets.

As you can see, we try and set targets using environmental rating systems where feasible. This allows true benchmarking not only within the fund, but also across business and the industry as a whole. In this case, the office portfolio uses the NABERS rating systems for energy and water ratings.

As NABERS was not available for retail center during the development of the retail strategy, specific targets have been set based on consumption per meter squared of lettable area.

Again, it should be noted that all of the targets have a date by which they should be achieved. This insures the necessary focus is maintained throughout the period of sustainability strategy.

As more standard property industry indicators become available through initiatives such as the global reporting index. I'm sure that the number of key performance indicators will be increased.

We are also in the process of implementing Environmental Management System across the Lend Lease business as a whole. What's the fund strategy? I'm sure that we continue to improve our sustainability credentials, the EMS will give us the opportunity to truly embed sustainability into the business and will provide a platform upon which we can manage our environmental risks effectively.

And internationally recognized EMS requires that we have a documented system that specifies our environmental policies, sets environmental targets and objectives, ensures that environmental and legal risk registers are maintained and requires that environmental management issues are embedded into roles and responsibilities of our employee across the business.

The system also makes us deliver training, review our document control procedures, set communications strategies with our employees and review our operational controls over environmental risk.

This system will underpin environmental management at a corporate level. We also intend to investigate the potential for asset specific environmental management systems as I believe prudential have done, where scale or environmental risks deem it necessary. Now I'm going to talk very briefly about 2 systems that we use to collect sustainability metrics.

The first system is the system called Insight Environment. This tool was built in house, with the aim of simplifying the way we collect environmental data. The Insight Environmental system is used to collect data from every construction project, every

asset and every office that we have across the globe. We collect data such as energy and water use and cost, waste generation and recycling rates, refrigerant use and diesel use.

This tool has been developed within a suite of reporting tools. The others are used for financial reporting, health and safety incident tracking and human resourcing.

As mentioned previously, we also implement sub-metric systems within our assets to give us greater transparency in our operations.

This diagram provides an example of a typical sub-metering system. As you can see the systems are relatively extensive...in one of our latest office buildings we have over 250 energy and water meters.

So now we've got all the data. What do we do with it?

Once the data is collected, it must be consolidated and delivered in the useful format. We report at several different levels, 4 of which are identified here - corporate level, fund level, asset level and where necessary the sub-system level.

Corporate reporting is obviously required by the company for governance reasons. We also use this information for our submissions to the Dow Jones Sustainability Index and Carbon Disclosure Projects.

Fund level reporting is used to engage senior managers, and once consolidated can be used for investor reporting. As you can see on this slide, it is important to communicate, in a simple format, where potential risks may lie. In this case, we use a traffic light system - green is good, red is bad. Once analyzed, this information can then be wrapped it up in a form suitable to our investors.

Asset level reporting aims to provide details to asset and property managers to let them know how they are progressing against their goals. Not tracking at the asset level results in sustainability being moved down the priority list.

We are now implementing asset level quarterly reporting by the fund team to ensure that all initiatives identified in the sustainability strategies are actually being implemented. If the reports identify that initiatives are not being implemented, we make sure that there is a plan for implementation.

The final reporting level I'd like to briefly touch on is the sub-system level analysis within our assets. To be truly successful at reducing energy and water consumption, I believe that this level of analysis and reporting is required - particularly on the poor performing assets. It's no good installing a really efficient fan if in fact the chilled water plant is the actually the problem. Similarly, there is no use in installing a rainwater recycling system if we have constant water leaks. We will only know this through a sub metric system. We really need to know how energy and water flows around our building.

As you can see on the slide, this particular building actually has monthly targets by sub-system. These were generated as part of design of the building. It is very easy to see from these charts where a building has problems. An Importantly you can see it on a monthly basis. You don't find it out a year down the track if you have problem or water leak.

OK, let me finish the speech about the system here.

I'm now going to briefly touch on the importance of stakeholders in this equation.

The first stakeholders I want to talk about are the employees; the people within the company that will be driving sustainability through the organization - it certainly won't happen automatically, even if you do have good leadership and good business system. In my experience, those employees that believe that they will be recognized for driving the sustainability agenda will do so. If their immediate managers have no interest in a sustainability agenda, they will be less inclined to deliver.

We also incentivize our employees through annual KPI's which are linked to annual bonuses. Almost all employees within the business have a sustainability KPI that is specific to their role. We also run employee excellence awards, giving them the opportunity to be rewarded for their efforts in health and safety, innovation and sustainability.

Other important stakeholders are tenants and investors Dr. McNamara talked about the importance of those stakeholders. We should be constantly engaging with them to determine what their sustainability aspirations are and how you meet their needs.

Additionally, we have many Joint Venture partners with who jointly own assets. If they are not on board with the sustainability journey, it becomes very difficult for us to invest in our assets without their equal support.

We should also acknowledge the importance of our supply chain. We employ a myriad of consultants, contractors and product suppliers during the day to day management of our assets. They are all key to delivering sustainable outcome - from the leasing agents to the people that actually clean our facilities.

It was interesting to note in a recent report that 65% of asset owners that are currently signed up to the UN PRI now include responsible investment or environmental, social and governance elements in contractual relationships with external managers, thereby driving a responsibility and accountability down the investment supply chain.

OK, so just wrapping up. We have spoken at length about the three key factors in effective implementation of sustainability in investment management.

We first spoke about leadership and the importance of determining why, who and what form. We then spoke about effective business systems - fund specific sustainability

strategies, the environmental management system, the importance of data collection and the role of reporting at various levels.

Finally we touched on stakeholder engagement and acknowledge that our employees play a key role in all of this. We also discussed other stakeholders such as tenants, investors, JV partners and our supply chain.

In closing, I should state that none of this is easy. As identified early in the presentation, Lend Lease Investment Management has been on this journey since 2006 and we are still learning and improving all the time - this level of change within an organization doesn't happen overnight.

For further information relating to sustainability at Lend Lease please refer to our website.

Thank you.