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White paper

Subject: Green Value-Added strategy

Office property investment strategies can be divided into three main categories:

a) core,
b) value added,
c) opportunistic.

Core strategies are characterised by relatively low risk, profits are generated mainly through long-term leases in newly constructed office buildings in the centres of major business hubs.

Opportunistic strategies are high risk investments. They concern empty buildings requiring significant investment or demolition and re-development, often located outside of the city centre or in smaller urban areas.

Investors in value-added (VA) strategies chose the middle ground approach. They seek to generate higher investment returns by increasing the risk profile of the capital employed relative to core strategies, while also paying attention to the increased role of capital preservation compered to opportunistic strategies.

The value-added strategy is based on active management, such as the re-letting of older, but in good condition, partially empty buildings, the optimisation of leases, and the repositioning of buildings through renovation or refurbishment. An important element of this strategy is the application of solutions suitable for sustainable construction in order to ensure the buildings' long-term compliance with the regulatory environment and competitive market position, which can therefore be referred to as "*Green Value Added*" or GVA.

The emphasis on pursuing a GVA strategy is of particular value with an investment model based on a long-term commitment[1] and using the cash flows generated from the assets held to acquire further facilities.

[1] https://irei.com/publications/article/greening-value-added-investors-find-advantage-esg/

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XII Wydział Gospodarczy Krajowego Rejestru Sądowego, kapitał zakładowy w wysokości 40 000 PLN,
zarząd w składzie Agnieszka Małgorzata Jamiołkowska i Andrzej Rafał Kraskiewicz, członkowie zarządu

As a result of the **crisis of 2020 and 2021,** there has been a permanent change in the activities of office users around the world, which can be an opportunity to create a portfolio of investments in office properties and to gain valuable relationships with tenants.

According to Mateusz Polkowski of JLL: "even though the pandemic slowed down in the first three quarters of 2021 and the health situation was brought under control during the summer, the office market still faces challenges. With the emergence of the Delta variant, or the next wave forecast to arrive in the autumn, a large proportion of companies have decided to continue with a hybrid working model.

This situation affects the Warsaw market, which is particularly visible in developer activity. It is the lowest since 2010, and only 330,000 m^2[2] of [office] space remains under construction. This is an effect of both the current economic situation and the reduced demand for office space in the previous years, which has contributed to an increase in the vacancy rate.

However, it should be taken into account that the low supply of new space projected for the next few years may affect the decrease of the mentioned ratio due to the limited leasing opportunities in new buildings."[3]

In our opinion, the supply of new office space in Warsaw will not return to pre-2020 levels for several years, due to tightening financial conditions and the lack of availability of land for such investments. At the same time, due to another long-term trend - the fight against climate change and the climate policy resulting from the Paris Agreement - office real estate will be subject to new requirements.

On the 15th of December 2021, the European Commission proposed[4] to align the legislation on the energy performance of buildings with the **European Green Deal** and to decarbonise the EU's building stock by 2050. This proposal will facilitate the renovation of office buildings and other buildings across Europe, helping to reduce greenhouse gas emissions and energy bills, while improving the quality of life for millions of Europeans. The proposed revision of the Energy Performance of Buildings Directive translates the Commission's 'Renovation Wave' initiative into concrete legislative action.

The Commission is proposing that all new buildings should be zero carbon from 2030. In order to take advantage of the opportunity for faster action in the public sector, all new public buildings must be zero carbon from 2027. This means that buildings must consume very little energy, be powered by renewable energy sources and not emit greenhouse gases from fossil

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[2] As of 1st quarter 2022
[3] https://www.jll.pl/pl/trendy-i-analizy/badanie/rynek-biurowy-w-warszawie
[4] https://ec.europa.eu/commission/presscorner/detail/pl/IP_21_6683

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fuels on site. It will also be mandatory to provide a global warming coefficient based on lifecycle emissions in the building's energy performance certificate.

Regarding renovations, new EU minimum energy performance standards have been proposed, which will require the most energy-intensive building stock in each Member State to be upgraded by 15% from G to at least F (as classified in the building's energy performance certificate). The deadline for achieving this target is 2027 for non-residential buildings and 2030 for residential buildings.

A certificate of energy performance will be compulsory for buildings undergoing major renovation, buildings for which the lease is being renewed and all public buildings. Buildings or building units offered for sale or rent must also have a certificate and the energy performance class will have to be stated in all advertisements. By 2025, all certificates must be based on a harmonised scale from A to G.

The national building renovation plans will be integrated into the national energy and climate plans. This will ensure comparability and traceability of progress and allow this area to be directly linked to mobilised funding and necessary reforms and investments. The renovation plans will have to include action plans for phasing out fossil fuels in heating and cooling by 2040 at the latest and strategies for transforming the national building stock into zero-carbon buildings by 2050.

In addition to the requirements arising from planned regulations, the requirements of tenants and their teams also speak in favour of investments in green building.

According to a report by JLL on 8 November 20215 there is a growing demand for sustainable office buildings. According to Mateusz Polkowski, buildings generate two types of carbon footprint. The operational carbon footprint is related to their daily operation. The embedded carbon footprint, on the other hand, is related to, among other things, the production of materials and construction processes - and it is this that accounts for around 10% of global emissions. For example, more than 6 billion sq m of buildings are built each year using high carbon content materials such as glass, iron, steel and concrete. While utility emissions can be reduced through energy efficiency improvements and renewable energy sources, the issue of carbon content in materials is an additional challenge for the industry.

Managers representing nearly 650 leading global occupiers and investors surveyed by JLL say their priority is to create green and people-friendly places. Tenants want to reduce carbon emissions and are integrating sustainability into their business models. 89% of them say it is

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[4] https://www.jll.pl/pl/trendy-i-analizy/miasta/branza-nieruchomosci-koncentruje-sie-na-odpowiedzialnosci-i-srodowisku

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increasingly important in their business strategies. Real estate investors are also making decarbonisation part of their strategies.

Older office buildings have an advantage over new ones due to the depreciated embedded component of their carbon footprint. Thus, all participants in the office property value chain, i.e. investors, users and authorities, can benefit from the environmental rents resulting from the implementation of a GVA strategy.

Nordcap.pl's team has experience in implementing VA/GVA strategies, gained during projects carried out in Warsaw in the office buildings at 12 Widok Street, 37 Kondratowicza Street, 7 Cybernetyki Street, 33/35 Mokotowska Street and 29 Koszykowa Street.

In our view, new sustainable trends resulting from the changed market and regulatory environment present opportunities for investors pursuing VA/GVA strategies to achieve long-term above-average capital appreciation.

We invite your comments and feedback.

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