Government Actuary's Department

Issue 4 - April 2019

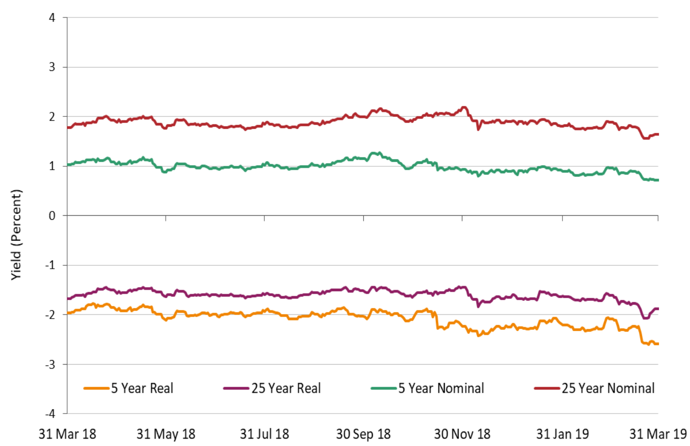
Investment Bulletin

This month in brief

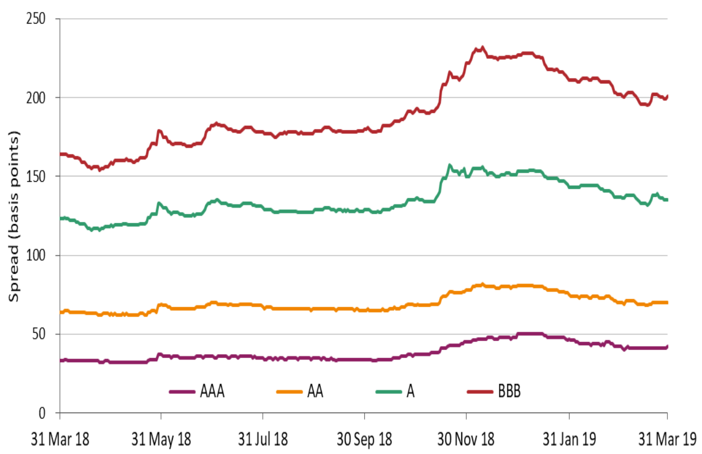
At their March policy meeting, members of the Bank of England Monetary Policy committee voted unanimously to keep interest rates at 0.75%. A combination of factors has kept interest rates at 0.75%, including; uncertainty surrounding Brexit, CPI inflation slightly below target and UK and global economic slowdown. It has been suggested that interest rates may rise if a no deal Brexit is avoided or delayed.

The UK employment rate rose to 76% for the period between November 2018 and January 2019 with a record number of 33 million people in employment since records began in 1971. There has been a concurrent drop in business investment in plant and machinery with some suggesting that under uncertainty companies may be choosing to invest shorter term in workers rather than in longer term assets.

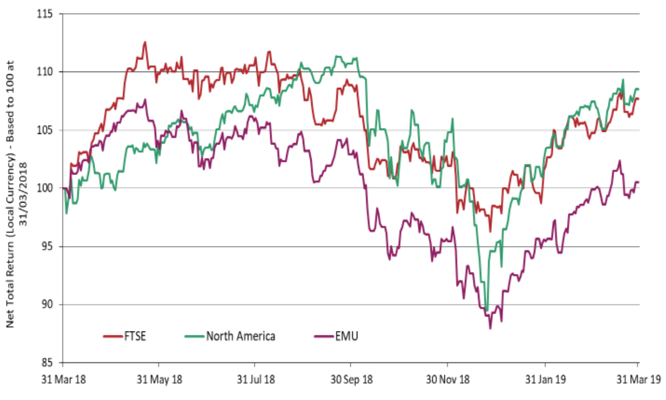
Real yields on short and long term bonds dropped sharply over the month with some recovery on longer term bonds towards the end of the month.



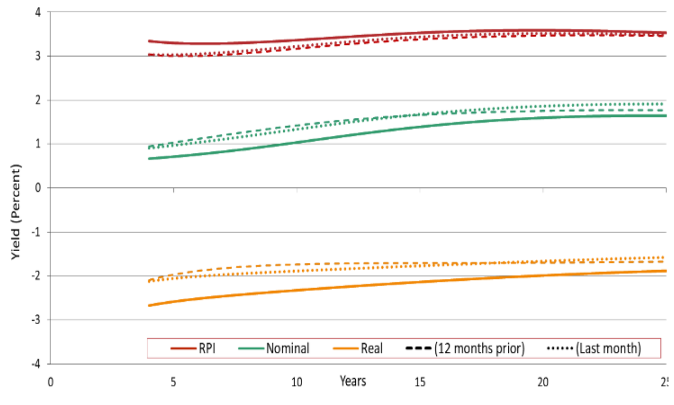
Credit spreads have stabilised over the month following a decline from the highs seen in November.



Equity markets continued to rise slightly over the month.



Real and nominal yields are lower than previously – particularly at the short end of the curve. There has been a slight increase in breakeven inflation.



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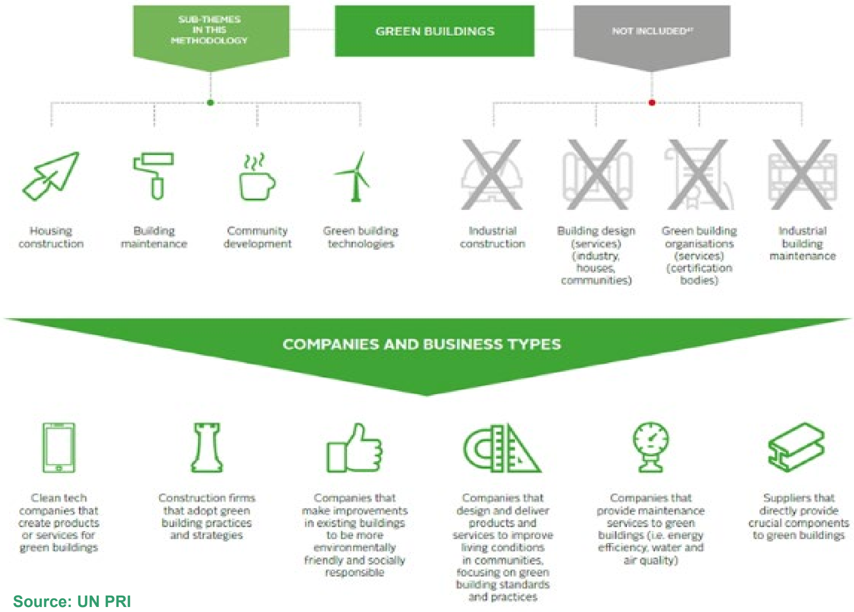
The rise of green buildings

With investors increasingly considering environmental factors, investment in green buildings allows investors to directly contribute to positive environmental impacts. Green buildings are defined as those having a positive impact on our climate and natural environment. The 'Principles for Responsible Investment', the world's leading proponent of responsible investment, recognises investment in green buildings and associated companies as one of 10 key investment themes within responsible investment. The figure (right), highlights the types of companies they believe might be invested in as part of the theme.



Source: UN PRI

Over the past decade there has been an increase in green building development which provides ample opportunity for sustainable investment. A global market survey of over 2,000 respondents conducted by Dodge Data & Analytics suggest this trend is set to continue over the next few years. Survey results indicate there will be an increase from 27% to 47% of respondents building over 60% of their projects as green developments. Figures suggest a more modest rise from 27% to 40% in the UK. Companies cite current lack of market demand and high initial costs as barriers to green development. The rise in green development is largely attributable to increasing demand and environmental regulation but wider social and health benefits are also increasingly being recognised. These include increasing worker productivity, improving occupant health, creating a sense of community and supporting the domestic economy.

Improved cash flow, better borrowing terms and risk reduction

The current interest of investors in green buildings may additionally be due to the fact these investments can generate higher cash flows and reduce systematic risk. Many organisations are prepared to pay a premium to rent certified buildings. This can lead to higher rental income which outweighs the slightly higher asset values of sustainable buildings. It has also been suggested that more stable occupancy and operating expenses leads to reduction in systematic risk for portfolios comprising of green buildings. These factors should mean that investors reap double rewards of higher and more stable returns.

Lenders offer further financial incentives to leveraged investors. There is a growing trend among major European lenders taking an interest in sustainability through green lending initiatives. Many of them offer discounts to borrowers who commit to reducing energy usage. There may be financial incentives in the form of tax credits as some governments offer tax relief on green buildings investments to encourage sustainable development.

Provided investment in green buildings continues to offer the aforementioned socioeconomic and financial benefits, investment should continue to support the green development which is crucial to a sustainable economy globally.