Valuing Sustainability

The Role of the Valuer: From Reflector to Influencer

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SB11 Helsinki, October 2011
• The challenge within existing practice
• RICS guidance for valuers
• The research agenda
• The role of the valuer moving forward
The challenge within existing practice
The current role of the valuer is primarily to reflect markets

- They work on data and evidence
- If there is a lack of evidence then the valuer cannot factor them in to their appraisals

“When calculating a property’s worth, the market doesn’t currently take the issue of sustainability into account, but this could also have been said for central heating way back in the 1970s when people weren’t convinced it was going to have a market impact.”

Ben Elder RICS Global Valuation Director, September 2011
MARKET VALUE
Market value is the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

WORTH OR INVESTMENT VALUE
Worth or Investment Value is: The value of property to a particular owner, investor, or class of investors for identified investment or operational objectives.

Market value & investment worth

RICS
Kingston University London
If the valuer should reflect the behaviour of the markets...

...how far can it be assumed that a knowledgeable and prudent purchaser would account for sustainability issues in any assessment of rents and yields now and moving forward?

Key questions for sustainability and market Value
“Worth is the stuff of decisions”

Mallinson, 1994

...how far in respect of sustainability issues can it be assumed that a knowledgeable and prudent investor would act ahead of the market?

Where worth leads – market value may follow

Key questions for sustainability & worth
The theoretical position

**Sustainability Criteria met**
- Sustainable Property Appraisal Tool identifies investment worth as higher than market value
- Sustainability aware investor exploits mis-pricing to purchase or retain asset
- As sustainability bites, asset performs better than market norm
- Market identifies mis-pricing and adjusts

**Sustainability Criteria not met**
- Sustainable Property Appraisal Tool identifies investment worth as lower than market value
- Sustainability aware investor exploits mis-pricing to sell asset
- As sustainability bites, asset performs worse than market norm
- Market identifies mis-pricing and adjusts
RICS guidance for valuers: An evolving art
• Effective from 15 September 2009
World wide application – due for review

• Started from a perception of no market movement and little knowledge – beyond energy

Aimed at balancing the needs for awareness of sustainability issues with

Information for valuers undertaking Market value and Investment Worth

Sustainability and Commercial Property Valuation VIP 13
• Aimed to lead consideration of characteristics
• Recognised that Worth would lead
• Highlighted key considerations:
  – Energy, waste, water, transport, flexibility etc
  – Dependent on building type
• Provided a checklist for valuers
  – Occupational
  – Depreciation
  – Future rental growth
The pinch points for commercial investment valuations

- Will rental value be compromised/enhanced by degree of ‘future-proofing’?
- How long will the building live?
- Timing & frequency of refurbishment?
- Will the risk of void increase?
- In multi lets – will costs of services increase?
- What yield will it command?
- What ‘risk premium’ should be built in?
• Effective from 20th September 2011
• UK focus only due to legislation variability and essential ‘local market’ nature of residential property
• Recognises that awareness of sustainability has moved on since 2009 - and data (e.g. Energy Certification now increasingly available)

IP/22 2011 Sustainability and Residential Valuation
• Underlying assumption of some level of sustainability literacy
• The valuer must reflect all “material factors that may influence value”
• Markets appear to be moving towards greater recognition of sustainability
• As they do so, it is “increasingly important that the valuer is aware and can reflect this in the advice given.”
• Valuers should collect data – even if it is not apparently reflected in MV

A step change in positioning
• 3 key owner-occupation sub-markets
  – Ethical consumers and early adopters: a matter of principles
  – First-time buyer; low end of the market: cheap to run
  – Older/retired movers who need flexible low maintenance, cost conscious

• Rented/Owner occupation sectors have different drivers

A Series of Sub-markets
• Oceania Guidance - 2011
• A prompt sheets and 12 key issues
• Encouragement to be more explicit in valuation terms

And in Oceania..
The research agenda – where is it now
• Surveys have long shown that many people say they might pay up to 10% premium for LEED/BREEAM (CoreNet/JLL)

• But interviews show that whilst sustainability is desired, traditional selection criteria dominate (Dixon et al; Cushman & Wakefield (2011))

“the trouble is that to calculate you need a sizeable benchmark and we don’t have that”
Assessing the state of play

- Sustainable v Green - still an issue?
- Energy the front runner – linking to the metrics
• Europe – less transaction based evidence of BREEAM/LEED – but starting ... (Leopoldsberger et al. 2010)
• Evidence from far east shows some negativity (Deng li and Quigley 2011)
• Investigations via Energy Rating Systems for Existing buildings: the new game in town (e.g. Dunse et al. 2011)
• Most work on multiple regression – and assume causality
• Moving towards a discount rather than a premium approach
- The Energy case is ‘there’ in US; far more tentative elsewhere
- Rating systems are variable – and too ‘broad brush’ – so don’t help valuers
- Very little known on the Social Case – health & well-being needs to be better understood – in value terms
- Pivo’s work explores social sustainability
- Arguably too many environmental metrics! – ‘FairTrade’ equivalence being explored (Ethical Property foundation)
• ISPI has few measures
• Based on weighted criteria:
  • Energy
  • Waste
  • Water
  • Flood
  • Accessibility or
  • BREEAM
• Few properties have full data
• Figures skewed by structural reasons abound
BUT shows little integration of sustainability factors in valuations

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An important UK initiative ...
The business/investment argument develops

Buying into sustainability
*Harms performance*

Buying into sustainability
*Has no effect on performance*

Buying into sustainability
*Enhances performance*

From cost to risk reduction, CSR (Pivo, 2009; Kimmet, 2009); Newell, 2009) and now ..
• Sustainability Reporting
  – Development of GRI & its CRESS supplement
• Examining the link with financial performance:
  – S-i-r-e –(Bernet, Sayce et al) analysing selection of 47 European Portfolios for linkage
  – GRI report analysis (Lützkendorf & Lorenz)

Financial performance links – another approach…
The role of the valuer: Should it change moving forward?
Why the role should change?

• A lack of market response at the pace required:
  • Energy targets not being met
  • Challenges to create economic case to retro-fit stock
  • Inadequate reflection of the relationship between health and well-being and building stock
  • Seeming inability to reflect the technological changes and the ratings appropriately into appraisals

• Changing corporate & societal environment
• Changing client requirements
  • Appraisal is not a ‘one-off’ exercise but integrated in strategic management
  • Move to a real Triple Bottom line – implying need to reflect 3rd party interests (the RPI movement; the link to financial performance)

• Value to one person may gives lead to quantifiable dis-benefits to others (.e.g. pollution; health risk) – these will feed into economic consequences

Why the role *should* change?
• **Other advisors** may gain relevance if valuers rely on simple evidence based analysis

• **Other methodologies** for assessing value are established through environmental economics
  – Contingent valuation
  – Hedonic pricing
  – CBA

• Real Estate Valuers have normally worked only within one economic paradigm (Lipscomb, 2011)

• This has been reinforced in Professional Standards
As a reflector, the valuer has not influenced behaviours

• Many valuers now part of multi-disciplinary organisations – this presents an opportunity to develop more integrated advice
• RICS recognises this in its relationship with IVSC
• Vancouver Accord is seeking worldwide debate to drive methodology and enhance education
The development of ‘sustainable value’ methodologies will take time and commitment and will reveal a skills gap that will require address.

But on the positive side it presents opportunities for those ready to rise to the challenge.

We must learn to measure that which we should value instead of only valuing that which we can measure.