Valuation & Sustainability
A Progress Report

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• There is an undisputed desire to find the proof that ‘green’ or ‘sustainable’ buildings command a higher value (or others should be discounted?)

  Why?

• we need to (must?) reduce energy/ carbon consumption

• We wish to mitigate – in preference to adapt to – climate change

• As a profession we have a belief in markets leading change – rather than rely on regulation
• The 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 Market Values – but may need to advise on investment worth

“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

The current role of the valuer
The theoretical position

**Sustainability Criteria met**
- Investment worth 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**
- Investment worth 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
Why the pace needs to change

- A lack of market response at the pace required:
  - Energy targets not being met
  - Challenges to create economic case to retro-fit stock – are they value efficient?
  - Inadequate reflection of the relationship between health and well-being and building stock
  - Difficulty in reflecting technological changes and the ratings appropriately into appraisals

- Changing corporate & societal environment
  - Changing client requirements and attitudes

Why the pace needs to change

RICS

Kingston University London
• Surveys have long shown that many people say they might pay up to 10% premium for LEED/BREEAM (CoreNet /JLL, 2008)

• But interviews show that whilst sustainability is desired, traditional selection criteria dominate (Dixon et al; 2009; 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

- It is all about energy ... where we have some metrics
- Offices in Australia: discounts for low scores; impact return, yield and vacancy of CBD offices (Building Better Returns (2011))
• London is one of the most ‘at risk’ cities internationally due to the economic importance
• Flood is as much about SUDS as coast of rivers
• Research found that whilst taken into account on purchases it is not adequately accounted for subsequently
• Too little recognition of impact of Flood & Water Management Act 2010
• Flood risk insurance is a ‘live issue’

“it is important for valuers to understand how to articulate flood risk when pricing property investment assets even though evidence of a measurable effect on investment yields of on property rents is not readily apparent”

CEM, 2011
• 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; still structural issues on ‘noise’
“despite the publicity and promotion, the voluntary certificated section is miniscule in terms of the current commercial real estate stock”  
(Fuerst & McAllister, 2011)

• They are concentrated in new stock

• EPCs may in some markets be important – but have acknowledged issues of accuracy and usefulness but are set to become critical

Are certificates the answer?...
• BSRIA: Soft Landings Framework Findings
• Buildings do not necessarily perform to design

Are certificates the answer?...
• “it is increasingly important that the valuer is aware and can reflect (moves to sustainability) in the advice given.”

• Valuers should collect data – even if it is not apparently reflected in MV (IP22)

• "In the UK, there's no evidence base – that's the issue."

(CBRE, November 2011)
• Some properties have data on construction (BREEAM; LEED) (or in-use).
• Data is often not shared between parties
• CBRE initiative: 6 point sustainability checklist
  – quality,
  – accessibility,
  – energy efficiency,
  – flooding,
  – waste and
  – water efficiency

The Need for Data ...
ISPI Monitor of Sustainable Properties in the UK
“One good return deserves another”

- Recognises that few properties have full data
- Based on weighted criteria:
  - Energy
  - Waste
  - Water
  - Flood
  - Accessibility or
  - BREEAM
- Now monitoring 1,200 properties across 100 portfolios
- “Sustainability is not yet priced into commercial property valuations in the UK, but when it is, the ISPI Monitor should show sustainability impacts on returns”.

An important UK initiative ...
Global Reporting Initiative

- provides guidance on how organizations can disclose their sustainability performance
- Construction and Real Estate Sector Supplement (CRESS – a sector supplement- September 2011)
Examining the link with financial performance:

- 47 European Portfolios for linkage
- GRI /CRESS framework reveals limited data & little time series

Financial performance links – another approach…
Analysis of data for carbon could indicate less carbon = higher rent – but perhaps over simple?

1% More Rent for 1% Less Carbon?

Rental Income

GDP

Carbon Intensity

Source: st-re

Another way of analysing ..
• RICS and United Nations Environment Programme – Finance Initiative (UNEP-FI) statement of intent to
  – Increase market transparency
  – Gain insight into performance
  – Integrate sustainability within the ‘everyday’
  – And all within 5 years

• Recognition that it is a challenge in terms of skills, working with clients and with other professionals
• We have come a long way in 2 years
• Undisputed impact for CBD offices in some markets
• Data is a continuing issue – consistency and accuracy
• Government agendas and grants may help step change
• There is a danger of thinking just energy
• Simple data collection will help – as long as we use it.