

Valuing Sustainability

The Role of the Valuer: From Reflector to Influencer

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- The challenge within existing practice
- RICS guidance for valuers
- The research agenda
- The role of the valuer moving forward

Agenda

The challenge within existing practice

Agenda

- 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 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

The current role of the valuer

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

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

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

The theoretical position

RICS guidance for valuers: An evolving art

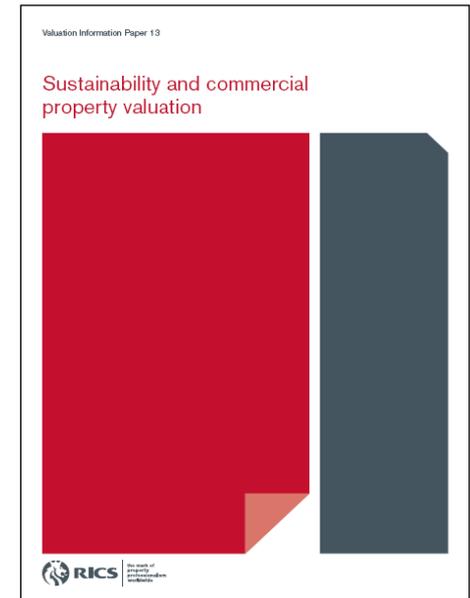
Agenda



- 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***

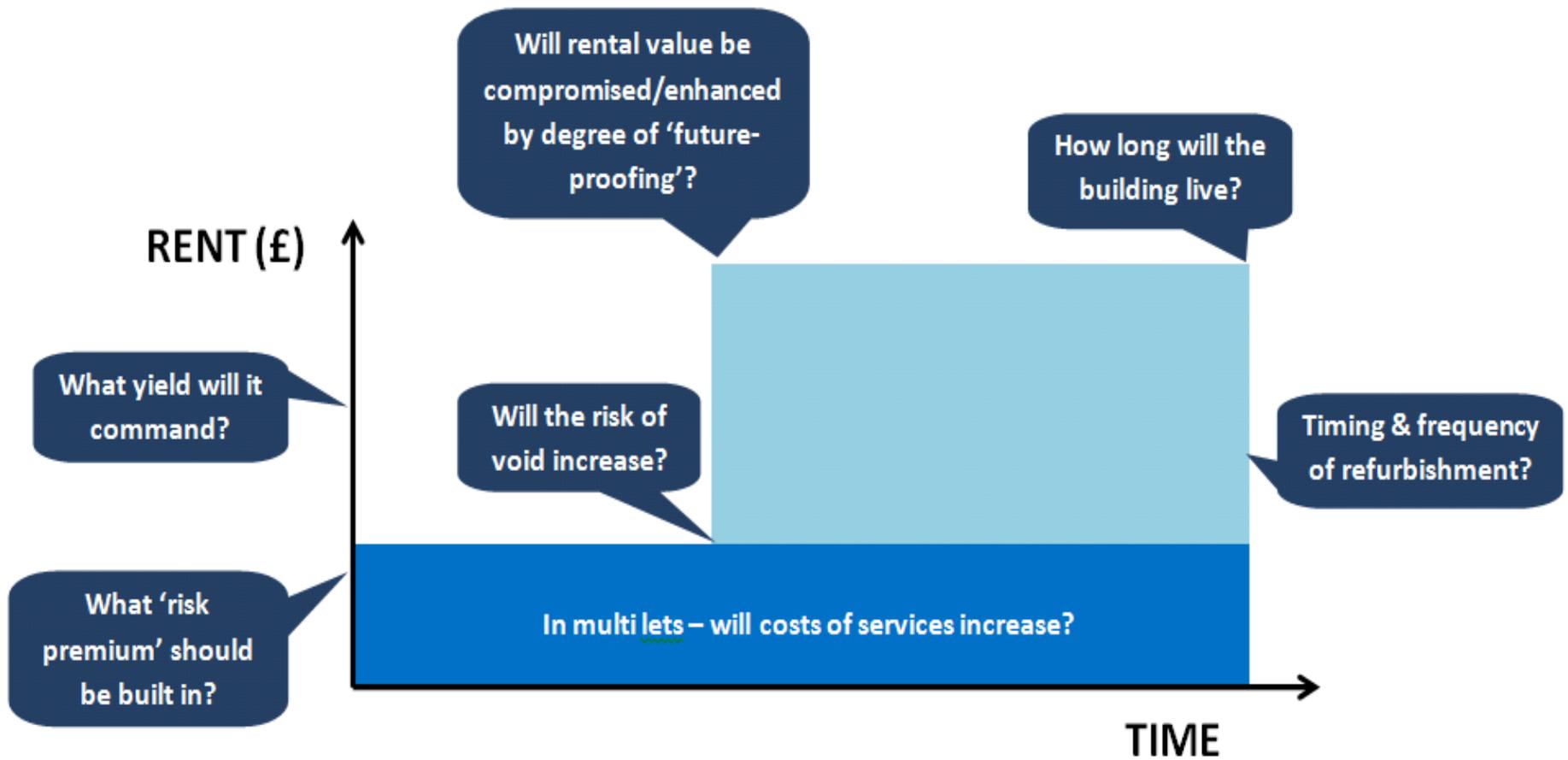


Sustainability and Commercial Property Valuation VIP 13



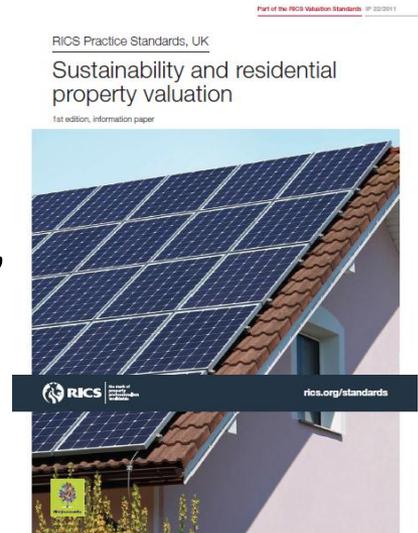
- Aimed to lead consideration of characteristics
- Recognised that Worth would lead
- Highlighted key considerations:
 - Energy, waste, water, transport, flexibility etc
 - Dependent on building type
- Provided a checklist for valuers
 - Occupational
 - Depreciation
 - Future rental growth

VIP 13: Catalyst for Change?



The pinch points for commercial investment valuations

- 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



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- 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

A Valuers Dozen – A summary

Issue	What Should the Valuer Look For?	Cost	Sustainability	Benefit
1. Are there energy efficiency aware management and management systems?	- Is there sub-metering? - Is there energy recording? - Is there continual commissioning? - Is there enthusiasm?	\$	🌳🌳🌳	
2. Variable speed drives.	- Have they been installed? - Have they been properly installed?	\$ \$	🌳🌳🌳	
3. Building Management and Control System (BMS)	- Is there new equipment? - Have there been recent upgrades? - Has been recommissioning (say in last two years)? - Has the BMS been set up to tune the building?	\$	🌳🌳🌳	
4. Energy Efficient Common area lighting	- Is there efficient lighting on timers (through BMS) or movement sensors?	\$	🌳🌳	
5. Energy Efficient Tenancy lighting	- Is the lighting energy efficient with zoned controls?	\$ \$	🌳🌳	
6. Air conditioning system	- Are there older, inefficient systems in place such as constant volume/direct expansion? - Are they fundamentally disruptive and difficult to replace? - Is there a need to coordinate with tenant lease expiries?	\$ \$ \$	🌳🌳🌳	

A Valuers Dozen – A summary

7. Chillers	- Do the chillers replacement generally show a high ROI? - Note savings and NABERS improvement could bring forward a replacement a year or two - Could the replacement be disruptive to tenants?	\$ \$ \$	🌳🌳🌳
8. Facade and windows	- Can improve letability and reduce heat gain and glare on to occupants? - Facade upgrades usually have a very poor ROI but will improve energy rating in summer. - They can improve air conditioning performance - They can make the building present better and increase daylight across the floor.	\$ \$ \$	🌳
9. Carbon Monoxide monitoring in car park	Look for fans only running when CO reaches a level when it needs vented. For example a car park painted white is often an indication that the lighting has been reduced.	\$	🌳
10. Sub-metering energy intensive plant	- Is metering in place?	\$	🌳🌳🌳
11. Water saving devices and monitoring.	- Is there metered and monitored cooling tower consumption? - Are there water saving fixtures?	\$ \$	💧💧💧
12. Environmental management systems	- Are there management systems that are focused on occupant health and environmental sustainability? Do these include: - Green cleaning? - Green pest control? - Green Star Interiors ready? - Indoor health monitoring?	\$	🌳🌳
13. Green Leases	- Is there a light, medium or dark green lease in place?	\$	🌳🌳

- Oceania Guidance - 2011
- A prompt sheets and 12 key issues
- Encouragement to be more explicit in valuation terms

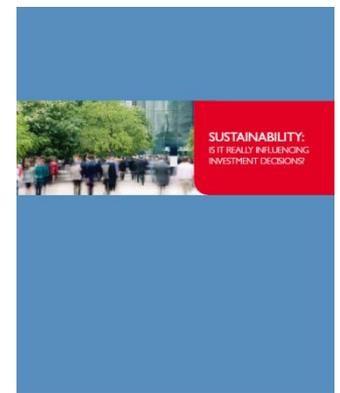
And in Oceania..

The research agenda – where is it now

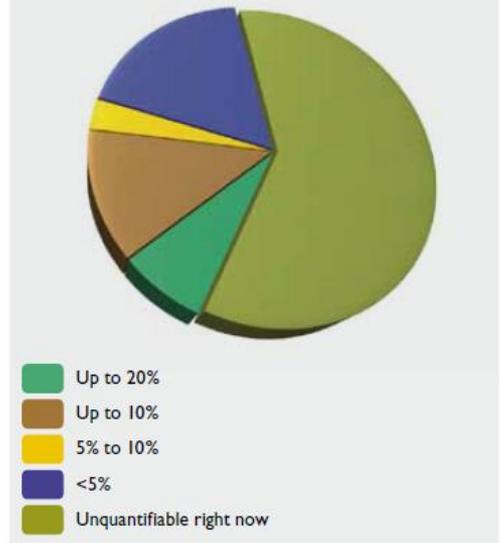
Agenda

- 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))

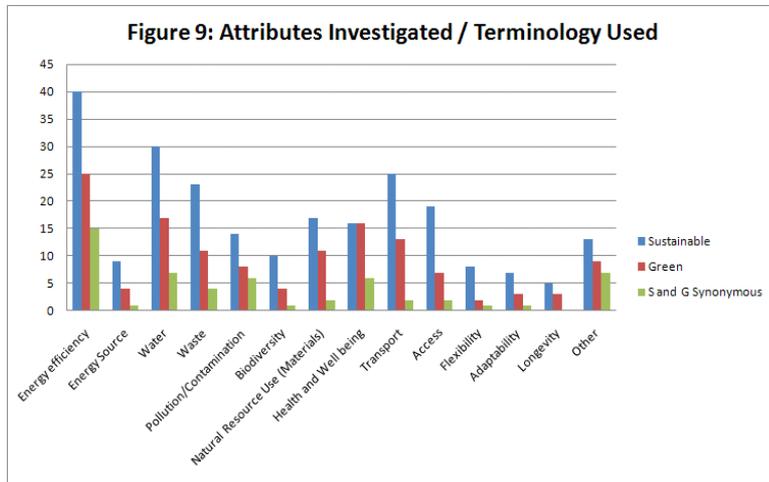
“the trouble is that to calculate you need a sizeable benchmark and we don’t have that”



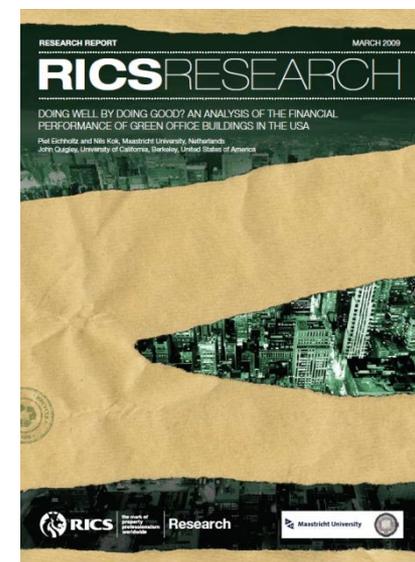
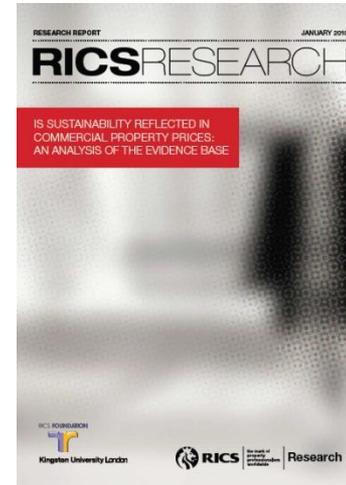
INVESTORS PERCEPTION OF A VALUE DIFFERENTIAL IN PERCENTAGE TERMS



What is the opinion evidence?



Sayce *et al.* 2010



- Sustainable v Green- still an issue?
- Energy the front runner – linking to the metrics
- Offices in US – links to energy certification (Energy Star) – some evidence re LEED (Miller *et al*, 2007; Eicholtz *et al*, 2009; Fuerst & McAllister, 2010)

Assessing the state of play

- 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

What is coming through ...



- 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)



What is not there...

- 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

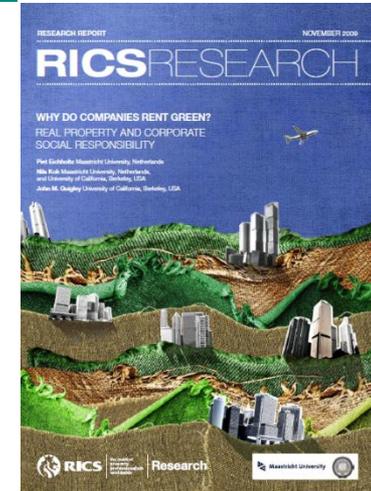
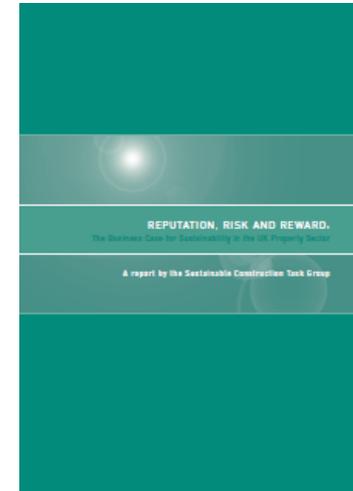
	12 months to March 2011	Q1 2011, Quarterly Return
Income Return		
ISPI more sustainable	6.0	1.4
ISPI less sustainable	6.3	1.5
IPD Quarterly Index	6.3	1.5
Capital Growth		
ISPI more sustainable	4.1	0.6
ISPI less sustainable	6.2	1.2
IPD Quarterly Index	4.7	0.8
Total Return		
ISPI more sustainable	10.3	2.0
ISPI less sustainable	12.9	2.7
IPD Quarterly Index	11.2	2.3

An important UK initiative ...

**Buying into
sustainability**
Harms performance

**Buying into
sustainability**
*Has no effect on
performance*

**Buying into
sustainability**
Enhances performance

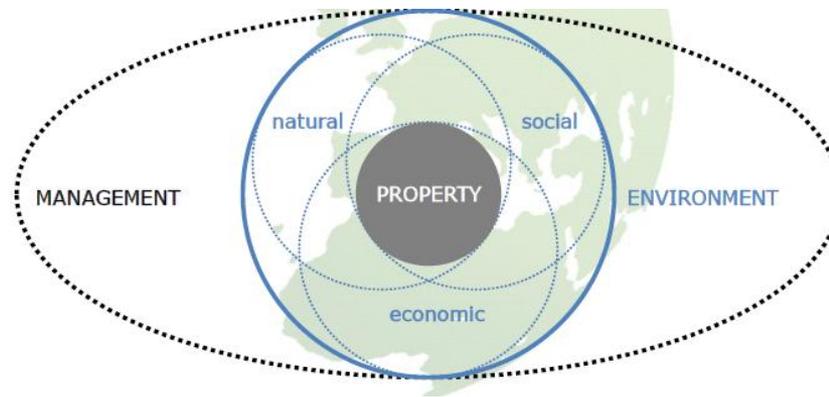


From cost to risk reduction, CSR (Pivo, 2009;
Kimmet, 2009); Newell, 2009)
and now ..

The business/investment argument
develops

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- 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?

Agenda

- **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**

Why the role *should* change?

- 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 give 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

Issues to consider

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 opportunity

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

Conclusion