Sustainability from a property valuer’s perspective: what the valuer needs

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The Role of the Valuer

“The Role of the Valuer is to reflect markets, not lead them”

A valuer is an interpreter and information manager/analyst:

- **Economic data**: they need to be aware of/alert to market conditions both in the locality and which could impact ‘market players’

- **Physical data**: they need information about the asset they are valuing – this is normally gained through physical inspection, but they do not undertake a full detailed survey; they may rely on such data if supplied

- **Legal data**: the value of an asset will be materially influenced by the tenure and rights being valued
The Purpose of valuations

• Valuations are undertaken for many purposes: sale/purchase; investment monitoring; company accounts; taxation and other statutory purposes

• The purpose dictates the basis upon which value is calculated

• As does the market player what matters to a home owner is not necessarily what matters to fund manager deciding strategy for office investment

Most valuations are undertaken of existing buildings:
Valuers follow standards and guidance
European Valuation Standards (2016)

• “sustainability, energy efficiency and green features can only be reflected in the valuation where this is supported by observable market evidence”.

• “The impact may vary over time, between sectors, uses and regions”
Red Book 2017

Valuation Professional Standard 2

• “sustainability and environmental matters ... are growing in importance in terms of market perception and influence and it is therefore essential that valuers have proper regard to their relevance and significance in relation to individual valuation assignments”

• “valuers are also strongly advised to collect and record appropriate and sufficient sustainability data, as and when it becomes available, for future comparability, even if it does not currently impact on value. This could be particularly beneficial where the valuer is retained to provide regular reports to a client”
For secured lending Valuers should “comment on maintainability of income over the life of the loan (and any risks to the maintainability of income), with particular reference to lease breaks or determinations and anticipated market trends – this may well need to be considered in a broader sustainability context.

Collectively these provide a ‘nudge’ to valuers to consider sustainability in their valuation process. But it does not prescribe how they do this.
The ‘Virtuous Circle’ aim

Owners & Tenants (Valuation Users)
We purchase and rent resource efficient buildings and invest in sustainability because this reduces risk of obsolescence and operational costs; and increases occupant well-being and comfort and ultimately asset value.

Professional Bodies
We spread the knowledge about the economic benefits of resource efficiency and sustainability because this is critical for capacity building and market transformation.

Built Environment Professionals*
We design, build and retrofit “green” buildings because of market demand and because lenders, investors and insurers provide preferential conditions.

Lenders, Investors, Insurers (Valuation Users)
We invest in, finance and insure sustainability projects because that is what occupiers want and therefore there are fewer associated financial risks.

Valuers
We recognise the economic benefits of resource efficiency and sustainability in buildings and reflect this in advice given to clients and other built environment professionals.

*Designers, constructors, developers, valuers, etc

Increase of ‘Green’ Buildings in EU
Supply

Demand
The 2 Main Internationally recognised Bases

**MARKET VALUE**
Market value is the estimated amount for which an asset or liability **should exchange** on the **valuation date** between a **willing buyer** and a **willing seller** in an **arm’s length transaction** after proper marketing and where the parties had each **acted knowledgeably, prudently** and without compulsion.

**WORTH OR INVESTMENT VALUE**
The value of **an asset** to the **owner or a perspective owner** for **individual** investment or operational objectives.

Other value definitions include **Mortgage Lending Value, Fair Value, Existing Use Value**
Several approved methods:

- **Comparison:**
  - *analysis of recent transactions*
  - *adjust/weight evidence according to factors that are considered to impact on value.*

- **Investment method:**
  - *Analysis of rental value established through comparison*
  - *Capitalised through adoption of a ‘cap rate’, again found through market evidence*

- **Discounted Cash flow (DCF)**
  - *Establish explicit cashflows over a set period (normally no more than 10 years); these will allow for future rental growth or/and depreciation*
  - *Discount all cashflows by the investors required return and an appropriate risk premium*
  - *Assume sale at end of the cash flow analysis period*
The Comparables Method

- Underlies all valuation methods
- Capital/rental Value is a product of observed comparable sales/lettings
- Valuers then adjusts each piece of evidence for a range of ‘value factors’: rents may be affected by running costs; utility; location etc.
- Capital values for owner-occupation by similar agenda...
- The valuer needs the data in a form that they can analyse

- Typically used where active market/ many transactions
- Residential owner-occupied
- Some commercial
- Not where purchaser would be investor
- Used for residential mortgages
The Investment Method

A two-stage process:

• Rental value (comparables)
• Conversion of the rental value into a capital value by applying a **multiplier**: a ‘yield’ or capitalisation factor: the higher the multiplier the more valuable the building

• The yield is a product of a **risk free rate** + **risk premium** + **depreciation factor** – **rental growth** prospects

• Yield is found through a process of analysing transactions of ‘let’ buildings

• Typically used where active market/ many transactions
• Most commercial property except city centre and big ‘institutional’ grade
• Not generally residential
Investment Value (a.k.a. worth)

- Specific cash flows analysis over set period (circa 10 years) – rent, outgoings, refurbishment etc
- End value (notional sale value)
- Discounted back at an investor’s required return – which will reflect perceived risks to the cash flow and future value risk (i.e. the same as for investment method)
- This is the ‘easiest’ method in which to build in sustainability explicitly

- Typically used where ‘top end’ commercial
- Also used for large – scale residential ‘blocks’ (social housing)
- Where less transactions (e.g. some hotels etc.)
- Driven by individual requirements
Value depends on demand and supply

• Market **demand** based on:
  – Location /context
  – Building attributes
    • Size; accommodation; condition/age; appearance; functionality.
    • And factors impacting performance:
      – Running costs
      – Investment performance includes future risks to value; comparison with other types of investment; risks of voids
    • *Sustainability can be a driver for ‘responsible investors’*

• **Supply** is fixed in the short term.. But over time *quality* and *quantity* matter... *as new higher quality stock comes on stream so it will impact markets*
Encouraging Markets to reflect sustainability factors

- **Transparency** so that buyers/tenants/valuers can better compare buildings
- And the **data** needs to be available and reliable
- Recognition of risks:
  - Over time, poorly performing buildings will be likely to suffer value depreciation... And as building quality improves, this might speed up the ‘brown discounting’
- Data in the ‘**levels’ approach** can support better recognition of risks/potential value advantage
The Challenge of integrating sustainability

- Data are often not available or in a form in which valuer can analyse..
- EPCs are the only ‘base line’ widely available energy data (as they are mandated)
- Other certification schemes are voluntary..
- **clients** are increasingly driving a quest for data – but this is changing rapidly.. Notably for **secured lending** and **investment**

*As consistent, reliable data becomes available this enables markets to move – and valuers to advise…*
What questions valuers need to answer..

- Will this building experience more/less rental growth than other comparable buildings?
- Will it suffer incurable/curable obsolescence?
- Will its characteristics make it easier/quicker to ‘lease up’ or sell?
- Is it economic to run leading to potentially more money available for rent?
- Does it present a greater or lesser value risk to an investor i.e. impact the discount rate (multiplier)?
Valuers undertake ‘due diligence’

Valuers investigate a wide range of issues. This ‘due diligence’ process for sustainability includes, but is not limited to:

• key environmental risks, such as flooding, energy efficiency and climate,
• matters of design, configuration and accessibility,
• legislation, management and fiscal considerations
Enhanced sustainability performance data would help

- Give **transparency** to markets
- **Raise awareness** raising within professionals/ across professions and within client stakeholders
- Enable **deeper holistic understanding**
- Help **deliver policy objectives**
Hypothetical case

1. Use stage energy performance

1.1 Use stage energy performance

1.2 Life cycle Global Warming Potential

2. Design for refurbishment and adaptability

2.2 Design for refurbishment and adaptability

3. Life Cycle Costs

3.1 Life Cycle Costs

4. Indoor air quality

4.1 Indoor air quality

5. Projected future climate: thermal comfort

5.1 Projected future climate: thermal comfort
The Valuer is encouraged to ask for:

Some key factors include:

- Energy/costs/consumption/certification
- Carbon emissions (CO2 – and other GHG)
- Utilities (e.g. water; waste) costs / consumption
- Maintenance requirements/refurbishment cycles
- Climate resilience (earthquake/storm/flood resilience)
- Accessibility/flexibility and adaptability
- Impacts and risks to the local environment; User comfort/satisfaction/indoor air quality
Linking Sustainability Features to the user/investor perspective

**Sustainable building features (examples)**

- Energy efficiency
- Reduced impacts on the environment
- Increased functionality, serviceability, durability and adaptability
- Ease of conducting maintenance, servicing and recycling activities
- Increased comfort and well-being of occupants

**Resulting effects**

- Lower operating and maintenance costs
- Improved marketability, lower vacancy risk and higher stability of cash-flow
- Higher rental growth potential
- Property loss prevention benefits and lower business interruption risk
- User / occupant productivity and health gains
- Reduced compensation costs and risk of litigation caused by Sick-Building Syndromes

↓

**Market Value / Worth / Mortgage Lending Value**
Selected Further Information

- *The Energy Efficient Mortgage Action Plan* (EeMap) is seeking to promote green mortgage product – and includes an (almost finalised) checklist for valuers [https://eemap.energyefficientmortgages.eu/](https://eemap.energyefficientmortgages.eu/)


- TEGoVA (2016) *The European Valuation Standards EVIP 1 Sustainability and Valuation* available at [https://www.tegova.org/en/p5724f2c7ea5f9](https://www.tegova.org/en/p5724f2c7ea5f9)
Questions?

Thank you