

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

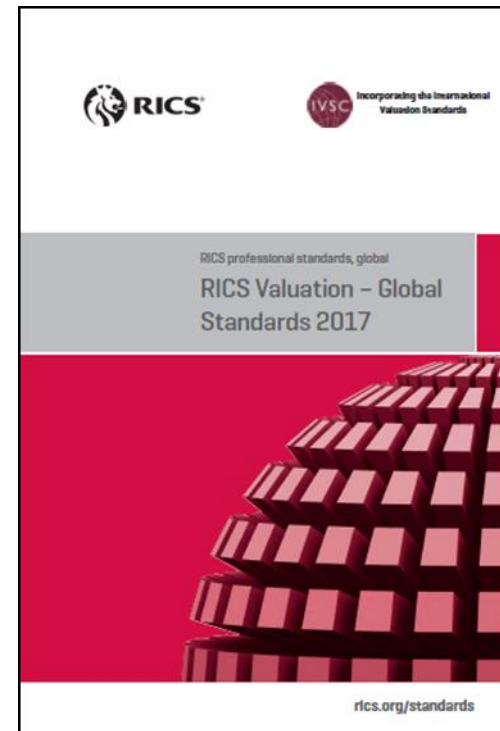
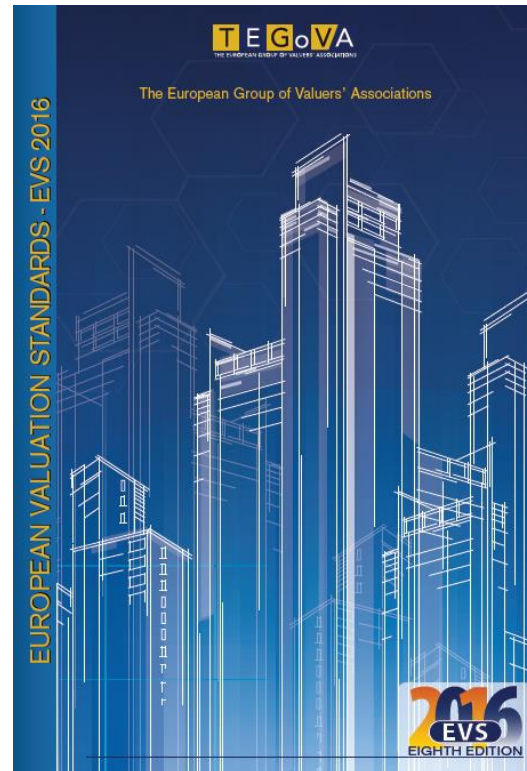
- Valuations are undertaken for many purposes: sale/purchase; investment monitoring; company accounts; taxation and other statutory purposes
- The purpose dictates the basis upon which value is calculated
- As does the market player what matters to a home owner is not necessarily what matters to fund manager deciding strategy for office investment

Most valuations are undertaken of existing buildings:

Valuers follow standards and guidance

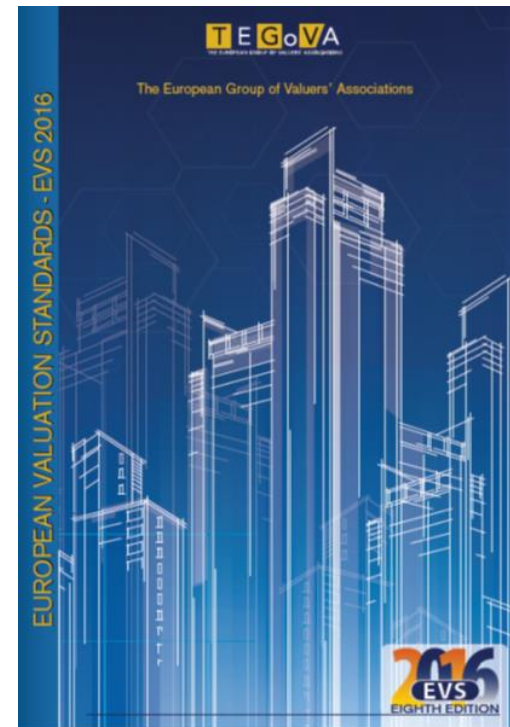


INTERNATIONAL VALUATION STANDARDS COUNCIL



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*”

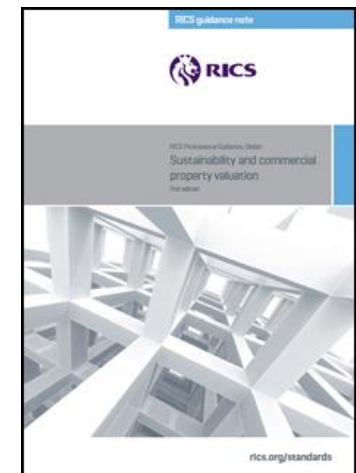
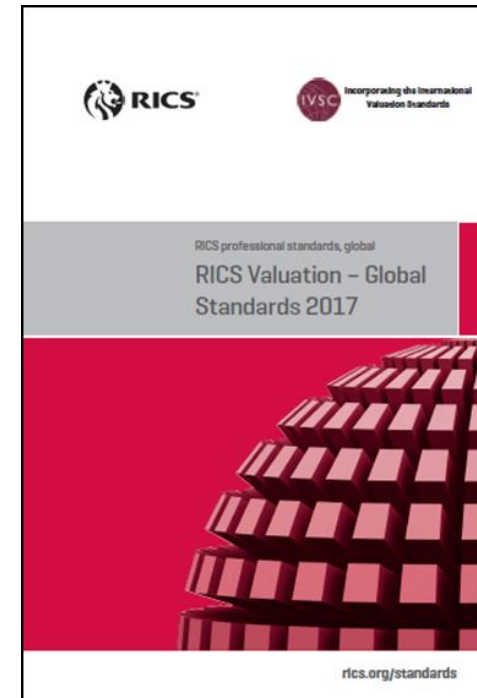


Red Book 2017

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”

Red Book: VPS 2



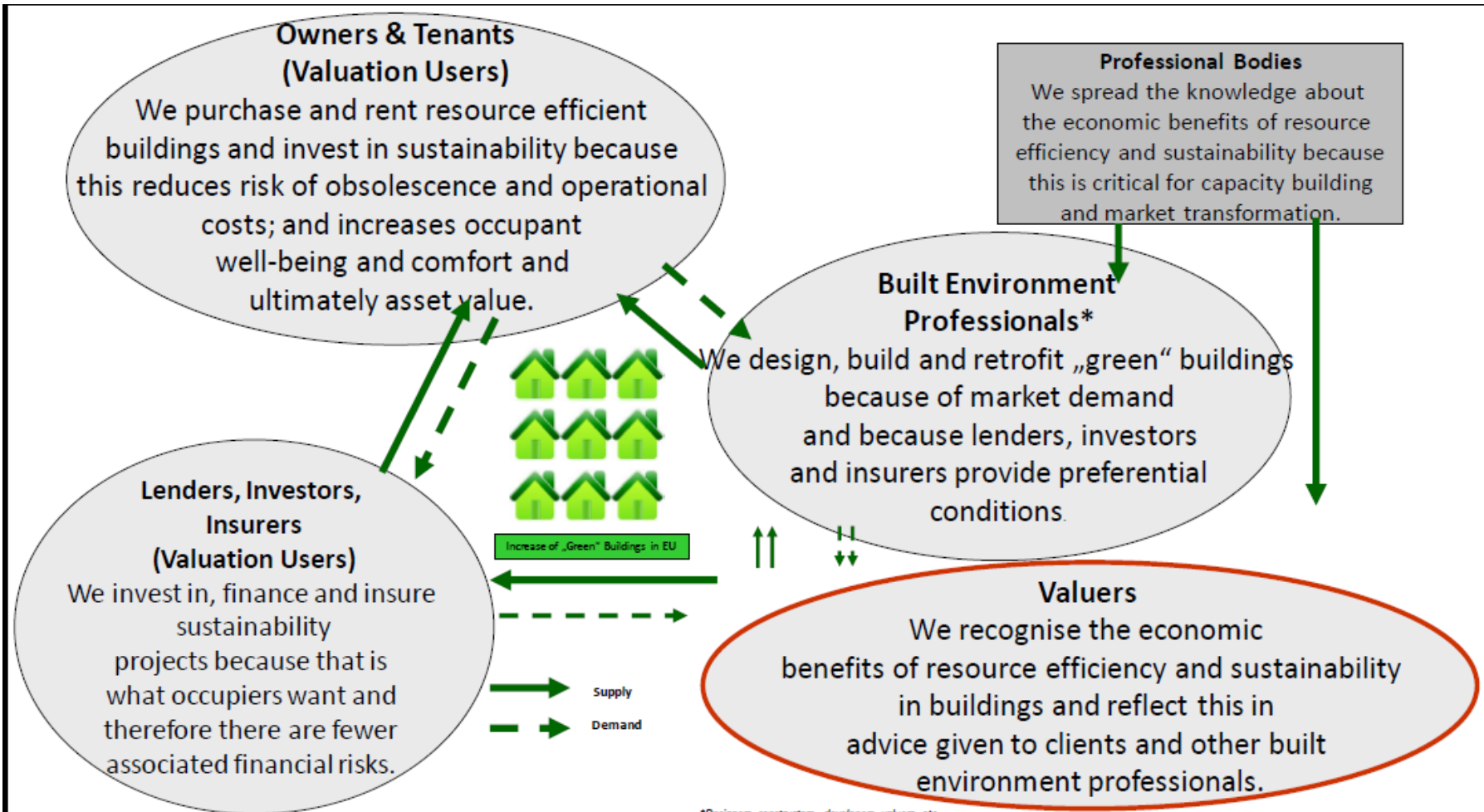
Red Book 2017

- 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.*

Red Book: VPS 2

***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



*Designers, constructors, developers, valuers, etc

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**

How Valuers Assess 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 adjust 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:

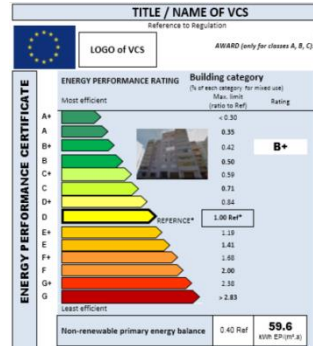
- key environmental risks, such as flooding, energy efficiency and climate,
- matters of design, configuration and accessibility,
- legislation, management and fiscal considerations

Enhanced sustainability performance data would help

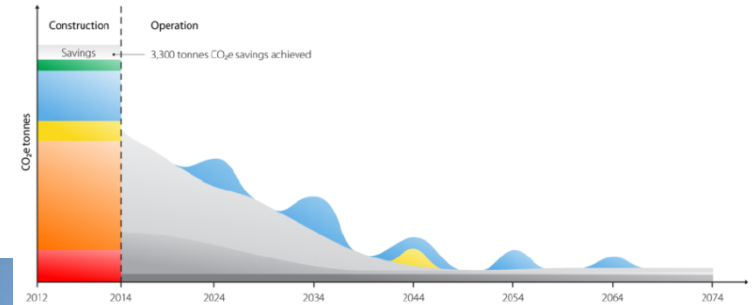
- Give **transparency** to markets
- **Raise awareness** raising within professionals/ across professions and within client stakeholders
- Enable **deeper holistic understanding**
- Help **deliver policy objectives**

Hypothetical case

1.1 Use stage energy performance



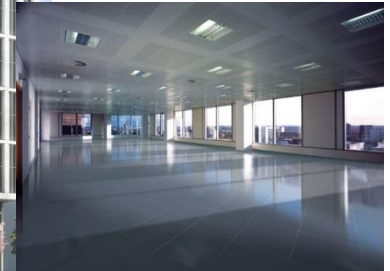
1.2 Life cycle Global Warming Potential



6.1 Life Cycle Costs



2.2 Design for refurbishment and adaptability



5.1 Projected future climate: thermal comfort



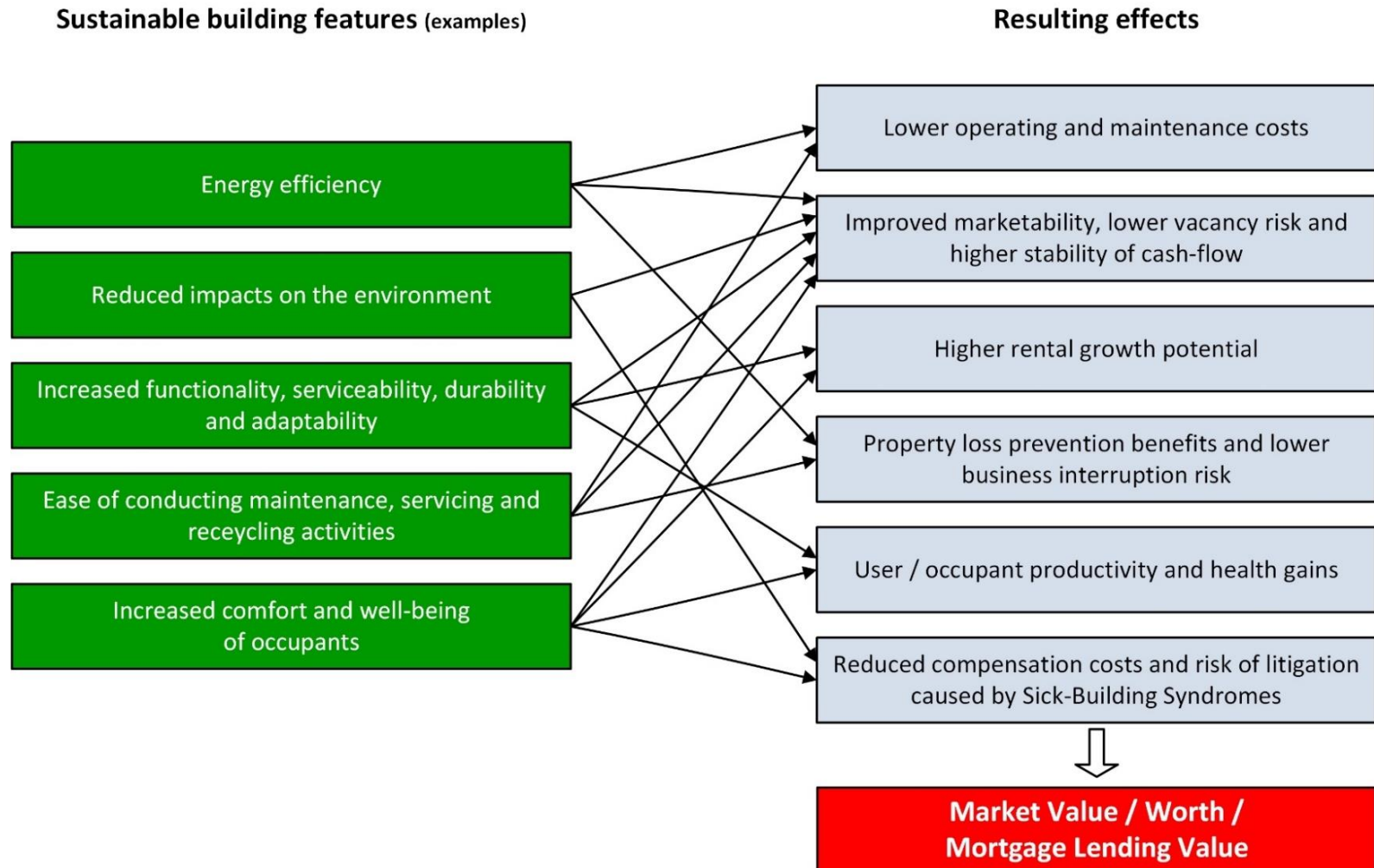
4.1 Indoor air quality

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



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/>
- RICS (2013) *Sustainability and Commercial Property Valuation*, 2nd edition
available at <https://www.rics.org/uk/upholding-professional-standards/sector-standards/valuation/sustainability-and-commercial-property-valuation/>
- RICS (2019)) *Energy Efficiency and Residential Values: a changing European landscape* available at <https://www.rics.org/uk/news-insight/research/insights/energy-efficiency-and-residential-values-a-changing-european-landscape/>
- TEGoVA (2016) *The European Valuation Standards EVIP 1 Sustainability and Valuation* available at <https://www.tegova.org/en/p5724f2c7ea5f9>

Questions?

Thank you