

The New Sustainability Agenda: connecting with valuation: framing the issues

Value and Sustainability Conference

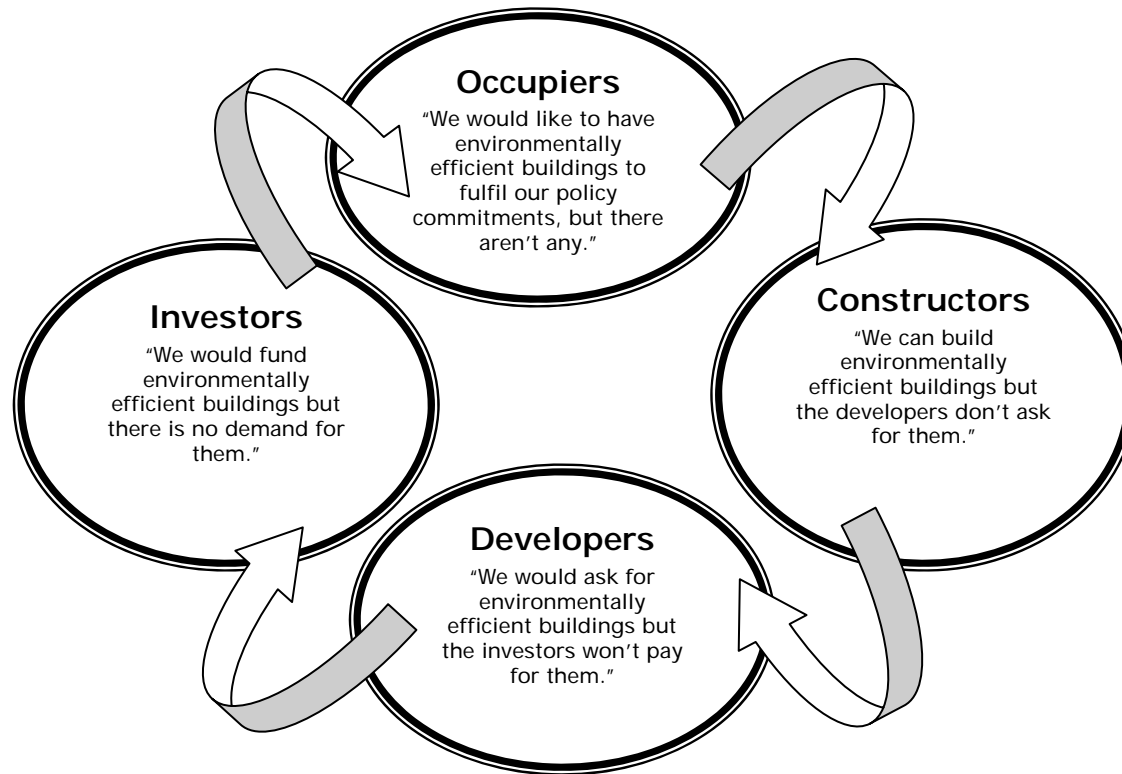
Vancouver
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UK 2000: the Circle of Blame and no business case – just rising awareness



Sir Martin Laing's Sustainable Construction Task Group

The Rise of the Sustainability Agenda

- General Market Drivers
 - CSR
 - Legislation & policy
 - Fear of legislation
 - Social concerns
 - Risk
 - Property market dynamics ?

The Agenda affects the client base – the impact on property is indirect as well as direct...

What do we mean by 'sustainable property'?

- Assessing social, environmental and economic performance – the “triple bottom line”
- Not just ‘green buildings’ – but sustainable ones
- Work for occupiers and owners
- Not just new build
- The existing stock – the 98/2 conundrum – more of an issue for the ‘old world’



Criteria for Evaluating Sustainable Property: The SPAP Project

- Energy & carbon efficiency
- Accessibility
- Adaptability
- Climate control
- Waste and Water
- Pollutants
- Occupier
- Contextual Fit

Performance under all these heads – and others - will drive future value performance: but are they factored into MV?

Connecting Sustainability Criteria with Value

- Sustainability will impact throughout the building life cycle and there exists ability to intervene through:
 - Property procurement and selection policies
 - Active management
 - Evaluating potential impact on value leading to
 - Market transformation

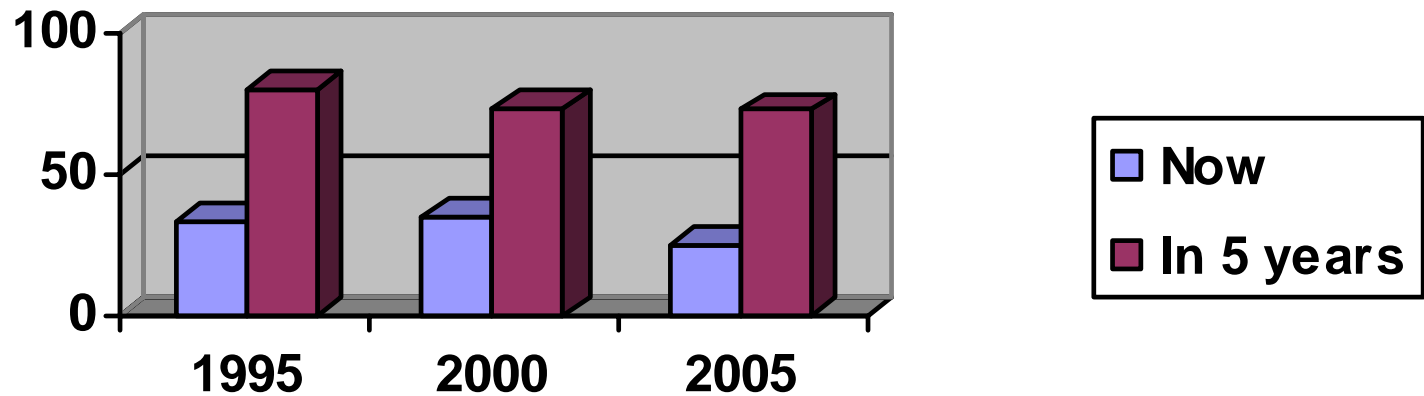


Connecting Sustainability Criteria with Value

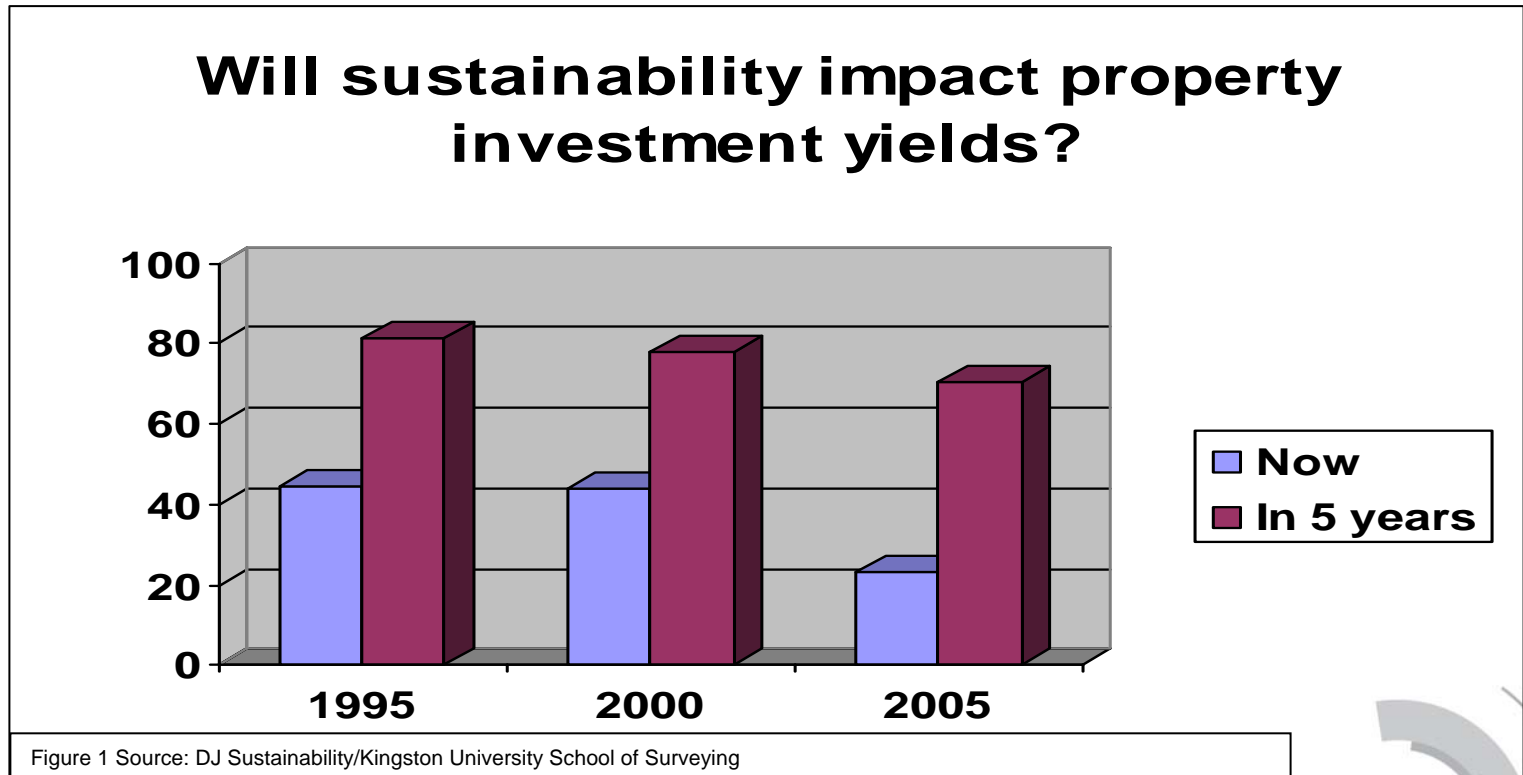
- There is little evidence in the UK that these factors are driving values – even though valuers may be aware of them...

Not yet an issue on rental values

Will sustainability issues impact rental values?



Nor yet investment yields...



But for Property Occupiers it is increasingly a reality...

- Occupiers are influenced by social, environmental and economic pressures
- They need buildings that operate effectively: adaptability and accessibility matter..
- Buildings that are compliant with legislation – now and in future
- Energy, waste and water, pollution are quantifiable cost and risk considerations
- CR polices are drivers - the case of M&S



For Property Investors...

- The case for investing in sustainable stock must make economic sense
- The Responsible Investor Case and the Universal Investor are gaining recognition
- Sustainable property will better meet their overall policies
- So appraisals should recognise this agenda – and values will follow



The Sustainable Property Appraisal Project

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 Sustainable Property Appraisal Project

**Property Rating
(Future Proofing Property
Questionnaire)**

**Translating Sustainability
Rating through to Worth
Variables**

**Production of Sustainable
Property Appraisal alongside
conventional appraisal**



The Sustainable Property Appraisal Project

- Requires capability to:
 - Assess for sustainability
 - Reflect sustainability in appraisals
 - Monitor investment performance against sustainability performance
 - Working towards a Sustainable Property Investment Index



Sustainable Property Appraisal Results

Pilot Property	Future-Proofing Property Rating	Standard NPV	Sustainability explicit NPV	% change
Retail 1	Poor	£81,941,626	£78,044,073	-4.99
Retail 2	Typical	£84,904,908	£81,377,074	-4.34
Retail 3	Typical	£6,578,254	£6,316,856	-4.14
Retail 4	Typical	£114,198,367	£110,767,540	-3.10
Retail 5	Typical	£2,072,871	£2,041,604	-1.53
Offices 1	Typical	£73,768,044	£71,852,635	-2.67
Offices 2	Good	£196,869,962	£197,727,958	0.43
Offices 3	Good	£11,372,296	£11,509,583	1.19
Offices 4	Good	£18,528,247	£18,876,900	1.85



Connecting to Value...

- Sustainability concerns will work through into the value that occupiers will place on property – non-sustainability responsive property will be worth less to them
- It will change their estates strategy and buying/ leasing preferences
- Valuers need to respond by recognising these issues in their appraisals..



The Role of the Valuer

- Valuers interpret markets
- They analyse and interpret *evidence*
- For them to build sustainability principles into their valuations will require observational evidence –
- This is backed up by Market Value definitions in International Valuation Standards, USPAP and RICS Red Book



Market Value (IVS)

The price most likely to be concluded by buyers and sellers of a good or service that is available for purchase. Value establishes the **hypothetical or notional price** that buyers and sellers are **most likely** to conclude for the good or service. Thus, **value is not a fact, but an estimate** of the likely price to be paid for a good or service available for purchase at a given time.”

Only if the parties recognise sustainability – or their advisors do - will it feed into valuations

The Current Role of the Valuer

- The role of the valuer has been dominated by commercial market activity
- Our current methods concentrate on price prediction based on the views and values of the 'internal stakeholder' only
- The requirement for single bottom line returns measured in terms of IRR and NPV will not go away – but they will not be enough in themselves
- The interest rate environment tends to drive decision horizons at all stages of the life cycle – and forces a focus on the 'here and now'

The Current Role of the Valuer

- Valuers methodology currently ignore externalities – and the impact of the property on 3rd parties – that has not been regarded as their business
- Even for ‘non-market’ properties the methodology adopted is taken from a narrow ‘cost as surrogate for value’ approach – if they have been valued at all
- Our role has not been extended generally beyond pricing from the one party standpoint **but**



The Role of the Valuer

- **But**
- If sustainability really matters to our clients the market *should* – in theory – respond and so will valuers
- In time this may lead to market transformation – where an inclusive TBL approach will be adopted
- A challenge – or an opportunity?



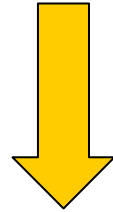
Change on the way in practice..

A discernible shift..

Lack of professional interest



Awareness Raising (client and valuer)



Imparting and sharing Knowledge (the Accord)



Valuing the incomparable

- The sustainability agenda draws attention to:
 - Tomorrow
 - Others without economic interests
- Valuers have concentrated on commercial and residential markets – but what of:
 - The growing power of the ‘external stakeholder’
 - The need for intra-generational equity?
 - The need to value e.g. Heritage assets?



Valuing the incomparable

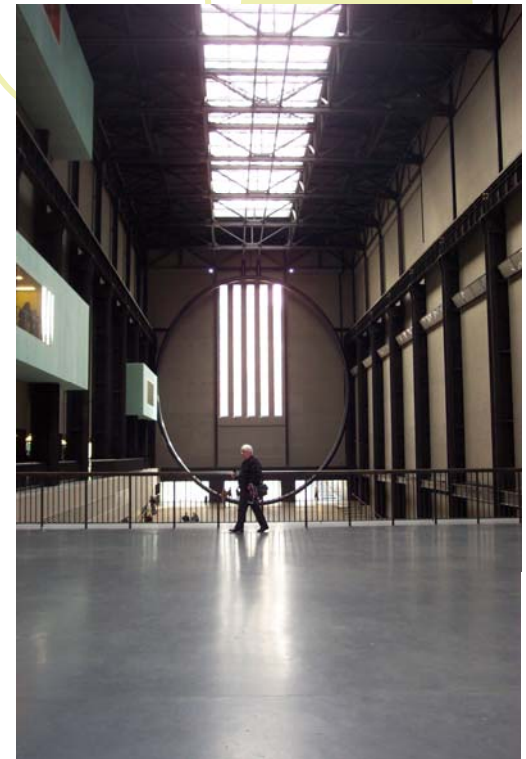
- Valuing Heritage is now upon (some of) us – for accounting
- This provides a catalyst to review our methods



Is there a need to value for other purposes and with other viewpoints and is this the valuer's role?

Valuing the incomparable

- Value to one person may give lead to quantifiable dis-benefits to others (.e.g. pollution; health risk)
- Society may recognise 'value' which is non-tradable
- But do (or will) clients?
- Will public and private sectors require different methodologies?



Do we need to consider other methods?

Educating the Valuer

- 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
- This has been reinforced in Professional Standards

The Accounting Interface

- The development of valuation standards is linked to accounting standards
- The role of the chartered accountant is now seen to relate to sustainability – at organisational and asset level
- The valuation profession needs to dialogue and up-skill to maintain relevance



The Accounting Interface

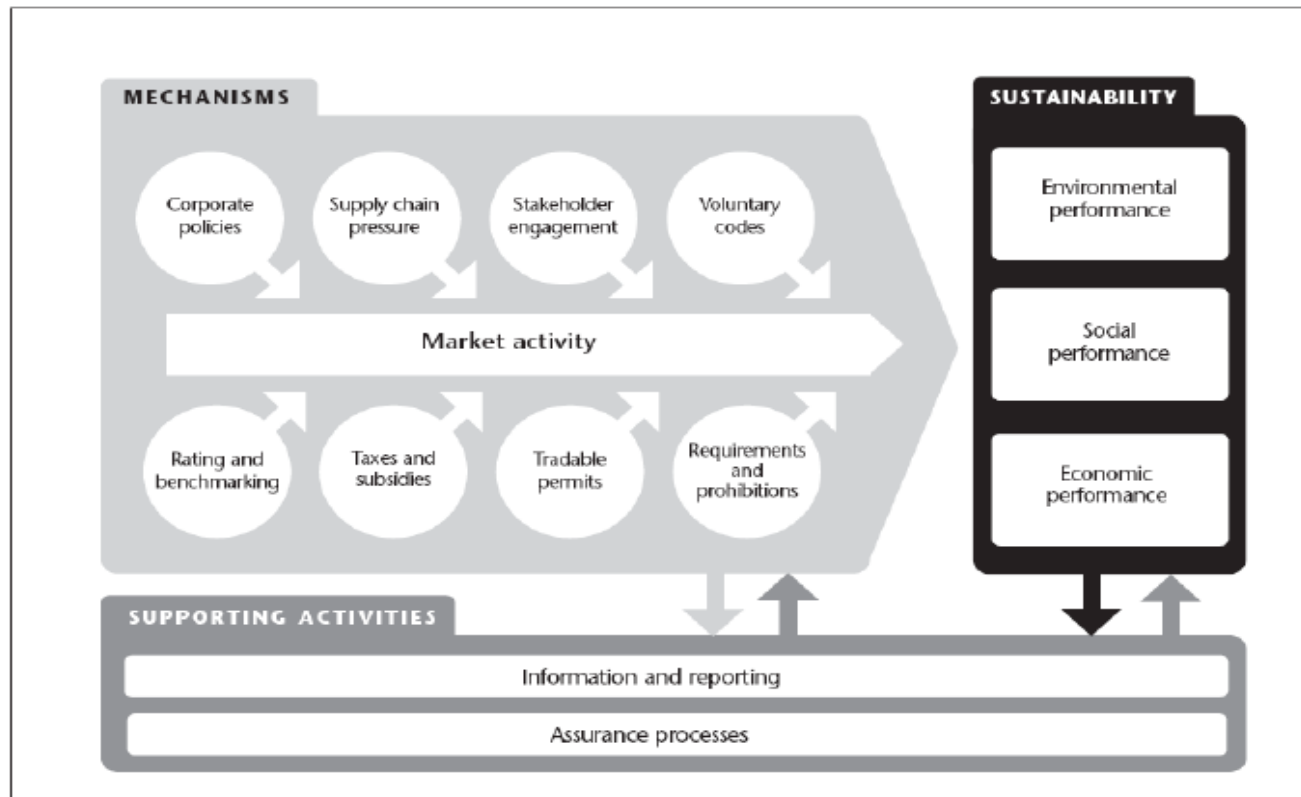


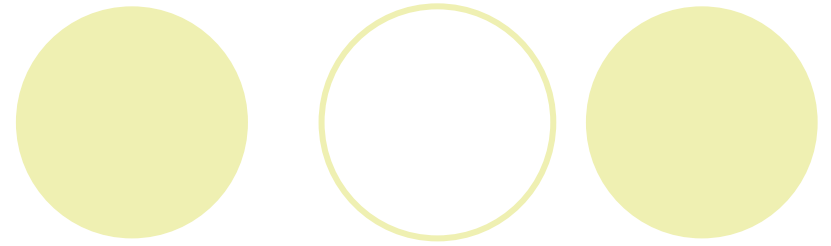
Figure 3 Diagram of eight market-based mechanisms that could be adopted to achieve development closer to sustainability. Taken from ICAEW (2004)



Conclusions (1)

- Still uncertainly about what sustainability is in relation to real estate – at building and settlement level
- Depreciation and obsolescence present real risks to the building owner – growth in knowledge and changing legislation are key
- Energy and carbon are the most obvious risks at the moment
- Other sustainability issues will move up the agenda: water may be the new energy

Conclusions (2)



- A better understanding of sustainability will lead to a more explicit relationship with market value
- To date market transformation has been slow – so first mover advantage is still available – clients need advice on ‘future-proofing’
- But it is not all about single bottom line...

Conclusions (3)

- Shifts in corporate accounting have long had a relationship with valuation methods
- Accountants are advocating a TBL approach
- Valuations will need to address non-economic matters of value – externalities will require quantification and inclusion
- The methods of environmental economics require refinement and adaptation for the valuer's use



Conclusions (4)

- 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