GERALDEVE

BRIEFING NOTE
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VALUING SUSTAINABILITY

The RICS recently published new guidance on 'Sustainability and ESG in commercial property valuation and strategic advice.' The Red Book has also been updated, and there is now a real focus on the importance of sustainability in valuations. Commercial property markets are becoming increasingly sensitive to sustainability and ESG, and it is widely acknowledged that sustainability factors can impact property values through either a 'green premium' for those properties that are particularly sustainable; or a 'brown discount' for those that aren't. However, as a valuer relying on market evidence, it can be difficult to demonstrate the impact of sustainability characteristics on value explicitly. Valuers are currently treading a fine line between reflecting wider sustainability trends in valuations; whilst only attributing value to sustainability factors where there is direct market evidence to do so. Until more evidence becomes available, this is a position we need to be comfortable with.

The RICS guidance recognises the growing relevance of sustainability factors in the market; and the need for them to form an integral part of any valuation. It outlines key sustainability characteristics and provides comment on how they could affect value – for example by affecting vacant or rent free periods, prospects for rental and capital growth, and/or susceptibility to obsolescence. This makes absolute sense, however finding evidence to support this can be difficult. Property as an asset class is heterogenous, therefore isolating an increase in value due to, say, increased energy efficiency, as opposed to another property feature is difficult. Those properties that are particularly sustainable are usually more modern and better specified anyway – what developer is producing a top spec unit with an EPC of E? And this is assuming that valuers are party to full information for comparable evidence, which may not be the case. A 'building passport' detailing the key specification and performance metrics of a building would go some way to addressing this issue.

Those premises that are less sustainable are likely to suffer from increased obsolescence due to increasing regulatory and market pressures – and are at risk of becoming stranded assets, suffering from reduced demand from both occupiers and investors. The RICS guidance suggests factoring in likely future cap ex requirements in valuations to account for this. There is, however, a slight risk here of valuers straying outside their area of expertise – valuers are unlikely to have the technical knowledge to make cap ex assertions on new plant and building upgrades and care must be taken to advise only where qualified to do so. In such cases expert guidance needs to be recommended; and agreed with the client in the terms at the beginning of an instruction.

In my opinion, there is a slight dichotomy between acknowledging the direction of the market, whilst only reflecting sustainability characteristics in value where you have explicit market evidence to do so. This will likely change as more evidence becomes available. However, in the meantime, my current approach is to record all of the sustainability characteristics of a premises (Gerald Eve have produced a checklist to help us with this); and to consider if and how these may affect value. If I think they do, and can back this up with market evidence then great. If I need to rely on wider market trends then I will be transparent about how and why I have done so. At the end of the day, all valuations require a certain amount of valuer judgement – what my boss describes as the 'stand back and look' step.