

Valuing Sustainability:

A team approach

The following is a summary of a talk given by Paul Halford BSc FRICS at the Regal Kowloon Hotel, on 17th January. The event was hosted by the College of Estate Management and attended by Hong Kong students and alumni of the College and their guests.

Sustainability is a much used term in all aspects of modern life, and particularly in the property industry. I am interested in the impact of sustainable development on value. There appears to be a broad acceptance that we need to manage our consumption of diminishing resources and generation of CO² but how can this be reflected in the valuation of sustainable property?

The Royal Institution of Chartered Surveyors Global Sustainability Survey (Q3, 2009) found:

- The vast majority of surveyors believe their clients place some to considerable importance on sustainability issues.
- Energy efficiency continues to be the most important sustainability issue according to the survey.
- Business bottom line continues to be overwhelmingly the primary driver of clients' sustainability agenda.

| | How important would you consider sustainability to be for your clients, % of respondents* | | | | |
|--------------|---|----|----|------------------|----|
| | Not important | 2 | 3 | 4 Very important | |
| Global | 7 | 23 | 34 | 23 | 14 |
| Australia | 0 | 23 | 46 | 31 | 0 |
| Brazil | 0 | 0 | 63 | 25 | 13 |
| Canada | 0 | 31 | 50 | 13 | 6 |
| China | 0 | 20 | 50 | 10 | 20 |
| Hong Kong | 0 | 40 | 40 | 20 | 0 |
| Ireland | 0 | 44 | 33 | 22 | 0 |
| India | 8 | 8 | 23 | 31 | 31 |
| Japan | 0 | 20 | 20 | 20 | 40 |
| Russia | 22 | 33 | 22 | 0 | 22 |
| South Africa | 0 | 20 | 10 | 50 | 20 |
| US | 13 | 38 | 22 | 19 | 9 |
| UAE | 21 | 5 | 21 | 26 | 26 |
| France | 0 | 0 | 75 | 25 | 0 |
| Germany | 0 | 7 | 27 | 33 | 33 |
| Spain | 9 | 9 | 55 | 27 | 0 |
| UK | 0 | 13 | 75 | 13 | 0 |

*Figures may not sum to 100 due to rounding
*Only countries with more than 7 responses have been listed individually

(Source: www.rics.org)

However, the Investment Property Databank Index of UK sustainable property returns for the period 2008 – 2010 shows only a small difference between the less and more sustainable properties in the index, and that differential has only arisen relatively recently.

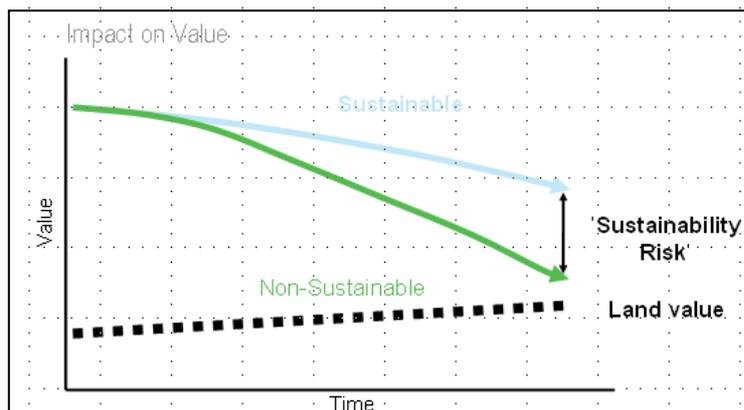
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(Source: www.ipd.com)

In the UK, as in many other locations, the supply of new property comprises only a small addition to the existing stock, so it may be surmised that the value of less sustainable stock is supported by the effects of substitution: that is, occupiers are prepared to offer higher rents for the best of the less sustainable property stock than would be the case if the supply of fully sustainable property were greater. Given this financial evidence, one may not be surprised that developers are sometimes reluctant to incur the additional capital cost of constructing sustainable buildings.

At the recent RICS International Valuation Conference (London, December 2007) it was suggested that the investor market had anticipated increased rental growth, and therefore yield, prospects for more sustainable property whereas what should be considered is that such properties will better sustain their rental and capital values over time, as shown in the following diagram.



(Source: Jones Lang LaSalle/College of Estate Management)

It may be argued that conventional property valuation, based on transactions which have taken place, cannot realistically allow for this scenario. If market evidence is somewhere close to the vertical axis, which it would be if the supply of sustainable property is a low proportion of total stock, there is no proof of the “sustainability risk” gap on which to base a formal valuation.

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However, valuers are also involved in providing valuation advice and it seems to me we should be advising our clients of this risk (or potential improved return). Discounted cash flow techniques allow us to model a range of rental values in differing economic circumstances. We can also take account of building costs which may make timely refurbishment to sustainable standards a more effective long term investment decision than waiting for the non-sustainable value to fall below site value. Some aspects of this will require considered input from other professionals – quantity surveyors experienced in refurbishment to sustainable standards, technology experts able to advise on the most beneficial sustainable technologies, economists and planners – all of which make the valuation process a true team effort.

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