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Encouraging the Uptake of Sustainable Buildings and the Critical Role of the Property Valuer

SB08

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A green profession?

RICS members and the sustainability agenda

A research report carried out for the Royal Institution of Chartered Surveyors by University College London and University of Melbourne, with input from George Tech University, USA, with key foreign university input.

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Three main objectives:

• Equip valuers, financiers, investors/owners and other stakeholders with a better understanding of the varying levels of sustainability and how it affects the level of risk (and subsequently the value associated with a commercial building);
• It will allow owners, investors, and tenants to appreciate the role of a valuer, their exposure to liability, and their challenging task of assessing the current and future risk, and subsequently value, of a sustainable commercial building; and
• Through this higher level of understanding it should mean that the benefits of sustainability will be fully reflected in the valuation process, therefore contributing to support for those developers and investors who are leading in the provision of sustainable solutions.

Communication between valuers and stakeholders

(Source: modified from Myers et al., 2007)
The main issues for valuers...

- Lack of a centralised market
- Off-market transactions
- Availability of accurate up-to-date information
- Privacy limitations about transaction data
- Limited information about leases
- Lag in the availability of information
- Contract v. unconditional v. settlement
Law of Diminishing Returns

- Site acquisition, preparation and pre-contract
- Building contract
- Letting period
- Investment sale period

Total development period

Months

(a)

(b)

Value ($) vs Construction Cost ($)
Market Value Model

- (c) Actual Construction Cost
- (b) Difference between (a) and (c)
- (a) Market Value

Sale Price ($) vs. Professional

- RISK
  - EQUITY
  - LOAN
  - BORROWER
  - FINANCIER
  - VALUER
  - INVESTORS - PUBLIC, REIT

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Highest and best use:

"The most probable use of a property, which is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value of the property being valued"

(RICS 2007)

Definition of market value:

"the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing wherein the parties had acted knowledgeably, prudently, and without compulsion"

(RICS Red Book – Valuation Standards)
Definition of special value:

“Special Value can arise where an asset has attributes that make it more attractive to a particular buyer, or to a limited category of buyers, than to the general body of buyers in a market. These attributes can include the physical, geographic, economic or legal characteristics of an asset. Market Value requires the disregard of any element of Special Value because at any given date it is only assumed that there is a willing buyer, not a particular willing buyer.”

(RICS Red Book – Valuation Standards)

Drivers of sustainability considerations in valuation

- Tenant demand
- Investor demand
- Government specification of sustainability in leasing contracts
- Socio-economic change including adoption of CSR
- Lower operating costs and increased accountability
- Increased performance measurement
- Improved rating systems
- Retention of staff
Barriers to acceptance of sustainability considerations in valuation

- Lack of knowledge about the effect on value
- Limited discussion in valuation circles
- Ability of valuation approaches to incorporate sustainability
- Impact of individual sustainability inclusions
- Quantifying the intangible aspects of valuation
- Systematic nature of buildings

Concept of intangible value in valuation

- Wider effect of buildings on the environment
- Point of difference
- Corporate social responsibility
- Government legislation
- Addressing long-term obsolescence
Policies, regulations and standards

- RICS Red Book – Valuation Standards
- International Valuation Standards Committee (IVSC)

Concept of intangible value in valuation

- Wider effect of buildings on the environment
- Point of difference
- Corporate social responsibility
- Government legislation
- Addressing long-term obsolescence
Incorporating sustainability into valuation

- Do the sustainable features cause the building to be associated with less or more risk?
- How is the level of sustainability reflected in the assessed value of the building?
- How is sustainability incorporated throughout the valuation process?
Environmental Efficiency in Buildings

- Improved working environment
- Reduced building operating costs
- Reduced facilities maintenance costs
- Greater capital cost
  - Greater demand for space
  - Lower operating expenditure
  - Lower operating and/or capital expenditure
  - Cannot lower initial return on capital
  - Increases net income or decreases capital
  - Increases net income on value
  - Positive impact on value
  - Positive impact on value
  - Positive impact on value
  - Negative impact on value

(Source: Boyd, 2006)

Likely future developments when incorporating sustainability considerations into valuation:

- Changing perception of sustainability
- The definition of market value
- Changing relationship between cost and value
- Increased communication and information availability
- Undertaking explicit valuations
- Increased data collection and transparency
- Enhanced understanding of the valuation process

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