

# REPORTING ON REVALUE

## IMPLICATIONS FOR EFFECTIVE FUTURE POLICY ON PROMOTING ENERGY EFFICIENCY IN RENTED DWELLINGS



On the 22nd of June 2018 in Brussels, the REVALUE project partners led a high-level roundtable discussion with key stakeholders to discuss the project's findings and the implications for future policy on energy efficiency (EE) and other ongoing European projects.

There were 20 registered participants, representing the European Commission, the European Parliament, valuation professionals, financial institutions and housing providers.

"The evidence of the relation between value, energy efficiency and individual dwelling components is promising in relation to the development of a Building Passport."

*Martin Schoenberg, UNEP FI Energy Efficiency Project Coordinator*

The REVALUE project is timely in relation to a number of broader initiatives taking place at a European level, and within related sectors. UNEP FI's Energy Efficiency Project Coordinator, Martin Schoenberg, highlighted the \$240 billion in annual EE investment and the central role finance is taking in the G20's EE discussions. Mr Bertalot of the EFM-ECBC stressed the connection with the EeMAP initiative of the lending sector.

While the REVALUE project focuses on the controlled rent sector which makes up only 13% of the building stock, the added value of the approach is the wealth of data typically available at dwelling level, with regards to valuation, technical components and energy performance. This allowed REVALUE to explore the connection between EE and market value at a much deeper level than previous projects could.

Among the project results presented, the elements that triggered the most interest were:

- Regression analysis showing relation between market value and individual building components
- Valuation and the role of valuers in improving market confidence
- Overall project impacts and unlocking investments



## Evidence from the regression analysis, Maastricht University

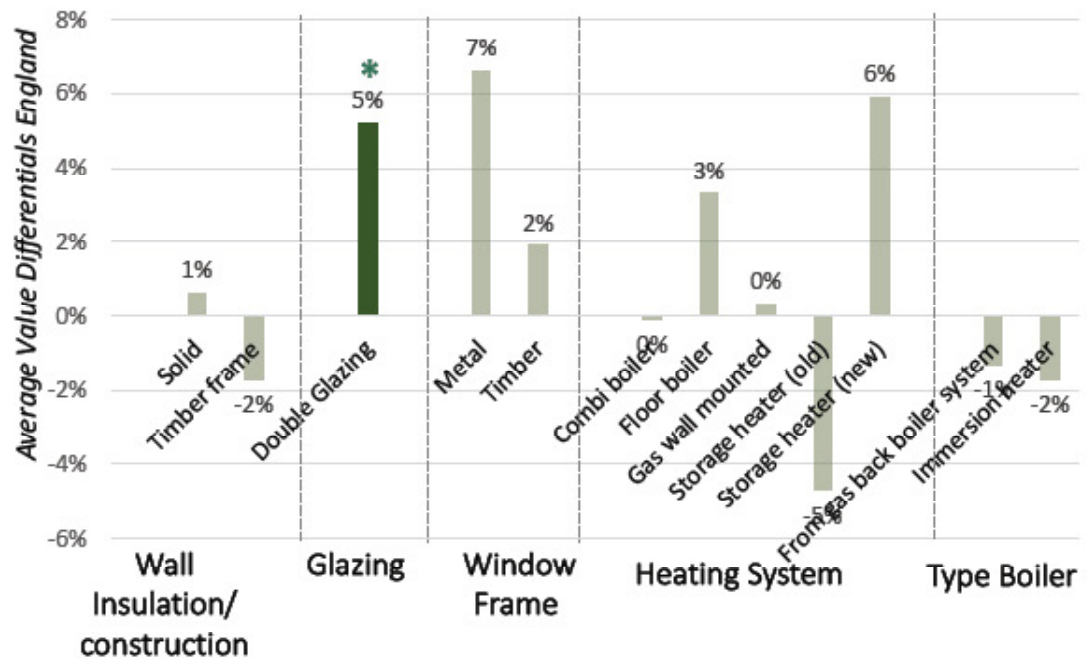
*Is EE incorporated in expert opinions of value?*

For over 120 000 dwellings in 4 countries across north-west Europe, the 5-10 datapoints - available per dwelling, and describing technical characteristics - were linked to 2 RICS market valuation with 5-year intervals.

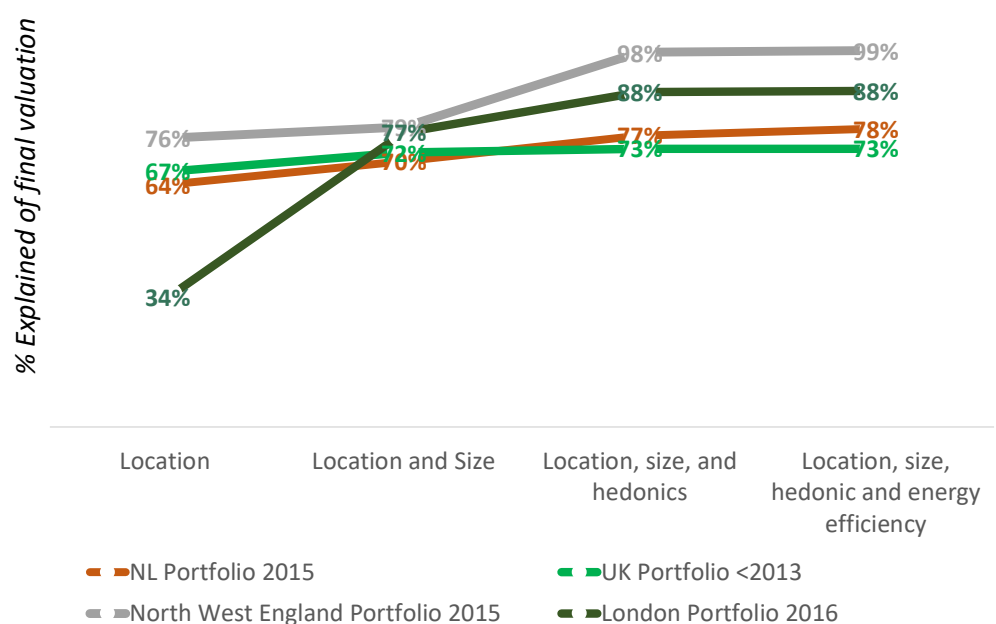
Regression analysis showed that about 1% of value could be attributed to EE and that markets showed an - admittedly small - increase in green premiums and especially brown discounts. The detailed analysis provided the first proof of individual building components being reflected in valuations; double-glazed windows and frames.

The results are highly relevant for the viability of the Building Renovations Passport, as a proof of concept. It shows the value of recording data at a component level as that is where valuers and investors seem to attach value.

The results seem to show that valuations mostly reflect visible dwelling characteristics. Components with energy impact that are less easily assessed (such as insulation, heating systems) in given timeframes and with potential knowledge gaps may thus not be properly reflected. This underlines the need for a data-driven valuation approach.



Visible EE components such as double glazing have a significant effect on assessed valuations. Graph: Maastricht University



The reported values of dwellings remain dominated by traditional value factors. EE explains just 1% of a building's value. Graph: Maastricht University

## RICS and the role of valuers

The REVALUE project has contributed to the new **RICS Red Book** in which sustainability takes a more prominent role. It will result in an Insight Paper describing the main findings, enabling valuers to explore methods. Indicatively, this could include; collecting and reporting on available information and simple indications of low-medium-high quality of key components. This provides context for lenders and investors to instruct valuers; and yet a majority of valuers are not asked to report on EE. The market demand to do so, and simple reporting on that information could inform and influence investment decisions since often these are largely made on non-financial criteria, but rather keeping up with current of existing standards, not financial returns.

For valuers, the challenge will be to cover more ground - within both the same timeframes and fee structures - on an element contributing currently perhaps 1% to a dwellings's value. It will be a practical challenge.

For lenders, there is financing available - sometimes favourable conditions for green investments. But there remains no clear method to assess how green, if at all, a project is. An aligned approach, e.g. through EeMAP is crucial.

For investors, compliance to regulation remains a key issue. For existing buildings, no tightening rules are expected soon. A better understanding of the social impact of EE (examples including energy bills and health) is becoming a key driver of investments. How could this be included?

For policymakers, the findings could contribute to the enhancement of the EPCs, currently under discussion. The insights into which building elements are already considered is of particular relevance.

## Overall impacts and unlocking investments

Valuers do not make markets, but inform the main actors. The evidence of EE value and enhanced guidance foreseen in the project could reduce risk perceived by investors and lenders through enhancements in methodology. Actual investments and lending conditions remain the decision of respective stakeholders.

For lenders, the previously mentioned lack of standard assessment methods could be tackled by valuers' reports. These reports could help ensure compliance with (emerging) standards.

For investors, being aware of the importance of instructing valuers is an important learning point itself.

For policymakers, the project findings could contribute to the discussions around the EPCs. Currently, they still require specialist knowledge from lenders and investors. New, more accessible, initiatives may improve the market.

## During the discussion, participants raised several key points:

- Unlike other hedonic regression analysis, this project looked at individual value drivers. Valuers are often including EE components, but not categorising them as such.

"What's significant about this project is that, compared to all the other hedonic regression analysis, for the first time, you looked at the individual value drivers."

- It is crucial not just to identify the relevant data points, but also the comparability and comprehensiveness of the data sets.

"Beyond specific types of data, you also need guidelines on homogeneous data sets. Of course, the more complete, the better! But sometimes we see that the basics are missing from a housing provider's data set - making it difficult to compare and connect."

- The EE components that are featuring the most prominently tend to be the more visible and tangible ones, such as double glazing.

"Energy efficiency is an intangible concept that a valuer can't see, but what is being put into the valuation is all the visible benefits of EE measures. They are being in under different categories, such as better living conditions."

- Policy-making needs to move beyond the real estate sector as a whole and become more targeted.

"We have to try and achieve more at a district level and embrace the concept of learning from your neighbour."

- Aggregation is key, both in terms of financing and implementing renovation models.

"Both with financing and innovative renovation business models, you need to aggregate. By collecting many buildings in one big project, you scale up the size and impact of the project."

- The EPCs are far from perfect but a huge improvement on what was there before. The REVALUE findings can shape the development of building passports - the EPC's successor.

"What data is needed? Where can it be found? Let the Commission know what the relevant information is. It's a good moment to talk about it."

## KEY FINDINGS

### **1** Instruction from the client is critical; many do not specify consideration of energy matters

Valuers confirmed that they act in accordance with client instructions and in compliance with professional regulatory codes. The latter have recently been revised and give greater guidance and encouragement to valuers to consider sustainability data where it is available. When the instruction is to provide a market value, normally there is no such specific instruction given by clients in relation to reporting on the contribution of the EPC or other energy data within their reports; further the fee basis is often insufficient to support detailed investigations regarding energy data, especially where market evidence would suggest it is not likely to have an impact on market participant behaviours. However, banks are beginning to ask for comments in certain cases.

Valuers also prepare investment valuations using discounted cash flow (DCF) techniques when acting for portfolio owners. Under such circumstances, the data made available to valuers may include more specific energy data which can be factored in to the cash flow analysis. However, valuers confirmed that often any cost reductions resulting from energy efficiency measures may not enhance the net cash flow if the cost savings are enjoyed by the tenant – not the landlord. In this case the only impact on value is on a potentially reduced investment risk.

### **2** Valuers have found little evidence that EPCs ratings impact the market value of residential assets

Valuers in all four countries in which discussions took place confirmed that EPCs, even where available, were not a key factor affecting the behaviour of market participants and, in turn, their assessments of market value. Differing levels of trust in the accuracy of EPC were reported but overall, they are not considered reliable data in terms of accurately assessing the true energy efficiency of a property. While participants acknowledged that accuracy had improved over time, notably since the re-cast of the regulations applicable from 2012, inconsistent ratings have been reported, even in new builds. The result is that most market participants were simply not factoring EPC levels into their offer prices. In turn, valuers, who are under a professional obligation to reflect, not lead, the market, do not generally factor the level of certificate rating into their valuations; they tend to report it as a 'tick box' exercise. Traditional value drivers such as location, specification, configuration, size and condition still dominate. However, the impending imposition of minimum energy efficiency standards requirements on England's residential investment market illustrates growing awareness of the issue. But where high demand for housing persists, valuers consider that economic and traditional factors will remain the priority.

### **3** Some features which enhance energy efficiency are increasingly regarded as 'normal' and a brown discount may apply if they are missing

EPCs may not directly relate to reported market values, but the specification of dwelling expected as a 'norm' in the market place will reflect some features which can increase energy efficiency. Where they are expected, the valuer may apply some level of 'brown' discounting to reflect that a purchaser would normally expect to expend capital on upgrading – although the anticipated costs may be more than the actual requirements. The energy efficiency features that do have a bearing vary by geography, typology and sub-market. For example, double



or even triple glazing is an expectation in northern Europe, whereas in southern Europe, an efficient cooling system is considered much more important. Valuers reported that features such as wall insulation, which are not easily visible, are less likely to influence values but, in some cases, where the installation has been poor, dampness can occur, leading to a value decrease. The resultant picture is therefore complex in terms of the relationship between any individual upgrade measure and any possible value impact.

## 4 Some valuers may lack the knowledge to do energy assessment

A formal valuation is not a building survey and, in most countries, valuers have limited training in the technical aspects of energy assessments, though all were confident and competent in building inspection. Valuers in only one of the countries in the study (Spain) tended to have an educational background in engineering; elsewhere, they were more likely to have had a business- or economics-based education. Achieving a closer integration of energy assessments within a building inspection to underpin a valuation would require not just greater cost and time, but also the input from an energy specialist. This might be appropriate in some cases, but it is outside the normal scope of due diligence for a valuation. Even then, not all data is readily available. Furthermore, in the absence of any objective measures directly linking a dwelling's energy performance to its value, an expert's input is unlikely to form part of a client's instruction.

"The findings on valuation of this report are good for the European Commission to retain because they are spot on, describing what valuers can and cannot do about energy efficiency given that the valuer's job is to objectively gauge market value, not drive energy efficiency, and given also client pressure on remuneration for valuation reports and thus on the amount of effort the valuer can put into energy efficiency aspects."

*Michael MacBrien, Adviser to TEGoVA*

