



International Valuation Standards Council

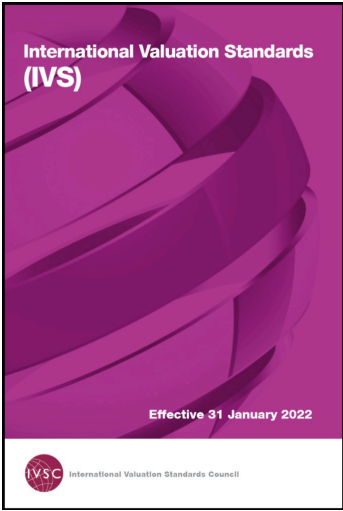
IVSC and ESG

The Journey So Far

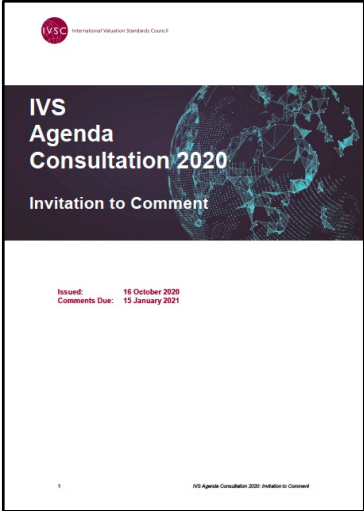
Alexander Aronsohn

IVSC Director of Technical Standards (Tangible Assets)

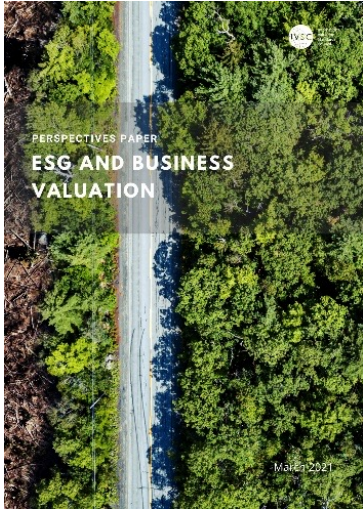
ESG the Journey So Far



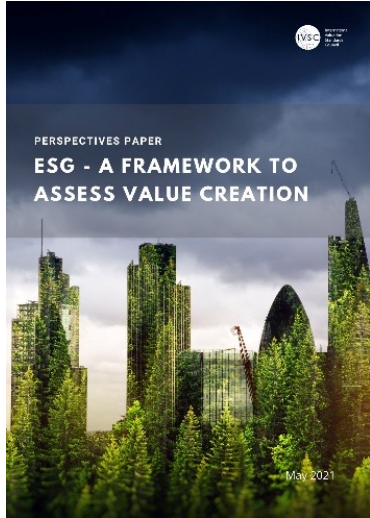
IVS wef: 31/01/2020
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IVS wef: 31/01/2022



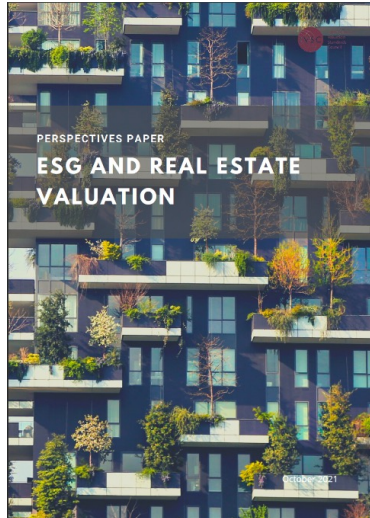
October 2020



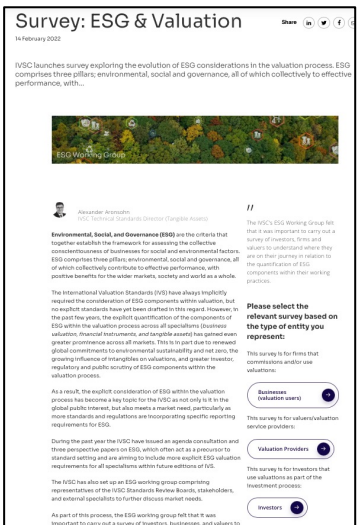
March 2021



May 2021



October 2021

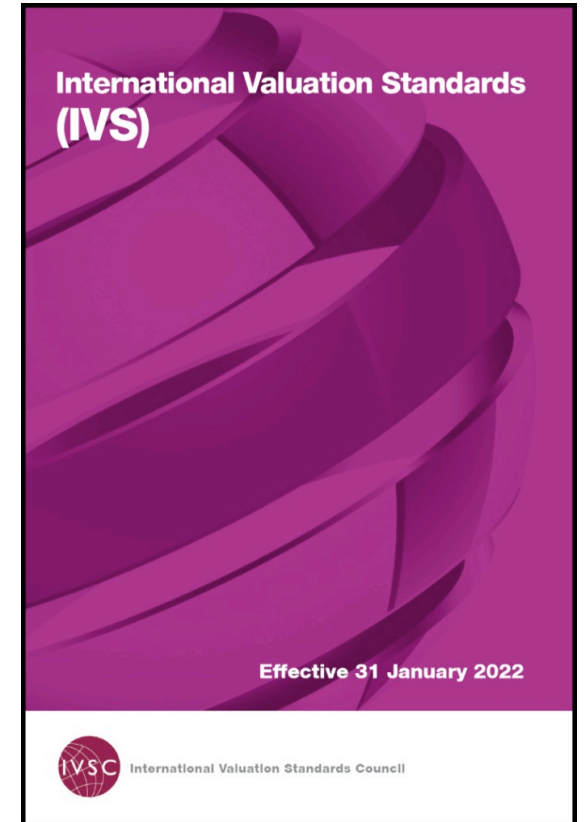


February 2022



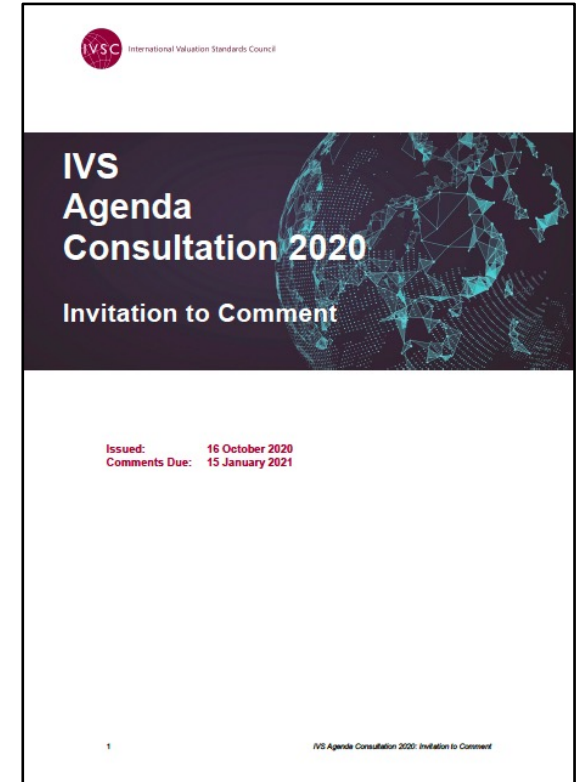
ESG and the IVS

At this time, the obligation to consider ESG within the valuation process is implicit in IVS. More specifically, under IVS 101 20.1 “all valuation advice and the work undertaken in its preparation must be appropriate for the intended purpose.” This is further referenced in IVS 102 20.1 where it states that “investigations made during the course of a valuation assignment must be appropriate for the purpose of the valuation assignment and the basis(es) of value”. Moreover, within IVS 105 50.36 through 50.4, the adjustments for additional risks within the cash flow projection require detailed consideration and this will include ESG elements



ESG and the IVS Agenda Consultation 2020 Part 1

Environmental, Social, and Governance (ESG) are the criteria that together establish the framework for assessing the impact of the sustainability and ethical practices of a company on its financial performance and operations. ESG comprises three pillars; environmental, social and governance, all of which collectively contribute to effective performance, with positive benefits for the wider markets, society and world as a whole.



ESG and the IVS Agenda Consultation Part 2

ESG factors for consideration typically include:

Environmental

- *Air and water pollution*
- *Biodiversity*
- *Climate change and carbon emissions*
- *Deforestation*
- *Resource efficiency (ie, energy and CO2)*
- *Waste management*
- *Water scarcity*

Social

- *Community relations*
- *Conflict*
- *Customer satisfaction*
- *Data protection and privacy*
- *Development of human capital (health & education);*
- *Employee engagement*
- *Gender and diversity*
- *Health & safety*
- *Human rights*
- *Working Conditions*

Governance

- *Audit committee structure*
- *Board diversity and structure*
- *Bribery and corruption*
- *Corporate governance*
- *Executive remuneration*
- *Institutional strength*
- *Donations and political lobbying*
- *Rule of law*
- *Transparency*
- *Whistle-blower schemes*

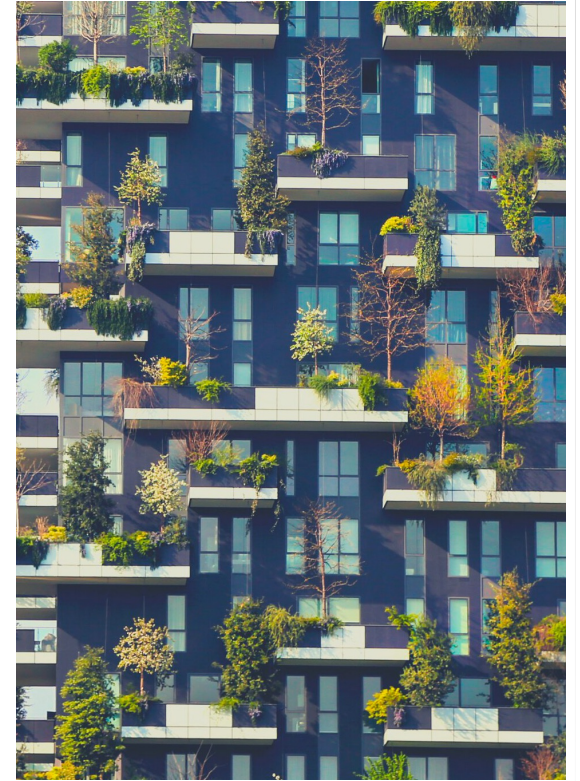


ESG – ESG and Real Estate Valuation Part 1

ESG Overview

Environmental, Social, and Governance (ESG) are criteria increasingly used to assess the impact of the environmental, social and ethical practices of companies on their operations, financial performance and attractiveness to investors. The three components; Environmental, Social and Governance which are metrics considered to evidence effective performance, reach beyond the individual organization out to the wider markets, society and world as a whole.

While it is very frequent to have ESG criteria assessed and measured from a company's perspective, they should also be considered from a tangible asset's perspective as the ESG principles affect not only the behaviour of owners and operators of assets, but also other matters related to the physical properties themselves, such as energy efficiency.

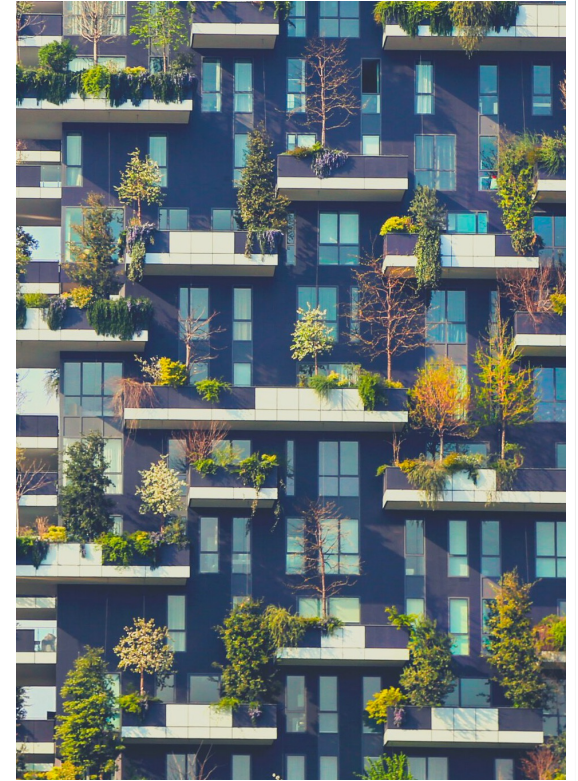


ESG – ESG and Real Estate Valuation Part 2

ESG and The Global Real Estate Industry

From a real estate perspective, Environmental issues are especially important as the built environment contributes approximately 39% of the world's carbon dioxide emissions and 40% of the energy consumption. An increasing number of occupiers, both in the residential and commercial environment, are seeking to occupy buildings with green credentials. Responsible valuers need to be aware of steps taken by governments which will affect real estate. Several examples follow:

Australia, China, Europe, Europe Union, Hong Kong, India , South America, United Kingdom, United States

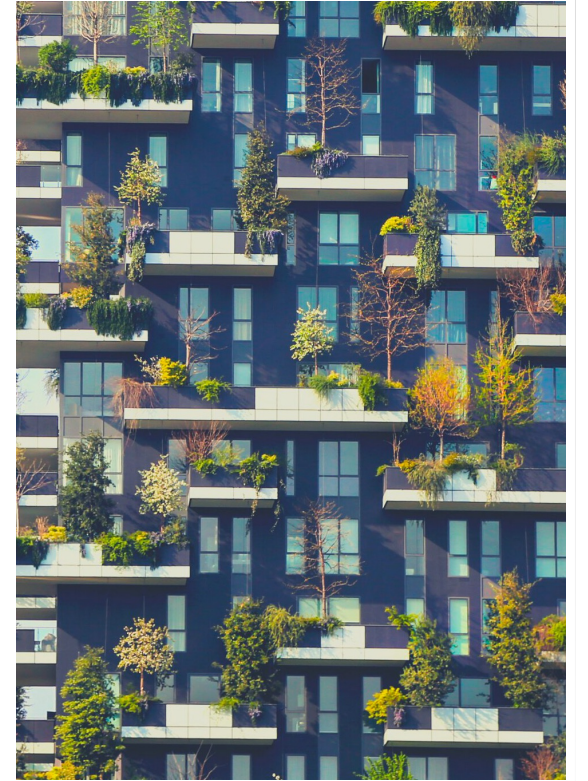


ESG – ESG and Real Estate Valuation Part 3

ESG and Real Estate Valuation

Cost Approach: While the Cost Approach could be used for part of the valuation to calculate the retrofitting costs to make buildings more ESG compliant, it would not be recommended as the main approach for quantifying ESG considerations within a valuation.

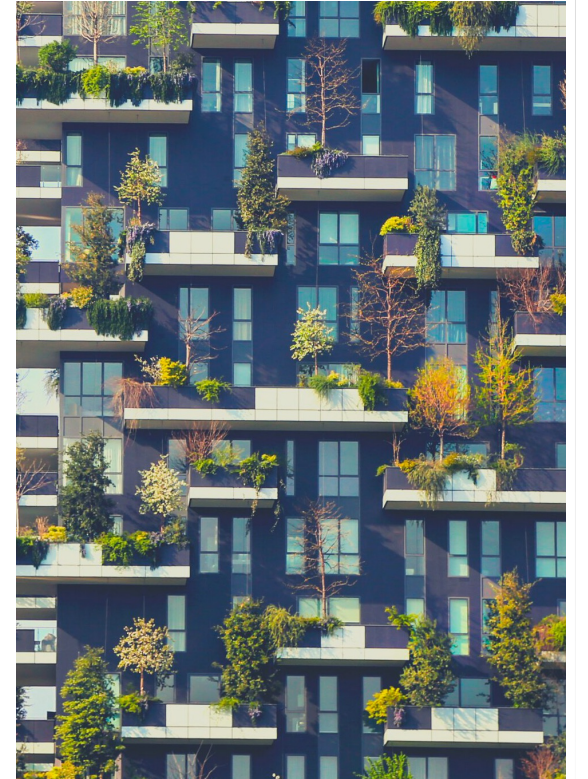
Sales Comparison Approach: At this early stage of market recognition and adoption of ESG practices, there is not yet full transparency regarding ESG characteristics for buildings making it very challenging to find comparable market transactions reflecting full ESG adoption, or to objectively know and compare the level of ESG adoption of the comparables used. This factor makes the Sales Comparison Approach more difficult to apply for the time being.



ESG – ESG and Real Estate Valuation Part 4

ESG and Real Estate Valuation

***Income Approach:** Discounted Cash Flow Analysis is very well suited to quantifying ESG factors within a real estate valuation because a DCF can explicitly reflect specific assumptions which relate to income, expense, capital expenditures and exit yields and vacancies over a period of years. This method allows the valuer to transparently project expected trends and changes in income and expenses.*



ESG – ESG and Real Estate Valuation Part 5

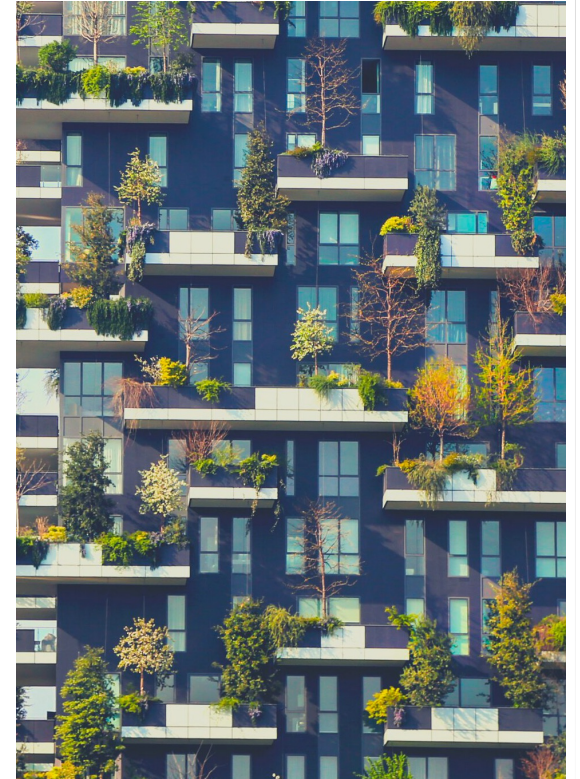
ESG and DCF's - DCF Inputs

***Income:** The influence of ESG on the rent a building can generate can be significant.*

***Non-recoverable operating expenses:** In respect of non-recoverable management costs borne by the property owner, these costs should not be significantly different for sustainable buildings.*

***Vacancies:** In some markets it appears that in some instances buildings that meet sustainable and ESG criteria may receive higher demand from occupiers and rent more quickly than similar class alternatives that do not meet this criterion.*

***Capitalisation Rate:** The capitalisation rate reflects the risk-return profile of the underlying property, and numerous aspects must be taken into account(location, type of use, occupancy rate, year of construction, tenant-mix, etc.)including the most probable buyer.*

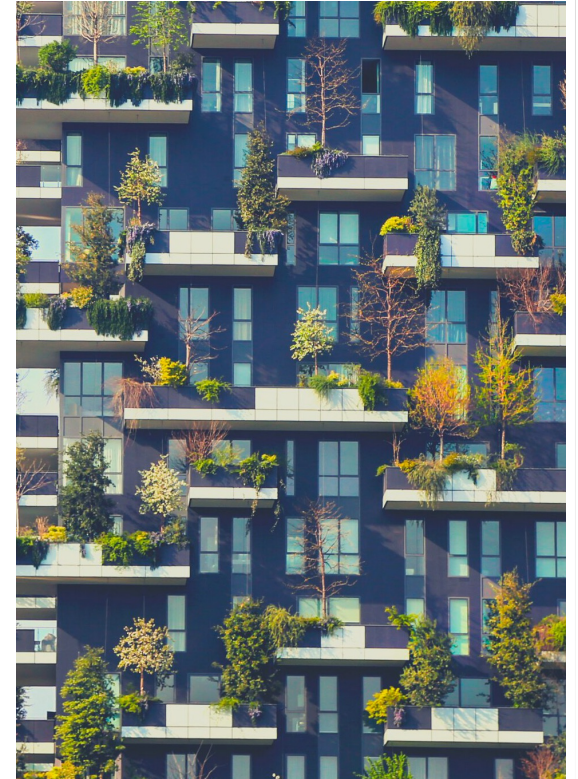


ESG – ESG and Real Estate Valuation Part 6

ESG and DCF's – Other Inputs

***Finance:** While many valuations of real estate assets are performed before consideration of financing, there are an increasing number of green loans available within markets where lower finance costs are offered to buildings where sustainability Key Performance Indicators are achieved. This results in lower costs of debt and enhanced equity returns to the property owner.*

***Useful Life:** In some markets such as the Netherlands, there is a legal restriction on the useful life of buildings that don't meet certain ESG compliant criteria. The valuer must be aware of this and consider the relevant legislation in the locality and when appropriate. In doing so, they must restrict the forecast cashflows to the remaining useful life of the building, or until the building is made more ESG compliant.*

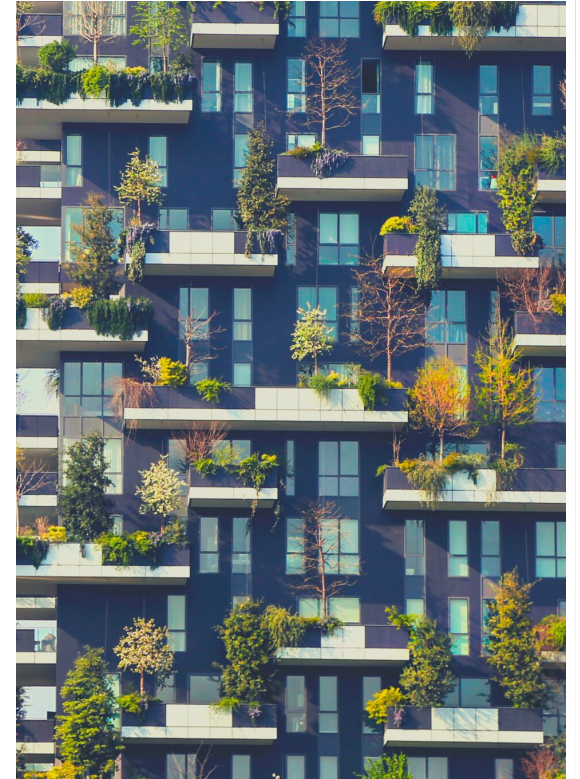


ESG – ESG and Real Estate Valuation Part 7

ESG and Valuer Requirements

In order to account for ESG factors within the valuation process the IVSC anticipate that the valuer will need to;

- Monitor the continued evolution of ESG and what building aspects result in higher or lower ESG ratings.*
- When evaluating a building in its market, be aware of applicable governmental ESG measures.*
- Maintain a keen understanding of leasing and other market requirements to accurately reflect supply and demand considering ESG.*
- Liaise with construction and build cost professionals to understand components that enhance ESG factors and their cost.*
- Understand ESG features of comparables used and determine how much emphasis market participants place on such features.*
- Understand whether favourable financing is available for buildings with a higher ESG rating.*



IVSC Survey: ESG & Valuation

Three separate surveys

1. **Business** (valuation users): firms that commissions and/or use valuations.
 2. **Valuation Providers**: valuers/valuation service providers:
 3. **Investors**: investors that use valuations as part of the investment process.
- Survey closes 30th April 2022
 - Perspective Paper to be published highlighting the results



Survey: ESG & Valuation

14 February 2022

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IVSC launches survey exploring the evolution of ESG considerations in the valuation process. ESG comprises three pillars; environmental, social and governance, all of which collectively to effective performance, with...



Alexander Aronsohn
IVSC Technical Standards Director (Tangible Assets)

Environmental, Social, and Governance (ESG) are the criteria that together establish the framework for assessing the collective conscientiousness of businesses for social and environmental factors. ESG comprises three pillars; environmental, social and governance, all of which collectively contribute to effective performance, with positive benefits for the wider markets, society and world as a whole.

The International Valuation Standards (IVS) have always implicitly required the consideration of ESG components within valuation, but no explicit standards have yet been drafted in this regard. However, in the past few years, the explicit quantification of the components of ESG within the valuation process across all specialisms (*business valuation, financial instruments, and tangible assets*) has gained even greater prominence across all markets. This is in part due to renewed global commitments to environmental sustainability and net zero, the growing influence of intangibles on valuations, and greater investor, regulatory and public scrutiny of ESG components within the valuation process.

As a result, the explicit consideration of ESG within the valuation process has become a key topic for the IVSC as not only is it in the global public interest, but also meets a market need, particularly as more standards and regulations are incorporating specific reporting requirements for ESG.

During the past year the IVSC have issued an agenda consultation and three perspective papers on ESG, which often act as a precursor to standard setting and are aiming to include more explicit ESG valuation requirements for all specialisms within future editions of IVS.

The IVSC has also set up an ESG working group comprising representatives of the IVSC Standards Review Boards, stakeholders, and external specialists to further discuss market needs.

As part of this process, the ESG working group felt that it was important to carry out a survey of investors, businesses, and valuers to

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The IVSC's ESG Working Group felt that it was important to carry out a survey of investors, firms and valuers to understand where they are on their journey in relation to the quantification of ESG components within their working practices.

Please select the relevant survey based on the type of entity you represent:

This survey is for firms that commissions and/or use valuations:

Businesses
(valuation users)



This survey is for valuers/valuation service providers:

Valuation Providers



This survey is for investors that use valuations as part of the investment process:

Investors



Next Steps

- IVSC to publish perspective paper highlighting the results
- IVSC to organise a series of round tables to discuss the survey results

Survey: ESG & Valuation

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International Valuation Standards Council


Next Steps

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ESG Working Group

 Alexander Aronson
IVSC Technical Standards Director (Tangible Assets)

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ESG Survey – Investors

15 February 2022

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The IVSC's ESG Working Group has launched this survey to better understand where investors are on their journey in relation to the quantification of ESG within their working practices. The...

The IVSC's ESG Working Group has launched this survey to better understand where **investors** are on their journey in relation to the quantification of ESG within their working practices.

The survey will run until the end of April 2022 when the Working Group will different stakeholders and publish a report. A copy of the report will be sent to the email address you provide.

Thank you for sharing your insights with us.

Survey questions:

1. What type of investor group do you represent?

☐ Private fund manager

☐ Public fund manager


☐ Sovereign wealth fund

☐ Pension fund / endowment

☐ Family office


☐ Other

Other




International Valuation Standards Council (IVSC)

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How are **#esg** components factored into the **#valuation** process today? Share your thoughts and contribute to an international survey looking at the latest trends.



Survey: ESG & Valuation - International Valuation Standards Council

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Thank you.

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