

Israel IVS Forum

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International Views and Approaches Real Estate Valuation and the Sustainability Challenge February 2021

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The issue of sustainability in real estate and construction is currently at the top of the international agenda, due to the worrying trends in climate change attributed to human interference. In Israel awareness of the subject is only just beginning, the Interior Committee of the Knesset having approved a few months ago a first pilot for implementing Energy Performance Ratings for newly built properties in Israel. These are similar to the certificates placed on all imported white goods. In Europe they have been in place for a few years and in the UK the Government has committed to ambitious targets for raising the minimum performance ratings in the coming years, as part of their all encompassing plan to attain carbon neutrality by 2050.

In view of this we are pleased that Professor Marco Percoco, the head of the GREEN centre for sustainability at Bocconi University in Italy, has agreed to our request to set out his views as to the role needed of valuers.



MARCO PERCOCO

Marco Percoco is the founding director of the GREEN - Center for research in Geography, Resources, Environment, Energy and Networks at Università Bocconi in Milan where he is also a professor of real estate and infrastructure economics in the Department of Social and Political Sciences. Currently, he is a Vice-chairman of the Bureau of the UNECE Working Party on Public-Private Partnerships. In the recent past, he has served as an advisor in the Evaluation Unit in the Prime Minister Office, as an economic adviser in the Infrastructure Regulation Unit of the Italian Government and has advised the UNECE, the World Bank, the IADB, the EIB, the Ethiopian Government, several ministries. Marco regularly acts as a consultant for real estate

and infrastructure funds, developers and infrastructure concessionaires with experience in four continents.

REAL ESTATE VALUATION AND THE SUSTAINABILITY CHALLENGE

Climate change and the sustainability in the use and consumption of natural resources are among the cardinal challenges faced by contemporary society. Cities are currently considered as pivotal in the fight against global warming as the real estate sector is considered to be responsible of 41% of global energy consumption (against 30% of the industrial and 29% of the transport sector respectively).

Real estate is called into action in order to meet the objectives of Paris agreement. The World Bank has in fact estimated that properties need to reduce CO₂ emissions by 36% by 2030 with respect to 2015 to meet the 20 C threshold set by COP21 in December 2015.¹ This objective in emission reduction implies a -1.25% in the annual consumption of energy and -3% in the annual emissions of greenhouse gases.

Macro-trends in the containment of climate change are driving changes in the real estate sector, especially in terms of energy and construction efficiency, not only to meet environmental objectives in a sort of societal inspiration, but also because investors are increasingly seeking investment opportunities with Environment-Societal-Governance (ESG) standards.

From the perspective of professionals and developers, the question is on whether sustainable practices of construction and management (mainly in terms of types of raw materials used and energy efficiency technologies) generate higher cash flows and hence higher values and returns. Interestingly, studies published so far point at a limited impact of green building on management costs, with an average reduction by 3-5%. However, demand for more sustainable assets pushes rental premium to +3-5% and sales premium to +13-18%, with small differences between residential and

¹ World Economic Forum (2016), Environmental Sustainability Principles for the Real Estate Industry, Geneva: World Economic Forum.

commercial properties.² This evidence suggests that market forces influence valuation of properties even more than cost minimisation.

Investment opportunities may arise not only in new buildings, but also in existing assets since an emerging global trend is urban regeneration according to circularity and resilience principles, prompting the re-use of urban spaces and real estate assets as well as the extension of green areas.³ The challenge for valuation practice, and even for investors, is the forecast of the increase in property values, not only for the assets within the regeneration project under consideration, but also for properties in surrounding areas which will experience sizeable net gains. In such circumstances, the use of a more sophisticated hedonic methods will prove to be useful.

Green buildings are certainly setting the scene in real estate markets. However, they are not changing the rules of the game and well-crafted valuations based on discounted cash flows combined with hedonic price approaches are hence needed for the identification of investment opportunities. The combination of property valuation techniques with competences in construction technologies and environmental economics will be a comparative advantage in the provision of modern professional services in the sector.

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The Israel IVS Forum is an informal association of senior property professionals and stakeholders in Israel. Our aims are to advance adoption of International Valuation Standards (IVS) in Israel and to disseminate international best practice within the Israeli profession. We hold regular webinars and publish international best practice papers in both English and Hebrew. You can find us on LinkedIn: <https://www.linkedin.com/groups/9012136>

² World Economic Forum (2016), op. cit. and N. Leskinen, J. Vampari, and S. Junnila (2020), A review of the impact of green building certification on the cash flows and values of commercial properties, *Sustainability*, 12, 2729.

³ Perhaps, the most vivid example is the network C40 cities, of which Tel Aviv is part, which was established in order to set standards of urban regeneration projects complying with climate change objectives.