FUTUREPROOFING VALUE

SUSTAINABILITY CONSIDERATIONS ARE INCREASINGLY IMPORTANT IN VALUATIONS.

Sustainability considerations continue to grow exponentially in significance across the commercial property sector. The focus has broadened from primarily new construction, and the requirement to achieve LEED, BREEAM, Fitwell, WiredScore and other sustainability benchmarks, and is now a key factor for older buildings too in terms of capital value, rental value and overall marketability and demand.

When it comes to assessing the impact of a building's sustainability credentials on value, various factors come into play. As is usually the case with valuations, it is often a combination of nuanced factors that an experienced valuer with comprehensive and up-to-date market knowledge will be aware of, rather than a textbook or formula-based adjustment.

FEATURE
Ken Noble
TWM Property

Building Energy Ratings

For older stock, the standard sustainability benchmark is the Building Energy Rating (BER) Certificate. BERs were introduced as a requirement for all new developments at planning stage in 2007 and subsequently for all sales and lettings in 2009. At that time, obtaining a BER Cert. was predominantly a 'tick-box' exercise, and often little or no attention was paid to the actual rating. This has changed enormously, and now very close attention is paid to the BER Cert., with certain organisations, including State bodies, having very strict requirements in terms of minimum BER ratings for the space they can occupy.

Such strict BER rating requirements and the growing focus on, and preference for, sustainable buildings in general, will impact on the pool of potential investors and tenants, and therefore the level of competition for a building in the market.

We have seen several examples in practice where landlords are commissioning new BER assessments where there is a possibility that a higher rating can be achieved.

In one large mixed-use development we valued recently, the original BER ratings were predominantly 'G' ratings, which did not tally with

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the age and specification of the building. Revised BER assessments were carried out, with full details and specifications provided to the new assessor, and the ratings improved from the 'G' level up to mainly 'B1' and 'B2' ratings. No capital expenditure was needed for this vast improvement. The original assessments had been carried out without the required level of detail around the exact specification and plant, etc., and the original assessor, therefore, defaulted to the lowest possible rating.

In this instance, the vastly improved BER ratings led to an increase in value, as assumed marketing, void periods, capital expenditure, and the likelihood of break options being triggered were all reduced, thus decreasing the risk to cash flow.

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Another example we have seen is a situation where some non-structural, cosmetic-type works carried out by a tenant, including the removal of some internal landscaping, resulted in the BER falling several ratings. While the tenant was obliged to reinstate the building to the original specification at lease end, these works impacted on certain investors' minimum criteria when they were assessing the asset at the time of the proposed sale mid-lease term. In several recent new leases that we have been asked to review and advise on, we have recommended that these leases clearly provide that tenants must not carry out any work that will adversely affect a building's BER rating at any stage during the lease. Such provisions protect the value of the asset.

Improving building performance

Increasingly, tenants will have their own environmental, social and governance (ESG) targets, and will also need to collate data such as energy consumption, waste/recycling data, water usage, etc., for the buildings they occupy. In order to ensure that this information is provided to and by landlords and tenants, we are now frequently seeing an obligation in leases on landlords and tenants to share such information and sometimes to agree to co-operate on any initiatives to improve a building's performance.

Green leases have been around for some time now, and the publication of standardised green lease clauses as part of the Chancery Lane Project in January is an important step towards placing clear and consistent obligations around sustainability on landlords and tenants under new leases. Again, the presence of such provisions makes the increasingly necessary BER, sustainability assessments and annual benchmarking more certain. Certainty reduces risk, and such provisions will appeal to investors who need this data for their own sustainability reporting and assessment needs.

Works to improve a building's BER rating, which can include mechanical and electrical (M&E) upgrades, insulation, installation of LED lighting, and new glazing, may not materially affect the rent achievable to a significant degree, especially if the works are not visible. However, such works will place the property well in the market and ensure that it features on prospective tenant tours.

Given the volatility in the market overall at present, it would be very difficult to make arguments around the exact impact on voids, rents and rent frees, as there are clearly other drivers, but it is probably safe to say that in the absence of undertaking such works viewing activity would be quieter, which means a longer marketing period/rent void, which will adversely affect value.

Similarly, this will also affect value when allowing for break options during the holding period. If works have been carried out to improve a building's services and BER rating, the assumed letting void period and also the need for further capital expenditure to bring a building up to a more modern specification will both be reduced, which therefore increases value.

These new market dynamics open opportunities for different categories of property owners. Those who may not be in a position expertise wise or cost wise to carry out such upgrade works may choose to trade a building needing work for a new or retrofitted building.

Those with the necessary expertise and available finance may find opportunity in acquiring older buildings needing upgrade works and bringing these up to the required improved standard, thus enhancing the value of their asset.