Sustainability: Regulation and valuation update

The IPF Sustainability Special Interest Group held its annual breakfast seminar on 23 March in the London offices of Pinsent Masons. The two speakers: Miles Keeping of Hillbreak and Philip Parnell of Deloitte Real Estate provided updates on regulatory and valuation matters (with reference to the RICS Valuation Sustainability Task Force) respectively.

Outlined below is a synopsis of the key topics covered during the event.

Regulatory update – Miles Keeping

Business energy tax reform

The HM Treasury consultation, 'Reforming the business energy efficiency tax landscape'[1] in September 2015 stated that, "it would consider reforms that:

- are consistent with fiscal consolidation plans;
- simplify and reduce compliance and administrative costs;
- support productivity through improving incentives for energy efficiency and carbon reduction; and
- protect energy intensive businesses at risk of carbon leakage."

The key issues for the real estate industry within the review were:

- Energy and carbon reporting;
- Taxes and price signals to enable occupiers/investors to plan efficiently; and
- Incentivising energy efficiency and carbon reduction.

The government received 356 formal responses to the consultation, which provided the backdrop to the Budget in March 2016.

1 See: https://www.gov.uk/government/consultations/consultation-reforming-the-business-energy-efficiency-tax-landscape

BUDGET 2016

The following regulations were referenced, or will be affected by the announcements made, in the Budget.

- **CRC Energy Efficiency Scheme (CRC):**
  - The CRC will be closed following the 2018-19 compliance year;
  - No purchase of allowances will be required to cover emissions for energy supplied from April 2019;
  - Last reporting under the CRC by the end of July 2019; and
  - The surrender allowances for emissions from energy supplied in the 2018-19 compliance year by end of October 2019.
- **Climate Change Levy (CCL):**
  - Main rates will increase to recover lost CRC revenue;
  - Against a backdrop of falling gas prices CCL rates for different fuel types will be rebalanced to a ratio of 2.5:1 (electricity:gas) from April 2019 (compared to the current 2.9:1). This should incentivise a fall in the use of gas, in support of the UK's climate change targets. and
  - In the longer term, the government intends to rebalance the rates further, reaching a ratio of 1:1 (electricity:gas) by 2025. This is intended to give businesses time to plan ahead to improve their energy efficiency and adopt new technologies that reduce their gas consumption.
- **Enhanced capital allowances (ECAs):**
  - The list of qualifying energy-saving & water-efficient kit will be updated in 'Summer 2016'.
- **Energy & carbon reporting:**

  The government intends to consult during 2016 on a simplified energy & carbon reporting framework, to possibly be introduced in April 2019. Potentially, this could mean some or all of the following:

  - Mandatory reporting for large organisations (ESOS-compliant);
  - Sign-off at board or senior level;
  - Reporting requirements for both public and private sector organisations; and
  - Annual reporting, compatible with internal business processes.
- **Energy performance certificates (EPCs)/Minimum Energy Efficiency Standards (MEES)**

  MEES: Energy Performance of Buildings (England & Wales) (Amendment) Regulations 2016

  - [Who has] access to EPC bulk data
  - A recommendation that report data be included on the Register
  - Changes to the Opt-out provisions for building owners/occupiers for publication of information from the Register

  The Building Regulations &c. (Amendment) Regulations 2016. For anyone responsible for procuding EPCs and holding data should note that there are some changes to the provisions relating to:

  - EPC calculation methodologies;
  - Certain building exclusions; and
  - The qualification of those able to issue certificates.

FUTURE ENVIRONMENTAL REGULATION

COP21 Agreement

The 21st UN Framework Convention on Climate Change Conference (COP21) was held in Paris at the end of 2015. The aim was to reach a global agreement to combat climate change effectively. The resultant document stated the parties' intent to:

- keep global temperatures 'well below' 2.0C above pre-industrial times & 'endeavour to limit' them to 1.5C;
- limit the amount of greenhouse gases emitted by human activity to the same levels that trees, soil & oceans can absorb naturally, beginning at some point between 2050 and 2100;
- review each country's contribution to cutting emissions every five years so they scale up to the challenge; and
- for rich countries to help poorer nations by providing finance to adapt to climate change & switch to renewable energy.

This means bringing down greenhouse-gas emissions to net zero within a few decades, in line with the scientific evidence.

In terms of UK domestic policy, the government says it is now committed to tightening the law and updating the (Climate Change Act) commitment of an 80% carbon emissions reduction by 2050. To deliver this, there would need to be major changes, including:

- Nuclear & renewables would have to be enhanced and available soon;
- Carbon Capture and Storage (CCS) would have to become the norm
- Energy storage would need to be more effective, cheaper and easier
- Energy efficiency and demand management would have to improve dramatically.

The UN Environment Programme Finance Initiative (UNEPFI) published, **Sustainable Real Estate Investment Framework** in February 2016 as an action framework for implementing COP21[2].

2 http://www.unepfi.org/work-streams/property/sustainablerei/

What makes for effective environmental policy?

The Green Property Alliance, of which IPF is a member, and other researchers have looked at which policy approaches are most effective in achieving the required outcomes.

A. Effective policies

- **Building regulations, codes, standards** are considered to be the most cost efficient and effective way of changing market participants' behaviour... it is important to ensure these are dynamic, ambitious, have a clear developmental trajectory and are supported by a broad policy package
- **Choice-editing by prohibiting the use of particular products**, e.g.
  - of a specific technology (e.g. ozone-depleting substances like HCFCs);
  - products which fail to meet performance criteria (e.g. Eco Products Directive);
  - reducing the liquidity of assets which do not meet pre-determined standards, as per MEES.
- **Policy bundles**: set a minimum standard; devise a label; provide over-performance financial incentives

B. Less effective policies

- **Broad impact policies** (e.g. CCL); and
- **Policies that require processes or the gathering of information without any compulsion to act on the findings** (e.g. Air-Con Assessments).

Sustainability and valuation – Philip Parnell

Sustainability has proven to be a challenging concept to embed into valuation – not least because in their role of providing opinions of value, valuers are primarily interpreting the market rather than making it, and there simply hasn't been a sufficient body of transactional evidence identifying the impact of sustainability. However, this area is evolving rapidly and the market is now requiring valuers to at least be able to provide qualitative comment as in respect of risks associated with sustainability.

RICS VALUATION SUSTAINABILITY 'TASKFORCE'

RICS started to focus on sustainability valuation issues over a decade ago – its first one-page 'policy' note was published by the RICS Presidential Commission on Sustainability in 2005. This was followed by the Valuation Information Papers for commercial and residential property in 2009 and 2011 respectively. Since then, these have been afforded the upgraded status of a Guidance note (2013) and more recently incorporated directly into the Red Book[3].

3 VPS4 Sustainability Assumptions

The RICS recently established a cross-industry Taskforce (chaired by Philip Parnell) to address the new sustainability challenges for valuers. The work plan is currently being established, with close collaboration with other interested real estate bodies (including the IPF), however the emerging principal areas of focus will be:

- 'Holistic' trends: including market risk & social change: For example, the market's appreciation for what constitutes a 'prime' property is evolving; how does this align with the credentials of so regarded 'sustainable property'?
- Specific factors: including regulatory and legislative change: What do valuers need to know and how should practices/approaches be developed to accommodate such 'interventions'? and
- Valuer 'Safety Kit': Recognising sustainability is a comparatively 'new' concept, what safeguards can RICS help to put in place to assist valuers in embracing the agenda and providing advice without undue fear?

The Taskforce is keen to engage with the real estate industry/market and would welcome members' thoughts, views and suggestions.