RICS/CPMF forum: commercial secured lending ESG and sustainability framework

This framework is a list of key considerations to help valuers and lenders consistently fulfil their ESG obligations for UK commercial real estate secured lending. It is **not mandatory**, and the detail is not prescribed. Professional judgement should be applied regarding applicability and materiality when considering individual circumstances, including specific and additional ESG considerations. The valuer and lender may need to consider the appropriateness of any additional time required to incorporate the considerations below, including any inspection and investigation.

This framework includes references to information provided by the lender, borrower and valuer. Valuation terms of engagement must explicitly include reference to the 'nature and source(s) of the information relied upon' (Red Book Global Standards VPS 1, 2.2, (h)).

1. General sustainability and ESG valuer requirements

1.1 Sustainability and ESG matters 'are commonly important in terms of market and societal perception and influence, and valuers should have proper regard to their relevance and significance in relation to individual valuation assignments' (Red Book Global Standards VPS 2, 1.5).

1.2 'Wherever appropriate, the relevance and significance of sustainability and ESG matters should form an integral part of the valuation approach and reasoning supporting the reported figure' (Red Book Global Standards VPS 3, 2.1(l) 3).

1.3 Red Book Global Standards VPGA 2 notes that valuations for secured lending 'should always have appropriate regard' to ESG factors.

1.4 Red Book Global Standards VPGA 8, *Valuation of real property interests*, also includes extensive commentary on sustainability and ESG issues, supported by RICS' guidance on Sustainability and ESG in commercial property valuation and strategic advice.

2. Minimum Energy Efficiency Standards (MEES) and Energy Performance Certificates (EPCs)

2.1 EPC(s) may be obtained via government open-source data included in the relevant EPC registers. The table below is an example of how the valuer's EPC findings can be presented in the report. The following information is based on the PRS Exemptions Register:

Property address, unit, floor	Postcode	Property type	EPC rating and RAG	EPC numerical score	EPC expiry date	Estimated building emissions rate and primary energy use numbers (where available)	Floor area (sq m)	Material risks identified in the EPC Recommendations Report and actions taken by the borrower to address them	If exempt, please state reason & confirm that the exemption is registered. Also state if out of scope of MEES.

RAG rating basis (all expenditure considerations to be based on data supplied by the lender/borrower):

- Green:
  - A or B rating
  - no EPC required due to the property being outside the scope of MEES, or
  - no EPC required due to the property being exemption registered on the national PRS Exemptions Register, where no material expenditure will be required on expiry of the exemption.

(Registered exemptions last for only 5 years and any necessary works may need to be undertaken on expiry of the exemption; otherwise, another exemption would need to be secured – a current exemption is not risk-free.)

- Amber:
    - C, D or E ratings
    - no EPC currently required as no trigger event has occurred, but any future EPC expected to be at an A or B rating, or
    - a registered exemption where only modest and viable expenditure is estimated on expiry of the exemption (or a new/continued exemption will need to be secured).
- Red:
    - F or G rating
    - registered exemption where material expenditure will be required on expiry of the exemption or a new/continued exemption will need to be secured
    - no EPC currently required as no trigger event has occurred but any future EPC expected to be at a C–G rating
    - the likely rating is unknown, or
    - a trigger event has occurred, but no EPC has been commissioned/an EPC has not been registered.

2.2 In some circumstances, it may be sufficient for the valuer, instead of completing all or part of this table, to summarise the relevant details and only comment on those that have particular risks in a separate section. Where appropriate, valuers may also aggregate common findings.

2.3 The borrower/lender is responsible for supplying the valuer with any proposed follow-on EPC actions for the asset(s) being valued, which may be based on the EPC recommendations or a fuller assessment. Reliance on this data should be stated in the valuation report.

2.4 Where appropriate and material, a copy of each applicable EPC may be appended to the valuation report to support the table above.

2.5 Having reviewed the EPC data, the valuation report may need to include commentary on the following (this list is not exhaustive), based upon information provided by the lender or borrower:

a) The latest energy performance profile of the property and risks related to the EPC that may impact value. Reference to the Lender's Action Points and/or suitability for secured lending section may be included as appropriate.

b) For red-rated assets, in whole or part; some amber-rated assets (see table at 2.1 above); and those with no recent assessment, which would all normally need a business plan: consider the impact on value of any improvements to mitigate re-letting risk and comply with current and reasonably expected MEES regulations. Where a business plan is in place and has been provided to the valuer, the valuer may comment on this in the valuation report, identifying any information in the plan that may impact on value or the property's suitability for secured lending. If a business plan has not been provided, the valuation report can include a lender's action point recommending that one be undertaken.

c) Whether additional expert advice may be required about the status of the EPC. This could include referring to the merits of the borrower obtaining a new EPC, where there is no EPC and a trigger event is imminent, when an exemption will expire shortly or where works to the property have been carried out since the EPC was commissioned.
d) If the valuer considers that the costs supplied by the lender/borrower to achieve legislative compliance may potentially be prohibitive/material. Valuers are not usually in a position to estimate costs and will rely on information provided by the lender/borrower. Where cost considerations are a requirement, the lender/borrower may need to instruct or facilitate additional expertise. In some circumstances, reference could be made to the payback test for exemption in the context of material costs.
e) An energy-inefficient property's suitability for secured lending. Consideration of the extent to which the property can meet current or future EPC requirements may require additional expertise and input beyond that of the valuer.
f) For commercial valuation instructions that include properties with domestic EPCs, lender- or borrower-provided details of indicative cost improvements, the extent of the works and the expected outcome required to bring the EPC up to a better standard can be used to support the valuer's professional judgement. These costs can then be considered, and appropriate comment can be included as to whether the valuer has been advised that this expenditure and the works/outcome associated with them will meet minimum current or anticipated future legislative or regulatory requirements/guidance (during the loan term). This would ensure the long-term letability/saleability and to enable input into cost allowances at lease break/expiry/expiry of exemption period (whichever is sooner).
g) Where the appropriate detail has been provided by the lender/borrower, the valuer may also consider commenting on planned works.

2.6 Comment will only usually be provided in the context of the MEES requirements and whether the occupational market has any general EPC rating hurdles that may apply locally.

2.7 For properties in Scotland, the EPC rating can be stated, and confirmation can be provided by the lender/borrower as to whether any necessary action plan is in place. The main improvements outlined in the action plan can be set out in the report and, where the data provided by the lender/borrower suggests that the improvement requirements are unduly onerous, it may be appropriate to highlight this under Lender's Action Points. Exceptions include smaller buildings below 1,000m^2 and residential property, which are not covered by the legislation.

2.8 In the provision of valuation services, valuers generally do not hold themselves to have expertise in assessing build costs. Where the instruction requires valuers to have regard to build cost information (for example in the valuation of properties with development potential or where works may be necessary to meet regulatory standards), valuers will typically only be able to comment on the implications of costs where they are prepared by a suitably qualified construction cost professional, such as a quantity surveyor. Reliance upon the build cost information supplied to valuers will be stated in the valuation report.

2.9 In the absence of any build cost information, the valuer may refer to published build cost information. Build costs produced using this approach can be assumed to be less reliable and accurate than advice from an expert, especially for energy efficiency and environmental upgrades. Any reliance that can be placed upon the valuation in these circumstances is severely restricted, and this should be explicitly referenced in the valuation report. Specialist professional advice sought by the lender in relation to build costs can support the valuation. If specialist build cost advice is subsequently obtained, the valuers may be instructed to review their valuation.

2.10 There is no current legislation with regards to Northern Ireland, the Channel Islands and Isle of Man in relation to minimum energy efficiency standards.

3. Green certification and leases

3.1 Where the valuer has been provided with sufficient detail by the lender/borrower relating to the subject property (stating, where notified, the date, version and status/target of the information), the valuer may comment on relevant and material valuation matters related to certifications, including BREEAM, DGNB, EDGE, Green Star, HQE, LEED, NABERS and WELL (this list is not exhaustive).

3.2 It may be appropriate for the valuer to comment on how the certifications and ratings achieved may be perceived by the market. If the valuer considers that obtaining additional certifications may have a material impact on valuation, the valuation report may refer to this.

3.3 Where appropriate and material, comment may be included as to whether sustainability issues are directly referred to in leases, such as reference to 'green leases' or as part of the service charge.

4. Flooding

4.1 Where value may be impacted by flood risk, this can be recorded and reported.

4.2 Where a specialist flood risk report is not available, a valuer can consult government websites and record available details on flood risk levels (for instance from GOV.UK **in England**, SEPA in Scotland, Natural Resources Wales in Wales and nidirect in Northern Ireland).

4.3 Using the above sources and other relevant and available data provided to the valuer by the lender or borrower, the valuer may comment on the following (this list is not exhaustive):

a) known flood risk in the area, to include, as appropriate and accessible, river, coastal, surface and storm drainage that could impact the property, and comment on any evidence provided that the property has been previously damaged or impacted by flooding

b) flood risk defence measures in the area that could mitigate risk and/or property flood resilience measures that have taken place at the property

c) current or future flood risk that has been identified by any environmental/flood risk audit made available to the valuer, and
d) an appropriate consideration of the impact, if any, flood risk may have on the marketability and value of the property.