

Do ESG Factors Drive Market Value in Commercial Property: Insights from Sri Lankan Valuers

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Abstract

Recognizing the global emphasis on sustainable development, the RICS incorporated the ESG components into the property valuation standard. Thus, this study empirically examines the influence of ESG components on the market value of commercial properties and analyzes the challenges of ESG applications. Five-point Likert Scaled questionnaire, in-depth interviews were applied to collect data from two types of samples selected from professional valuers. Spearman Rank Correlation Test results shows that all three ESG components were positively correlated with market value changes, with the environment component having the highest mean value. The lower level of ESG concern in small and medium-scale commercial properties and the complex nature associated with estimating the ESG components are generated as the major issues in the word cloud analysis. The preparation of a formal guideline to reduce the complexities in the calculation ESG may improve its use in Sri Lanka.

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Introduction

Environment, Social, and Governance (ESG) factors that affect the risk appetite of the companies consequently affect the market value of a property have been identified by the Royal Institution of Chartered Surveyors (RICS) (RICS, 2021a; 2024). Meanwhile, Anand et al. (2021) noticed that in assessing financial values from the traditional to the current, there is a tendency to integrate social and environmental values. This tendency is further supported by Lützkendorf & Lorenz (2005) and indicates that there is a growing prominence of incorporating sustainability issues into property valuation. With the increasing number of investors who are concerned about sustainability, prominence has been given to ESG components in assessing companies' ethical and sustainability practices (Mansouri & Momtaz, 2022).

There is a strong concern about ESG performance in the Sri Lankan cooperate sector, indicating that sustainability is highly valued in Sri Lanka. The findings of Machmuddah & Wardhani, (2020) and Viduranga & Fernando, (2022), confirm this statement, identifying that there is a positive correlation between ESG performance and market value in companies listed on the Colombo Stock Exchange. However, there is no evidence of formal research on ESG considerations in commercial property valuation. Consequently, this study focuses on addressing the empirical gap in the impact of ESG components on market value changes in commercial properties while also addressing the issues and challenges valuers face currently with the application of ESG.

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The objective of the study

The objectives are two-fold as follows

- I. To analyse the influence of ESG on market value changes, through the perspectives of professional valuers
- II. To examine the challenges valuers faced in applying ESG elements in commercial property valuation in Sri Lanka through the perspectives of professional valuers

Literature Review

The crucial role of ESG in assessing sustainability and ethical impacts would be greatly beneficial for long-term investment (Zhang et al., 2022) and ESG disclosure impacts firm value positively (Gawęda, 2022). . In the middle of a level of reduced capital costs in the world during a period like the COVID-19 pandemic, ESG has played an important role in the identification of the true value of businesses (Kevin Prall, 2021). Efforts are still in progress for the formulation of a stronger ESG concern framework by the International Financial Reporting Standards (IFRS) and the European Financial Reporting Advisory Group (EFRAG) for the further improvement of non-financial reporting quality and coherence (Broughton & Maurer, 2020; EFRAG, 2020).

The concentration of ESG in property valuation, though not in the same terms but in different terms, has gained attention in the past according to the different scholars' findings. An increased concern among buyers about the impact of the green ratings on property prices is mentioned by Kats (2003). There is evidence of ESG and property valuations in the names of 'sustainability features' or 'sustainability issues' Warren-Myers (2013), emphasizes the fact that there is a need to identify the sustainability factors by the valuers and presents the results as 'all appeared to have some level of positive influence on value', where they consider eight sustainability characteristics (energy efficiency, water conservation, low emissions, indoor environmental quality, etc..) in that research. These sustainability characteristics are found in the ESG components. Considering the challenges, Lorenz & Lützkendorf (2008), have highlighted the fact that there is a problem of identifying comparable for the application of ESG when the valuation is conducted based on the "sales comparison method" of valuation. Warren-Myers et al. (2018), found that a reluctance to apply ESG among valuers in Australian real estate market due to limited knowledge of valuers on these features. Similar results were reported by Jayasiri and Wickramaarachchi, (2024), due to the lack of proper guidance to incorporate green features, there is less concentration of these aspects in property valuation.

Methods

This research used mixed methods. Using convenience sampling 30 professional valuers were selected and perceptions were collected on all ESG components declared in IVSC, 2020 guidelines and market value changes through a Likert scale questionnaire were analysed using Spearman correlation in the quantitative analysis. Qualitative analysis involved word cloud analysis for the data collected via in-depth interviews from five senior valuers on the challenges faced by valuers in applying ESG in commercial property valuation.

Results and Discussion

Quantitative analysis

Three hypotheses as follows developed for the quantitative analysis.

H1: There is a positive relationship between the environmental component and the Market Value changes in Commercial Properties.

H2: There is a positive relationship between the social component and the Market Value changes in the Commercial Properties.

H3: There is a positive relationship between the governance component and the Market Value changes in the Commercial Properties.

systematic tool. Last, “Credibility” raised question of the alarm that the government is gradually taking over the ESG certifying institutes, thereby calling for the credibility of the certificates they produce into question.

As for the quantitative analysis of the hypothesis, it has been stated that valuers are conscious of the ESG factors and there exists a positive relationship between the specific ESG components and the alterations in the market value of the firms. This accords to the findings of Warren-Myers, (2013) as pointed out that sustainability characteristics had a positive impact on property prices. Similarly, our results support to the findings of Gawęda, (2022) disclosing ESG has a positive impact on firm value.

The challenges that have been unveiled from the qualitative approach include the idea that it is quite easy to oppose on the values that constitute ESG given that it is quite subjective and, the fact that there is limited comparative data, limited awareness also presented by (Lorenz & Lützkendorf, 2008) and (Warren-Myers et al., 2018).

Conclusion

In conclusion, the paper reveals the importance of ESG, specifically the environmental factor, in property valuation as well as major obstacles by directing to the findings of possible approaches to integrate ESG aspects into the valuation procedure. This positive quantitative correlation proves the hypothesis that all kinds of ESG components are linked with changes in market value; specifically, the environmental factor. This shows that market values as assessed by valuers have the highest priority to environmental aspects. Low adoption and awareness on ESG by the small and medium properties, difficulties in measuring the components appropriately are the major challenges in the applications. Thus, the insights suggest it is high time to develop a framework with a guideline that discusses the ways and methods to adopt ESG in property valuations.

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