IVSC PERSPECTIVES PAPER

ESG & Real Asset Valuation

SHARPENING THE FOCUS,
NOT REINVENTING THE WHEEL

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Issued by the International Valuation Standards Council (IVSC)
Tangible Assets Valuation Board

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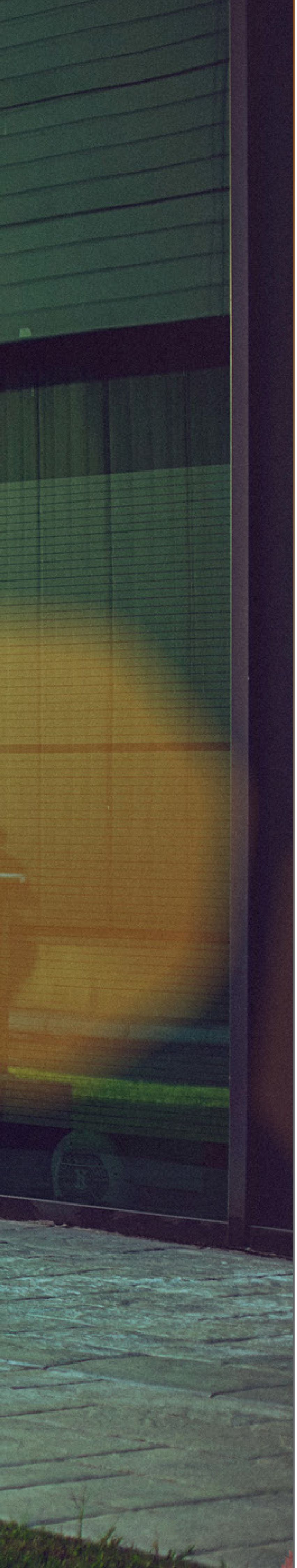
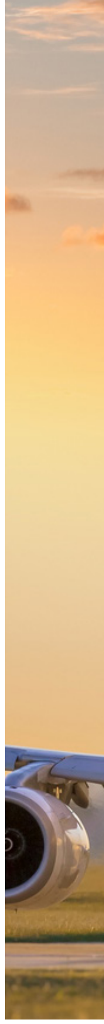


IVSC Perspectives Paper

ESG & Real Asset Valuation: Sharpening the focus, not reinventing the wheel

The IVSC periodically publishes Perspectives Papers to address significant topics and emerging trends within the valuation profession. These papers are designed to stimulate discussion, provide the valuation community with valuable insights, and support the consistent application of the International Valuation Standards (IVS). While Perspectives Papers offer guidance, they are not intended to replace or override the IVS, which remains the authoritative framework for valuers.

This Perspectives Paper focuses on the evolving role of Environmental, Social, and Governance (ESG) factors in the valuation of tangible assets. It follows recent changes to the IVS, including the introduction of an ESG appendix within IVS 104, and addresses the increasing interest and concern from market participants about incorporating ESG criteria into valuation practices. By exploring how ESG factors impact various tangible asset classes—ranging from real estate to infrastructure—this paper aims to encourage informed and confident adoption of ESG considerations within everyday valuation assignments.



ESG & Real Asset Valuation:
Sharpening the focus, not reinventing the wheel

WRITTEN AND ISSUED BY THE
IVSC TANGIBLE ASSETS VALUATION BOARD

The IVSC's Tangible Assets Board (TAB) have issued this Perspectives Paper following the recent changes to International Valuation Standards, effective 31 January 2025 (IVS). These include an Environmental, Social and Governance (ESG) Appendix within IVS 104 Data and Inputs. The Paper also builds on the earlier publication of IVSC's Perspectives Paper on "ESG and Real Estate Valuation"[1]. Furthermore, the recent IVSC ESG survey, which closed on the 31st May 2024, indicated a high level of interest for this topic from valuation stakeholders.

ESG considerations are increasingly being referenced as relevant risks and opportunities by market participants making investment decisions when considering a broad variety of real assets.

1 https://www.ivsc.org/esg-and-real-estate-valuation/

For the purposes of this perspectives paper, real assets include all tangible asset classes such as real estate, undeveloped land, farmland, plant & equipment, infrastructure, transportation assets, utilities and commodities, amongst others.

Whilst the correlation between value and ESG criteria may vary across real assets for a variety of reasons, capital flows appear to be increasingly channelled into asset classes which take into account a variety of ESG determinants.

This comes at a time when there is increasing ESG regulation, examples of which include the EU taxonomy, the recently issued IFRS Sustainability Disclosure Standards created by the International Sustainability Standards Board (ISSB)[2], and the

2 https://www.ifrs.org/projects/completed-projects/2023/general-sustainability-related-disclosures/

US SEC Enhancement and Standardisation of Climate-Related Disclosures for Investors[3]. This heightened regulation has a direct impact on market participants, causing an indirect knock-on effect to valuation service providers. ESG factors and regulatory environment should be considered in valuations to the extent that they are measurable.

The recent IVSC ESG survey[4] however, highlighted areas of significant stakeholder unease regarding the incorporation of ESG factors into valuation opinions. Perceptions around the lack of suitable valuation approaches and methods creates a cause for concern for valuation standard setters. Some 47% of respondents to the survey believed

'The recent IVSC ESG survey highlighted areas of significant stakeholder unease regarding the incorporation of ESG factors into valuation opinions.'

3 https://www.sec.gov/newsroom/press-releases/2024-31

4 https://www.ivsc.org/esg2024/

that quantifying the impacts of ESG in valuations requires the development of wholly new valuation approaches and methodologies.

But with the backdrop of these challenges, the TAB believe the IVS are well placed to assist valuers in providing valuations of real assets within an evolving ESG paradigm. This Perspectives Paper aims to create greater awareness on the ESG topic as it pertains to real asset valuation, to stimulate discussion and debate, and ultimately provide a calming influence which acts as a catalyst to encourage and give confidence to more widespread use of robust ESG concepts in everyday valuation assignments.

Setting the scene: what are the changes to IVS as it pertains to ESG?

Recent changes to the IVS have incorporated several references to ESG that pertain to real assets. These can be found within the Glossary, the General Standards, and the respective Tangible Asset Standards including IVS 300 Plant, Equipment & Infrastructure; IVS 400 Real Property Interests; and IVS 410 Development Property.

Whilst these changes are subtle, the incorporation of new terminology gives the valuation community impetus for more detailed and explicit consideration of ESG's influences on valuation. We now consider each in further detail.

Glossary

Collectively, ESG has been defined within IVS as:

> The criteria that together establish the framework for assessing the impact of the sustainability and ethical practices, financial performance or operations of a company, asset or liability. ESG comprises three pillars: Environmental, Social and Governance, all of which may collectively impact performance, the wider markets and society.

ESG should not be viewed as being solely limited to sustainability. ESG is regarded by many as having a much broader definition than merely sustainability.

General Standards

Within IVS 101 Scope of Work, the scope of work must specify, amongst other factors:

> (m) Environmental, Social and Governance factors: Any requirements in relation to the consideration of significant environmental, social and governance factors.

The Appendix to IVS 103 Valuation Approaches, adds a requirement to analyse and adjust for any significant differences between comparable transactions and the subject asset:

> A10.08 The valuer should analyse and make adjustments for any significant differences between the comparable transactions and the subject asset. Examples of common differences that could warrant adjustments may include, but are not limited to:
>
> ...
>
> (l) differences in ESG considerations, and

...

Perhaps the most salient change in relation to ESG occurs within the Appendix to IVS 104 Data and Inputs, where valuation professionals are prompted regarding various ESG factors impacting a valuation:

> The valuer should be aware of relevant legislation and frameworks in relation to the environmental, social and governance factors impacting a valuation.
>
> A10 Environmental, Social and Governance (ESG) Considerations
>
> A10.01 The impact of significant ESG factors should be considered in determining the value of a company, asset or liability.
>
> A10.02 ESG factors may impact valuations both from a qualitative and quantitative perspective and may pose risks or opportunities that should be considered.
>
> ...
>
> A10.06 ESG factors and the ESG regulatory environment should be considered in valuations to the extent that they are measurable and would be considered reasonable by the valuer applying professional judgement.

The use of the word 'significant' should be noted. It is defined in the IVS Glossary as 'any aspect of a valuation which, in the professional judgement of the valuer greatly impacts the resultant value'. Furthermore, the valuer should have an awareness that ESG can represent either 'risks or opportunities' associated with an asset.

Emphasis should be placed on the fact that it's not the valuer's role to invent ESG characteristics;

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Read the full paper at:

www.ivsc.org/esg-perspectives