

CLIMATE CHANGE

A challenge for valuers

This article looks at the role of valuers in the fast-moving area of climate change and its effects.

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The world is changing – faster

The emergence of issues around climate change is a swift-moving area that most people would agree is increasingly commanding the attention of regulators, the media, environmentalists and the general public. Equally, it is also an evolving matter demanding earnest consideration by New Zealand businesses.

Following the 2021 United Nations COP26 Climate Change Conference, a recent Knight Frank report points out that almost every country on earth is now working to tackle climate change. Moreover, this report ([Harley et al., 2021](#)) looks specifically at how the world of real estate is adapting, and how the property market might look in the future.

To many, this whole area is proving to be quite challenging, as it is typically technologically complex and often involves emotive and controversial responses. While reaction and involvement by the business community one way or another seems unavoidable, there are nonetheless potential new opportunities emerging for registered valuers and their businesses. However, due to the nature and scope of the issue, those in the valuation profession wanting to become involved are encouraged to develop their thinking 'outside the box'.

New and emerging legislation requires visionary and proactive thinking so that valuers (and other professionals for that matter) are well positioned to help businesses, property owners and other stakeholders meet their obligations into the near future.

In pointing out that climate change will affect everyone, the [Ministry for the Environment \(2020\)](#) has directed that the community needs to plan how it will respond and adapt 'hand-in-hand with

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reducing our emissions.' Despite uncertainties around adverse consequences and outcomes, the likely impact of how climate change is projected to impact New Zealand is well documented, for example [Mullan et al. \(2018\)](#), with a national framework for assessing risk already developed under the Climate Change Response (Zero Carbon) Amendment Act 2019.

This legislation sets a framework for the effective adaptation of risk assessment issues across New Zealand, and in the process identifies this country's 10 most significant climate change risks





based on consequence and urgency. The most urgent of these risks is about the built environment, and the most pressing problem is that there are risks associated with the availability and quantity of potable water supplies. This is closely followed by risks to buildings due to extreme weather events, such as drought, increased fire weather and ongoing sea-level rise. All very much valuation-related issues.

Climate change reporting has already begun

There has been a modicum of written material produced lately in various parts of the world about how climate change might impact property valuations, for example in the US ([Hao et al., 2012](#)), UK ([French, 2020](#)) and Malaysia ([Zulkarnain et al., 2020](#)).

However, readers may be surprised to know that New Zealand has become the first country in the world to introduce a law that requires the financial sector to disclose the impacts of climate change on their business, and explain how they will manage climate-related risks and opportunities. New Zealand valuation specialists are therefore in a unique position to respond to the new financial sector requirements, which includes taking into account the introduction of new policy and changing market participants' perspectives.

Quite apart from the legislation, one can already see how other regulatory controls might have paved the way. For example, consider the recently introduced mandatory requirement for farmers to have a Farm Environmental Management Plan (FEMP). Every rural valuer would be aware that as of 1 May 2020 all landholdings above 20 ha have needed an FEMP, which helps farmers and landowners recognise on-farm environmental risks. Many rural valuers, especially

those involved in rural consultancy, will already be highly involved in preparing and delivering on this kind of reporting.

On a broader scale, the 'market' for climate change information and reporting is huge. If you count FEMP as part of this, then it has already well and truly begun and some registered valuers in New Zealand are already strongly engaged. But if you extrapolate demand across all sectors in the context of climate change, it is clear the potential market for all valuers is massive, especially for rural and commercially-focused (including high-rise sector-based) practitioners.

The new climate-related disclosures legislation – the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021 – makes it mandatory reporting for some organisations, (i.e. large publicly-listed companies, insurers, banks, non-bank deposit takers and investment managers). This new legislation has effectively amended the Financial Markets Conduct Act 2013, the Financial Reporting Act 2013 (FMC Act) and the Public Audit Act 2001.

As a result, the new law will require around 200 large financial institutions covered by the FMC Act to start making Climate-Related Disclosures (CRDs). Affected organisations – known as Climate Reporting Entities (CREs) – are expected to publish disclosures from financial years commencing in 2023, subject to the publication of climate standards from the External Reporting Board (XRB).

Technically speaking the current legislation has application to only a relatively small number of businesses (numerically). However, these are the biggest entities and new regulations can create a domino effect for all the other financial market participants. It is clear that the stage is set to expand these sorts of requirements more widely.

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Also, some businesses (possibly wanting to be perceived as being corporately responsible and/or environmentally friendly) are voluntarily engaging in the process regardless of any mandatory requirement that might apply just to 'big business'. Therefore, the opportunity for the involvement of valuers is already there, providing an example as to how they might become involved in the assessment of risks in the built environment. Three key areas are:

1. Risks to buildings due to extreme weather events, drought, increased fire weather and ongoing sea-level rise.
2. Risks to potable water supplies (availability and quality) due to changes in rainfall, temperature, drought, extreme weather events and ongoing sea-level rise.
3. Transition risks: 'transitional impacts (i.e. policy changes and economic consequences of efforts being made towards decarbonisation of the economy). With respect to transitional risk there is both a 'top-down' impact – in the form of changes in legislation and policy – as well as a 'bottom-up' shift in consumer preferences for low – or no emissions products' ([du Plessis et al., 2022](#)). Importantly, this aspect is a CRD requirement for financial reporting.



Ideal positioning of valuation profession

Possibly because of their advocacy position and independence (making them arguably less biased than many other industry participants and advisors) valuers are as well placed as anyone to comment on the economic impact of the foregoing risks. This is because it is their job to know the market and how it might respond to them. Of course, this does not abrogate the responsibility of valuers deferring to technical experts for certain specialised issues, as that practice is very appropriate and already commonplace in the profession. But the overall positioning of the profession as one having the expertise and capability to contribute to risk assessment more generally is undoubted.

Climate change may have special significance for the built environment, but according to the Ministry for Primary Industries it is farming that creates the greatest proportion of methane and nitrous oxide gases, accounting for around half of New Zealand's total greenhouse gas emissions ([MPI, 2020](#)). This concentration of gases – often referred to as ‘the greenhouse effect’ – has commonly been attributed as the leading cause of adverse changes in the earth's energy balance and temperatures. There is currently a good deal of research and development going on that seeks to explore options that reduce biological emissions without reducing farm productivity, especially around the number of animals on farms.

Bearing this in mind, it is rural valuers who are particularly well placed (arguably along with rural consultants as many are registered valuers anyway) to comment on the impact of any issues that affect farm productivity, including (and in particular) anything to do with



water. In 2021, the Valuer's Education & Integrity Foundation (VEIF) sponsored a series of seminars dealing with this topic, and they covered off considerations and guidance on this for property valuers and other related professions. Rainfall, temperature, drought, extreme weather events and ongoing sea-level rise are all things greatly affecting farm productivity, and who better than a registered valuer to determine the impact of such risks?

Also, the NZIV Property and Valuation Standards Board are developing, as a preliminary step in this area, a climate risk introduction and glossary paper. This paper will summarise definitions and cross-referencing relevant legislation as a basis for the establishment of a valuation 'knowledge hub' (i.e. think-tank), which will fundamentally incorporate a climate change component.

Climate Reporting Disclosure (CRD) requirements

Increasingly, the influence on property values is being seen as one of the more significant impacts brought about by climate change. [Holmes et al. \(2020\)](#) suggest that the stakeholders here include virtually everyone, and therefore we all have a role to play in considering and assessing this impact, along with the other primary impacts (human health and essential services).

Accounting firm PWC have recently issued a report ([du Plessis et al., 2022](#)) looking at CRD requirements for tangible assets. It considers how climate-related matters impact on the financial statements of organisations in a New Zealand context, including the implications for a number of aspects, some of which relate directly to the work of valuers. This is shown in the following extracts:

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1. Financial Statements

- Borrowers could face a new range of risks that will likely impact their credit risk, and therefore ability to meet their debt obligations. If the value of assets against which loans are secured fall in value or become inaccessible or uninsurable, the collateral value represents expected credit losses.
- Organisations will need to consider disclosures about market risk – including investments in industries impacted by climate risk. There may be cases where enhanced sensitivity disclosures for particular risks might be relevant.



2. Fair Value Measurements

- Valuations involving forecasts might need to be adjusted to factor in climate-related risk. This includes adjustments reflecting climate impacts on rental income, occupancy rates as well as insurance cost assumptions.

3. Insurance Contracts

- The measurement of insurance liabilities should incorporate assumptions about climate-related risks. Such disclosures may include significant judgements, and changes in those judgements, as a result of those assumptions.
- The disclosure of risk exposures, concentrations of risk, risk management, and sensitivity analysis showing the effect of changes in risk variables may all need to be reflected in climate-related risk disclosures.

The PWC report also provides commentary on the impact on Property, Plant and Equipment, which may also be of interest to some. [du Plessis et al. \(2022\)](#) suggest that 'over time, the impact of climate change will likely result in an adjustment to the forecast income expected to be generated from an asset, or changes to an entity's cost base' (p. 7). For example, cost bases might increase where: (a) businesses are forced to source 'greener' inputs; (b) they incur the impact of carbon taxes (or credits); (c) there are increased physical risks in evidence in certain business locations (e.g. increased flood risk); and (d) the costs involved in repurposing certain assets is apparent.

Forward-thinking, risk averse valuers may be appropriately challenged to think about ways they could become involved in climate risk reporting as a new, exciting avenue for their business.

The challenge for valuers

The chaos and devastation of climate change (whatever the cause or reason) being experienced in many parts of the world, including New Zealand, is both saddening and very sobering. However, the positive news is that the valuation profession is in an excellent position to help in the assessment of risk and impact, assisting property stakeholders in the mitigation of its potential impact.

Many valuers are currently extremely busy just coping with client demand, which for many is at an all-time high. Just keeping pace with that is probably proving quite a challenge for many firms. However, our profession is cyclical and this situation is unlikely to last. Therefore, forward-thinking risk averse valuers may be appropriately challenged to think about ways they could become involved in climate risk reporting as a potentially new, exciting avenue (with new economic opportunities) for their business into the future 🏡



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