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## **Green Building Trends Challenge Appraisers, Realtors, and Insurers**

A Marshall & Swift Whitepaper

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*A valuation solution incorporating the latest data on sustainable building components is essential to manage risk in the appraisal process.*

Green building is here to stay. Structures that are environmentally responsible and resource-efficient throughout their entire life-cycle will be the norm, not the exception. New construction will be designed to take full advantage of the latest energy efficiency technology and existing buildings will be retrofitted to be more resource-conscience. Occupants of new and existing buildings alike will benefit from operation and maintenance practices that are ecologically sustainable. Federal, state and local mandates, often in the form of stricter building codes, will make the Green movement not an elective method, but rather the required approach. "What once was will no longer be" - an axiom that applies not only to buildings, but also to the way they are valued. MSB and Marshall & Swift, long recognized as the leader in building valuation, is committed to being the real estate valuation industry's source of knowledge for Green building, and for the up-to-date information and techniques necessary to properly value all that is associated with this new and rapidly growing phenomenon.

Reliable, current cost data is vital for residential and commercial construction appraisal calculations that are fair, defensible and accurate. Now the growing trend of "Green" construction adds a new level of complexity to the valuation process for building appraisers, tax professionals, real estate agents, and insurance managers. Market data on comparable properties is often unavailable, cost data on sustainable building materials is difficult to source, and the Green building landscape itself is evolving at a break-neck pace.

Appraisals are facing a growing need to incorporate Green into their building valuation process. Without fully considering Green construction factors, appraisers can seriously undervalue buildings, impacting everything from tax rolls to property insurance coverage limits. Additionally, without accurate and objective Green building valuation data, appraisers have a difficult time explaining and justifying calculated building valuations to property owners. Appraisers need to incorporate Green into their building valuation process.

### **A Growing Trend**

Green building focuses on the location, design, construction, operation, maintenance, renovation and deconstruction of a building, or what is often referred to as a building's "cradle-to-grave" evolution. Green building incorporates environmental considerations into every phase, without compromising economy, utility, durability or comfort. Green building must also recognize all applicable federal, state and municipal building codes.

Green building programs already have a firm foundation today. LEED (Leadership in Energy and Environmental Design), Green Globe, NAHB Green Home, Energy Star, and Canada Green Building Council (CGBC) are all well-recognized programs in North America.

Additionally, Green is growing. Building experts predict that Green construction will continue to expand in spite of the global recession, with some projecting a 60 percent annual growth trend that will last for at least the next four years.<sup>1</sup> The U.S. Green Building Council (USGBC), which administers the LEED certification process, contends with backlogs in certifications due to high demand, pushing what should be a five-week certification process to five months.<sup>2</sup> Additionally, even if a building is not fully certified Green, it may still incorporate a number of sustainable construction components that impact reconstruction costs.

Green homes will become increasingly prevalent in new residential development; and the "Greening" of existing homes and buildings will also increase, driven both by consumer demand as well as by local, state, and federal government mandates and incentives. For instance, the American Recovery and Reinvestment Act contains several provisions that are likely to shape Green building in the coming years, including loan guarantees for renewable

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<sup>1</sup> Yudelson, Jerry, "Top Ten Green Building Trends for 2009," Island Press, January 28, 2009.

<sup>2</sup> Sinha, Vandana, "D.C.-Area Buildings Constructed to Meet Green Standards Face Certification Lag," Washington Business Journal, May 20, 2009.

energy projects and tax credits for homeowners who add energy-efficient windows, furnaces and air conditioners to their properties. In the commercial sector, similar mandates as well as tax credits will increasingly encourage sustainable building as well.

In short, Green is not a passing fad; it is a trend that will impact construction for the foreseeable future.

### **Impact on the Appraisal process**

As the construction of Green buildings becomes even more widespread, appraisers will need to consider sustainable components in their building cost calculations. This is new code required cost, which by law is necessary to include in valuations of all types. In a report on Green building valuation issues, *The Appraisal Journal* confirmed that, from both anecdotal evidence and case study research, Green and sustainable features can and do influence values and therefore require careful consideration by appraisers and others.<sup>3</sup>

However, despite its rapid growth, Green building design is a relatively recent phenomenon compared to the history of construction, presenting appraisers with challenges in obtaining credible cost information. If appraisers lack readily available and objective data, or if their valuation methodology is flawed, the possibility of undervaluation, exposure to losses, and even legal action looms.

Without accurate data on Green materials, appraisers need to make their best guess at the cost or trust estimates given by property owners. They may undervalue property for tax purposes. This not only impacts municipal tax revenues, but may put a municipality in violation of laws that require fair and consistent treatment of taxpayers.

Additionally, insurers that provide replacement cost coverage generate inadequate premium if costs of Green components are not considered in building values, while their claim departments struggle with how to adjust partial or total losses with associated legal implications. Finally, without objective data, appraisers cannot defend the building values that are calculated for tax assessment or premium calculation purposes to property owners.

### **Challenges for Appraisers**

Appraisers, realtors, and insurers understand the need to assess sustainable construction in calculating building values, but face several challenges in doing so.

**Green building certification does not equal real building value.** A building may receive a silver, gold, or platinum LEED certification, but this does not provide appraisers actionable information about the reconstruction cost of the building. There are different methods to acquire certification points or credits, many of which have nothing to do with the actual construction of the property. For example, one structure may have received Green credits related to site selection, whereas another may have garnered similar credits for sustainable building materials. Therefore, appraisers need to assess actual building components, not simply Green certifications.

**Buildings can include many Green components but not be certified.** Countless thousands of building owners are pursuing features either in new or retrofit projects that address LEED or alternate certification standards, even though they do not intend to seek formal certification. Appraisers need to identify sustainable building components and be armed with a resource to help them create accurate values for those components.

**Green building materials can be difficult to define or identify.** Green building features address areas such as water efficiency, energy efficiency, indoor environmental quality, and reuse of materials and resources, among others. However, it can be a challenge to determine exactly what constitutes a sustainable component, and a product may be considered Green for more than one reason. A component with multiple benefits could qualify on the basis of its overall environmental performance, even if it doesn't meet a threshold in any one category alone. Conversely,

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<sup>3</sup> Pitts, Jennifer, and Jackson, Thomas O., "Green Buildings: Valuation Issues and Perspectives," *The Appraisal Journal*, Spring 2008.

a product with one or more Green attributes might not qualify if other attributes cause a negative environmental impact.

**Sustainable material costs are only part of the Green construction calculation.** Even if appraisers augment their valuation resources by independently obtaining cost data on sustainable building materials, this data alone is not enough to guarantee an accurate building valuation. Installation of Green building materials may require specialized skills that carry a premium rate. Costs to retrofit Green materials into existing buildings can be substantially higher than installing new. Conversely, not all sustainable materials are more expensive to purchase or install than traditional components.

## **A Green Solution**

In the rapidly evolving Green building marketplace, some valuation systems have struggled to respond. Simply put, some providers lack expertise in Green construction and are not current with trends, regulations, and other factors affecting sustainable design.

In contrast, Marshall & Swift provides a disciplined and well-structured approach to the implementation of Green building cost information. This approach incorporates values that are not only inclusive of all expenses owners will face when building and restoring properties, but also includes the many hidden “soft costs” that may not be readily apparent. Marshall & Swift’s solution also enables appraisers to calculate replacement costs for Green buildings, for Green additions, and for individual Green items.

Marshall & Swift’s Green building solution is a supplement to the Marshall Valuation Service (MVS) resource and can apply to both commercial and residential properties. The supplement includes the most common Green line item additions to a building and distinguishes new versus retrofit, including cost of labor. Created using the resources and expertise of nationally recognized Green building consultants, this data will be continually updated and refined based on current market data.

Marshall & Swift, long recognized as the leader in building valuation, is committed to being the industry’s source of knowledge for Green building, and to providing appraisers, real estate agents, and insurance professionals the up-to-date information and techniques necessary to properly value all that is associated with this rapidly growing building trend.

## NOTES

Online links to cited resources

- 1 - <http://washington.bizjournals.com/washington/stories/2009/06/01/story10.html>
- 2 - <http://blog.islandpress.org/296/jerry-yudelson-top-ten-green-building-trends-for-2009>
- 3 - <http://www.real-analytics.com/Green%20Buildings.pdf>