

Practice Briefing: Environmental, social and governance (ESG) and real estate valuation - the case of Sweden

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Abstract

Purpose – The aim of this briefing is to investigate how the impact of environmental, social and governance (ESG) is incorporated into real estate valuation in Sweden. The specific research questions are as follows: How is ESG incorporated in the valuation? What obstacles do the valuers meet in this process?

Design/methodology/approach – This practice briefing is an overview of the role of ESG in the property valuation process in Sweden. The indicative research was conducted through round table discussions. Each round table discussion consisted of six representatives –: two authorised valuers, one bank representative, one auditor and two real estate company representatives – which lasted three hours.

Findings – The outcome of the research can be summarised by that the valuers has a lack of evidence-based data on how and to what extent different sustainability factors affect property values.

Practical implications – This study highlights the struggle of the valuation community in the matter of incorporating sustainability factors in the valuation process.

Originality/value – The research targets the Swedish real estate industry and includes the perspective from not just the valuation community but also the auditors, banks and real estate owners.

Keywords Real estate valuation, ESG, Sustainability, Valuation process, Valuation report, Sweden

Paper type Practice briefing

Introduction

As awareness of climate change and the impact of sustainability issues grows, it is becoming increasingly important for the property market to adapt to change. As the property sector accounts for almost a quarter of all carbon emissions and over a third of all energy consumption in Sweden, sustainability aspects are central to the sector's long-term value and impact on the environment.

Future climate changes, such as flooding and increased risk of extreme weather, are likely to affect the attractiveness of specific locations, as there may be an increased risk of damage to the property. There are studies that indicate that these risks already affect property prices and may have an increasing impact in the future (Lind and Nordlund, 2021).

There are also studies on the valuation of green buildings that are environmentally certified, which argue that a green building can have a higher value for several reasons, such as lower operating costs, higher rental income and better financing opportunities (Lind and Nordlund, 2021). Lind and Nordlund (2021) also argue that sustainability issues have led to a discussion about the role of property valuers: whether they should only reflect the market or whether they should instead emphasise the environmental characteristics of buildings. Lütsendorf and Lorens (2007) and Michl *et al.* (2016) also provide a discussion in relation to this, concluding that sustainable aspects are valued through its performance. However, Warren-Myers (2022, 2023) argue that competence among the valuers are a crucial component to enable sustainability

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and environmental, social and governance (ESG) factors to be capitalised in the property value and the valuation report.

The integration of sustainability aspects into property valuation is a requirement set by the International Valuation Standards Council (IVSC), and the Royal Institution of Chartered Surveyors (RICS) requires that sustainability be integrated into the property valuation. However, it is not self-evident how this integration should take place and how the sustainability aspects should be quantified in a valuation report. For example, RICS have arranged several meetings around the world to discuss this question and published different policy briefs on the matter. At the same time, IVSC has acknowledged ESG factors as important in the valuation process by including directions to valuers in their International Valuation Standards (IVS). The inclusion of ESG within the valuation approach section directs valuers to consider ESG factors in their comparable sales analysis.

Therefore, the aim of this briefing is to investigate how ESG are incorporated into real estate valuation in Sweden. The specific research questions are as follows: How are ESG incorporated in the valuation? What obstacles do the valuers meet in this process?

Previous studies

During the past 2 decades, both researchers and practitioners have debated if and how real estate valuers should take sustainability factors into account in their valuations.

Looking back, a survey conducted already in 2006 (Dixon *et al.*, 2008) concluded that RICS members from all over the world considered that sustainability factors were of great importance for their work. This result was consistent with a survey among Australian real estate valuers conducted in 2007 (Warren-Myers, 2016).

However, this enthusiasm altered over the years, and as the Warren-Myers survey was repeated in 2011, 2015 and 2021, the real estate valuers were less optimistic about the effects of including sustainability aspects in the real estate valuation process (Warren-Myers, 2016, 2023). This opinion among valuers were also detected in other studies, for example, Lambourne (2022), concluding that only one-third of the valuers in the United Arab Emirates think that sustainability is important, and they only see limited relevance of sustainability factors for real estate valuation. In a European context, Hossain *et al.* (2023) also found that environmental certifications were considered as a factor in the valuation reports. This is an indicator of the sustainability work that comes with a reduction of risk. At the same time, Michl *et al.* (2016) conclude that green rental contracts are not considered a factor and therefore should not be included in the valuation process. Furthermore, Nguyen and Nguyen (2024) conclude that integrating ESG factors always plays a positive role in the valuation process. Something that should be considered in light of Sidig *et al.*'s (2024) conclusion that buildings that are labelled as green come with a premium to the value.

Discussing what sustainability factors would influence real estate values, most studies rank energy efficiency as the most influential factor (Bently *et al.*, 2015; Chegut *et al.*, 2019; Thanh Le and Warren-Myers, 2019; Warren-Myers, 2016, 2023). However, to what extent and in what way energy efficiency should come into play in the valuations are not easy to conclude (Warren-Myers *et al.*, 2020). Also, environmental risks, for example, flooding and extreme weather, are put forward as factors for consideration (Michl *et al.*, 2016; Sayce *et al.*, 2022; Warren-Myers, 2022). This is a change from earlier studies where environmental risks were discussed from a perspective of polluted land (Dixon *et al.*, 2008; Wilkinson *et al.*, 2018). However, Nguyen and Nguyen (2024) also add that investors tend to prioritise these risks first when companies face significant risks.

Risk is also discussed in terms of how sustainability can contribute to reduce the risk component by integrating a discussion of the benefits of sustainable buildings in respect of other buildings (Lütskendorf and Lorens, 2007). Like Lütskendorf and Lorens (2007), Warren-Myers (2022) points out that the focus on improving sustainability has increased, leading to the development of several tools and systems to measure the sustainability aspects

of buildings. For example, in the new updated version of RICS “Red Book,” guidelines for ESG are presented.

Warren-Myers and Craddock (2022) found that valuers in Australia identified risks in terms of structural problems, such as flooding. Climate change risks are rarely identified and considered in the valuation process due to a lack of guidance and information (Warren-Myers and Craddock, 2022). Their study also pointed to a lack of data availability and understanding of climate-related risks, which is also confirmed in Hossain *et al.* (2023). Hossain *et al.* (2023) found that valuers in the UK are now more likely to refer to the sustainability standards published by RICS. However, their study showed the lack of data collection may indicate that valuers in the UK do not perceive a price difference for sustainability attributes. Although some previous studies have shown that sustainability certifications can lead to higher rents or prices, there is limited evidence on other factors. Although the RICS has published several guidance documents on sustainability, they have not systematically addressed the problem of lack of data and how the sustainability factors in different ways influence the value of the real estate. Many valuers report difficulties in analysing sustainability data, partly due to a lack of education and training (Hossain *et al.*, 2023; Warren-Myers, 2022, 2023).

Although concluding that the valuers have an interest in sustainability features as they partly have a lack of knowledge on how these features could or should influence the value and be reported in the valuation reports, the impression is that the sustainability work is driven mainly to legislation (Dixon *et al.*, 2008) and the financial sector, for example, the European Union (EU) taxonomy and the reporting system, that are developing (Hossain *et al.*, 2023; Oktabec and Wills, 2024). Furthermore, the S in ESG is more or less not investigated in relation to real estate valuation. Newell (2023) speculates in terms that a lack of metrics and measuring is the reason.

Method and data

This study was initiated by the local RICS organisation in Sweden together with the board of valuation within the non-profit organisation Samhällsbyggarna. The process started with a group interview with three authorised property valuers discussing how sustainability is taken consideration in valuation reports. The outcome was that the different companies are struggling with this question as they see both RICS and bank requirements together with questions from the real estate companies to recognise and promote these aspects at the same time as the auditors, when making valuation reports for the real estate companies annual reports, ask for more information and transparency.

The research was conducted through three round table discussions. Each roundtable discussion consisted of six representatives – two authorised valuers, one bank representative, one auditor and two real estate company representatives – which lasted three hours.

The three round table sessions were organised, where each session was divided into two parts, focusing on two different questions with a coffee break in the middle, each session lasting for approximately 1.5 h, and the whole round table session lasted four hours. The first part had the focus on the question, “How is the company sustainability work incorporated/ considered in the valuation report?” The second part was devoted to information and obstacles targeting the following two questions: “What parameters and information influences your valuation most?” and “Where do you see the largest challenges?”

Furthermore, the round table sessions were organised with six participants. The grouping was made so that each table had participants representing valuers, banks, owners and auditor companies (see the distribution in Table 1). The real estate valuers were all authorised by Samhällsbyggarna and certified by RICS except for one person who only had an RICS certification. Also, a couple of the other representative holds an authorisation by Samhällsbyggarna. All the respondents are in a senior position in respective companies with a position to influence the valuation praxis either from a performer, contractor or auditor perspective.

Table 1. Participants in each round table session

Round table 1		Round table 2		Round table 2	
Valuer 1	RICS and authorised	Valuer 3	RICS	Valuer 5	RICS and authorised
Valuer 2	RICS and authorised	Valuer 4	RICS and authorised	Valuer 6	RICS and authorised
Auditor 1	authorised	Auditor 2		Auditor 3	Authorised
Bank 1	authorised	Bank 3	Authorised	Bank 4	Authorised
Bank 2		Real estate owner 2	Head of sustainability	Real estate owner 4	Head of sustainability
Real estate owner 1	Head of sustainability	Real estate owner 3	Authorised		

Source(s): Authors' own work

As we wanted this combination of perspectives and the respondent had a senior position with the ability to have a clear insight and possibility to have an influence in their companies processes, the selection of respondents followed a stratified purposeful sampling as defined by Patton (2002) and Eisenhardt (1989a, b). The representatives were divided as a portrait in Table 1.

As seen in Table 1, there is a larger share of valuers represented in the sessions. This was deliberate as our ambition was for the focus of the discussions to revolve around valuations and how the ESG is expressed in the valuation reports. This was also done in line with the reasoning in Patton (2002) and Eisenhardt (1989a, b).

Findings and discussion

This section is divided into three parts, starting with the broad perspective of sustainability and how it is considered by the respondents, followed by the question of ESG in the valuation reports and the respondents' thoughts about challenges of integrating ESG in the valuation reports.

Sustainability

All participants in all three sessions consent that sustainability is a very broad term, concerning several different aspects. The topic has had a big boost in recent years and is constantly in discussion today. All participants agree that sustainability is a broad area, not least in the property sector. All of the companies interviewed currently have employees – as entire departments or teams – working with sustainability. Participants emphasise above all the importance of using the premises that already exist and creating a long-term product together with sustainable financing. The participants believe that banks drive sustainability issues, partly because of external requirements but also because they want to know all the risks associated with the money they lend. The participants also say that sustainability issues have become a very topical subject of discussion at industry meetings.

But above all, I think it is the banks that will drive it. Banks are happy to have a document to file so they feel safe when they lend money. That this is a safe asset that we have lent money to without a lot of risks. (Valuer 1)

All the valuers refer to ESG when asked what sustainability means to them in their role as valuers. In a valuation context, it is primarily the E (environment) that can actually be linked to valuation today. All participants agree that the environment is currently characterised primarily by the energy consumption of the properties. Energy performance can be measured, which means that the measure is comparable with other properties. Furthermore, energy

performance has a direct impact on net operating income, which also affects the market value of the property.

We look a lot at energy costs and then you have to break it down into energy consumption and be able to control it and make it as efficient as possible. So, energy is probably the biggest issue, the one that has an impact. (Valuer 3)

However, the participants from the real estate companies added that although the bank largely drives these questions when it comes to the valuation reports, they also see a great interest from their tenants as they, to a much larger degree, have sustainability requirements when leasing today than a couple of years ago. Both statements to some degree go against [Dixon et al. \(2008\)](#), who conclude that sustainability work is driven by legislation. However, considering the tenants' interests and the banks' interests in these questions, we can speculate on what degree legislation and the EU taxonomy come into play.

In addition to the energy performance of a property, several of the participants mention sustainability aspects such as flood risk, soil contamination and other sustainability risks related to the environment. Although these environmental risks are concrete, they may not apply to all properties, but it is above all important that the properties that are affected should be highlighted and captured in a valuation. This is a topic that several researchers over the years have concluded that the market considers and capitalise in the prices (see, for example, [Lind and Nordlund, 2021](#)).

Several participants also highlight other sustainability aspects that are not directly related to the environment. Real estate owner representative 3 mentions the S in ESG, social sustainability, which, as real estate owners, includes sustainability such as healthy employees, customers who want to work with them and sustainable suppliers who meet their requirements. Furthermore, aspects such as a good environment in the buildings and a healthy indoor climate had a consensus around the table as aspects of importance. Real estate owner participants 3 highlighted the importance of working with all sustainability issues and integrating sustainability work in all areas of activity in order to have a holistic view of sustainability. This includes not only what happens in the building but also the work done together with municipalities, authorities and so on. These types of partnerships were believed to be important for the long-term improvement of entire areas. However, the discussion around the tables reflected upon how the real estate company's sustainability work can influence the real estate value but is not automatically transferred to another (i.e. the next) owner.

Integrating ESG in the valuation report

The integration of sustainability into the valuation process currently depends on what the customer wants. They all agreed that it was, more or less, only asked by the banks or indirectly when the client uses the valuation report for credit. Otherwise, sustainability is not directly integrated in the report. Although all agreed upon that they do assess property risks in their daily valuation work, it is seldom put forward in the valuation reports. The exception is when the property is at risk (i.e. flooding or soil contaminated). Despite the [RICS \(2021, 2023\)](#) standards on sustainability integration, the representatives stated that they generally do not integrate any sustainability risks in valuation but instead address this in the transaction and portfolio analyses for the company. However, the participants mention other environment-related risks in line with [RICS \(2023\)](#) – for example, all valuers take flood risk into account. This is also in line with [Lind and Nordlund's \(2021\)](#) statement that these risks are capitalised in the valuation process.

The participants stated that they tend to consider sustainability data that they are familiar with, such as environmental certifications, energy declarations and certifications. The first two are then included in the valuer's assessment and valuation report. However, they explain that it is not quite as simple as certification affecting the value by itself. However, if the sustainability

documentation shows that the property lacks certification and has poor energy performance, it is more likely to affect the valuation.

It was argued that the value always must be judged based on what a likely buyer would be willing to pay. A property with a poor energy performance may have great potential and the ability to improve that can attract larger real estate companies that can afford to invest money to improve the property, and this potential should also be priced. Real estate owner representative 3 also mentions that they look at the property's development potential when it comes to improving, especially the technical parts of the property such as heating systems and energy performance. From a property owner's perspective, the ability to buy brown properties when the property is in a good location, with the possibility of converting the property to green, presents a good opportunity. However, this cannot be directly reflected in the valuation report.

All participants agree that environmental certifications have a direct or indirect impact on valuation. However, the participants consider that there is insufficient data to draw conclusions about how much impact certifications really have on market value. The valuers probably tend to assume a higher net operating income for environmentally certified properties. Together with the attractiveness and competitive advantage of the property, most of the respondents believe that this can lead to a lower required rate of return, as there are more buyers for a certified property, especially for foreign operators. If the valuer can also identify a potential buyer, it is therefore possible to assume that the yield requirement can be lowered.

There is probably, as an appraiser, a tendency to perhaps assume slightly lower cost levels in that type of facility. Because properly operated in any case, they should cost less to run. (Valuer 2)

It is not the environmental certification itself that affects the valuation but rather the effects of lower operating costs and higher attractiveness. The environmental certifications come with specific requirements for the properties, which should result in reduced operating costs.

In addition to the effects in terms of reduced operating costs, the real estate owner representatives report that tenants are prepared to pay more when they rent a classified property. According to real estate owner representative 3, larger companies (tenants), especially international companies, have higher demands on sustainability aspects, which means that they can only rent certified properties. Bank representative 2, on the other hand, believes that this is mainly a metropolitan phenomenon. This is where the certified properties mainly are located and tenants have certification requirements and are willing to pay more. One of the valuers expressed it as.

The mechanical workshop in Falun does not care if it is an environmentally certified property they rent. They just want a cheap rent. (Valuer 1)

When acquiring properties, different investors have different requirements. Bank representative 4 says that not all actors can buy a property that is not certified, as they have guidelines and requirements regarding sustainability. Real estate owner representative 3 says that there are more buyers for a certified property than buyers for a property without certification. This means that a property without certification can be more difficult to sell. Auditor representative 2 highlights the fact that institutions, pension funds and so on have entire ESG frameworks, which means that the property requires a certain environmental certification, energy class, etc. International investors also place higher demands on sustainability aspects in a property, which all participants also confirm.

For example, for a German fund, it must have the highest environmental certification and it must be this and this and this. And when property meets the requirements, they pay very well. If property don't, they don't go in and buy. (Bank representative 2)

Auditor 1 believes that it may be more important for foreign investors to have a stamp, as they may not be so close to their properties and outsource their property management. It speculated that Swedish investors may not require certification, as it is more important how the property performs (i.e. energy performance) and later can obtain certification. It was mentioned that the

investor community favours certified properties. Along with reduced operating costs and higher rents, investors are then willing to lower their required return. Also, the insight that everyone can rent properties with certifications and good sustainability aspects, the vacancy risk can be reduced and the risk premium lowered. This goes well with the conclusions of Michl *et al.*'s (2016) observations. When it is also a property that institutions and foreign investors can also buy, it drives down the risk and the required return even more.

The valuers explain that they look at all parameters of ESG, although the parameters do not always end up as a note in the valuation report. For the assessment of rental income, for example, an environmentally certified or green property should yield higher rental income, as it is easier to attract tenants. Therefore, environmental certifications also have a positive impact on potential vacancies. The cost side is also being reviewed to see what can be done to improve energy costs. When breaking down the required return, the most likely buyer is assessed. If it turns out that the most likely buyer wants an environmentally certified property, the required rate of return will decrease for the certified properties, as there are more buyers for that type of property. The higher demand will also increase the value of the property. According to Valuer 1, taking sustainability into account in the valuation process should only be considered if the market does. If the market does not take it into account, the valuer cannot and points out that it is always a matter of reflecting what the market thinks and how it acts.

We cannot make anything up. We can only try to reflect the market. So is it the case that the market would absolutely not want to buy brown properties. Yes, of course I will take that into account. But I can't just sit and consider something and then the market does something completely different. My job is to try to reflect what the market thinks. Therefore, we the valuation community tends to be more reactive than proactive. Because it is simply not our job to tell the market what to do or how to act and what features to pay more or less for. (Valuer 1)

Like Valuer 1, other valuers agreed, and Valuer 2 also points out that it is not they who should value the sustainability factors but that it is the person who will buy the property who must have knowledge and understand these risks. Valuer 2 says that, as an appraiser, you can take in as much information as possible about a property and can choose to consider that information as crucial in the valuation. However, if it is information that the market does not have, the market will deal with the situation in a different way.

Challenges towards implementing ESG

Implementing sustainability factors in the valuation process is something that comes with many challenges. These range from a lack of data to difficulties in quantifying the impact of sustainability factors. Sustainability is a very broad concept, which makes it difficult to concretise. There is currently no official or general system or industry standard for how sustainability factors should be used in the valuation process. Valuer 4 says that there are still different ways of doing and thinking between valuation firms, banks and real estate companies. The lack of systematic measurement tools makes it difficult to quantify and interpret the impact of risks. Auditor 1 stated that it is not possible to say by what percentage the value is affected by a particular risk or certification. All of these valuation tools are fussy, and new ones are coming up all the time that are integrated with sustainability elements to capture all the public records. However, there are simply no data points in respect to the ESG. We are not able to see how the investor reasons in these matters.

The EU taxonomy is portrayed as unclear in two of the sessions. Mainly it is the uncertainty of how this will affect the Swedish market. The respondent wonders what happens to the properties that do not meet the requirements; can they not be rented out? Will they not be able to be sold? One of the real estate owner representatives stated

For a couple of years, we have not considered to buy properties that do not fulfil the highest energy standards, if we did not see the potential to upgrade them to this standard that is. This as we see it as a potential threat that we as a company will not be able to attract tenants as well as not being labelled as a sustainable company ourselves. (Real estate owner representative 2)

How this will affect the valuation is unclear, and the directive is around the corner, but there is uncertainty about when it will be implemented and how it will be implemented. Auditor 2 also attests to the uncertainty of how this will actually play out in the market. Real estate owner representative 3 believes that it will be a challenge as the less sustainable properties may become less attractive and more difficult to rent out. The taxonomy will be an important part of the process, as it will determine where the capital will be invested in the future.

One challenge in valuations is the lack of data or difficulty in obtaining information. Valuer 3 says that, as valuers, they want as much information as possible, and it's not always possible to get all the data you need or want for your valuation. It is not only data on sustainability but all kinds of property-related information that can be difficult to obtain, and the lack of data is an important aspect of being able to integrate sustainability into the valuation, which is confirmed by all participants. There are currently very few transactions, and it is therefore difficult to see how the risks actually affect the value. The participants speculated that it will take a couple of years to be able to analyse sustainability data and to see the real impact of sustainability on risk and value.

Auditor 1 urges that valuers have to be critical and sceptical in their thinking about what to integrate and what data to rely on. The participants agree upon that it will be a question of competencies about which aspects to use and how they affect the valuation. In order for data to be used in the valuation, there needs to be evidence for the assumptions made. All believe that it will be a challenge to try to translate the sustainability aspects into some form of risk premium or price. Real estate owner representative 2 also highlighted the potential risk of real estate companies portraying themselves as being on top of the sustainability agenda although not walking the talk. She referred to companies with great-looking sustainability reports; however, when looking deeper into the company's actual work, not much is done.

Conclusion

As sustainability integration is still relatively new, valuers are still in a learning phase. In a couple of years, when they have learnt more, gained more experience and had the opportunity to look back and evaluate their valuations, better judgements will be made. This was also expressed by Valuer 1, stating, "We are all on a learning journey." A statement confirming that the Swedish real estate valuation community is on the same level as the Australian as concluded by Warren-Mayers (2022, 2023).

To conclude, Swedish real estate valuation professionals are still struggling to incorporate ESG factors in the valuation accordingly. This is mainly because it is hard to identify how the market values sustainability factors, as too few transactions are made on the market. In respect to the IVSC's direction in the IVS to include the ESG factors, alongside traditional valuation considerations in the comparable sales analysis, they are not observable and unable to be properly considered. Instead, observable factors with an impact on the net operating income, such as energy consumption, are taken into consideration.

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