Olivier Mege

Chief Executive, RQR

Real Quality Rating (RQR) is a Paris-based tech company that provides rating and valuation tools to its clients. We recently caught up with CEO, Olivier Mege.

Can you tell us a bit about RQR and how it came about?

RQR is the real estate rating agency that offers tools to support sustainable valuation and investment-decision making process. RQR was established in 2017 and is now covering all major European markets for offices, logistics, retail, residential and mixed-use properties.

The ratings we provide look at not only the building but also its location. We act on the behalf of major investors and on a pan-European level.

The real estate sector accounts for almost 40% of total CO_2 emissions. The environmental impact of real estate is now at the heart of owners' and managers' concerns. However, these concerns fail to be effectively accounted for in investment decisions: today's practices rarely go beyond simple reporting and ambitious statements of intent, including the famous "net zero" target.

What is your own background in valuation and real estate and how has this led you to where you are today?

I founded Real Quality Rating (RQR) after 15 years in real estate asset management in Asia and 5 years at MSCI as global head of real estate index research. I'm a member of the Royal Institution of Chartered Surveyors (RICS), a member of the Chartered Alternative Investment Association (CAIA), a member of the IPF (Investment Property Forum), a master of the Japanese Association for Real Estate Securitisation (ARES, Japan) and a certified transactor of the Japanese Ministry of Infrastructure and Transport (Takken).

Through my career, I have witnessed the deeply negative consequences for end-investors (pension funds, insurance companies, etc.) of not being able to quantify quality (wrong investment decisions, misleading financial benchmarking analyses, wet finger valuations, etc.), and I have seen investors unsuccessfully attempting to create home-grown rating systems, which are very often subjective and inadequate as an external reference.

> *"THE REAL ESTATE SECTOR ACCOUNTS FOR ALMOST 40% OF TOTAL CO_2 EMISSIONS. THE ENVIRONMENTAL IMPACT OF REAL ESTATE IS NOW AT THE HEART OF OWNERS' AND MANAGERS' CONCERNS. HOWEVER, THESE CONCERNS FAIL TO BE EFFECTIVELY ACCOUNTED FOR IN INVESTMENT DECISIONS."*

Why do you think the environmental impact of real estate is lacking from investment decisions?

Investments in sustainable development currently have little or no financial value in the market: our research shows that of the 45 potential dimensions of a building considered as fundamental by the market, only 8 (relating to the location and external appearance of the building) are typically valued.

Now, financial value is the primary measure and incentive for all management decisions.

The root cause of this highly problematic situation does not lie in ill will on the part of professionals. It results, on the one hand, from a lack of tools to support the human brain with apprehending the complexity of real properties attributes (the human mind is not capable of integrating more than 5 dimensions +/- 2), and, on the other hand, the result of a conceptual void on how sustainable value should be measured.

Thus, this creates a kind of cognitive dissonance between current practices and industry’s desire for more integrative valuations.. Hence, the expected proliferation of regulations aimed at filling this gap. Some are there already, for example European taxonomy, Décret tertiaire, the BACS regulation in France. More are to come as, at least in continental Europe, there is a strong propensity to think of additional regulations as the only way to solve environmental challenges. I do not pretend that regulations are not necessary, but they are not the panacea: the way the market values properties is also key.

How is RQR seeking to address this problem?

The tools that we have developed allow investors to evaluate their buildings over the long term, with accuracy, by integrating all sustainable development factors into an Integrated Valuation & Decision Support (IVDS) platform.

How does this IVDS platform work and what is being ‘integrated’?

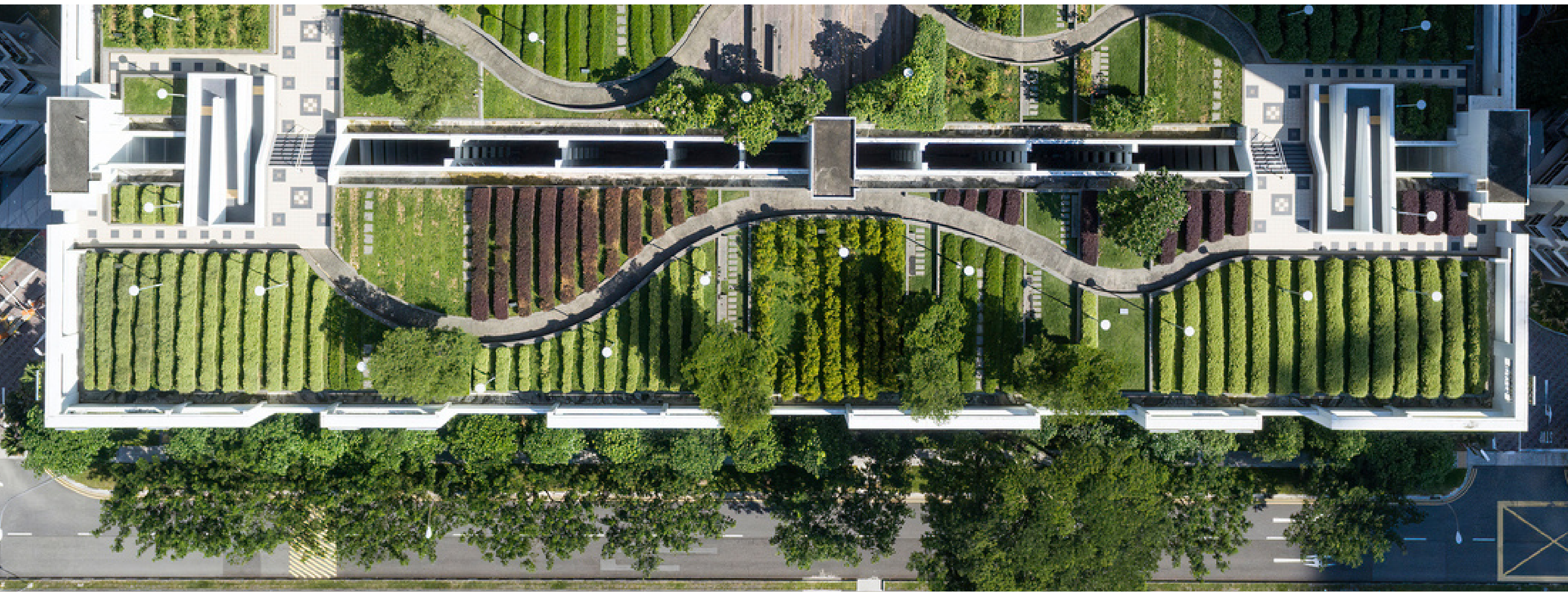
IVDS (Integrated Valuation & Decision Support) is the world's first valuation and decision support platform for investors, based on an Integrated Valuation approach. This valuation is called integrated because it formally connects sustainable value rating with financial value, two dimensions that are usually managed within siloed decision-making processes.

This new valuation approach was the subject of a pilot project that brought together, for almost 12 months, major investors (insurance companies, real estate companies, management companies) and real estate appraisal firms at the international level.

> *"AT LEAST IN CONTINENTAL EUROPE, THERE IS A STRONG PROPENSITY TO THINK OF ADDITIONAL REGULATIONS AS THE ONLY WAY TO SOLVE ENVIRONMENTAL CHALLENGES."*

It is the sustainable value rating that makes it possible to integrate all the dimensions of a building: traditional fundamentals and dimensions brought by sustainable development considerations. The rating objectively reflects the underlying pre-financial market's value judgement of a property, factoring in all its dimensions (economic, social, and environmental). This value judgment is “chemically pure” because it does not happen in the context of a transaction.

The rating model is established based on surveys of the market's sustainable preferences, which are conducted among more than 3,000 professionals (investors, tenants, etc.). In concrete terms, the survey consists of understanding the importance the market accords to each of the dimensions to weigh them accordingly in the rating. These sustainable preferences are themselves shaped by social norms and expectations (hence our motto: Reconciling value with Values). As these sustainable preferences evolve, it is necessary to update the rating models periodically.



How similar or different is this to an Automated Valuation Model (AVM)?

The rating for a building is converted by a multifactor pricing model into a financial value (in euros). Unlike AVMs (automatic valuation models), the system does not exclude the human from the assessment process: on the contrary, the user can adjust the algorithmic valuation at will based on his or her sensitive perception of the property and knowledge of the local market. Furthermore, IVDS does not only assess the financial value of the property “as is”, but it also quantifies value creation potential associated with each dimension.

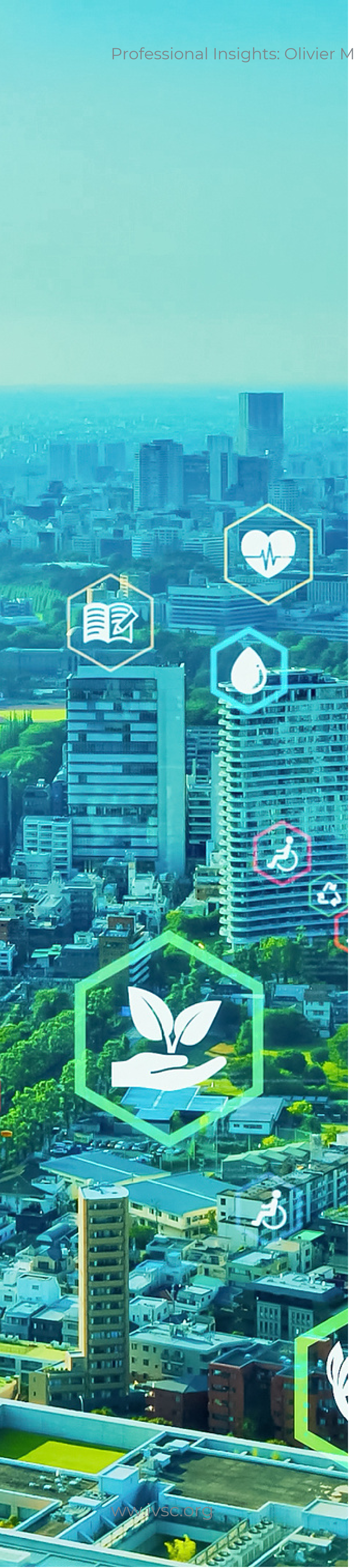
> *"I FOUNDED REAL QUALITY RATING (RQR) AFTER 15 YEARS IN REAL ESTATE ASSET MANAGEMENT IN ASIA AND 5 YEARS AT MSCI AS GLOBAL HEAD OF REAL ESTATE INDEX RESEARCH."*

From the sustainable value rating, the system both estimates the financial value in the short term (spot market value) and in the long term (sustainable value):

- ·the short-term value pragmatically models the pricing mechanisms prevailing at the valuation date, even if these ignore most of the building's dimensions (as is the case today).

- the sustainable value is obtained by substituting the market's sustainable preferences for short-term pricing mechanisms into the pricing model. It estimates the value that ·the building would have if the surveyed sustainable preferences, now latent, were realised. Indeed, as the market is constantly working to improve its efficiency, it is reasonable for an investor to bet on that “reversion” to underlying market preferences. Moreover, the longer the investment horizon, the greater the probability of this happening. A sustainable value greater than spot value, suggests a potential green premium, conversely a potential brown discount.

The system therefore allows investors to choose their position between spot value and sustainable value, depending on their convictions and on the length of their investment horizon: a long-term investor will be able to choose a value close to the sustainable value, while a shorter-term investor will be obliged not to stray too far from the spot value.



How do you see the application growing over the next 3-5 years? What is the biggest driver of uptake amongst your clients?

The IVDS is primarily a product for investors and banks, and a collaborative tool they can prescribe/share with their service providers, among which the appraisers, the building consultants and facility / property managers. The biggest drivers of uptake are the need to value ESG factors and to make values and investment decisions objective and data driven.

What other market factors do you think will increase awareness of, and appetite for, rating tools such as this?

In the short run, global real estate markets are on the eve of a major downward correction, and investors will have to defend their values, while avoiding operational risks related to the temptation of managed valuations. The IVDS allows that as it provides a factual / objective framework to both sides.

Why has RQR become a member of the IVSC and why is it important that the valuation profession is promoted globally, through a public-interest standard setting organisation?

We have decided to be a member of the IVSC in order to contribute to the making of internationally consistent valuation standards. Value is the incentive by excellence that drives decision, along with (or even above) regulations: while people may not necessarily respect regulations, they will always do their best to capture or create value. It is vital that such a powerful tool is regulated by industry bodies like the IVSC that have public interest at heart.

Why do you believe it is important to have internationally consistent, principles-based standards underpinning valuations?

It is key to keep in mind that real estate is rooted in local markets with diverse cultures and economies. And nature likes diversity. Meanwhile, diversity can co-exist with international standards that provide consistency through markets and asset classes. International standards are an important condition for cross-border investment and a way to share best practices.

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How have the needs of valuation end users changed in recent years (including in terms of their global interest and multi-market/asset approach)?

Five years ago, end users were satisfied with valuation approaches that were both mono-dimensional (location, location, location) and transposed from traditional financial assets. It is no surprise that financial approaches, designed for financial assets like stocks and bonds have been applied to real assets: data processing had to be manageable with Excel and the human brain. In the meantime, two major trends have modelled valuation end users expectations: sustainability and technology. Sustainability has led to the necessity to integrate new and multiple dimensions into the valuation equation (climate, well-being, etc.), and correlatively to the need for long term valuations. Technological developments have played the role of enablers: algorithms and artificial intelligence have made possible the emergence of tools that can manage physical real estate complexity and multi-dimensional valuations.

International Valuation Standards Council

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