
Perspectives Paper: *Defining and Estimating ‘Social Value’*



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Perspectives Paper: Defining and Estimating 'Social Value'

The IVSC issues Perspectives Papers from time to time, which focus on pertinent valuation topics and emerging issues. Perspectives Papers serve a number of purposes: they initiate and foster debate on valuation topics as they relate to the International Valuation Standards (IVS); they provide contextual information on a topic from the perspective of the standard setter; and they support the valuation community in their application of IVS through guidance and case studies.

Perspectives Papers are complementary to the IVS and do not replace or supersede the standards. Valuers have a responsibility to read and follow the standards when carrying out valuations.

By: IVSC Social Value Working Group¹, in consultation with the IVSC Standards Review Board and IVSC Technical Boards.

Introduction

The concept of 'Social Value' is an area of growing government, public and commercial interest. However, its meaning is often clouded in uncertainty, with many definitions, and the lack of an internationally recognised measurement framework and standards of practice.

In this perspectives paper we explore

some of the concepts surrounding Social Value and seek your comments to determine whether standards or guidance material are required.

Background

Whilst the concept of Social Value has relevance to both for-profit and not-for-profit entities, its growing importance is principally driven by investment or

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financial management decisions associated with entities with a not-for-profit focus including:

- i. Governments, NGOs and Charities desire or need to select, or assess the performance of, investments or projects.
- ii. Corporates seeking to justify investments, particularly where planning permission or licences are required, not solely on commercial merits but also on the benefits to the wider community.
- iii. Governments, NGOs and Charities seeking to administer valuations for financial reporting purposes to adhere to financial management standards and regulations.

The problems and challenges for valuers in the for-profit sector are, perhaps, better understood than they are in the not-for-profit sector. However, the lack of an internationally recognised valuation framework has the potential to result in jurisdictions and/or valuers developing their own divergent approaches and definitions. This has the potential to lead to reduced consistency, transparency and comparability across borders and asset classes, creating significant debate and reducing the credibility of such valuations

amongst stakeholder groups.

As was once the case for discounted cashflow methods, the concept of Social Value is in its infancy in many jurisdictions, and as such is prone to challenges as the practice develops. However, with an increased focus on governance and transparency we anticipate that in the longer term it has the potential to become a more prominent part of the standard reporting framework for investments and financial management decisions.

In the following sections we address the concept of Social Value and consider the implications for framework development.

Defining Social Value

During our research we identified several definitions of Social Value, however, while there were some consistent themes there was also a lack of common language. At times it would be possible to draw quite different conclusions by applying two different definitions of Social Value.

On further analysis it appeared that much of the difference in the definitions arises from the perspective applied, specifically from whose perspective Social Value was being considered.

In a commercial valuation, the perspective is accounted for upfront and forms part of the Basis or Standard of Value. This might consider the value from the perspective of a particular buyer or seller, a market participant or even a hypothetical market participant where no observable market exists.

In the case of Social Value, the breadth of perspectives is vast as an asset may have different value to different stakeholders. It is therefore imperative that the definition of Social Value i) does not constrain the valuer to considering only one particular element and that ii) the valuer is able to specify the group or groups from whose perspective it is being considered.

We believe that the following definition of the concept of Social Value best encapsulates each of the elements described above:

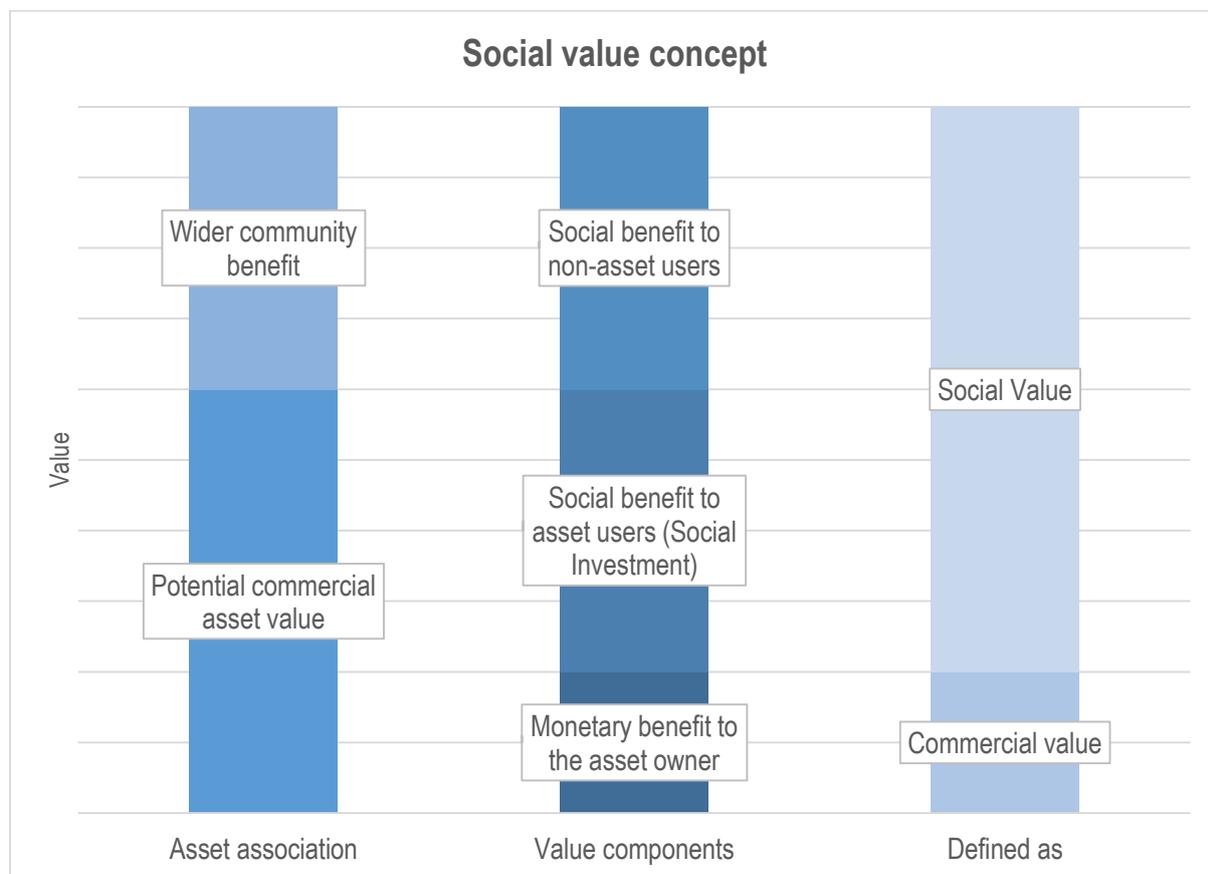
'Social Value' includes the social benefits that flow to asset users (social investment) and the wider financial and non-financial impacts

including the wellbeing of individuals and communities, social capital and the environment, that flow to non-asset users.

What do we mean by Social Value?

One approach to assist in visualising the concept of Social Value is to consider the following three elements:

1. Monetary benefit to the asset owner: the cash flows derived from the use of the asset that flow to the asset owner(s).
2. Social benefit to asset users: the benefits derived from the use of the asset that flow to the asset users.
3. Social benefit to non-asset users: the benefits derived from the asset that flow to the non-asset users including the wellbeing of individuals and communities, social capital and the environment.



There are well-defined bases of value and valuation approaches to measure the monetary benefit to the asset owner(s). However, the measurement of social benefits can be challenging.

With regard to the benefits that flow to the asset users, examples might include:

- Cash flows foregone by the asset owner, in the form of subsidised, reduced, or minimal access fees in relation to the assets employed.
- Value foregone by the asset

owner, in the form of sub-optimal (from a commercial perspective) uses of the assets employed.

For the purpose of this paper we have adopted the term "social investment" to encapsulate these benefits.

With regard to the wider social benefits that flow to non-asset users, these can include economic and non-economic components such as increased economic activity, as well as improved social and environmental outcomes.

In the case of for-profit entities (entities whose principal objective is to generate a commercial return), the monetary benefit to the asset owner, is likely to be the dominant element. That is not to say that social benefits to asset users and non-asset users cannot also exist, however, these are likely to be secondary rather than primary objectives.

However, in the case of not-for-profit entities (entities whose principal objective is not the generation of a commercial return but the provision of a public service), the social benefits to asset users and non-asset users are likely to be the dominant elements. That is not to say that there can be no monetary benefit to the asset owner, however this is likely to be a secondary, rather than a primary objective.

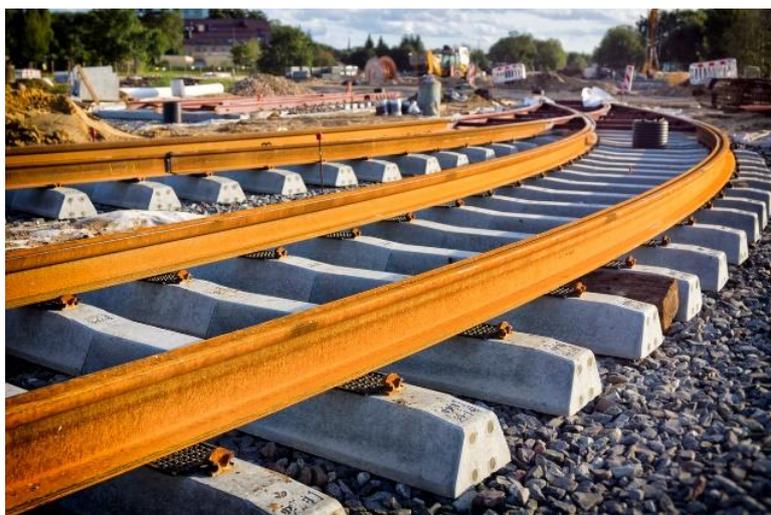
Where might we see these various elements of Social Value at play in the community?

The following examples are provided to help illustrate the concept of Social Value:

Example 1: Rail Line

A not-for-profit public sector entity builds a new rail line connecting an outlying township to a major city. To encourage

the community to use this new rail transportation infrastructure rather than travel by private vehicle, the government, as the asset owner, determines that fares will be recovered on a subsidised basis.



By the government foregoing a large portion of the potential monetary benefit, the asset users are receiving a social benefit in the form of reduced train fares. Furthermore, the social benefits to non-asset users, in the form of increased economic activity in the township and reduced air pollution, are also likely to be significant.

In this case the monetary benefit to the government as the asset owner is likely to be secondary and the social benefits to asset and non-asset users, are likely to be the primary objective.

Example 2: Residential Development

A for-profit entity is seeking planning

permission for a mixed-use residential development. The developer would maximise its return by maximising the footprint of the construction. However, the developer has determined that its chances of obtaining planning consent will be improved by the inclusion of additional social improvements (e.g. an element of low-cost social housing and green public space).

By foregoing some of the potential monetary benefit it might have obtained from the development, the developer is effectively transferring that benefit to the asset users, who will benefit in terms of wellbeing from the low cost social housing and green public space.



In this case the monetary benefit to the asset owner is likely to be the dominant element. The social benefit to asset users whilst important, is likely to be secondary. The social benefits to non-asset users, in the form of increased economic activity

and amenity, may also be significant, but are likely to be secondary to the monetary benefit to the asset-owner.

Example 3: Cemetery

A government not-for-profit public sector entity acquires a large parcel of rural farming land for the purpose of creating a new cemetery. The price paid to acquire the rural farming land reflects a market rate at this time.

The permitted use of the land is subsequently amended to the specific public use as a cemetery. On one interpretation of highest and best use principles, this has the effect of materially diminishing the value of the land (from a commercial perspective), because those alternative uses are no longer permissible.

The cemetery will only seek to recover costs associated with the operation of the cemetery and will not generate a return on the initial acquisition of the land; as such the net cash flow to the government as the asset owner is nil. By the government foregoing the entire monetary benefit associated with the asset, the asset users are receiving a benefit in the form of reduced burial fees. Furthermore, the social benefits to the broader community, in the form of having a place to pay respect to the deceased,

are also significant.

In this case the monetary benefit to the government as the asset owner (nil) is clearly secondary and the social benefits to asset users and non-asset users, are likely to represent the primary objective.



The concept of Social Value outlined above includes implicit assumptions that need to be tested during the valuation process. For example, it assumes that the decision to use the asset for a given activity was because value, inclusive of Social Value (to the wider community), is greater than or equal to its commercial highest and best use value (to the owners). However, it represents a helpful cross check for the assessment of value, particularly since existing valuation methods can be applied to determine the monetary benefit to the asset owner and an approximation of the social benefit to the asset users.

The fact that a not-for-profit entity is prepared to expend public funds on social investment is entirely consistent with acting with the objective of providing social benefit to the community rather than focussing on the monetary benefit to the asset owner. However traditional value measurement methods and principles may not recognise these benefits adequately, and as a result, tensions can arise as to the appropriate way to measure value, especially from a financial reporting perspective.

Further, identifying and quantifying the wider financial and non-financial impacts of assets that flow to non-users of the assets, including the wellbeing of individuals and communities, social capital and the environment, is important when considering the business case for, and effectiveness of, the deployment of public funds.

Setting the scene for why Social Assets exist

As can be seen from the foregoing, the decision to hold an asset with the primary objective of providing monetary benefit to the asset owner or of providing social benefits to asset users and non-asset users, can have a material impact on the relative significance of the elements of

Social Value. Where an asset is held with the primary objective of providing social benefits to asset users and non-asset users, the asset can be described as a Social Asset.

'Social Assets' are assets or projects that exist primarily for the social benefit they provide. The value of these assets rarely accrues solely to the providers of capital.

All assets, projects and organisations have to some degree, a social impact. The impact may range from being significantly negative to extremely positive, and the quantum will often depend on the stakeholder being considered.

For example, in addition to the wider health benefits delivered to the community, the development of a large private hospital will have a positive social impact extrinsic to the asset in the form of significant job creation. This can have further beneficial impacts on parties other than those employed by the hospital. For instance, the government may benefit from increased income taxes. Public hospitals in the area may also enjoy a reduced patient load resulting in shorter waiting lists. However, there may be others in the same community who are negatively impacted, for example public

hospitals in the area who must now compete for staff.

In this example, the primary objective of the private hospital is to generate a return on the capital it has invested, while its social impact is a function of how it operates. Notwithstanding that both public and private hospitals provide similar services, a public hospital run on a not-for-profit basis would have a reduced focus on generating a return on the capital it has invested (or monetary benefit). As such, the public hospital would be described as a Social Asset, whereas a private hospital run on a for-profit basis would not.

Entities that primarily create, hold, or operate Social Assets include governments, charitable, not-for-profit, non-profit and non-government organisations. Social Assets exist for a variety of reasons, but incorporate at least some, if not many, of the following characteristics:

- They are generally acquired, built, held, and managed by not-for-profit entities, acting as trustees in the public interest.
- They are often essential services, recreational or monopolistic assets in nature, but may also service a greater public interest from an

- environmental or social perspective.
- These assets often have planning overlays, covenants, regulatory regimes or the like attached to them that ensure that they are used in the manner in which they are intended.
 - They are often acquired or built using capital generated in the form of public taxes or private, philanthropic or public contributions.
 - In some cases, they may be acquired or built to facilitate a foreseeable use where the private sector cannot justify the investment on a risk-adjusted basis.
 - In many cases, there are much wider benefits to the community that go beyond the asset itself, creating an ecosystem where further industry is created, or social benefits realised.
 - Access fees are typically either free or discounted in some way.
 - As a result of these low access fees, they will often have impaired profitability from a commercial economic perspective relative to the assets that they employ.

Social Assets are many and vary by jurisdiction, but may include the following:

Transport & utilities	Governance, Safety and Security	Social	Cultural, sports & recreational
Roads	Parliament buildings	Schools	Stadiums / Theatres
Railways	Law courts	Universities	Museums
Ports	Prisons	Hospitals	Arts centres
Electricity	Emergency services	Cemeteries	City parks & gardens
Gas	Armed forces	Care & social housing	Wilderness areas
Water/wastewater	Arbitration centres	Sanitation	Memorials
Airports	Communications	Libraries	Sporting precincts
Launch facilities	Mediation centres	Youth centres	Skate parks
Waste management		Health clinics	

Of course, many of the above assets may not meet the definition of a Social Asset, if held for the primary objective of generating a commercial return for the asset owner. A critical feature of Social Assets is that the value generated by the asset does not solely accrue to the owners, but rather to a much larger group of stakeholders. Consequently, traditional valuation models that assess the value accruing to the providers of capital are likely to understate the wider value of the Social Asset. In contrast, estimates of Social Value extrinsic to the asset seek to capture the benefit that accrues to non-owners.

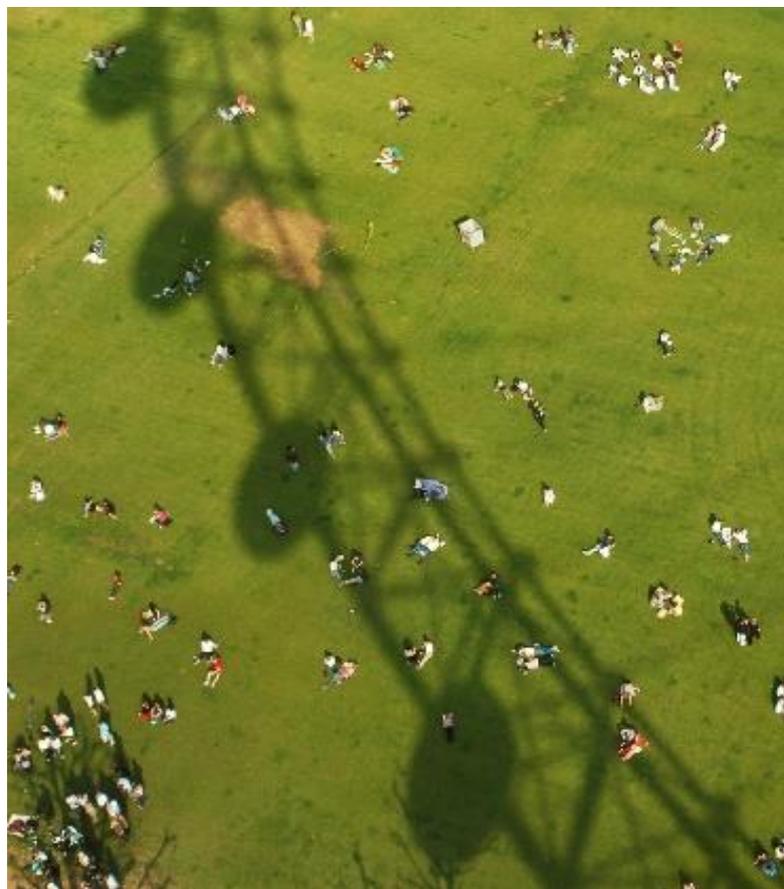
What makes Social Value difficult to determine?

It is in this setting that Social Value can be confusing for a valuer because the traditional theories of value are challenged for the following reasons:

- Social Assets or commercial assets with social attributes are often unique and are rarely, if ever, traded in the open market.
- Transactions that do occur may only price in the value to a certain owner, not the wider community benefits.

- The wider community benefits associated with the assets are often difficult to measure.
- In some instances, the present owner may be the only buyer.
- Where sales do take place, they may not represent an arm's-length sales process.
- The assets often generate either nil or impaired cash flows.

This requires the valuer to think deeply about the concept of Social Value, and importantly what the value of these assets and benefits are to both the owners and wider stakeholder groups (i.e. public).



Give us your feedback on the concept of Social Value

Much of the above has considered the qualitative areas of Social Value. Who might use it, what does it mean, why is it difficult to determine, in what settings is it used? As we begin to unpack the concept of Social Value, there will be various quantitative areas that we will seek to discover.

But before we do this, the IVSC would be interested to hear your thoughts on the concept of Social Value discussed in this paper. This is the first of a series of Social Value perspectives papers, where the second paper is intended, subject to feedback, to explore the quantification and other issues in relation to the measurement of Social Value.

Any feedback in relation to the following questions would be welcomed:

Social Value:

1. Do you agree with the three-component model of Social Value described above? If not, why not and what components would you propose?
2. What components of the Social

Value model described above do you value in your jurisdiction, and what valuation methods or applications do you apply in doing so?

3. Do you think there are appropriate standards and guidance in your jurisdiction relating to the concept of Social Value?
4. Do the International Valuation Standards provide a strong enough framework for valuers and users of valuations to consider the concept of Social Value?
5. Do you agree with the definition of Social Value provided above? If not, why not and what alternative or amendment would you propose?
6. How should the valuer think about highest and best use as it relates to Social Value?

Social Assets:

7. Do you think a definition of Social Asset is helpful? Do you agree with the definition of Social Asset proposed above? If not, what alternative or amendment would you propose?
8. Do you value Social Assets within your jurisdiction and if so, for what purpose and

- under what standards, guidance or legislation?
9. Do you think the valuation of Social Assets is important, or will become increasingly important, for Governments, NGOs and Charities as part of good governance processes as the public seek greater accountability from the trustees of these assets?
 10. For those that are actively involved in the valuation of Social Assets, what areas or concepts prove the most difficult that could benefit from improved clarity or guidance?
 11. What elements, if any, identified in the Social Value model, do you feel might provide useful information to users of financial statements?
 12. Are planning overlays, covenants or regulatory regimes that are often attached to Social Assets inhibitors to value or complementary to them achieving their highest and best use in the public interest?
 13. Are there additional highest and best use considerations that are important in the consideration of Social Asset valuation?

The IVSC will continue to consider the topics in this article, and feedback outside our formal consultations is always welcome. You can share your thoughts with the Board or contribute to the discussion through the IVSC LinkedIn group page.

You can contact the authors through the IVSC at: contact@ivsc.org