

INTEGRATING CLIMATE RISKS IN REAL ESTATE

Real estate investor members of UNEP FI, CERES - INCR, IGCC, IIGCC, PRI and the RICS believe it is economically and practicably feasible for the real estate sector to play a significant role in limiting global temperature increase to 2°C. We support national greenhouse gas (GHG) reduction targets aligned with IPCC recommendations and policy frameworks which enable a smooth transition to a low carbon economy.



Role, risks and opportunities for real estate investors

The buildings sector consumes around 40% of the world's energy and contributes up to 30% of global annual GHG emissions. At the same time, the global universe of investable real estate is worth about US\$50 trillion.¹ Supporting the real estate sector to accelerate the integration of environmental, social, governance (ESG) and climate risks into investment decisions and to scale up energy and climate-related investments, including retrofitting, is thus a key factor in ensuring global temperature increase is limited to 2°C.^{2,3}

Climate change poses clear and material risks to the real estate sector. In addition to the physical and social impacts of extreme weather,⁴ growing regulatory pressures and changes in market preferences are impacting investment performance.⁵ However, there is growing evidence across geographies that a climate-friendly and sustainable real estate sector can both preserve and increase asset value. Data from the US, Australia, France, the Netherlands and Singapore make a convincing case that the financial performance of green and energy certified office and residential buildings is superior and the risk of mortgage default is lower compared to that of non-certified properties.⁶ Technology and operating processes are currently being used to improve energy efficiency of existing building portfolios by a further 2-4% each year and are estimated to continue to do so

for the foreseeable future. Over the long-term, these efficiency gains drive reduced operating costs of commercial and residential buildings, resulting in enhanced asset values. Indeed, new buildings can readily be built to use 30-50% less energy than required by most energy codes dating back to 2005,⁷ and in growing instances can achieve zero net energy consumption.

With growing evidence an increasing number of institutional investors and their stakeholders have started to recognize it as their fiduciary duty to manage climate risk in their investment portfolios, with leaders in commercial real estate systematically integrating climate risks and opportunities into existing investment, valuation and asset management processes.

Through UNEP FI, CERES-INCR, IGCC, IIGCC, PRI and RICS who promote and enforce valuation standards globally, this knowledge has been disseminated globally via guidance, frameworks and publications. Despite this, huge investment opportunities remain untapped and much more could and should be done. Indeed, the scale of the investment opportunity in energy efficiency building retrofits globally will rise to US\$300 billion annually by 2020 and is supported by a robust business case.⁸ Yet, the current rate of investments is a fifth of that required to stay within the desired less than 2°C pathway.⁹

1. La Salle Investment Management | Research & Strategy (2015), <http://www.lasalle.com/research>
2. Emissions would be 2.8 Gt (or 8%) lower than in the Intended Nationally Determined Contributions (INDC) Scenario by 2025 and 4.8 Gt (or 13%) lower by 2030, meaning that energy-related GHG emissions would peak and then begin to decline by around 2020. International Energy Agency (2015), <http://www.iea.org/publications/freepublications/publication/WEO2015SpecialReportonEnergyandClimateChange.pdf>, p.74.
3. To limit global warming to 2C, GHG emission reductions would need to be 40 – 70% lower than compared to 2010. Potsdam Institute for climate impact research (2014), <https://www.pik-potsdam.de/news/in-short/archive/2014/global-warming-can-be-limited-to-2-degrees-with-major-technological-and-institutional-change-ipcc-report>
4. There has been a fivefold increase in inflation-adjusted insurance losses from weather-related events from around \$10bn in the 1980s to around \$50bn over the past decade. MunichRE, NatCatSERVICE (2015), <http://www.munichre.com/en/reinsurance/business/non-life/natcatservice/index.html>

Time to scale up integration of environmental, social, governance (ESG) and climate risks

“WE ARE THEREFORE CALLING ON FELLOW INVESTORS TO FOLLOW SUIT AND SCALE UP THE INTEGRATION OF ESG AND CLIMATE RISKS IN A MANNER THAT PROTECTS AND ENHANCES VALUE ACROSS THE COMMERCIAL PROPERTY INDUSTRY AND SUPPORT THE 2°C GLOBAL UN TARGET.”

Tatiana Bosteels, Head of Responsible Property Investment, Hermes Investment Management & Co-chair, UNEP FI Property Working Group.

To support this move, we have come together to review, synthesize and evaluate the relevance of major publications and tools produced in recent years. We aim to create a concise, actionable investor framework that maps the actions which real estate investors and related service firms could easily implement, regardless of where they currently might be on their journey to integrate environmental, social, governance (ESG) and

climate risks into their mainstream investment activities.

“How to integrate ESG and climate risks into Real Estate – An Investor Framework” will be launched in early 2016.

To receive a digital copy upon its release and find out about any updates and events, please connect to:

www.unepfi.org/ESGinRealEstate

5. ‘Protecting value in real estate’, IIGCC (2013), http://www.iigcc.org/files/publication-files/IIGCC_Protecting_Value_in_Real_Estate.pdf; ‘Managing investment risks from climate change - Assessing climate change risks and opportunities for investors - Property and Construction Sector’, IIGCC (2013), http://www.iigcc.org.au/Resources/Documents/property_assessing_climate_change_risks_for_investors.pdf; ‘Unlocking the energy efficiency retrofit investment opportunity’, UNEP FI (2014), http://www.unepfi.org/fileadmin/documents/Commercial_Real_Estate.pdf
6. Non-exhaustive references: ‘The environmental and financial performance of buildings’, PRI (2012); Eichholtz, Kok, Quigley (2011 & 2); Eichholtz, Kok, Younder (2012); EU Commission (2013); MSCI indices (2014 & 2015). On mortgage risk see: An X and Pivo G, Default Risk of Securitized Commercial Properties: Do Sustainability Property Features Matter, Real Estate Research Institute Conference Paper, (2015); Kaza N, Quercia RG, and Rian CY, Home Energy Efficiency and Mortgage Risk, Cityscape 16, 1, (2014)
7. ‘Unlocking the energy efficiency retrofit investment opportunity’, UNEP FI (2014), http://www.unepfi.org/fileadmin/documents/Commercial_Real_Estate.pdf, and UNEP FI members’ expert view.
8. McKinsey & Company (2009). This 2009 figure of USD 231 billion is converted from the original figure of EUR 169 billion using <http://www.xe.com/> on 29 January 2014 – in UNEP FI et al, Business case for energy efficiency, (2014)
9. Energy Efficiency Financial Institutions Group (EEFIG) (2015), Energy Efficiency – the First Fuel for the EU Economy: How to Drive New Finance for Energy Efficiency Investment, page 11. www.eefig.com

Summary of selected environmental, social and governance (ESG) integration tools and publications



'Fiduciary Duty in the 21st century', UNEP FI, PRI, UNGC and UNEP Inquiry 2015 - The report examines the reasons why investors are not systematically integrating ESG as part of their fiduciary duty and proposes practical actions for institutional investors and policy-makers to address these barriers.



'Protecting value in real estate: Managing investment risks from climate change', IIGCC 2013 & 'Trustee's Guide: Protecting value in real estate through better climate risk management', IIGCC 2014, provide key questions which EU asset owners should be asking themselves and their investment manager to integrate ESG and climate risks into their real estate assets.



'Sustainability metrics: translation and impact on property investment and management', UNEP FI et al 2014. The report provides useful recommendations of clear steps that should be taken at each level of an organization: Corporate, portfolio and buildings.



'Climate Change Investment Solutions Guide', IIGCC 2015, provides EU asset owners and equity investors with a four step framework for considering the range of investment strategies and solutions to address the risks and opportunities associated with climate change.



'The 21st-century investor-ceres-blueprint-for-sustainable-investing', Ceres 2013, recommends ten action steps for US institutional investors, asset owners, their advisers and managers, who are seeking to become sustainable investors.



'Sustainability and commercial property valuation - Professional Guidance Note, Global', RICS 2013, provides recommendations for valuers on how they need to seek to continuously enhance their knowledge of sustainability and may begin to complement traditional value drivers.



'Aligning expectations: guidance for asset owners on incorporating ESG factors into manager selection, appointment and monitoring', PRI 2013. The guide provides a framework for asset owners who appoint and monitor external managers to assess whether their managers' investment policies and processes are consistent with their ESG expectations.



'Assessing climate change risks and opportunities for investors - Property and Construction Sector', IIGCC 2013, helps Australian investors assess and integrate climate risk and opportunity into investment analysis.



'PRI reporting framework', PRI 2015, dedicated modules provide the structure that is required to monitor responsible investment in line with the PRI principles, of relevance for Real estate are the 'direct property' and 'Direct Private equity' modules.



'Advancing Responsible Business in Land, Construction and Real Estate Use and Investment', RICS / UN Global Compact, 2015 - helps set the strategic agenda for companies operating in the sector, real estate users and investors, through clear action items supported by a list of benefits and real life case studies.



'Unlocking the energy efficiency retrofit investment opportunity', UNEP FI 2014, provides a detailed briefing on why investors should invest in retrofit opportunities.