TRUSTEE’S GUIDE

PROTECTING VALUE IN REAL ESTATE THROUGH BETTER CLIMATE RISK MANAGEMENT

IIGCC
Institutional Investors Group on Climate Change
The core principle of real estate investment is to create and sustain long term value. Growing regulatory pressure from EU institutions and member states, increased market demand for green buildings, and heightened risks from physical impacts on buildings associated with climate change, are changing real estate market conditions and require asset owners to assess and mitigate these risks.

This document provides guidance for asset owners and investment managers covering key questions that they should ask of themselves, their consultants and their property investment managers as well as approaches to manage and mitigate the real estate investment risks arising from sustainability and climate change trends. This guide is based on the findings of the IIGCC report published in March 2013 and available at: www.iigcc.org: “Protecting value in real estate: Managing investment risks from climate change”.

The report provides a detailed analysis of the risks and points to the following key messages:

• **Growing regulation in Europe on climate and sustainability is changing real estate market conditions.** Given the sector’s potential to deliver cost-effective resource efficiency solutions, policy ambitions and market demand will only intensify pressures in coming years.

• **Impacts on value from green building characteristics are recognised by leading investors across Europe.** Already such investment decisions are influencing real estate market fundamentals including client demand, void lengths, obsolescence, rate of depreciation, operational costs and liquidity.

• **Investors and occupiers are developing tools to implement responsible investment and management strategies** in order to mitigate these risks and enhance long term value.

• **Understanding and actively managing these investment risks is consistent with institutional investors' fiduciary duty.** This includes ensuring investment managers and consultants are fully integrating sustainability and climate change considerations into their investment and asset management practices and advice. Investors also have a role to engage with policy makers to encourage policies that support scaling up investments in sustainable buildings.
Climate change is shifting the value drivers of real estate investment

Changing EU regulations, increasing market demand for green buildings, and heightened weather risks and impacts associated with climate change are changing real estate market conditions. The cost of doing nothing is already being felt: Monetary losses related to real estate and infrastructure have tripled during the last decade – global direct losses recorded by re-insurance companies amounted to US$150 billion annually (ULI and Munich Re¹).

There is a growing consensus among market professionals that demand for buildings with green characteristics will continue to increase and that such characteristics are already influencing investment fundamentals including client demand, void lengths, obsolescence, rate of depreciation, operational costs, and liquidity. In turn they agree that investment decisions made today will impact the value and financial returns of European real estate investments in the coming years. More recently, Mercer’s climate scenario study² pointed to real estate as one sector where institutional investors should re-think their risk assessment models given the exposure of this asset class to climate impacts.

Fiduciary duty dictates that institutional investors should understand and actively manage the risks and opportunities from such market shifts – occupier preferences and changing behaviour, as well as the regulatory framework and legal requirements – and to adapt and respond to these emerging trends within real estate market cycles.

### Key climate change and sustainability risks to real estate investment portfolios

- **Climate, energy and building regulations bring about obsolescence and depreciation faster than anticipated. Investment in operation, maintenance and refurbishment needs to be in tune with these changes.**
- **Occupiers’ demand for high performing green assets impacts tenant retention, length of void periods and lease conditions. A clear understanding of changing tenants’ needs and preferences is required to adapt portfolios.**
- **Active building management can help lower operating costs and total occupancy costs in an environment where energy and natural resource prices are increasing.**
- **Modern and sustainable methods of construction reduce costs while managing natural resource constraints. The use of healthy and sustainable materials improves internal quality and occupiers’ health and well-being.**
- **More frequent and extreme weather and flooding events affect building infrastructure and its internal components. Financial impacts can be mitigated by design, flood management and disaster preparedness.**

The way forward is to embed sustainability in standard risk assessment methods and, through selection and monitoring processes, to ensure that investment managers and consultants are fully integrating sustainability and climate change considerations into investment and asset management practices and advice. In the current context of growing regulatory pressure, institutional investors also have an important role to engage with policy makers to improve the efficacy and cost effectiveness of the sustainability regulatory process, as IIGCC argued in its recent paper, *Enhancing the real estate sustainability policy framework*.³
**Risk management toolkit for responsible property investors**

In recent years, IIGCC has been advising trustees, investors and investment managers on the evolving climate change and sustainability agenda and opportunities for managing the associated risks. This Trustee’s Guide offers updated direction on questions institutional investors should ask themselves and their investment managers to account for changes and uptake in the market related to climate change. It provides support to better understand these changes and what can be done to mitigate the risks in order to protect the long-term value of real estate investments and to take advantage of new market opportunities.

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<td>Do we understand enough about the risks and opportunities from climate change and how they affect our commercial property assets?</td>
<td>Do we have an understanding of the potential impacts from climate change and sustainability on our investments, and are we encouraging and pursuing opportunities to engage and contribute to dialogue on these issues?</td>
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<td>Are we confident that the regulatory environment is consistent with institutional investors’ risk requirements to support investment in climate change proof and sustainable real estate?</td>
<td>Are we encouraging and pursuing opportunities to engage with policymakers to encourage policies that support scaling up investments in sustainable real estate as well as encouraging our investment managers to contribute to relevant policy and sector-led initiatives?</td>
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<td>Should we favour investment managers committed to the responsible investment agenda and include specific requirements for responsible investment and sustainability expertise in the selection processes?</td>
<td>Is it appropriate for us to require explanations on how sustainability and climate change issues are managed as a feature of requests for proposals for new segregated mandates?</td>
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<td>Is the way in which we are rewarding our investment managers conducive to encouraging them to address climate and sustainability considerations?</td>
<td>Are the medium to long-term time horizons over which interventions to address climate change are set consistent with short term performance horizons typically placed on investment managers?</td>
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<td><strong>Do our investment managers take into account the direct impacts of climate change and related changes in sustainability policy and regulation throughout the real estate investment cycle?</strong></td>
<td>Social, environmental and economic considerations of climate change and sustainability are being integrated into standard investment appraisal processes and these issues are incorporated in management, monitoring and reporting procedures.</td>
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<td><strong>What evidence can the investment manager provide of the policies in place to address climate change and sustainability, and of the resulting improvement in the social, environmental and economic impact of climate change and sustainability of the real estate assets under their management?</strong></td>
<td>Investment managers are providing a clear sustainability monitoring and reporting framework as part of the annual and quarterly communications and reporting procedures. This includes descriptions of how they are incorporating environmental and social governance in their investment management practices, track record of data collection, presentation of sustainability performance achieved, contribution to sector wide sustainability benchmarks, transparent disclosure of the industry guidelines being followed and whether performance is externally verified and publicly reported.</td>
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<td><strong>What mechanism does the investment manager have in place to embed the climate and sustainability risks in the buy, hold and sell decisions being made on properties?</strong></td>
<td>Dedicated sustainability and environmental risk assessment is embedded in standard due diligence processes for acquisitions and disposal of property assets.</td>
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<td><strong>What actions is the property investment manager taking to reduce the environmental footprint of the properties already held in the portfolio, through management and leasing of properties and how do these actions relate to the need to continue to provide competitive returns?</strong></td>
<td>Sustainability programmes are in place targeting energy, water, waste, transport and adaptation to climate change. These include activities aimed at establishing and maintaining accurate data, the public communication of performance targets, the disclosure of annual performance and the description of the actions that delivered the performance improvement.</td>
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<td><strong>What actions and what evidence can the property investment manager provide of reducing environmental impacts from development and refurbishment activities in recent years?</strong></td>
<td>The investment manager demonstrates understanding and implementation of measures to address medium term regulatory requirements in its development activities. For example there are minimum sustainability requirements for development and refurbishment projects aligned with market demand in specific geographies.</td>
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<td><strong>What actions is the investment manager taking to engage and cooperate with occupiers of the buildings being managed?</strong></td>
<td>An active occupier engagement policy is in place, including for example green clauses in standard leases, commitment to implement joint sustainability programmes with occupiers, and/or occupier surveys to assess the effectiveness of their implementation.</td>
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# Putting climate change on the agenda with managers

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<td>What policies does the property investment manager have in place to ensure that those supplying goods and services to the property portfolio are doing so in a responsible manner?</td>
<td>Impact assessments and the resulting policies covering key suppliers are in place, commensurate with the range of the investment manager activities. The policies can include a process to monitor suppliers’ performance and ensure that policies are implemented.</td>
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<td>How active is the property investment manager in dialogues within the property industry and with government to develop appropriate awareness and action to reduce the environmental impact of buildings?</td>
<td>The investment manager is an active contributor to policy dialogue, consultations and sector-led initiatives that support the commitment to disseminate responsible investment practices across the sector. The emphasis placed on training and learning within the organisation will be reflected in staff’s awareness and knowledge.</td>
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## References: Real estate sector responsible investment tools and methods

- **Better Buildings Partnerships toolkits**: Hands on, practical toolkits to enable the uptake of sustainability in the built environment. [www.betterbuildingspartnership.co.uk/media/tollkits](http://www.betterbuildingspartnership.co.uk/media/tollkits)
- **Green Rating Alliance – The Green Rating tool**: is a sustainability assessment of a property to assess, improve, communicate and benchmark sustainability performance. [www.green-rating.com](http://www.green-rating.com)
- **Global Real Estate Sustainability Benchmark (GRESB)**: undertakes an annual survey that benchmarks the sustainability performance of real estate investments focusing both on ‘Management and Policy’ and ‘Implementation and Measurement’. [www.gresb.com](http://www.gresb.com)
- **Global Reporting Initiative Construction and Real Estate Sector Supplement (GRI CRESS)** provides a global set of standardised indicators and reporting methodologies. [www.globalreporting.org](http://www.globalreporting.org)
- **IIGCC guide for pension funds on climate and sustainability reporting for property investment portfolios**: guide to manage environmental impacts of pension fund real estate portfolios. [www.iigcc.org](http://www.iigcc.org)
- **IPD Eco-PAS, Eco Portfolio Analysis Service**: sustainability investment risk of whole portfolio and compares exposure with other market players. [www.ipd.com](http://www.ipd.com)
- **The International Sustainability Alliance (ISA)**: provides detailed benchmarks of different type of buildings across geographies. [http://www.internationalsustainabilityalliance.org/](http://www.internationalsustainabilityalliance.org/)
- **Sustainable Building Alliance, Common Metrics**: provides a set of 6 common metrics to measure sustainability performance. [http://sballiance.org](http://sballiance.org)
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Note

This guide is aimed at institutional investors with interests in commercial property investments to help them understand how to manage investment risks to real estate from climate change and sustainability. Institutional investors include pension funds, charitable foundations, sovereign wealth funds and insurance companies. The guide is also aimed at supporting investment managers who act as clients to institutional investors in managing direct, indirect and equity investments in real estate. Finally, while not the primary audience, the content is also relevant to real estate companies.

About IIGCC

Institutional Investors Group on Climate Change (IIGCC) is a forum for collaboration on climate change for European investors. It provides investors with a platform to encourage public policies, investment practices, and corporate behaviour that address long-term risks and opportunities associated with climate change. IIGCC currently has over 85 members, including some of the largest pension funds and asset managers in Europe, representing around €7.5trillion in assets.

The overriding aims of the IIGCC Property Programme are:
• to ensure that considerations of climate change and its implications are integrated into the management and decision-making processes for property investment portfolios; and
• to engage with policy-makers at national and international level to ensure appropriate property-related policies are put in place which maximise environmental benefits whilst maintaining/protecting property investment returns.

Contact IIGCC

For more information on IIGCC or to arrange a trustee training session, please contact Stephanie Pfeifer at spfeifer@iigcc.org or visit www.iigcc.org

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Endnotes

2 Mercer, February 2011: “Climate change scenarios: implications for strategic allocation.” Mercer, January 2012: “Through the looking glass: How investors are applying the results of the climate change scenarios study.”
3 Institutional Investors Group on Climate Change (IIGCC), July 2012: “Enhancing the real estate sustainability policy framework,” IIGCC property working group. Available at: www.iigcc.org