Paper

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Assessing long-term climate transition risk for real estate assets and funds

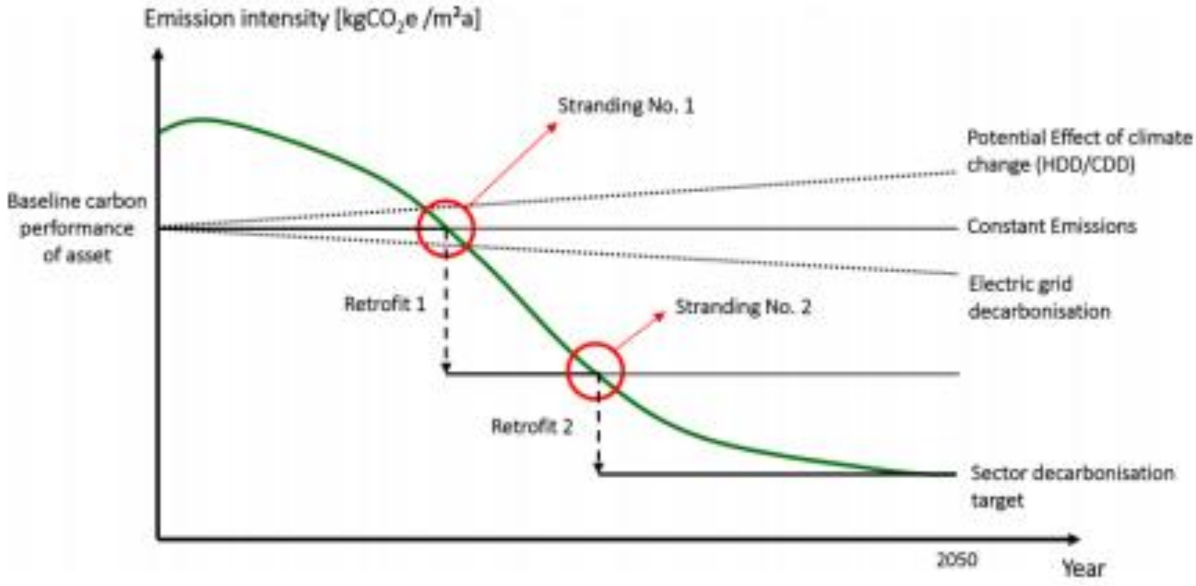
A report released in May 2019 by a consortium of real estate investors and academic groups called the Carbon Risk Real Estate Monitor (CRREM) details the potential implications of global and European climate policy on long-term risk in the European commercial real estate sector. The report was funded by the European Commission.

The report of the CRREM project applies findings from natural science, economics, and finance to conclude that the current rate of emissions from the European commercial real estate sector is too high given the carbon budget available for 2050 defined by EU climate targets. In fact, the available carbon budget would be consumed by 2036, suggesting the average energy-intensity of commercial real estate is 45 percent higher than an emission pathway aligned with long-term EU climate targets.

The report has several implications for real estate investors:

- That the long-term is getting closer. Targets set for 2050 may seem far off but are only a few renovation cycles away. Major retrofits planned and completed today will in effect lock in energy- and carbon-intensities for a decade or more, given the life span of major equipment and management systems. The report implicitly states that it may therefore be prudent to set sustainability ambitions for major retrofits that are aligned with the sector carbon budget at the end of the renovation cycle.
- Tighter carbon budgets will likely accelerate innovation. As the development of environmental technologies accelerates, the energy performance gap between new buildings and newly retrofitted buildings on the one hand, and existing stock on the other hand, will grow. This may increase the risk of obsolescence for individual assets (“stranding risk”) resulting from declining tenant demand and higher operating and compliance costs.
- Carbon budgets are emerging as potentials tools for assessing and managing long-term climate risk associated with the broader transition to a low-carbon economy. Governments are using carbon budgets to define the extent of the climate problem, set policy ambitions, and define targets for different economic activities and sectors. We can assume that funds or assets that generate more carbon emissions than what their respective carbon budgets allow carry more long-term risk than those that do not. For real estate investors and managers, risk can materialise in the form of higher expected capital, operating and compliance costs, and asset depreciation.

Overall, the CRREM report highlights the need for new risk management tools to understand, assess, and monitor long-term risks in the real estate sector associated with the broader transition to a low-carbon economy. The report opens up the door to integrating commonly agreed, plausible, and scientifically-derived scenarios into the range of environmental KPIs used in the real estate industry to asses asset and fund performance.



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[Stranding Risk and Carbon Science-based decarbonising of the EU commercial real estate sector]