SIERA

INSIGHTS INTO REAL ESTATE INVESTMENT SUSTAINABILITY (IRIS) SURVEY 2022: PART 3

CLIMATE RESILIENCE

DEAR READERS

In our most recent Insights into Real Estate Investment Sustainability (IRIS) survey we have seen responses that cover $3.3tn AUM, which is one-third of the professionally managed global real estate market. An increase from $2tn in our first IRIS 2021 survey.

In IRIS 2021, investors highlighted a Climate Resilient Location as the best means of future-proofing asset value. Consequently, we chose to explore this topic in more detail in IRIS 2022.

Almost half of the investors surveyed in IRIS 2022 have seen physical climate change impact their real estate investments.

Investors have seen climate risk impact asset values, both through changes in capital value, through changes in income projections, and through voids and default rates.

How are the leaders responding to make their investments more resilient? They are looking to invest in green building design and in renewable energy.

Some are introducing an internal carbon price and exploring the voluntary carbon markets.

Whilst we will see fewer deals transact in 2023, we should expect them to face a higher level of climate risk scrutiny from institutional investors and larger investment managers. Smaller funds and family offices may lag a little further behind.

All of these results in IRIS 2022 point to a solid foundation for ESG and climate risk integration into investment decision-making as we enter a markedly different economic environment. A period of reduced liquidity could force investors to hold riskier assets for longer making these risks more apparent.

To future-proof asset value, green building design has emerged as a higher priority this year, moving ahead of sustainable property management and climate resilient locations. Although these latter two areas remain the highest priorities for the larger investors.

In summary, we have seen progress over the past year in the integration of climate risk into real estate investment decision-making. A positive development when we are seeing increasing financial legislation of climate risk disclosure and building regulations to encourage active management. The picture of what is 'market leading' is even clearer and this should indicate to all firms where they should be heading in the year ahead.

Sonny Masero
EVORA Global, Chief Strategy Officer

INTRODUCTION

In 2021, aligned with one of our strategic objectives – *to understand our clients and their markets better*, we launched **EVORA Insights**, a series of industry engagement events, reports, and thought leadership – to better understand the ESG evolution in real asset investment.

Our inaugural Insights into Real estate Investment Sustainability (IRIS) Survey in 2021 was well received in the market with investor responses representing $2tn of real estate Assets Under Management (AUM). In IRIS 2022 we have responses from investors with $3.3tn AUM. While the IRIS 2021 Survey was focused on European Investors, with the IRIS 2022 Survey we have been able to capture responses covering a wider geography, especially North America.

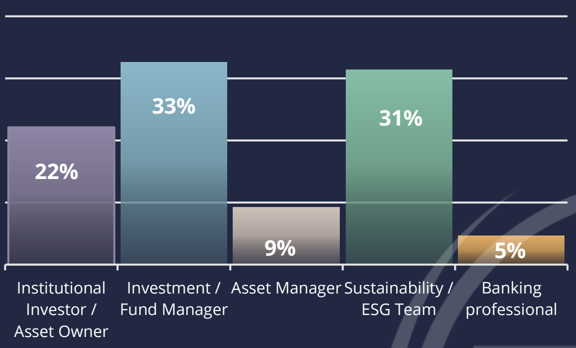
We will be releasing our survey results in three parts, with a final report covering all of the survey results

Part 1 – ESG Market Maturity

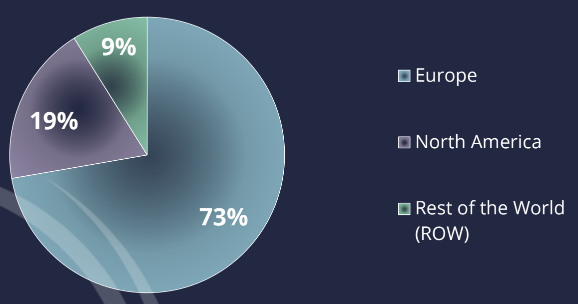
Part 2 – ESG Data Challenge

Part 3 – Climate Resilience

INVESTMENT ROLES - TOTAL 102



RESPONSE PERCENTAGE

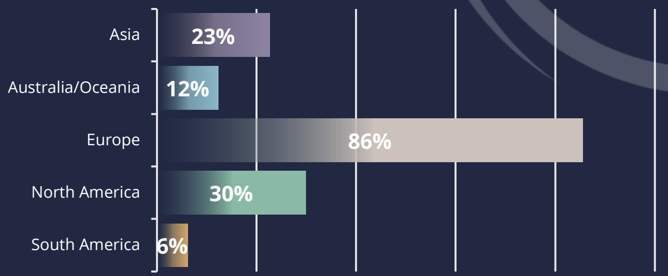


102 Investment roles

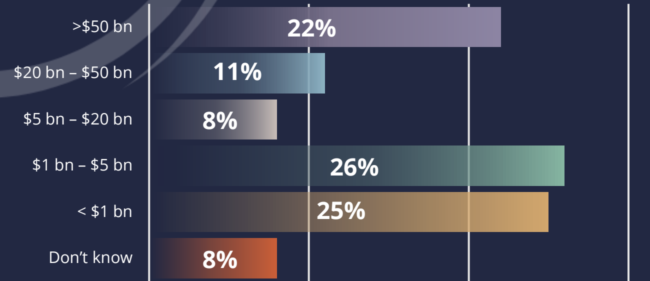
2021
22 Countries covered
90% from Europe

2022
25 Countries covered
73% from Europe

CAPITAL ALLOCATION FOR RESPONDENTS



REAL ASSET INVESTOR AUM



86% of the investors surveyed allocate capital in Europe, **30%** in North America & **23%** in Asia

$2 trillion AUM in 2021 | **$3.3 trillion** AUM in 2022

This is approximately one-third of the professionally managed global real estate market

CLIMATE RESILIENCE

60% of the investors considered climate-resilient location as the top priority to future-proof asset value in IRIS 2021.

To explore this topic further in IRIS 2022, we introduced a new section focused on climate resilience to explore the investors' perspective on:

- Impact of physical climate risk on their investment and if they are pricing it into their investments
- Climate risk perception and the emerging opportunities
- Internal carbon pricing and approach for carbon credits

We hope this report will foster discussions, and actions, and inform the future approach of ESG integration into investment decisions.

CLIMATE RESILIENCE

46% of the investors have witnessed the impact of extreme weather on their investments.

This includes the impact on capital value, income, default rate, occupancy voids and additional costs such as insurance.

of the large investors with over $5bn AUM believe the biggest opportunity arising from climate resilience will be the increased investment demand for green buildings. **81%**

45% of the investors do not plan to have an internal carbon pricing mechanism unless required by law.

We believe this could lead to a price shock in the market if carbon is priced through regulations, like the EU's new carbon border tax, as a majority of the investors are not pricing it into their existing investments.

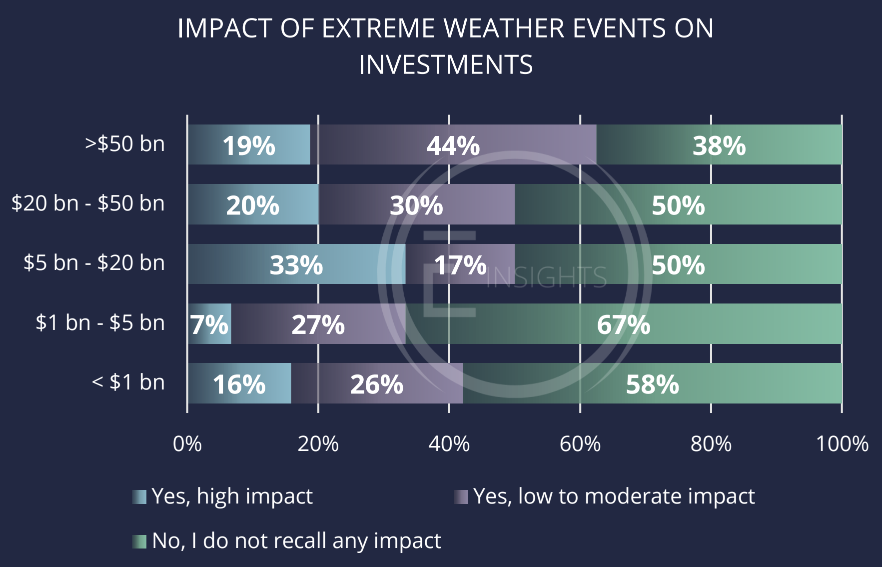
We believe the market is evaluating climate risk and its impact on their investment. Green Building Design and Sustainable Property Management practices are the top two priority areas for future-proofing the asset value. The large investors with over $5bn AUM still consider Climate Resilient Location as one of their top two priorities. Investors are closely watching this space and evaluating the risks and opportunities arising from climate risk mitigation and adaptation.

The large investors are a bit more advanced in their approach to integrating carbon prices in their investments and most of them are planning on introducing a carbon price.
We also believe carbon markets could impact the real estate investors' approach to decarbonisation. We do think offsetting through carbon credits is not the best practice, but the carbon markets are evolving to improve quality, transparency and additionality. Governments across the world are building carbon exchanges to trade carbon credits.

IMPACT OF EXTREME WEATHER EVENTS ON INVESTMENTS

56%

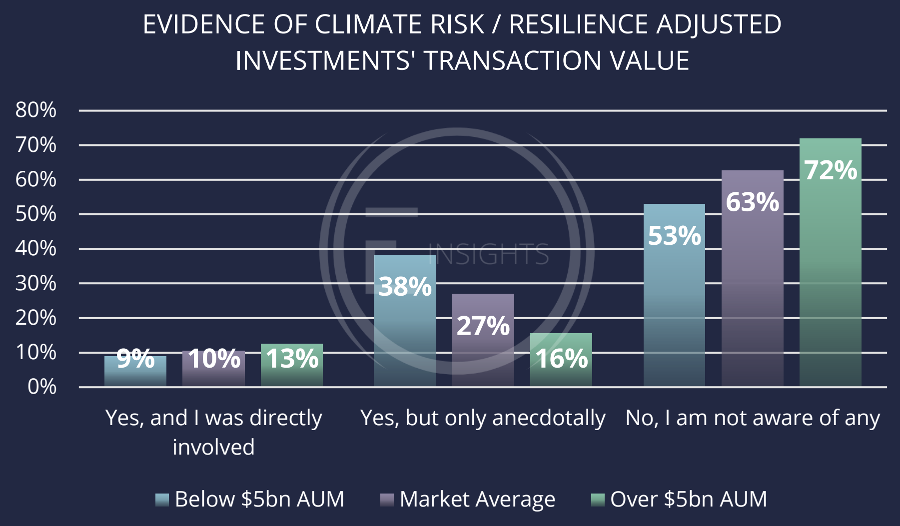
of the large investors with >$5bn AUM have witnessed some impact on the investment value due to extreme weather conditions. The financial impact manifests in capital value, net operating income, default rate and occupancy voids.



Large, geographically diverse portfolios are more exposed to climate risk. The investor size tends to dictate the portfolios' geographical diversity; thus the episodes and the impact of extreme weather events are correlated with the investor's AUM and/or geographic diversification.

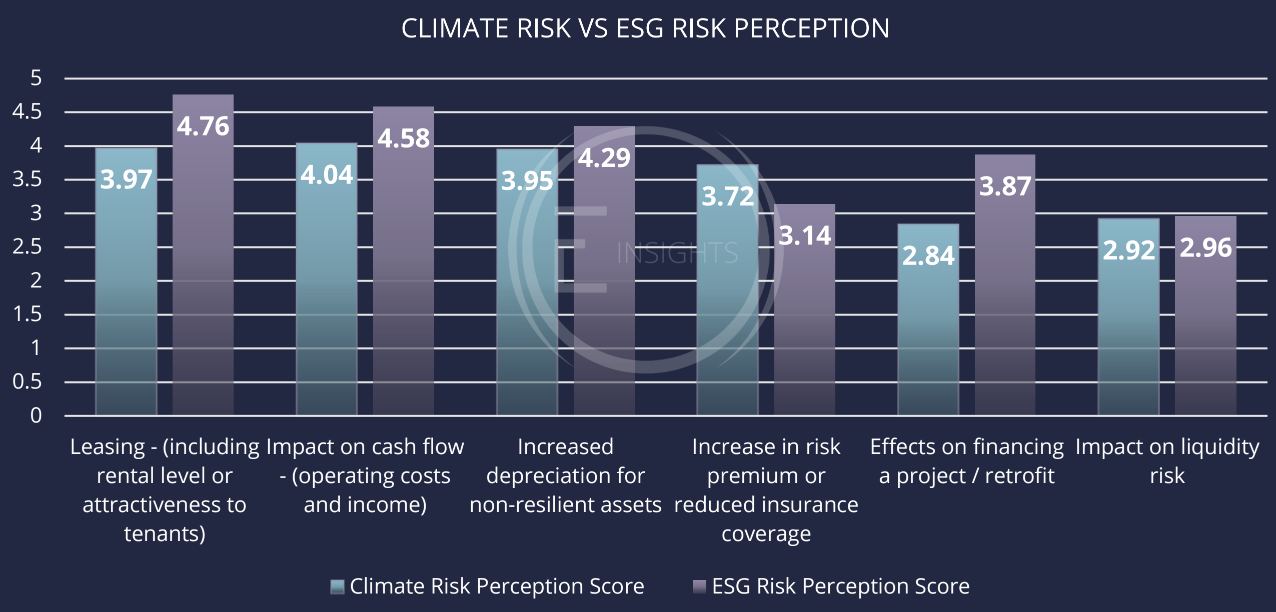
37%

of the large investors do have evidence that an investment transaction price was successfully adjusted based on climate risk and resilience credentials in the past 12 months.



This evidence supports the anecdotes we've heard at EVORA over the last year that climate risk is beginning to impact real estate transactions.

CLIMATE RISK PERCEPTION

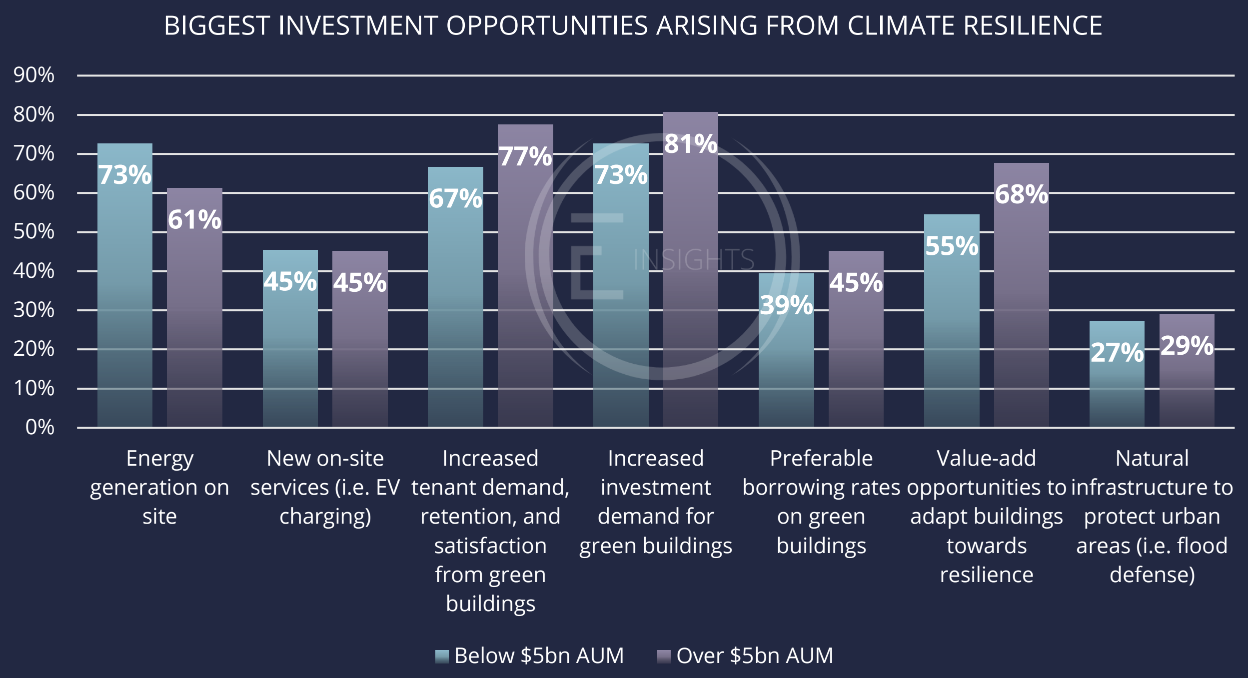


For large investors, with over $5bn AUM, the increase in risk premium or reduced insurance coverage is the top concern.

Across the market, the top three perceived impacts from both Climate risk and ESG risk are:

1	**Impact on cash flow (operating costs and income)**
2	**Leasing (including rental level or attractiveness to tenants)**
3	**Increased depreciation for non-resilient assets**

INVESTMENT OPPORTUNITIES



75%

Green Buildings

of the investors believe Green Buildings will be the top investment opportunity. The surge in demand is expected from both investors and tenants.

68%

Investment Strategy

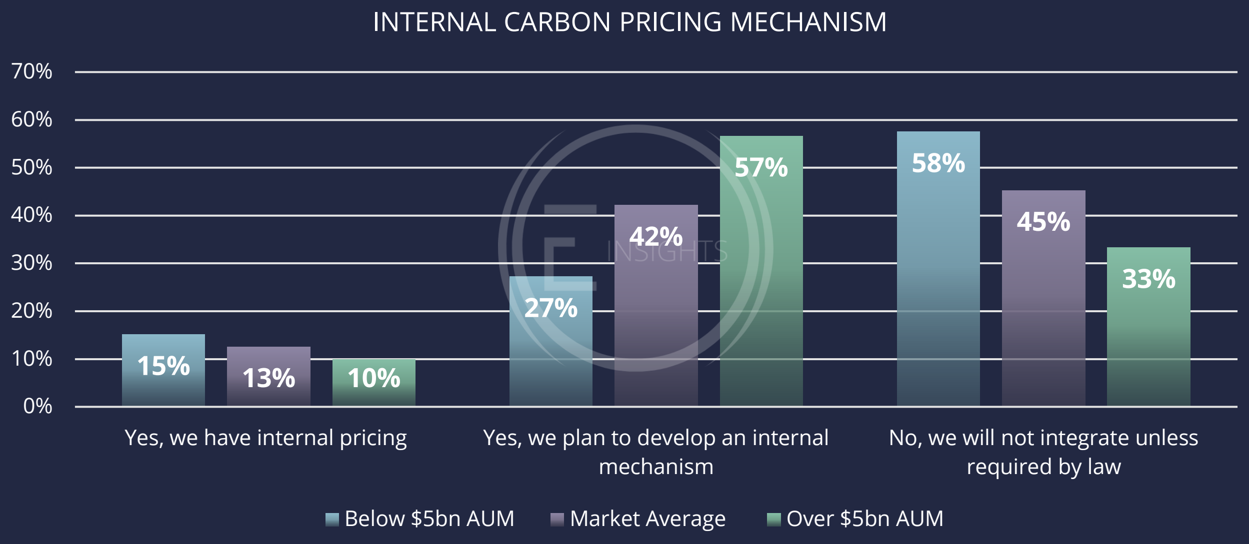
of the large investors, with over $5bn AUM, believe there will be increased investment in value add funds to adapt buildings towards resilience.

66%

Renewables

of the investors believe renewables and energy generation on site will be in demand as it will help investors reduce scope 2 emissions.

INTERNAL CARBON PRICING



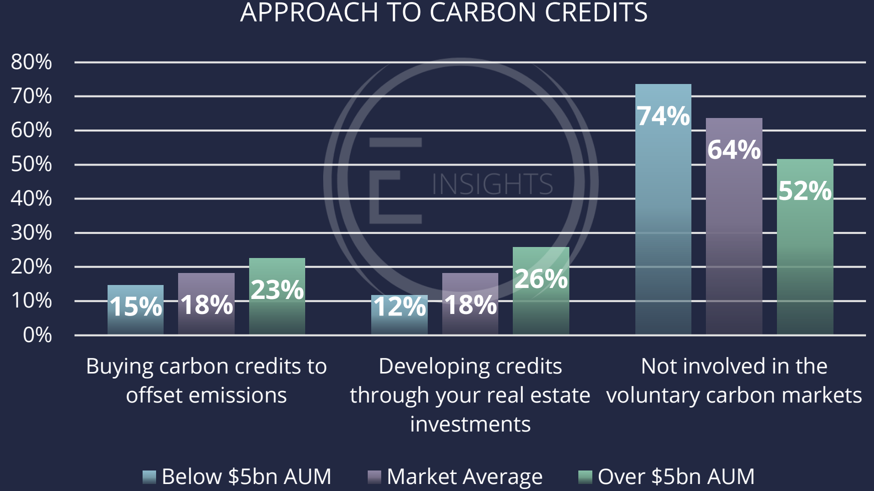
67% of the large investors, with over $5bn AUM, either already have or plan to develop an internal carbon pricing mechanism to price climate risk.

58% of the small investors do not plan to integrate internal carbon pricing unless required by law.

CARBON OFFSETS AND CREDITS

48%

of the large investors are either buying or developing carbon credits through real estate investments to offset emissions.



CONCLUSION

Climate change poses a potentially greater threat to the economy and investments than COVID-19 over the long term. Investors recognise that there is a risk to reputation and income, of price corrections and reduced liquidity, and now they are building resilience plans for their investments. The regulations on climate disclosure across the world are also forcing investors to understand emerging risks and opportunities as they are made more visible.

The top three takeaways are:

1	**Climate risk is an investment risk**	Although it is early days, investors have started witnessing the financial implications of climate risk on their investments. Climate resilience to future proof asset value is being delivered through Green Buildings, Sustainable Property Management and Climate Resilient Locations.
2	**Climate investment opportunities**	Green buildings and renewable energy will gain more attention from investors for investment. Funds with a value-add investment strategy will also witness an increase in investments to build climate-resilient assets.
3	**Carbon markets 'watch and wait'**	The report indicates a mixed response from investors regarding internal carbon pricing and carbon offsets. While there are a few early movers, especially large investors, the majority of the market is still expecting regulations to accelerate the adoption of carbon pricing. In other areas of ESG, we have seen the majority follow the lead of large investors.

We believe that, in the future, climate risk exposure will play a vital role in determining asset and investment value. To monitor the advancement, we plan to come back with IRIS 2023 and inform our clients on the evolving real asset investment and finance ESG landscape.

evoraglobal.com
info@evoraglobal.com
+44 (0) 20 3326 7333

HEAD OFFICE
London

MANCHESTER
Bolton

GERMANY
Hamburg

NORTH AMERICA
New York

ITALY
Milan

INDIA
Bengaluru

ROMANIA
Iasi

@evoraglobal
www.linkedin.com/company/evora-global
@evoraglobal

SIERA