LaSalle

The Future of Climate Change

AUGUST 2020

What we Learned during the Pandemic

It is undeniable that the global economy and real estate portfolios are being tested by the COVID-19 crisis. The pandemic has also accentuated the link between the economy and the drivers of climate change. Reduced movement and economic activity have disrupted global energy consumption, resulting in substantial declines in carbon emissions. Between January and April 2020, global emissions fell by -8.6% compared to the same period in 2019[1]. This reduction has given climate scientists evidence that curbing the global rise in temperature, with great effort, might be possible.

The long-term risks and opportunities arising from climate change will outlive the impact of the pandemic. As lockdown restrictions ease and economic activity levels rise, carbon emissions will return, and even surpass, pre-pandemic levels. Meanwhile, the construction and operation of real estate will continue to be a principal contributor to global carbon emissions. Pre-pandemic estimates highlighted that the sector contributes roughly 40% of global emissions according to the World Green Building Council[2].

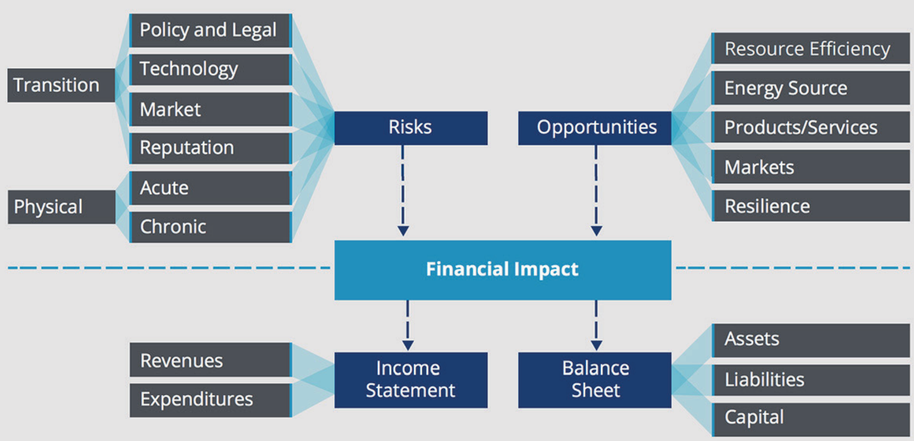
Over recent years, awareness of the threat climate change poses to our planet has only increased. Different actors are taking steps to keep global warming below 2°C and accelerate the transition to a clean energy, low carbon economy, including the US $4.6 trillion AUM represented by the United Nations-convened Net-Zero Asset Owner Alliance, and the 1,000+ organizations that have publicly signed on as supporters to the Task Force for Climate-Related Financial Disclosure (TCFD). Reporting frameworks will play an integral role for investors, and the TCFD framework ensures consistent standards of reporting from investment managers across the asset classes, including real estate.

While steps are being taken by asset owners to push the market towards net zero carbon adoption through carbon offsets and emission reductions, the 2020 edition of JLL & LaSalle's Global Transparency Index highlights that, in fact, no country achieved LaSalle's highest score for this factor. Market transformation and disclosure have proven to be the main drivers of lowering carbon emissions to date in the real estate industry, especially in Australia, Canada and across Europe, including the UK.

Investment professionals' awareness of the interplay between political, regulatory, and climate-related factors and investment performance has increased[3]. Most analyses decompose climatechange-related risks into two categories: physical[4] and transition[5] risks. Physical risks could pose financial implications for organizations; through damage direct to assets or indirectly via impacts such as supply chain disruption. Most notably, transition risks will be manifested through the way asset owners and tenants respond to changing regulatory and political landscapes. In addition, the regulatory environment will differ country-to-country, and often city-to-city. The geographically diverse yet localised nature of real estate investment means that climate-related risk and opportunity identification will also differ

Figure 1

Climate-Related Risks, Opportunities, and Financial Impact



1. "Temporary reduction in daily global CO2 emissions during the COVID-19 forced confinement", 19.05.20. Nature Climate Change https://www.nature.com/articles/s41558-020-0797-x
2. Buildings play a dominant role in the clean energy transition. Building construction and operations accounted for 36% of global final energy use and nearly 40% of energy-related carbon dioxide (CO2) emissions in 2017. See:unenvironment.org/resources/report/global-status-report-2018
3. The release of the Taskforce on Climate-Related Financial Disclosures (TCFD) recommendations in June 2017 and the more recent launch of the Net-Zero Asset Owner Alliance at the United Nations Climate Change Summit in September 2019 show how international organizations are acting, sometimes without the support of national governments.
4. Acute physical risks physical risks refer to those that are event-driven, including increased severity of extreme weather events, such as cyclones, hurricanes, or floods. Chronic physical risks refer to longer-term shifts in climate patterns (e.g., sustained higher temperatures) that may cause sea level rise or chronic heat waves.
5. Transition risks involve broader societal, economic, and political implications. Transitioning to a lower carbon emission economy will likely entail extensive policy, legal, technology, and market changes to address requirements related to climate change. Depending on the speed of these changes, transition risks may impose immediate or distant future financial liability and reputational risk to investment managers.

by region/location, market, and property type. This makes adapting to climate change and mitigating transition and physical risks more complicated in the real estate industry than in other asset classes, since stocks and bonds are not typically rooted to specific locations. As LaSalle begins to analyse climate risk data that has been generated for our portfolios, we expect to learn a lot more about which risks can be eliminated or contained and which cannot.

Insurance plays a pivotal role in understanding the financial impact of climate change for numerous reasons. Most notably, insurance coverage is a key consideration for most firms when addressing loss from climate-related catastrophes. No matter the natural catastrophe, insurance is often the first, and sometimes only, recourse for recouping financial loss. Secondly, the insurance industry has long been the modeler of choice for predicting and evaluating these natural catastrophe events, which are now occurring with more frequency and severity. The output of these models has important implications for insurance availability and pricing, terms and conditions, regulatory oversight, and capital adequacy.

Recognizing the key role of insurance, LaSalle, in conjunction with its risk management advisor Aon, has identified nine global insurers to begin a climate change information exchange. This will help LaSalle in its decision making around financing and insurance costs for our investment models, at both the portfolio level and the property level. Additionally, it will allow LaSalle to enter dialogue with insurance companies to compare views on current and future pricing, availability, and the intersection of real estate, insurance decisions, and climate risk.

Beyond the information exchange, LaSalle’s Sustainability, Risk Management, and Research teams are working together on two parallel initiatives analyzing climate-related physical and transition risks. First, in collaboration with Aon, LaSalle has been reviewing and vetting the capabilities of several climate change analytics and modeling firms. Second, LaSalle is developing its global carbon strategy and European pathway to achieve net-zero carbon by 2050. Although considerable work remains, these efforts enhance LaSalle’s understanding of the risk factors with a goal to apply this knowledge to any investment strategy.

With many pressing short-term concerns created by the pandemic, climate-related factors could be relegated temporarily to a secondary role within investment analysis. We believe that would not be prudent. Given the long-term window over which climate-related risks operate, portfolios will eventually need to anticipate the cost of rising insurance costs or possibly the loss of any coverage for real estate in the highest risk locations or jurisdictions. Analysis of climate risk in 2020, followed by careful portfolio re-positioning, could spare a portfolio manager from much bigger costs in 2025, as the insurance and investment markets begin to price climate change. This kind of longer-term view will build financial resilience into an investment portfolio as well as begin to make a positive contribution to the pressing societal need to “flatten the curve” of rising temperatures.

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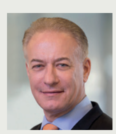
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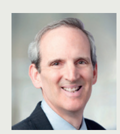
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