FALL 2019

the COUNSELOR®

Published by The Counselors of Real Estate® | *The professional organization for the most trusted advisors in real estate.*

CLIMATE RISK
& real estate

ANALYSIS BY DEBORAH J. CLOUTIER, CRE®
President & Founder | RE Tech Advisors, Inc.
> Page 2

ALSO IN THIS ISSUE

THE COUNSELORS OF REAL ESTATE®

www.cre.org

CLIMATE RISK

Why Climate Risk is an Urgent Concern for the Real Estate Industry

BY DEBORAH J. CLOUTIER, CRE®
PRESIDENT & FOUNDER | RE TECH ADVISORS, INC.

This analysis was adapted and updated from the ***2019-2020 Top Ten Issues Affecting Real Estate®****, where "Weather and Climate-Related Risk" was ranked #3.*

Many investors can no longer rely on historic performance to predict future returns. Climate risk has emerged as a new – and likely permanent – aspect of fiduciary duty and what it means to assess, disclose, and manage these risks for real estate investments. Increasingly, investors are demanding that climate risk be assessed and factored into future return projections and day-to-day decisions. One Counselor notes, "whether it is coming or not, it is affecting investment decisions."

Weather and climate related events present physical and operational risks for property assets, both in terms of acute risk from hurricanes, flooding, wildfires, landslides, and extreme snowfall, but also chronic risks from sea level rise, drought, heat waves, water scarcity, and food security. For the real estate industry, these risks provide new opportunities and additional challenges. Many real estate owners and developers are adapting by hardening assets, strengthening emergency preparedness plans and strategies, moving mechanical systems to higher floors, installing backup generators, sea walls and berms, and calculating the ROI of on-site renewables and battery storage.

Even if a property isn't exploring or implementing adaption and resiliency strategies, they are surely relying on insurance as a strategic response to climate risks. The National Center for Environmental Information (NCEI) is the Nation's scorekeeper of the economic impact of weather and climate data. According to NCEI, the average insured loss per year for 1980 to 2018 was $19.3 billion. But the frequency and intensity of weather events are increasing. During 2017, the U.S. was impacted by 16 separate billion-dollar events – resulting in the largest, most expensive year in recorded history for weather and climate related insurance losses, costing the U.S. more than $300 billion. In 2018, the U.S. also experienced the 4th highest total costs ($91.0 billion). The combined costs of the 2018 disasters trails only the years 2017 ($312.7 billion), 2005 ($220.8 billion) and 2012 ($128.6 billion) when all years are inflation-adjusted to January 2019 dollars.

As one Counselor astutely says, "Our cities will survive Trump, Brexit, and even another downturn, but we cannot continue to have Houston-like events and pretend this won't impact our industry."

Since 2008, the volume of property and causality premiums written increased over 33%. The 2018 insurance losses for California topped $12 billion following the deadliest and most destructive wildfires in a century. More than 13,000 insured homes and businesses were destroyed out of more than 46,000 claims reported by insurers.

*(CONTINUE ON **PAGE 3**)*

the COUNSELOR®

2019 CRE CHAIR
Julie L. Melander, CRE®

EDITOR-IN-CHIEF
Deborah C. Nisson, CRE®

ASSOCIATE EDITOR
Constantine Korologos, CRE®

EDITORIAL COMMITTEE
Tom Hamilton, Ph.D., CRE®
Paige Mueller, CRE®
Alex Ruggieri, CRE®

PRESIDENT & CEO
Mary Fleischmann

DESIGNER & MANAGING EDITOR
Alyssa Bray

PUBLISHED BY
THE COUNSELORS OF REAL ESTATE®

Read *The Counselor* online at cre.org/the-counselor/

Subscribe to the digital or print edition at cre.org/subscribe/

Send questions and comments to info@cre.org

Midwest flooding recently prevented farmers from planting crops, and there is much discussion about how weather is likely going to affect farmer yields this year.

Following climate-related events, property valuations are taking a big hit. An analysis of NCREIF and National Hurricane Center data found that for all property types, the hurricane decreased values by almost 6 percent one year after the storm occurred, and the negative effect was even greater two years out with a startling 10.5 percent valuation decrease.

As a Counselor warns, "Insurance will be unable to deal with the risk, and costs will rise sharply. Insurance will no longer be available for certain types of risk. Costs to remediate effects of rising sea levels will be astronomical." Further, insurance has its limitations as a response strategy. While properties can be insured against the actual damage from a climate event such as hurricane, it can't address the loss in value due to changes in the supply and demand for space in that market.

Additionally, there are also transitional risks associated with climate, especially that of policy and legal risk, technology risk, market risk, and reputation risk. One Counselor expresses concern regarding "our general unpreparedness" as an industry by saying, "the associated risks of climate change will be a game changer for our industry and we are not prepared to integrate these new risks into our standard business processes for due diligence, operations, valuation, and sale."

The Counselors correctly observe that climate change is driving a host of new building laws and ordinances that owners and operators need to quickly come up to speed. Twenty-nine cities and two states now require building laws that range from mandatory energy and water benchmarking to ambitious climate goals. Public and private buildings must be made dramatically more energy efficient. For example, in Washington D.C. the Clean Energy DC Omnibus Act focuses on energy reductions with performance targets that must be met, where New York City's Local Law 97 focuses on carbon reductions, setting annual carbon intensity limits on building emissions, including emissions from electricity consumed by buildings 25,000 square feet and larger. In D.C., the rulemaking process will define the details of compliance, whereas New York City's Local Law 97 already spells out carbon intensity limits that will effectively require improvements by the bottom 20% of worst performing buildings in the initial 2024-2029 compliance period. In order to comply with these laws and maintain projected returns, property owners and investors have a new set of rules to understand and strategic responses to be developed.

Flooded Bayou River after Hurricane Harvey in 2017.
Photo: Trong Nguyen/Shutterstock.com

Responding to greater market awareness of these risks, investors and stakeholders are increasingly pushing for more actionable information and greater transparency. In particular, the Financial Stability Board (FSB) Task Force on Climate-Related Financial Disclosures (TCFD) seeks to stimulate market dialogue and increased transparency on climate-related risks by providing information to investors, lenders, insurers, and other stakeholders, encouraging investment managers to align their disclosure with investors' needs. As of February 2019, over 580 companies, responsible for over $100 trillion of assets, have expressed support for the TCFD recommendations and are working to assess and integrate climate-related risk in upcoming company disclosure.

One way investors can rank and compare real estate fund performance is through the proliferation of more than a dozen voluntary reporting frameworks. These frameworks have emerged to evaluate, validate, score and provide business intelligence on Environmental, Social and Governance (ESG) aspects of sustainability. Among these frameworks, the Global Real Estate Sustainability Benchmark (GRESB) is uniquely designed as an ESG benchmark for listed property companies, private property funds, developers, and investors that invest directly in real estate. In 2019, more than 1000 property companies, real estate investment trusts (REITs), funds and developers surveyed over 100,000 assets across 64 countries that represent more than $4.1 trillion in gross value. More than 100 institutional investors, collectively representing over $22 trillion in institutional capital, used GRESB data and rankings in investment decisions.

This is really just the tip of the proverbial iceberg, with many additional implications for real estate. From building certifications and rating systems, to new underwriting and lending products, to more stringent building codes and standards, to an already strained and antiquated infrastructure, investors and policy maker's response is having a dramatic and indelible mark on the real estate industry. Climate related risks are deeply interconnected to other top issues on the 2019-2020 Top Ten Issues Affecting Real Estate®, including political divisions, infrastructure, affordability of housing, and investor confidence. •

MULTIFAMILY HOUSING

Linking Voices for a Better Multifamily Housing Discussion

BY MICHAEL J. DINN, CRE®
PRESIDENT | DINN FOCUSED MARKETING, INC.

In February of this year, Oregon became the first state to pass state-wide rent control laws. California followed in September after rent control was expanded in New York City earlier in the year. Going forward, another dozen states have rent control measures teed up for ballot initiatives. Why has rent control become so popular? Nationally more than half of all renters are paying 30% or more of their gross income on rent - and affordability is worse in large, high-growth cities.

Dinn Focused Marketing and Eigen 10 Advisors, two CRE® consulting firms, joined with two noted academics from Hoyt Advisory Services this year to serve the National Apartment Association's need to better understand the regulatory environment around creating new multifamily housing. Earlier in the year, Chicago was hosting the NAA Government Affairs Roundtable conference and the audience was over 100 executives. I was fielding questions that all focused on legislative advocacy and several of our attendees mentioned the Wharton Residential Land Use Regulatory Index (WRLUR) which was now over ten years old. Clearly, there was advocacy value in a measure of local development issues and their restrictions. "We have your leadership in most every metro market. Let's create our own measure, a genuine rental restrictions Index."

The scope of the project was to compile a comprehensive survey of multifamily development issues, from land and constructions costs to environmental and affordable housing restrictions. Unlike the 2007 WRLUR Index of 15 questions mailed to over 6,000 civic managers, our survey would be directed toward select developers, planners and housing leaders using a powerful online survey platform. The NAA put us in touch with their metro executives while we chose four "pilot" metros to test the approach: Austin, Miami, New York and San Diego. With good feedback and a few adjustments, the survey was launched toward another 25 metro markets selected by the NAA. Within weeks, we had created the NAA-sponsored Barriers to Apartment Construction Index survey. We also enlisted the American Planning Association leadership for survey feedback and dissemination. For select metro markets like Seattle and Philadelphia, I reached out to local Counselors for their contacts and support. The final survey was over 90 questions, detailed but cleverly quick and took another six months to complete. Results were compiled and sorted with a constant emphasis on quality responses and statistical significance. The ten categories of restriction were:

- Community Involvement
- Land and Constructions Costs
- Land Availability
- Infrastructure Constraints
- Affordable Housing Requirements
- Density and/or Growth Restrictions
- Environmental Restrictions
- Zoning Entitlement Process
- Zoning Approval Timeline and
- Local Political Complexity

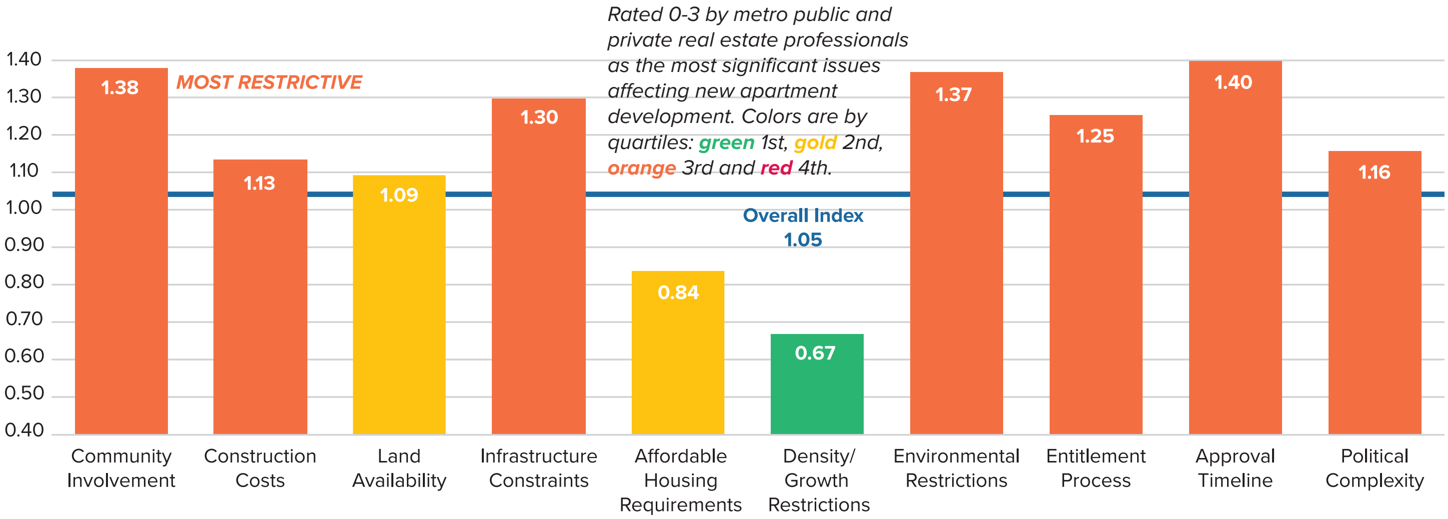
For an example, under Community Involvement, the survey questions ranged from:

- Rate the importance (1=not present to 4=very important) of citizen opposition to growth.
- Can public votes be used to circumvent a council or planning commission vote?
- Is a community meeting required before any change of zoning request is presented?
- Is it required that a zoning request be put to a popular vote at an open town meeting?
- How frequently (never to very) are citizen lawsuits filed to delay or halt the process?

The initial results were distilled into a simple, one-page Metro Summary of graphical metrics, as seen on page 5. Combining private and public sector responses, this younger, vibrant market noted that Approval Timelines, Environmental Restrictions, Community Involvement and Infrastructure Constraints were the most restrictive. We note that these four categories are impacted by policy, but changes to infrastructure are the slowest to implement. Interestingly, Affordable Housing and Density and/or Growth Restrictions were rated the lowest. Charlotte's overall index was 1.05, ranked 33 among 58 metros.

*(CONTINUE ON **PAGE 5**)*

Barriers to Apartment Construction Subindices in Charlotte, NC



Metro Charlotte Summary Excerpt: *The full report including survey design, methodologies and 28 other major metros can be accessed at* **https://www.naahq.org/news-publications/barriers-apartment-construction-index**.

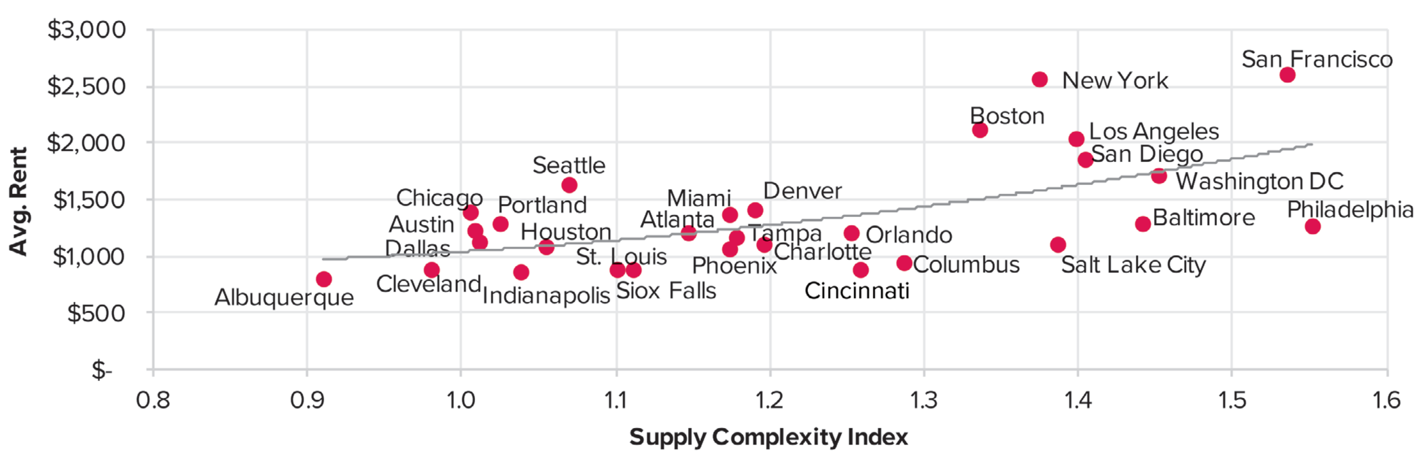
We included key advocacy metrics for Charlotte such as 61,700 new rental units needed by 2030, a 40% high-rent burden, a low 18% of rental units in lower quality, smaller rentals (see our STAR definition) and that their median rental household income of $40,470 was just below the $43,840 needed to meet the average metro rents at 30% of household income.

Early metro executive feedback was very positive. Each Summary and its back story became a narrative tool for local initiatives and regulatory debates. Results were discussed in national circles, including the Secretary of HUD. Not surprisingly, we reaffirmed that the array of development issues varied greatly at the metro level; each metro was distinctive by age, size, land availability and household capacities. For example, the older Boston metro has several submarkets within its MSA and Suffolk County is vastly more complex in restrictions than neighboring Middlesex County. The younger Austin metro indexed higher in restrained growth concerns such as environmental and density issues as well as high fixed costs that limit the development of small properties. And San Diego, well, they just don't want to see any more apartments - with high ratings across all ten categories.

Nationally, we note significant correlation between higher rents and complex regulatory markets that increase uncertainty, time and costs, limiting the ability to deliver more affordable rental housing as seen in the graph below.

These are only initial results, a first trial. Our survey architecture and growing response network remain in place to further serve these and other local metro discussions. The goal of the project was and remains to provide solid metrics and action priorities for productive rental housing affordability discussions. •

Rents Higher in Markets with Higher Complexity Scores



CRE GIVING BACK

Making an Impact With the CRE® Consulting Corps

BY JOHN J. LEARY, CRE®
SENIOR VALUATION CONSULTANT | ADVISRA CONSULTING, LLC

Jim McConnell, staff writer for the Chesterfield (Virginia) Observer, was flabbergasted. He was interviewing me in my role as Chair of the Counselors of Real Estate® Consulting Corps project on behalf of St. Michael's Episcopal Church in Bon Air, Virginia (just outside Richmond) right after we finished our public presentation to members of the congregation and interested community members. He just could not believe that five real estate professionals would spend a week without compensation to undertake such a project. As I said to him at the time:

> *"We're all very fortunate people, and we know that out there in the world are clients who cannot afford good real estate advisory services. One of our goals is to give back in some way."*

The CRE Consulting Corps is part of the essence of who we are as an organization. The typical assignment is conducted on behalf of a nonprofit entity that is faced with a real estate problem and does not have the resources to privately contract for real estate counseling services. A team of five CREs is assembled, and the Chair of the team coordinates a site visit and information gathering process with the client. The CREs on the team donate their services; the client pays for travel, meal and lodging costs.

The team prepares via conference calls prior to the site visit and traditionally assembles on the Sunday prior to the start of the site visit. The team conducts a series of interviews with the client, key stakeholders, relevant governmental agencies and other parties as needed during the first several days of the project according to a schedule set up by the team Chair and the client. Evening meals are usually spent brainstorming, and by Wednesday ideas that will comprise the team's recommendations start to surface. On Thursday, the team locks in, formulates its recommendations, and puts together a PowerPoint presentation to be delivered to the client on Friday. The Chair of the team then coordinates the development of a thorough, written report to be delivered to the client about four weeks after the visit.

Here are some of the specifics about the St. Michael's Episcopal Church assignment that took place in February 2018. The Church property in historic Bon Air, Virginia encompassed several parcels totaling approximately 12 acres. The church and school buildings, constructed between the late 1950s and 2001, were aging and displayed some obsolescence. The property is owned by the Episcopal Diocese of Southern Virginia with the Church as Steward. In the summer of 2018, the Lower School was to relocate to its new campus about three miles away where the Upper School moved in 2008. The loss of income from the school for operating expenses and shared use space will have significant financial impact on the Church. Both the Church and the School had appointed Transition Work Groups that had been meeting to develop a Transition Agreement governing the orderly exit of the School from the facilities.

The immediate need was for a workable exit strategy for the School that would offset the financial burden on the Church while the property is repositioned. At the same time, Church leadership recognized the timing was right for development of a viable strategic plan for the current and future use of all the facilities on the Church campus that would maintain the presence and relevance of the Church within the community; maximize potential land use for the needs of new users; and create synergies and/or catalysts for additional community and economic development to create a viable revenue stream. In addition to the objectives and interests of the Church, the plan needed to incorporate the economic and social development efforts of Chesterfield County and the City of Bon Air as set forth in the recently adopted Bon Air Special Area Plan.

After multiple interviews and focused deliberations, the team drafted and presented their recommendations. They prepared a private briefing for client representatives and a public briefing that included press.

*(CONTINUE ON **PAGE 7**)*

Front Row: *Timothy R. Lowe, CRE, Waronzof Associates, Inc., El Segundo, CA; Rev. Jeunée Godsey, Rector, St. Michael's Episcopal Church, Bon Air, VA.*

Second Row: *David W. Baird, CRE, Cushman & Wakefield, Baltimore, MD; John J. Leary, CRE (team leader), Advisra Consulting, LLC, New Haven, CT; Casey R. Kemper, CRE, Collegiate Asset Management. New York, NY.*

Back Row: *Doug Schepker, CRE (local resource and St. Michael's Vestry Member), CDS Realty Company, Richmond, VA; William R. Quinlivan, CRE, Colliers International, Milwaukee, WI.*

In addition to a Proposed Transition and Mutual Rights Agreement, the team recommended that St. Michael's Vestry establish a strategic plan for the property for discussion with and approval by the Diocese of Southern Virginia that (1) defined the future use of the property in mission-based terms; (2) addressed transaction management for the portions of the property to be monetized and asset management for the portions of the property to be retained; (3) considered how cash flow from the property will be applied; and (4) identified plans for staff and volunteer development in order to manage the change and growth implied in the re-use of the property.

The process is ongoing, but the initial reactions of the client were positive. The CRE team in effect served as a neutral in the development of the Transition Agreement after listening carefully to the issues raised by the Church and School representatives. One of the school buildings is now being leased to an adjoining private school whose leadership was interviewed by the team. A public sidewalk-bike lane project linking the St. Michael's property to the commercial center of Bon Air has moved from the planning stages into construction. In a letter to the Counselor office, the client stated:

> *"The CRE team approached the assignment with great sensitivity and awareness of the relationship between the Church and School. They exhibited the highest level of professionalism in the performance of the assignment and boiled down the range of possibilities to sensible and realistic options, including some options we had not considered before. They also structured and recommended a very concise and fair Transition Agreement between the Church and School."*

So why might a Counselor volunteer for the Consulting Corps? On a professional level, the opportunity to interact with four colleagues on an assignment on behalf of a client that truly needs your advice and counsel is an unforgettable business experience. On a personal level, the bond you develop with each of those four colleagues lasts well beyond the week spent with the client and reinforces the culture of collegiality that is an integral part of being a CRE. •

The Solution to Giving Back is YOU, the CRE.

The Consulting Corps provides strategic action plans for complex real estate challenges faced by nonprofit organizations, government agencies, educational institutions, and other entities.

Clients benefit from high-level advisory services at a fraction of market rates to address problems such as affordable housing, economic development, underutilized land, closed hospitals, or obsolete schools.

You likely know of organizations that could benefit from The Consulting Corps, or you may want to lend your expertise to a project.

Participate in the Consulting Corps or Identify a Potential Client!

Contact Samantha DeKoven at (312) 329-8431 or sdekoven@cre.org.

CRE.org/Consulting-Corps

CRE®
THE COUNSELORS OF REAL ESTATE®

430 North Michigan Avenue
Chicago, Illinois 60611

Visit Us Online

Learn more about our initiatives and upcoming events, find member news, and much more at cre.org.

SUBSCRIBE

Visit cre.org/subscribe to receive *The Counselor*® and *Real Estate Issues*®.

FOLLOW US ON SOCIAL MEDIA

Don't miss an update!

@CounselorsofRE
CounselorsofRealEstate
TheCounselorsofRealEstate
TheCounselorsofRealEstate