

# REAL ESTATE INDUSTRY SHOWS MIXED REACTION TO **CLIMATE THREATS**

Hurricane Sandy. Hurricane Katrina. The tornadoes of the Midwest.  
The sweeping fires and mudslides of Southern California.

Much media attention has focused in recent years on the changing, and increasingly volatile, nature of climate conditions around the country. Much of that coverage has been politically oriented, turning the important issue of how to address climate-based threats to our lives and property into a partisan debate over global warming.

Whatever the cause, whatever your political views, there is a growing awareness among the general public of the impact of nature on our places of work, where we shop and where we live. But is that a broadly shared awareness in the commercial real estate community, and how much is being done to protect public safety and property and guarantee an unbroken chain of commerce?

With those questions in mind, Goulston & Storrs and ALM collaborated on a national survey of developers, investors and owners to create a profile of the perception of climate-related threats and how those threats impact business. Most important, the Climate Change Survey sought to

gauge the emergency preparedness of the professionals who fund, build, own and maintain our nation's office buildings, retail centers, hotels and multifamily complexes. In many cases the results were surprising.

Although the survey results suggest a general level of awareness concerning the impacts of climate change on the development process, this has not affected a significant percentage of the respondents' near-term planning and operations. For some, the significance of the issues is just now becoming clear, and many believe climate change is really only of concern to certain market segments, and in certain geographic areas.

A distinct minority expressed complete skepticism about the issue as a whole. One survey participant, a vice president at a southern development firm, commented that: "I have made no adjustments whatsoever regarding risks associated with weather events. Extreme weather events have been occurring for eons, so we were prepared

### Prepare Yourself for Climate Change Threats

The need for climate resiliency is clear, and professionals in all aspects of commercial real estate are charged with the responsibility to protect lives and property. The American Red Cross, the Federal Emergency Management Agency and the Urban Land Institute are just some of the resources real estate professionals can use to develop an emergency-preparedness plan tailored for your region or your portfolio.

Here are just some of their suggestions:

- Know your region and the types of disasters most likely to have an impact on your business;
- Assess the capacity of your employees to prepare for and respond to an emergency;
- Educate them accordingly;
- Identify external emergency resources that will provide assistance during or after a disaster;
- Develop a plan for a response to emergencies as well as a Continuity of Operations Plan;
- Practice the plan;
- Allow partial compliance and mitigation measures in order to create flexibility in insurance premiums;
- Accurately price climate risk into property value and insurance;
- Consider long-term resilience when evaluating (re)building strategies.

for them before the media started hyping them, just like we are prepared for them today. The weather is no more or less extreme, subject to normal cycles, than it ever has been.”

Such comments were tempered by those respondents who are both aware and concerned: “Ultimately, real estate development costs will reflect the realities of a changing climate environment,” said a senior executive at another development company, this one in the West. Then the ability of tenants and buyers to pay a rent or sale price that makes the project economically feasible determines whether such development moves forward.”

The extent of impact may differ by area or segment, and awareness might vary from respondent to respondent. However, it seems reasonable that there will ultimately be significant impact across all segments, and in all areas, over time.

### WEATHER THREATS

Obviously, the type of threat posed by our changing climate falls along geographic lines. Interestingly, hurricanes were not voted as the biggest climate change risk. That dubious distinction went to flooding, which as anyone who has lived in coastal cities knows, can be one of the ill effects of hurricanes.

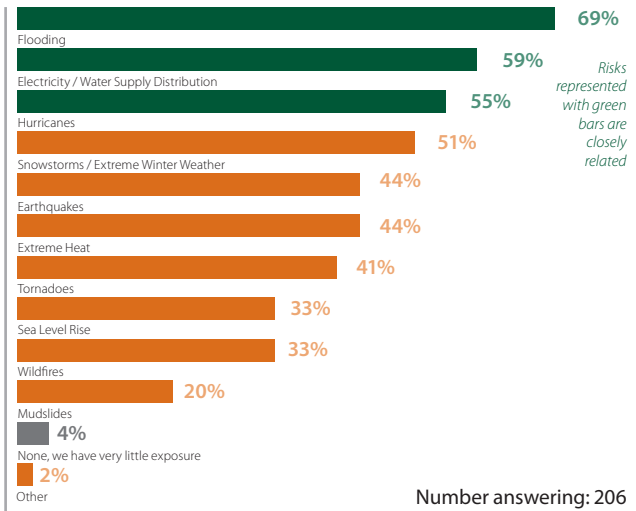
Hurricanes Katrina and Sandy both caused massive damage through coastal flooding and high winds, but Sandy did most of her record-breaking destructive work without significant rainfall. Similarly, hurricanes often bring electricity and water-supply disruption, as more than half of our surveyed professionals know. Hurricanes themselves came in next at 55%, though increases in sea level, the third leg of this devastating stool of destruction, was deemed important by only a third.

### NO TO GOVERNMENT AID

Very few respondents, including those who acknowledge the risks involved, turn to the federal or state governments for assistance, and those that do leave the accompanying processes to their outside counsel. In fact, only 6% have taken advantage of federal grant programs for mitigation.

Such sentiments were clear in the comments of some of our respondents, such as this from an executive at a national lending organization: “No governmental agency, no matter how powerful or intrusive, can fight nature. What it can do is slow down progress, impede development and get in the way of improving the human condition.”

### Most Important Climate Change Risks



## LITIGATION FEARS

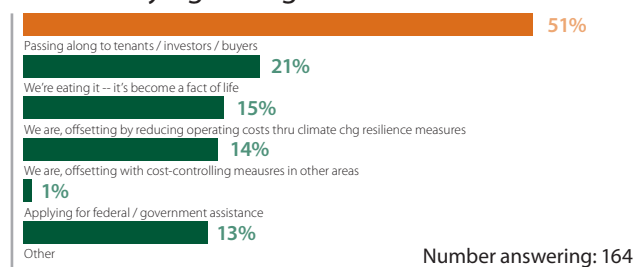
What are the biggest risks to the commercial assets that lie in the crosshairs of catastrophic climate events? Nearly half of the respondents identified the physical risk to the property itself. The next two most popular answers go hand-in-hand: market- and tenant-demand disruption and risk of litigation and liability were both ranked as significant by roughly a quarter of the respondents, indicating that our respondents feared the second as a result of the first.

Beyond triggering the obvious need to respond with immediate repairs and modifications, these climate events carry longer lasting effects. For nearly a quarter of our survey-takers, uncertainty about future policy and regulation is the main downstream risk. This is especially true for an industry that by history, temperament and lobbying firepower feels strongly about self-regulation.

Our survey-takers seem to be losing less sleep over pressures coming from within the industry. Some 9% worry that capital sources have become more wary, while only 5% are feeling the strain from tenants focused on climate impacts. Only 4% worry about the need for greater disclosure, an indication of the real estate industry's relative lack of publicly traded companies.

Many real estate executives pass along the increased cost of climate issues, ("As a lender it is a cost of doing business that is passed along to clients/investors," said one respondent), but more than a third absorb the expenses themselves, some simply eating them and others offsetting the cost through the long-term reduction of operating costs by implementing climate change resilience measures. Only 1% claim to look to the government for assistance.

### Who Is Paying for Higher Costs?



## MODERATE PROACTIVITY

How are commercial real estate executives responding to climate-related risks?

In planning new developments, nearly two-thirds of commercial real estate executives look no farther than 10 years out. The remaining respondents go beyond that.

### Who Took the Survey

The respondents to the Goulston & Storrs Climate Change Survey ranged over the entire ownership/development spectrum and provided diversity as well in geography and building type. Depending on the question (not all participants answered every question), responses ranged from 156 to 206 professionals, providing a cross-section of geographies, practice areas and building types.

Developers, at 36%, represented the largest class of respondents, followed by lenders at 21% and private equity firms at 19%. Institutional investors, pension funds and corporate users (office, industrial and retail) came in at 11%, 11% and 3%, respectively, with 9% of survey takers checking off "Other."

Geographically, our respondents not only cover the waterfront—in the form of coastal cities—but the plains and mountains as well. Some 38% ply their trade nationally, while at 21%, the Southeast squeezed out both the Northeast and West (both at 19%) for the Number 2 slot. Thirteen percent of our survey takers focus on the Southwest, while the Midwest is the playing field for 11%.

What are their areas of specialty? It's multifamily rental for the majority (68%), followed tightly by office at 66%, the total greater than 100 clearly indicating multiple disciplines. Some 55% deal in retail and 48% in industrial. Forty-nine percent of our respondents focus on mixed-use and 38% on hotels. Condominium development is the field of choice for 23%, while more specialized dwellings—ironically at different ends of the age spectrum, seniors housing and student housing—each garner 21%. Biotech and Healthcare are the domain of 12% of our survey responses, while Hospitals, Institutions and Universities came in at 11%. The ubiquitous "Other" ranked at 9%.

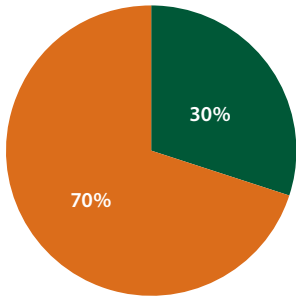
Total answers greater than 100 for many questions indicates multiple responses.

Given the relatively short-to-mid-term hold strategies of most investors—from five to seven years generally, according to Real Estate Forum Magazine—that is an impressive number.

"Climate change induced by human activity will undoubtedly happen," wrote one survey respondent, a developer in the western states. "However, if our typical

exit is seven years from now (and buyers' exits are five to 10 years from that), there's greater uncertainty about just how much climate change will affect investment and development in the relative near term."

What happens once the building is constructed? Only a third of the industry conducts a formal or even informal climate-risk assessment. Fully 70% said no.



**Percentage Climate Risk Assessment Conducted in Last 5 Years**  
Number answering: 206

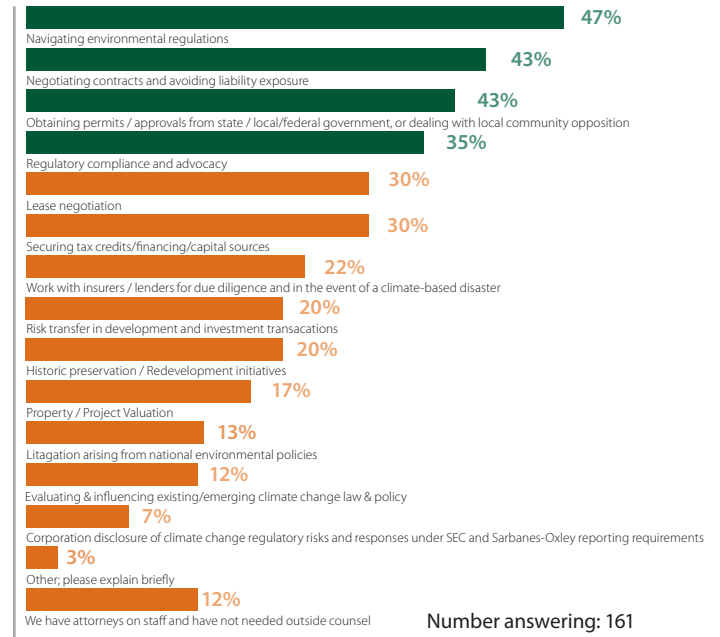
One lender commented that certain threats are simply not coverable: "We check to make sure we have mitigated some of these risks by not lending on a development that is substantially in a flood plain." That respondent indicated a willingness to go ahead with a project if proper insurance was in place. Another commented that they "mitigate potential risks through careful underwriting of these prospective events."

## THE ROLE OF OUTSIDE COUNSEL

Finally, the survey explored how commercial real estate executives engage their outside legal counsel in climate-related issues. Nearly half of our respondents turn to their legal representatives to manage the complexities of environmental regulations and a nearly equal number ask their lawyers to obtain permits and approvals from the state, local or federal government. Another third call in legal counsel for regulatory compliance and advocacy, while a little over 10% focused on litigation arising from national environmental policies.

A small contingent (12%) recognize a need to advocate for change. These politically minded professionals use their legal counsel to evaluate and influence existing and emerging climate change law and policy.

## Areas Where Outside Counsel Is Sought



## AN INDUSTRY SLOW TO RESPOND

The survey results suggest that while between 40% and 50% of real estate professionals are factoring the risk of climate change into their business decisions, more than half say it plays no role, or that, at most, the risk posed is no higher than that of natural casualty that business has always faced. This is a striking result, given that there is near unanimity among the scientific community worldwide that climate change is having significant impacts, which will be occurring within the typical planning horizon of the real estate industry.

### ABOUT GOULSTON & STORRS:

Goulston & Storrs is an Am Law 200 law firm, with offices in Boston, New York, Washington, DC and Beijing. With nearly 200 lawyers across multiple disciplines, Goulston & Storrs is a real estate powerhouse with leading-edge corporate, capital markets and finance, litigation, and private client and trust practices. Our lawyers employ a proven team approach that values client outcomes over individual recognition. The firm's dedication to providing prompt, practical legal advice, cost-efficiently and tailored to our clients' business needs, has resulted in Goulston & Storrs being acknowledged for excellence by Chambers USA, BTI's A-Team for Client Service, Best Lawyers in America and other leading industry rankings.