



## PRINCIPAL REAL ESTATE INVESTORS: CLIMATE RISK ASSESSMENT

### SOLUTION OVERVIEW

Principal Real Estate Investors engaged in a pilot climate risk assessment for one of its private equity funds. The assessment evaluated Principal assets across different forms of climate-related risks, allowing the team to identify areas for further research and to take appropriate risk mitigation, disaster preparedness, and operational actions to improve resilience.

### CHALLENGE

Assessing, measuring, and disclosing the potential impacts of climate-related risks for a building portfolio

### SOLUTION

Principal engaged in a pilot to assess climate-related risks for assets in one of its funds to determine material risks and applicability across the fund and individual assets

### OUTCOME

Data produced from the pilot enabled Principal to provide property teams with risk information, better inform organizational policies and practices around resilience, and share resilience performance with investors

### POLICIES

Principal Real Estate Investors and its partners use a unique, overarching Environmental, Social, and Governance (ESG) framework called the Pillars of Responsible Property Investing (PRPI) initiative. This framework helps drive asset management and fiduciary governance and delivers positive financial results and ESG outcomes for clients and investors.

Recent market forces and industry initiatives such as the [Task Force on Climate-related Financial Disclosures \(TCFD\)](#) are encouraging property owners to assess and publicly disclose climate risks to investors and other stakeholders. TCFD is a set of voluntary recommendations on climate-related financial risk disclosures that companies can use to report to investors and other stakeholders. Though not a formal policy, TCFD is a framework that many organizations are following to properly disclose climate-related risk in their portfolios. The framework is structured around four core elements of organizational operations (governance, strategy, risk management, and metrics and targets) and consists of 11 total disclosure recommendations. TCFD was built off

of existing guidance from many leading ESG frameworks with the intent of developing a universal set of climate-related risk disclosure guidelines.

## PROCESS

Principal Real Estate Investors is a real estate manager with over \$86 billion in assets under management. With recent high-profile climate disasters and increased interest in resilience from the investment community and other stakeholders, Principal recognized the need to better understand and disclose climate-related risk. As a preliminary exercise, Principal completed a pilot climate risk assessment on one of its real estate funds to build organizational capacity on climate risk and inform future property management strategies. Principal had been conducting some level of climate risk analysis and mitigation through acquisition due diligence, insurance, emergency preparedness strategies, and other standard actions. However, a full-scale climate risk assessment had not yet been conducted.

In developing its plans for the assessment, Principal identified several key objectives that the team intended to accomplish:

- Identify and characterize emerging property and fund allocation risks
- Test and validate risk assessment methodologies and data
- Build institutional knowledge and expertise within Principal to understand and address climate risks as part of investment management
- Prepare for potential compliance requirements from regulator agencies, or investor queries
- Align with GRESB and Principles for Responsible Investment (PRI) survey practices and standards

While current scientific models, data, and forecasts have limited ability to indicate the probability or severity of a particular risk on a real estate investment within a given year, exposure to physical climate risks can be reasonably assessed for a given asset. In performing the risk assessment, Principal analyzed individual assets by their exposure level to physical and transition risks.

**Transition risks** are associated with movement to a low-carbon economy or that of a macro-economic model with markedly different policies and regulations than what exists today. Primary transition risks of concern for Principal are policy and legal, with technology and market acting as secondary issues. From a policy and legal perspective, an increasing number of U.S. jurisdictions – cities, states, and regional governments – are adopting climate action plans, renewable energy portfolio standards, or other environmental regulations targeting greater energy efficiency and reduced carbon emissions associated with commercial buildings.

**Physical risks** concern the impact of climate-related weather events and long-term meteorological trends on property physical conditions, infrastructure, operations, and systems and equipment. Principal worked with a third-party consulting firm to characterize risks and develop a “score” to assess property-level risks and portfolio exposure. After providing address, asset value, and other property attributes, the firm calculated scores based on models derived from publicly available historical data (extreme drought, flood risk, major storms, wildfires) and forecasted data (climate

change risk, extreme temperatures, flooding, heating/cooling exposure, precipitation). These risk scores, segmented by risk category, were normalized nationally and based on a 1-100 scale with 100 indicating the highest risk and 1 the lowest risk. Assets with a score of 90 or above were considered “high-risk”. While the risks scores provide insights into risk exposure, they do not necessarily indicate risk probability, severity, or material impact if an event were to occur.

Principal used the risk exposure data to evaluate investment risk in several ways, such as focusing on properties with the highest number of risk exposures and the most “value at risk” (asset value times number of exposures for different risk categories). Principal also performed a portfolio segmentation analysis to see where the fund may be overexposed in some markets from a climate risk perspective.

## MEASURING SUCCESS

The climate risk assessment identified various transition and physical risks at the property level, giving Principal insights into which properties pose potential investment risk and the overall exposure of the full portfolio. Principal also learned many valuable lessons on the challenges and nuances of climate risk issues, developing institutional knowledge that will help drive further efforts. Additionally, the assessment demonstrated to investors its approach to assessing, disclosing, and managing climate risk.

## OUTCOMES

Based on its preliminary findings, Principal is planning to incorporate the following climate risk actions into its standard procedures:

- Include asset-level climate risk information in the underwriting process for all new acquisitions, including revisions to the due diligence process through assessing climate risk and identifying resilience measures in place or that need to be addressed.
- Create individual climate prescriptions for each operational asset based on climate risk factors and materiality. These prescriptions contain concrete, actionable steps that property teams can take to improve asset resilience to identified climate-related risks. Specific prescriptions were developed for six material risks: flooding, heat stress, major storms, sea level rise, water stress, and wildfires.
- Strengthen emergency, disaster preparedness, and resilience guidelines to include climate risk and resilience for property managers.
- Continue to refine and expand portfolio risk mitigation strategies using lessons learned from ongoing work.

Principal plans to conduct an additional climate risk assessment on another fund and is exploring the possibility of working with properties on specific climate risk mitigations plans.

Principal is engaging with clients and investors on the topic of disclosing climate risks. Recognizing that the lessons learned through the pilot climate risk assessment may be useful to others in the industry, Principal drafted [a blog article](#) sharing several key takeaways and best practices on climate risk and TCFD.