Asset Risk Resilience and Underwriting Flowchart

Step 1
Evaluate whether the asset is exposed to material physical climate risk

- Identify chronic risk
- Identify acute risk

Step 2
- Identify and forecast long-term market implications
- Evaluate potential cost of inaction
- Assess whether, and to what degree, acute risks impact usability and structural integrity
- Assess whether, and to what degree, the local market resilience mitigates recurring and/or rare acute impacts

- Evaluate strategies to reduce vulnerability to chronic climate risk
- Evaluate the potential cost of strategies to cope with chronic risk
- Evaluate strategies to mitigate vulnerability to acute risk
- Evaluate cost of strategies to mitigate acute risk with common and uncommon hazards

Compare cost of hazard mitigation alternatives against cost of inaction

Step 3
Does risk-adjusted return, under various scenarios, meet fund/capital objectives?

- Pass on deal as appropriate
- Adjust deal terms as needed
- Consider fund and portfolio impacts
Step 1: Identify risks

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- Examine a time horizon (e.g., 30 years) including acquirer’s hold period as well as the expected buyer’s
- Begin with a high-level, aggregate physical climate-risk screen of the asset with some firms also choosing to examine each individual hazard risk including chronic risks such as heat stress, water stress, or sea level rise and acute risks such as flood, wildfire, and severe storm
- Confirm there is no underrepresentation of risks in assessment data

Step 2: Evaluate strategies and quantify costs to mitigate or effectively bound the issue(s) of concern

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- Look to standards such as ASTM’s draft Standard Guide for Property Resilience Assessment for due diligence
- Engage with asset-level risk metrics while developing forward-looking strategies for physical risks, including both acute and chronic stresses
- Consider capital expenditure needed for hazard mitigation, most often in collaboration with consultants
- Account for items such as the needed CapEx, cost and/or availability of insurance, and exit cap rate when evaluating the cost of potential hazard mitigation strategies
- Evaluate impacts such as potential downtime, business disruption, and cost of repair when analyzing the cost of inaction
- Include an additional discount to exit capitalization rate for individual assets and occasionally for assets in markets with heightened physical climate risk such as flood, wildfire, and severe storm

Step 3: Assess whether the risk-adjusted return of the asset meets fund or capital objectives or whether adjustments to deal terms need to be made

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- Actively coach their teams to challenge existing assumptions about investment theses for real estate assets and how climate risk may (or may not) change their investment perspective
- Look for ways to mitigate or bound the risk first rather than exit the deal altogether