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Mark Carney warns net zero will mean 'significant' stranded property assets

Real estate investors squeezed between falling valuations and pressure to upgrade energy efficiency

Joshua Oliver and Attracta Mooney || October 2, 2024

Mark Carney, UN Special Envoy on Climate Action and Finance speaks at the Earthshot Prize Innovation Summit in partnership with Bloomberg Philanthropies on Sept. 24, 2024 in New York City. PHOTO BY BRYAN BEDDER/GETTY IMAGES FOR BLOOMBERG PHILANTHROPIES

Former central banker Mark Carney has warned there will be "significant stranded assets" in commercial real estate as governments push to reach net zero, highlighting the risks to property owners and lenders from older buildings that cannot adapt.

Property investors are facing a double whammy from the sharp fall in asset values caused by higher interest rates, and increasingly urgent demands to invest in energy efficiency.

Stranded assets are often associated with fossil fuels that will be phased out through the green transition, but Carney underscored that there are also older buildings that "aren't going to make it" as countries regulate to cut greenhouse gas emissions across all sectors.

"There will be a tail of stranded assets…which are going to have to turn over and be refurbished if possible or knocked down and repurposed," he said.

European real estate investors need to increase their annual capital spending by 30 per cent to get on top of upgrading buildings, according to a report this week by investment manager AEW. It found that the energy performance of European buildings was significantly behind the progress needed under the Paris agreement, where countries across the world agreed to limit the global temperature rises.

At the COP28 climate conference in Dubai last year, countries agreed to double the rate of energy efficiency improvements by 2030.

But in some cases, such as older, poorly located office buildings, the upfront cost may be uneconomic due to a lack of demand or low rents for the space.

Trying to knock down buildings that are deemed obsolete — such as the Marks and Spencer Oxford Street flagship or the former Museum of London — can also cause controversy, since preserving existing structures saves carbon from building materials such as steel and concrete.

Operating buildings accounts for 26 per cent of global energy-related emissions, according to the International Energy Agency, which has warned that faster progress is needed to put the property sector on track to net zero by 2050.

Commercial buildings in the U.K. face a tough series of deadlines to upgrade their energy efficiency ratings by 2030. About 12 per cent of commercial properties missed an energy rating deadline last year, according to the Centre for Cities.

Carney warned investors about banking on these deadlines slipping. "There will be people…who either implicitly or explicitly think that these timelines are going to shift, or that somehow or another it is not going to become a binding constraint. But that is a big risk to take," he said.

Carney, who is chair of Brookfield Asset Management, was speaking in London for the opening of Eden Dock, a new waterside garden at Canary Wharf, which is co-owned by the Canadian asset manager. He said adding biodiversity to urban settings was another key challenge for landlords, alongside reducing emissions.

Dutch bank ING last month warned 2,000 of its biggest clients, including commercial real estate developers and owners, that it would stop providing them with financing if they failed to make sufficient progress on tackling their climate impacts. It found that commercial real estate was a laggard compared with other sectors when it came to disclosing climate impacts.

But despite climate risks for the sector, Carney said he was not concerned about risks to financial stability from the property sector.

“I am very sanguine about commercial real estate risks in the financial sector as a whole, because the risk is more broadly spread, there is less liquidity pressures than would have come in a bank-based commercial real estate sector,” he said. “And I think that the work out process is proceeding for those assets that need to be worked out.”