Reducing Costs & Increasing Value: Climate-related Trends for CRE in 2025

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While some elements of sustainability may face growing political headwinds, climate risk is engrained in CRE. Investors and lenders are focused on identifying opportunities to reduce costs, while also determining the long-term implications for asset value. Energy efficiency and resilience to extreme events address both of these concerns and thus are expected to stay in the spotlight this year. Meanwhile, local regulations like building performance standards will increasingly influence underwriting and investment decisions, as will tenant demand for healthy and sustainable spaces. Below we outline four key themes related to CRE and climate in 2025.

Reducing Opex with Energy Efficiency and Technological Innovation

Reducing energy costs has emerged as a clear opportunity with the growth in green energy and advancement in storage and metering technology. Meanwhile, more energy-efficient cooling is becoming increasingly important with the growing frequency and severity of heat waves in many places.

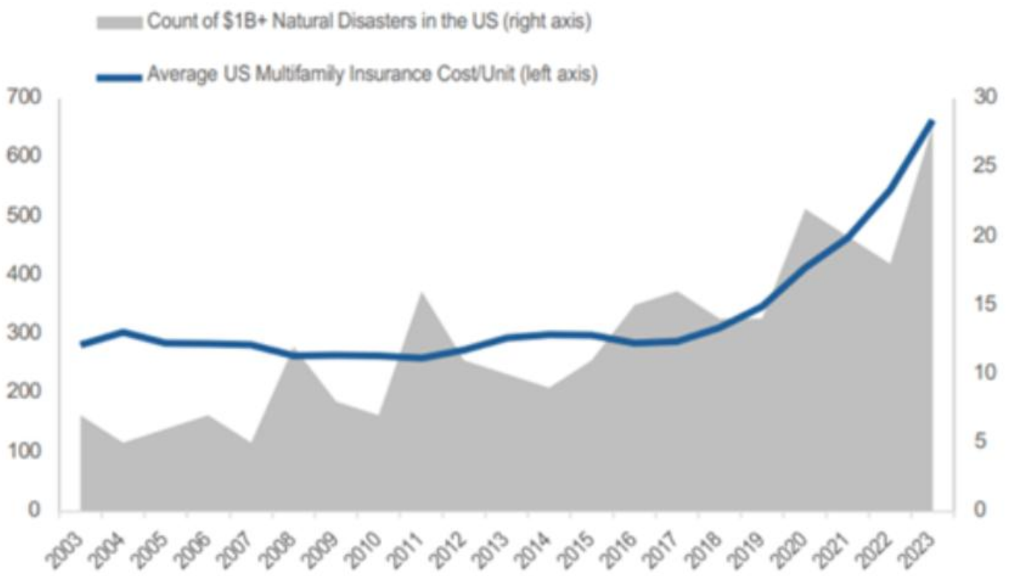
There is a growing focus on engagement with utilities, which can help reduce costs for building owners while helping utilities better balance their loads. Utilities offer incentives for various energy efficiency measures and demand response strategies. Distributed energy resources and grid interactive buildings are growing topics of interest for owners and utilities.

Likewise, owners are looking to leverage technological innovations with sensors to optimize energy use, AI that can predict and prevent errors and advancements in batteries and storage. The set of available tools will continue to evolve.

Identifying Opportunities for Value Creation with Resilience Investment

The devastating Southern California wildfires kicked of the year underscoring both that physical hazards continue to cause unprecedented damage, and that property insurance is not the straightforward risk mitigant it once was (Fig 1). These realities have placed resilience in the spotlight, and efforts to more systematically quantify both a property's resilience and the financial benefits of that resilience, will only continue to accelerate.

Figure 1. National multifamily insurance costs and rising billion-dollar disasters



Sources: NOAA National Centers for Environmental Information (NCEI), Moody's CRE, Moody's CMBS

Developments like the publication of the ASTM's new guide outlining a process for conducting a Property Resilience Assessment (PRA), will help to bring direction and consistency to these efforts. Overtime lenders will likely come to expect a PRA alongside other due diligence reports, which will help set a baseline for physical risk and resilience assessments in CRE transactions.

This also provides a tool for negotiations with insurers, at a time when the industry is trying to understand how property-level risk mitigation measures translate to reduced insurance premiums. Unpacking the relationship between resilience and insurance premiums will continue to be a topic of focus this year.

Meanwhile, there is growing attention on translating the financial benefits of property-level risk mitigation into capex planning, discounted cash flow analysis and cap rate calculations. Efforts to integrate resilience investment into standard investment processes, in a way that captures its impact on value will continue this year.

Complying with Building Performance Standards and Disclosure Requirements

While federal climate-related regulation is uncertain, real estate companies are continuing to prepare for the implementation of local laws setting emissions or energy use limits. To date, over 10 jurisdictions have passed building performance standards (BPS) with fines for noncompliance, and over 30 more jurisdictions have committed to passing BPS.

Owners need to adjust their capex planning to consider the potential for fines if they aren't in compliance with these laws. Meanwhile, lenders' underwriting must account for the additional costs if either retrofits are noncompliance penalties. Moody's CRE platform includes BPS data, allowing lenders to screen for a property's compliance requirements, potential fines and deadlines, as part of the due diligence or risk management processes.

Source: Institute for Market Transformation

Meanwhile, owners are preparing for the implementation of California's climate risk and emissions disclosure rules which are meant to have their first reporting year in 2026. The laws require the reporting of Scopes 1, 2 and 3 (in 2027) emissions, as well as physical climate risks, for companies above a certain size that do business in California.

Owners highlight the persistent challenges of obtaining whole building energy data, which is required for compliance with these laws. The data sharing process between landlord, utilities and tenants will likely continue to evolve this year, as both tenants and owners navigate their own set of disclosure requirements, building performance standards and corporate commitments.

Life Cycle Emissions and Health Remain Relevant

Globally, there is a growing focus on embodied carbon (emissions from raw material extraction, construction and end-of-life), and California has rules setting life-cycle emissions thresholds for new buildings. While many owners continue to focus on understanding operational emissions, supply chain emissions are on the radar as next steps.

This also relates to a growing focus on building materials and their contribution to human health. While tenant demand can fluctuate, recent years have seen a growing focus on spaces that foster occupant health, as well as sustainability. Resources like the WELL Building Standard provide a comparable benchmark for developers aiming to create buildings that satisfy this tenant demand, and for lenders and investors who want to screen properties for these characteristics.

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