The SEC's Climate Disclosure Rule:

Implications Beyond Disclosure for the Real Estate Industry

On March 6, 2024, the SEC released a final draft of its Climate Disclosure Rule focused on requiring certain companies listed in the United States to provide disclosures concerning their greenhouse gas emissions and specific elements of their exposure to climate-related risks.[1]

Given that many real estate companies have been tracking energy and environmental metrics for several years, we believe they may have a comparative advantage in achieving reporting compliance compared to entities in other industries.

However, while at face value these advantages would indicate a reduced burden for the real estate industry, the specter of more standardized disclosures on emissions and climate-related risk will likely cause scrutiny to expand and shift, moving from point-in-time disclosures to a demand for increased information and action on performance improvement strategies.

Specifically, we will discuss select direct and indirect impacts we expect this rule will have on real estate stakeholders — namely, equity investors and lenders — in their pursuit of compliance and the implications thereof.

Below, for reference, we provide a brief overview of the different "scopes" of greenhouse gas emissions and how they relate to one another.

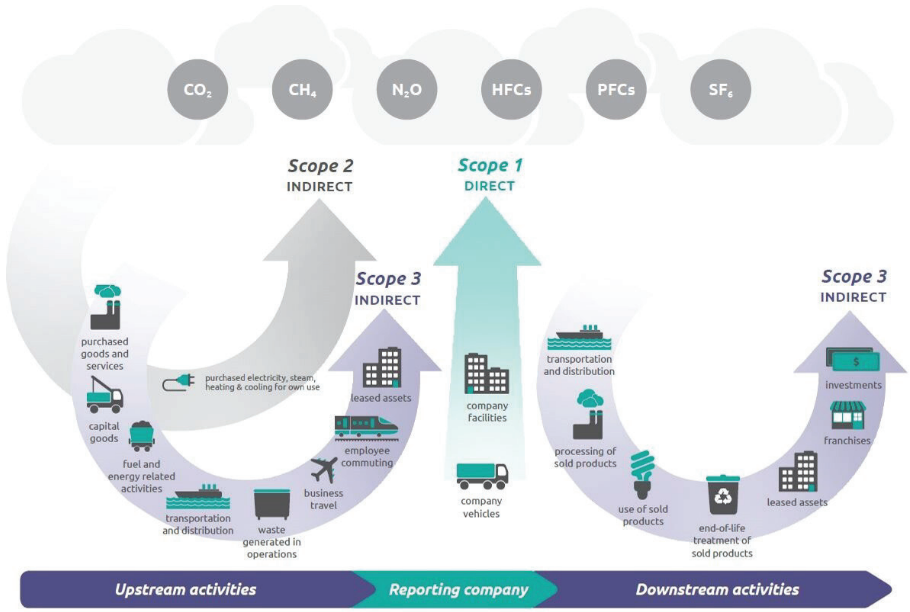

Figure One: Greenhouse Gas Emissions Categorization in the Value Chain[2]

A Summary of the SEC Climate Disclosure Rule and Its Impact

This final draft of the SEC rule will require many companies to report climate-related information, including but not limited to Scope 1 and Scope 2 greenhouse gas emissions (see Figure 1 for more information) and specifications on the expected impact of climate-related risks.[3] Though this regulation builds on the reporting that many public companies are already publishing in the face of increased investor scrutiny, the implementation of this rule will have significant direct and indirect impacts.

More detailed information can be found in the full SEC rule,[4] and a condensed view can be found in the SEC's factsheet.[5] FTI Consulting has also issued a comprehensive overview of the implications of the rule here.[6]

Direct Impacts

1. **Requirement for external assurance:** The final rule demands third-party limited assurance of reported Scope 1 and 2 emissions for all companies required to report them. Furthermore, reasonable assurance — in line with the assurance that companies currently receive for their financial statements — will be required for large accelerated filers after a phase-in period.[7] ***Meeting these requirements will necessitate improved data quality and controls.***
2. **Understanding the materiality of Scope 1 and 2 emissions:** Although the final rule notably removed the requirement to report on Scope 3 emissions (see Figure One), understanding the degree to which Scope 1 and 2 emissions are material to a business is challenging without analyzing how they fit into a company's full Scope 1 through 3 emissions profile and the impact on its ability to operate. ***Even though reporting on Scope 3 emissions is not directly required, the implications of this rule will necessitate their calculation in many scenarios.***
3. **Defining the impact of climate-related transition risks:** Even though the final rule removed some of the draft rule's more burdensome requirements to quantify the impact of climate-related transition risks, companies will still be required to provide some degree of disclosures to this effect. ***Importantly, defining exposure to transition risk will require a holistic understanding of climate impacts across a company's value chain and modeling of different climate scenarios.***

Indirect Impacts

4. **Increased focus on improved environmental performance:** As the phase-in of the requirements of this rule unfolds, merely reporting on environmental metrics, e.g., greenhouse gas ("GHG") emissions, will no longer present a differentiating factor. Emboldened with the like-to-like disclosures this rule will support, certain investors are likely to increasingly focus on how companies are managing to reduce their emissions footprint over time and address their exposure to climate-related risk. ***Increased pressure to deliver on climate-related objectives will require a full understanding of a company's emissions footprint — including certain non-reportable SEC metrics (i.e., Scope 3) — to accurately identify emissions reduction levers and performance improvement opportunities.***

The practical implications of the points noted above go well beyond purely disclosure; they will necessitate a shift in strategy for how real estate companies approach their operations, business plans and engagement across their value chain.

Expected Impacts on Constituents in the Real Estate Industry

Even in the context of the potentially favorable positioning that the real estate industry has in terms of preparation for data disclosure requirments, the implications beyond reporting are likely to have a significant impact on two of its key consituents: equity investors and lenders. Below, we provide an overview of how equity investors and lenders are directly exposed to greenhouse gas emissions on real estate assets by type of lease on Scope 1, Scope 2 and impacted Scope 3 categories.

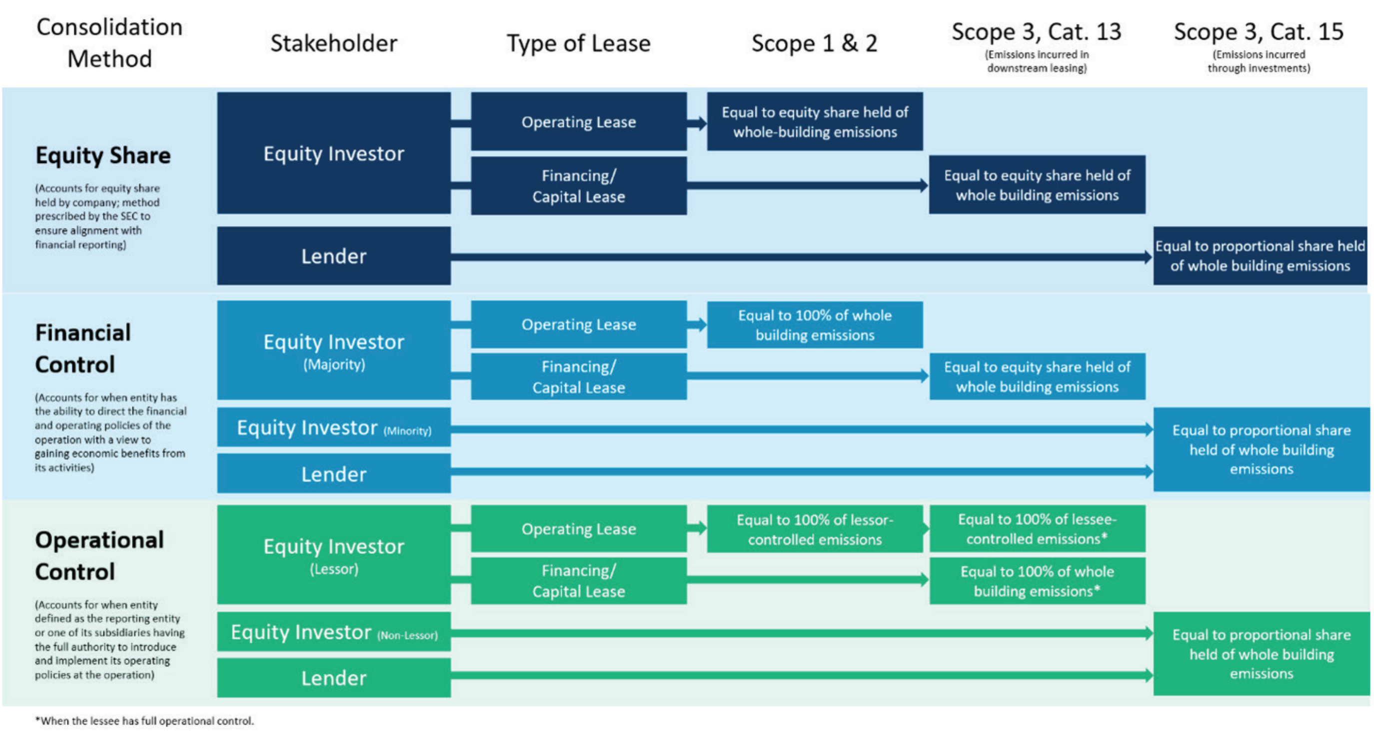

Figure Two: Impact of Emissions Accounting for Real Estate[8]

It is important for stakeholders to understand the different methods of emissions consolidation; while the equity share method for calculating emissions is what the SEC requires to ensure reported emissions match the boundaries of financial reporting, this method will understate financed emissions by lenders, as they do not have a direct equity stake. As such, the GHG protocol and GRESB recommend emissions reporting on the basis of either financial or operational control.

Looking beyond reporting, the SEC rule will impact real estate equity investors and lenders by two linked, yet separate, forces. From an operational perspective, there will be an increasing need to protect income and valuations by addressing demand shifts from tenants who will be looking to reduce their own emissions through leasing in more efficient buildings. From a capital attraction perspective, there will also be pressure to act on increasing demands for reduced emissions from investors (e.g., equity holders in REITs and financial institutions engaged in real estate lending). As such, real estate equity investors and lenders will increasingly be incentivized to reduce emissions and exposure to both transition and physical risks related to climate impact.

The Path Ahead

The impact of the finalized SEC Climate Disclosure Rule on the real estate industry will be complex and nuanced, informing key elements of business strategy in the coming years. Indeed, the SEC rule is only one element of an evolving regulatory landscape that real estate asset investors and lenders face; the EU Corporate Sustainability Reporting Directive and the California Climate Accountability Package (SB 253 and SB 261) will also require reporting of Scope 1, 2 and 3 GHG emissions, in addition to an assessment of exposure to climate-related risks. FTI Consulting's broad sector expertise mixed with deep climate, carbon, sustainability reporting and regulatory compliance expertise allows companies to respond effectively to sustainability-related regulations and market trends, and ultimately effect meaningful operational change across their organizations.

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Endnotes

[1] "The Enhancement and Standardization of Climate-Related Disclosures for Investors," The Securities and Exchange Commission (March 2024), https://www.sec.gov/files/rules/final/2024/33-11275.pdf.

[2] Greenhouse Gas Protocol, "Corporate Value Chain (Scope 3) Accounting and Reporting Standard," World Resource Institute (WRI) and World Business Council for Sustainable Development (WBSCD) (September 2011), https://ghgprotocol.org/sites/default/files/standards/Corporate- Value-Chain-Accounting-Reporing-Standard_041613_2.pdf.

[3] "The Enhancement and Standardization of Climate-Related Disclosures for Investors," The Securities and Exchange Commission (March 2024), https://www.sec.gov/files/rules/final/2024/33-11275.pdf.
Specifically, reporting of Scope 1 and 2 greenhouse gas emissions will be required if deemed material for companies that are large accelerated filers ("LAFs") (i.e., public float of over $700 million) or accelerated filers ("AFs") that are not smaller reporting companies ("SRCs") (i.e., those companies with a public float between $250 million and $700 million, with annual revenue below $100 million). All U.S.-listed companies will be required to report on certain aspects of climate-related impacts on their business in their forms S-K and S-X.

[4] "The Enhancement and Standardization of Climate-Related Disclosures for Investors," The Securities and Exchange Commission (March 2024), https://www.sec.gov/files/rules/final/2024/33-11275.pdf.

[5] "Fact Sheet: The Enhancement and Standardization of Climate-Related Disclosures for Investors," The Securities and Exchange Commission (March 2024), https://www.sec.gov/files/33-11275-fact-sheet.pdf.

[6] "The SEC Climate Disclosure Rule: Separating Signal from Noise," FTI Consulting (March 2024), https://www.eiconsulting.com/en/insights/articles/sec-climate-disclosure-rule-separating-signal-noise.

[7] "The Enhancement and Standardization of Climate-Related Disclosures for Investors," The Securities and Exchange Commission (March 2024), https://www.sec.gov/files/rules/final/2024/33-11275.pdf.

[8] Adapted from: "Accounting and Reporting of GHG Emissions from Real Estate Operations," GRESB, PCAF & CRREM (March 2023), https://carbonaccountingfinancials.com/files/downloads/ghg_emissions_real_estate_guidance_1.0.pdf.