APRIL 2024

# Climate Disclosure Regulations

## INTRODUCTION

Climate disclosure is a priority issue for corporations, investors, and advocates, with a confluence of new mandatory disclosure policies in the U.S. and the EU. The U.S. Securities and Exchange Commission (SEC) recently finalized its rule on standardizing financial disclosures. In 2023, two landmark climate disclosure laws were enacted in California.

Other requirements are coming as well. The EU's Corporate Sustainability Reporting Directive (CSRD) is now in effect, and as it phases in over the next five years, it will start to apply to an estimated 3,000 U.S. companies based on criteria including listing on regulated markets and total economic activity.

While the SEC and California policies are being legally challenged, all signs point to mandatory climate disclosure as a trend that will continue to expand.

## A PRIMER ON CLIMATE DISCLOSURE

The climate is changing, and along with that, risks to current businesses and supply chains. Corporations, investors and insurers cannot ignore those risks. Moreover, publicly traded corporations have an underlying responsibility to disclose financial risks to the company - including those that are climate-related. The SEC Rule in particular responds to what investors already are asking for, seeking to provide more consistent and comparable risk information.

To understand future business risk, the starting point is GHG emissions inventories. The key issue for building developers, owners, and tenants is the inclusion of Scope 3, which are the up and downstream emissions and often eclipse Scopes 1 and 2.

Complementing emissions reporting are climate risk disclosures, intended to reveal potential weaknesses, as well as dependencies, in the context of a business' strategy, operations and financial condition.

The increased visibility of decarbonization and climate goals underscores the need for corporate sustainability teams to pay attention to the most significant components of their emissions and their climate exposure. Buildings and spaces are likely high up the list of emissions as well as physical risks for many types of companies.

To be credible to investors, and to be able to show progress once reporting starts, companies will need to develop plans to tackle emissions related to their buildings and spaces.  They need to track, report, and to the greatest extent possible mitigate physical risks and the costs of extreme weather events. There's also an opportunity here; as companies report their activities to mitigate or adapt to climate risks, they can build a story around their decarbonization actions and improvement across their portfolio, deepening investor confidence. This risk reporting will also be scrutinized as portfolio owners refine best practices– and this will create more demand for building decarbonization and resilience in existing and new buildings.

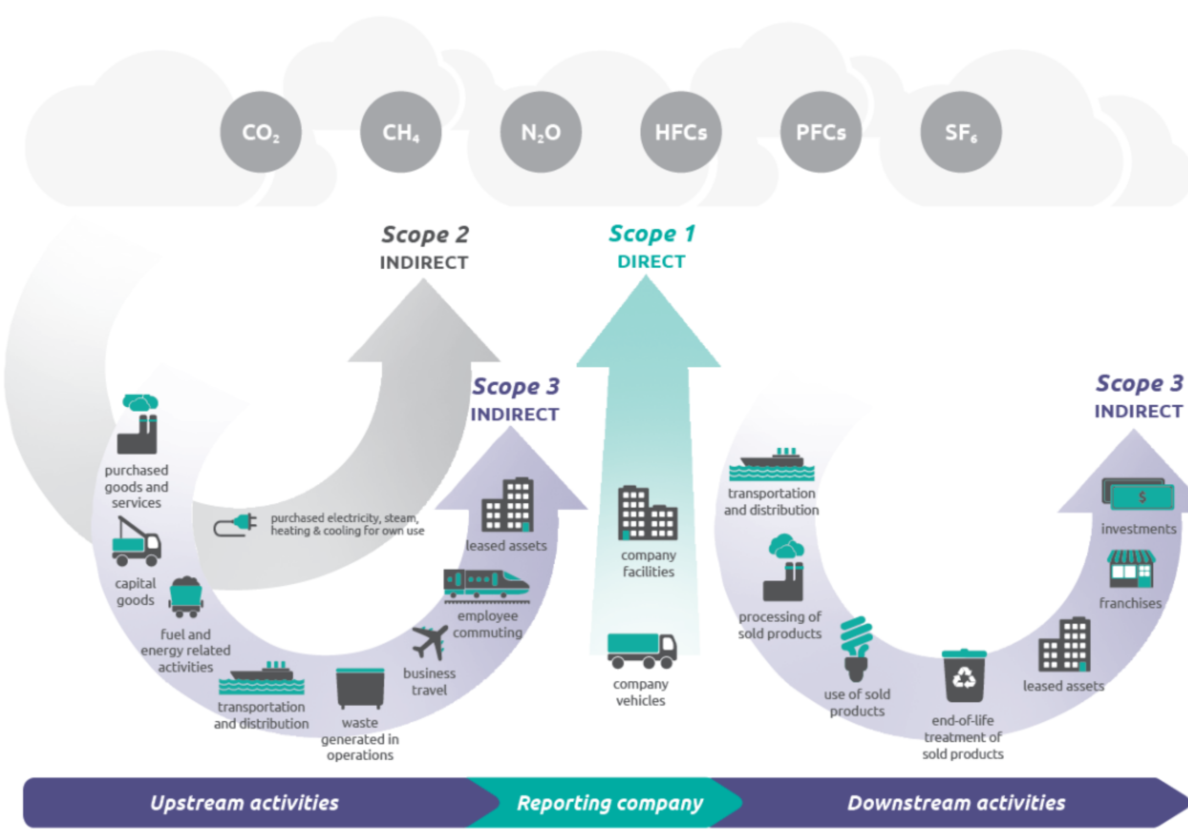
## THE FINAL SEC RULE WILL IMPROVE QUALITY OF REPORTING

In March 2024, the SEC adopted the final rule, “The Enhancement and Standardization of Climate-Related Disclosures for Investors.” This rule stems from the existing framework of U.S. securities laws that call for disclosure about the material risks that companies face. The SEC has required environmental disclosures for many decades and has previously issued guidance about how climate change could impact businesses financial condition. Already, hundreds of companies are reporting various information about climate risks to their operations and financial outlook. What the new SEC rule will do is standardize the types and quality of information that companies should be looking at and sharing in these disclosures so there’s greater comparability from company to company from the investors’ perspective.

### Scope of GHG Emissions Reporting

Much attention is being paid to what isn’t in the rule. With the final rule, the SEC reduced the extent of emissions reporting from what was proposed in 2022. Mandatory greenhouse gas (GHG) emissions will be limited to Scopes 1 and 2 – businesses' direct emissions plus the emissions generated by the power they purchase. Scope 3 emissions, which typically result from the activities of third parties in the supply chain, were included in some circumstances in the SEC proposed rule but were omitted in the final rule. Critically, the final rule also narrowed the applicability of the Scope 1 and 2 reporting, only requiring it when deemed relevant for investors, that is, “material,” and excluding certain types of publicly traded companies altogether.

**Figure [1.1]** Overview of GHG Protocol scopes and emissions across the value chain




Source: GHG Protocol. https://www.epa.gov/climateleadership/scope-1-and-scope-2-inventory-guidance

### Climate Risk Disclosure

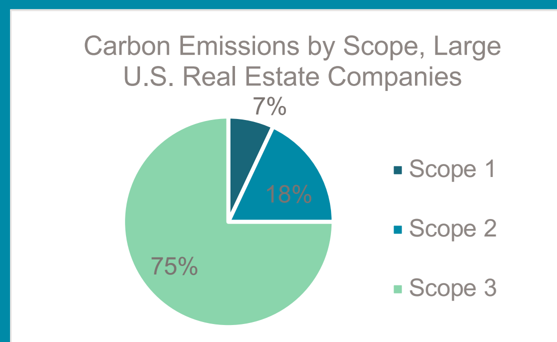
In addition to GHG emissions, the final SEC rule requires disclosures of risk on key financial statements. For example, a company will report potential material risks of climate change on its strategy, and activities to mitigate or adapt to such risk such as the use of transition plans, scenario analysis, or internal carbon prices. Companies may also report climate-related targets or goals that are reasonably likely to materially affect the registrant's business, results of operations, or financial condition. Notably for the real estate sector, companies will also need to report the capitalized costs, expenditures, and losses incurred as a result of severe weather events and other natural conditions which exceed 1 percent in impact.

### Implementation

These requirements were poised to be phased in by company size, beginning with reporting year 2025. Legal challenges have been initiated by the U.S. Chamber of Commerce and over 20 states, and two environmental organizations (seeking inclusion of Scope 3 emissions). In light of these challenges, now consolidated in the U.S. Court of Appeals for the Eighth Circuit, the SEC voluntarily stayed the rule pending completion of judicial review. This will avoid the situation where the court case, if protracted, may still be unresolved when the rule's first compliance deadlines occur. The SEC's stay expressly states that other guidance remain in effect, referencing the 2010 Commission Guidance Regarding Disclosure Related to Climate Change.

## Buildings and Scope 3 Emissions

Some leading companies are voluntarily disclosing Scope 3. An analysis of 2021 corporate reports by Robeco showed 56% of the 200 largest real estate companies worldwide already report Scope 3 emissions. For the U.S. companies, the reported Scope 3 emissions represent the most significant, averaging 75% of the overall emissions for companies that disclose all scopes.




Lendlease, a global, integrated real estate company, regularly discloses its Scope 3 which comprise about 90% of its total emissions. In 2023, Lendlease issued the Lendlease Scope 3 Emissions Protocol V.1. With the Protocol, Lendlease aims to contribute to broader efforts to help define a global approach to the measurement and reporting of Scope 3 emissions associated with real estate investments, development and construction activities.

### CALIFORNIA LAWS POISED TO ADVANCE SCOPE 3

Beyond the SEC rule, states are advancing their own climate disclosure requirements. First to make it into law are two California laws enacted in 2023, while in New York, Washington, and Illinois, bills are active in the current legislative sessions.

California's 2023 laws include:

- The Climate-Related Financial Risk Act (SB 261), which will require an estimated 10,000 public and private U.S. companies that do business in California and have over $500 million in annual revenue to disclose their material climate-related financial risks and measures in a report published biennially on the company's website.
- The Climate Corporate Data Accountability Act (SB 253), which will require an estimated 5,300 public and private U.S. companies that do business in California and have over $1 billion in annual revenues to disclose their GHG emissions – notably including Scopes 1, 2, and 3 following a phase-in period.

These laws require action by the California Air Resources Board (CARB), including a rule to be issued by January 1, 2025. CARB reportedly has begun working on implementation but needs funding for this work and has not formally initiated rulemaking. While such funds were absent from the Governor's budget request earlier this year, the state's budget process is ongoing with the legislature having a key role. Senator Wiener, the sponsor of SB253, is on a key budget committee, and is expected to pursue funding the CARB work.

In the meantime, the litigation is progressing. These factors align to suggest a likelihood of delayed implementation of these rules. Still, in our view, the California laws and forthcoming regulations will lead to a growth in tools and methods for tracking Scope 3 GHG emissions and more companies will start to do so to get ahead of their peers.

### EUROPEAN UNION'S EXTRA-TERRITORIAL CORPORATE SUSTAINABILITY REPORTING DIRECTIVE WILL REACH U.S. COMPANIES

In January 2024, the European Union (EU) Corporate Sustainability Reporting Directive (CSRD) went into effect. The CSRD requires certain large and listed companies and other entities to report on sustainability-related issues in line with the European Sustainability Reporting Standards (ESRS).

CSRD aims to improve the quality of sustainability reporting throughout the region. It will replace the existing reporting framework and broaden the scope of companies covered, from 11,000 initially to now 50,000. The CRSD is extra-territorial, as it reaches non-EU entities that are either listed on EU regulated markets, or have economic turnover in the EU over $160 million USD plus meet a subsidiary or branch threshold. There are additional criteria for EU subsidiaries of non-EU parent companies.

The CSRD framework includes common mandatory standards, and sector-specific standards as well as separate enterprise-wise reporting standards applicable to certain non-EU companies. The European Commission has pushed back the date for sector-specific ESRS standards to mid-2026; at present these do not identify construction and real estate as a sector for specific standards. The core "horizontal" standards reporting apply to all companies on the phased-in schedule. These general standards include approximately 80 disclosure requirements, some of which are also phased-in. Notably, ESRS will require Scope 3 GHG emissions to be reported beginning in the second year of an entity's mandatory reporting.

Reporting starts with the first report due in 2025 (covering 2024 activity) for the largest listed companies, with additional triggers added each year, reaching the non-listed non-EU companies in 2029 (covering 2028 activity).

The CSRD uses “double materiality” which means that a company must report “both on the impacts of the activities of the undertaking on people and the environment [impact materiality], and on how sustainability matters affect the undertaking [financial materiality],” whereas the SEC Rule and California’s SB261 use only financial materiality. Regarding GHG emissions reporting, the CSRD and California SB253 include Scope 1,2, and 3 and are not limited to material emissions while the SEC Rule is limited to Scope 1 and 2 only when financially material.

CSRD standards are largely aligned with the CDP Climate Change questionnaire. The EC is expected to approve other standards or requirements as equivalent to the ESRS, which could recognize California or SEC reports.

### WHAT DOES ALL THIS MEAN?

On the emissions front, companies that fall under the California rules could be required to report Scope 1, 2, and 3 emissions – with no materiality test – as soon as 2026, but more likely in 2027 or 2028. The CSRD will kick in with Scope 1, 2, and 3 emissions – also with no materiality test – for covered companies on their second year of mandatory reporting, which could be from 2026 to 2030. Together, these rules will likely drive the scope of GHG reporting for larger U.S. companies regardless of the delayed SEC Rule, because even once in effect, the SEC Rule is limited to Scope 1 and 2 and only when financially material. It should be noted that the environmental plaintiffs challenging the SEC Rule are seeking restoration of Scope 3 requirements there, given its significance.

As for climate risk disclosures, the more specific information that would be required by the SEC rule will be on hold as the litigation runs its course; the potential timeframe for this could be one to four years. In the meantime, publicly traded companies remain subject to baseline SEC requirements to report material financial risks including those that are climate related. Those companies that are already voluntarily disclosing climate issues on SEC filings will continue to do so, and many others will begin to prepare, if not report, which may include establishing internal tracking systems and developing risk assessments. The 2010 Guidance and other SEC issuances such as its 2021 ESG risk alert, are key resources.

California’s climate disclosure laws may move faster through state court than the SEC Rule will in U.S. District Court -- and the California Air Resources Board (CARB) is already initiating work to implement them. California’s SB261 focuses on climate risk disclosure with financial materiality, similar to the SEC Rule, with reporting to start as soon as 2026, but likely to be delayed one to several years.

For large U.S. companies operating in Europe, the CSRD will start to kick in over the next five years, with some disclosures mandatory and others determined based on “double materiality” whereby a company must report its impacts on people and the environment as well as how climate and sustainability factors impact the company’s financial outlook. Here, the development for U.S. entities could be opportunities for streamlining reporting with EU equivalencies.