

Louisa Chender
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Response by email to: cp21-17@fca.org.uk

10 September 2021

Response to FCA CP21/17 Enhancing climate-related disclosures by asset managers, life insurers, and FCA-regulated pension providers

Executive Summary

We, the Association of Real Estate Funds¹ (AREF) welcome the opportunity to respond to the FCA's consultation on enhancing climate-related disclosures by asset managers, life insurers, and FCA-regulated pension providers.

AREF wholeheartedly supports the UK implementing enhanced climate-related disclosures. This is something the real estate fund industry have been focussing on for a while as the real estate sector has one of the highest carbon footprints of any sector. It currently contributes 30% of global annual greenhouse gas (GHG) emissions and consumes around 40% of the world's energy, according to the UN Environmental Programme. Many of AREF's Fund Members participate in GRESB (Global ESG Benchmark for Real Assets). GRESB supports CRREM (Carbon Risk in Real Estate Monitor) which provides a real estate specific assessment of climate risks and a high-quality analysis of Climate Value at Risk and other risk analyses. More about CRREM can be found in the paper we have attached in the Annex to this response.

In general, we agree with the proposed scope and timing of the rules although we have noted in our response that the FCA should keep in mind other climate related disclosures requirements that firms have to abide by whether in other jurisdictions or even in the UK such as the new DWP requirements. As well as not causing an additional burden for firms, it is important that there is some consistency for investors too. We are pleased to see the FCA basing its rules upon TCFD reporting as this should ensure some consistency.

AREF, along with other trade bodies in the real estate sector, would like ongoing engagement with the FCA to enhance climate-related disclosures for investors so they can make considered choices. We would like to liaise with the FCA on:

- firms having to use proxy data or assumptions due to issues in obtaining the appropriate data.
- the proposed metrics not being, in the main, relevant for real estate. CBRE have kindly assisted AREF and the IPF to draw up a paper (see Annex 1 to our response) with our recommendations for metrics for real estate assets including the use of CRREM. Also, we provide more detail on this in our responses to Q11 and Q14.
- ensuring there is clear and standard methodology for undertaking scenario analysis for real estate assets.

¹ The Association of Real Estate Funds represents the UK real estate funds industry and has around 60 member funds with a collective net asset value of more than £72 billion under management on behalf of their investors, including £18 billion on behalf of retail investors in the UK. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the AREF/IPD UK Quarterly Property Funds Index and the AREF/IPD Property Fund Vision Handbook.

In relation to reporting requirements, we believe that ESG disclosure should be consistent with a product's investor reporting more generally. We have highlighted in our response some issues with the practicalities of reporting on individual holdings. Also, we have offered to assist in the production of standard client reports so these are not too onerous for firms to provide outside of their own reporting cycles.

Finally, as we have addressed in our response to Q20, we believe the FCA have underestimated the costs to firms of implementing these rules.

Our response to the consultation

Below we give a detailed response to the consultation. If you would like to discuss our response with us, please contact either myself (prichards@aref.org.uk) or Jacqui Bungay (jbungay@aref.org.uk), Policy Secretariat at AREF. Also, as our members invest in real estate and other real assets for various types of open-ended and closed-ended funds, in the UK and in other jurisdictions, we are always willing to assist FCA by sharing this wealth of knowledge and expertise.

Yours sincerely



Paul Richards
Managing Director, The Association of Real Estate Funds

Response to CP21/17

Chapter 3 – Design, scope, timing of implementation and compliance basis

Q1	<u>Scope: Firms in scope of our proposals</u> <i>Do you agree with our proposed scope of firms, including the £5 billion threshold for asset managers and asset owners? If not, please explain any practical concerns you may have and what scope and threshold would you prefer.</i> AREF agrees with the proposed scope of firms outlined and is supportive of the proposal to exclude asset managers below a £5 billion size threshold. We note that the proposed rules are based on TCFD guidance, which has been widely accepted internationally. We suggest that the guidance should be applied to real estate funds, whether domiciled in the UK or elsewhere, on the basis of uniform standards. We would be pleased to engage with the FCA and Climate Financial Risk Forum to facilitate this process.
Q2	<u>Scope: Products and portfolio in scope of product or portfolio-level requirements</u> <i>Do you agree with the proposed scope of products? If not, what types of products should or should not be in scope and why?</i> In relation to the real estate funds, AREF agrees with the proposed products and portfolios in scope. Although we would ask for flexibility around what asset managers should be required to report, especially where data is not available and there is high dependency on proxy data and assumptions. Where a firm feels that disclosures could be counterproductive they should be able to advise clients that this is the case and report the percentage of the portfolio where reliable data is currently not available. As we have explained in our response to Q4, the FCA should work with trade bodies and other relevant parties to address the data gaps so that they can be meaningful disclosures for all products over time. Although we would ask the FCA to keep in mind how these proposed products and portfolios are aligned with the requirements in other jurisdictions. This is to ensure providing climate-related disclosures for these products and portfolios are not too onerous for firms to meet or lead to confusion for investors. The FCA's approach to using TCFD as a basis for its proposed ESG rules and guidance is a good step towards ensuring UK climate-related disclosures are aligned with global requirements.
Q3	<u>Timing of implementation</u> <i>Do you agree with our phased implementation and timings? If not, what approach and timings would you suggest and why?</i> AREF agrees with the FCA's phased implementation and timing of the proposed rules. We would welcome dialogue with the FCA on ensuring real estate funds can meet this ambitious timeframe. Ideally, the FCA and DWP would have aligned their implementation timeframes for TCFD disclosures. Asset managers, with pension scheme clients, are already having to ensure they can produce the data their clients require for the DWP's TCFD reporting from October this year.

Q4	<u>Compliance basis – Data availability</u> <i>Would there be significant challenges in using proxy data or assumptions to address data gaps? If so, please describe the key challenges and implications as well as any preferred alternative approach.</i> AREF has concerns with firms having to report on the basis of ‘best efforts’ using assumptions and proxy data. The term “best efforts” is ambiguous and open to different interpretations. We ask that the FCA provides guidance on the definition of this term or this is an issue for discussion via the Climate Financial Risk Forum. In addition, reporting on the basis of proxy data and assumptions has many problems. Assumptions still need data to support them and the data and results are likely to be unreliable and not comparable. Also, firms can use assumptions to their favour which makes the output questionable and meaningless. Where there is no alternative to using proxy data or assumptions we suggest the FCA engages with appropriate trade bodies, such as AREF, and provides guidance to ensure there is consistency in the type of data or assumptions used. The FCA and other policymakers should also first work with the appropriate trade bodies to resolve the data gap. For example, in the case of real estate holdings, data may only be available to the occupiers and other third parties. The occupiers and other third parties may have proprietary rights to such data. Real estate asset owners or fund managers are not entitled to use nor able to access the data. Some real estate fund managers may have formalised lease (typically known as “green leases”) or other contractual arrangements whereby the managers can access the data, but these arrangements are sporadic. AREF is keen to work with the FCA, other policy makers, associations (including those representing occupiers) and utility authorities to solve this and other data issues. One solution would be for the Government or the FCA to mandate that occupiers and third parties must provide the data to real estate and other fund managers (obliged to comply with the climate finance disclosure regulations). Another area, AREF would like to liaise with the FCA on, is the proposed metrics which are, mostly, inappropriate for real estate funds. We provide more information on this later in our response.
------------------	---

Chapter 4 Entity-level disclosure rules and guidance

Q5	<u>TCFD entity report and compliance statement</u> Do you agree with our proposals for the provision of a TCFD entity report, including the flexibility to cross refer to other reports? If not, what alternative approach would you prefer and why? AREF supports the proposals for in-scope firm to publish a TCFD entity report, including the flexibility to cross refer to other reports.
Q6	<u>Contents of the TCFD entity report - Governance, strategy and risk management & scenario analysis</u> Do you agree with our proposed approach to governance, strategy and risk management, including scenario analysis? If not, what alternative approach would you prefer and why? AREF agrees with the FCA proposed approach to governance, strategy and risk management in relation to the TCFD entity report. As an asset that is held for the long-term, the scenario analysis related disclosures should be possible for real estate holdings. However, the FCA should allow for the fact that scenario analysis may not be appropriate, or possible, for some other asset classes. Where this is the case, firms should have the option to provide an explanation why scenario analysis is inappropriate.
Q7.	<u>Contents of the TCFD entity report - Metrics and Targets</u> <i>Do you agree that firms not yet setting climate-related targets must explain why not? If not, what alternative approach would you prefer and why?</i> AREF agrees that firms not yet setting climate-related targets should explain why not.
Q8.	<u>Specific proposals for asset managers where investment management is delegated to third-party portfolio managers</u> Do you agree with our proposals for AFMs that delegate investment management services to third-party portfolio managers? If not, what alternative approach would you prefer and why? AREF agrees with the FCA's proposals for AFMs that delegate investment management services to third-party portfolio managers. As the AFM is expected to take into account climate-related matters when selecting third party investment managers AREF believes that it should be reasonable for the AFM to rely on TCFD disclosures made by the investment managers.
Q9	<u>Specific proposals for asset owners – Entity-level TCFD report</u> <i>Do you agree with our proposals for asset owners to cross-refer to group-level, third-party or delegate reports, where relevant? If not, what alternative approach would you prefer and why?</i> AREF agrees that asset owners, when producing their entity-level TCFD report, should be able to cross-refer to group-level, third-party or delegate reports, where relevant.

Chapter 5 Product or portfolio-level disclosure rules and guidance

Q10	<u>Product or portfolio-level disclosure requirement, timing and location</u> <i>Do you agree with our proposed requirements for product or portfolio-level disclosures, including the provision of data on underlying holdings and climate-related data to clients on demand? If not, what alternative approach would you prefer and why?</i> AREF wholeheartedly supports firms being transparent with their clients. However, we have some concerns with the proposed disclosure rules and guidance. We believe that ESG disclosure should be consistent with a product's investor reporting more generally. Therefore, we agree with firms including ESG performance data disclosures in their regular reporting to clients but not with it being disclosed publicly on a firm's website as this is not required for other performance data. The FCA should consider the practicality of disclosure for individual holdings within a product or portfolio. This is highly dependent upon the data to be provided and the nature of the underlying investments. For real estate, providing data on a building by building basis could be impractical, for example, where a fund holds several hundred individual residential properties. Where a client requires ESG performance data at a specific time to meet their own reporting requirements we propose that firms should be able to provide the report in their own, and not the client's, standard format. This is to ensure it is not too onerous for firms to provide this data outside of their own reporting cycle. We suggest that trade bodies, such as AREF, provide guidance on the reporting format to ensure consistency across firms.
Q11	<u>Content of product or portfolio-level disclosures – Core metrics</u> <i>Do you agree with the list of core metrics, including the timeframes for disclosure? If not, what alternative metrics and timeframes would you prefer and why?</i> The core metrics proposed follow the TCFD recommendations, which are based on funds investing in equities. Most of them do not have a strong alignment with real estate and are not standard for real estate reporting. However, we appreciate that the metrics for commercial real estate (CRE) may need to be aligned with other asset classes for TCFD reporting by firms so they can be aggregated or compared with other investment sectors. The Greenhouse Gas Protocol Boundary definition the TCFD proposes using is an equity control boundary. This is indicated by "value of investment/current portfolio value" modifier on three of the metrics. CRE is better described using the Operational Control Boundary² under the GHG Protocol, which includes complete buildings into the footprint rather than the amount of equity invested. This is standard practice for INREV (European Investors in Non-Listed Real Estate) and EPRA (European Public Real Estate) reporting, as well as the definition of reporting under GRESB (Global ESG Benchmark for Real Assets). We would ask the FCA to take this into consideration to ensure consistency in reporting. Reporting of equity portfolios using an equity control boundary makes sense, but the more direct approach to reporting under operational control for commercial real estate makes for a more complete picture. Weighted average carbon intensity (WACI) The TCFD WACI metrics are not aligned with current approaches to reporting in CRE where revenue/rents are not considered within reporting; rents are quite variable and can fluctuate. If CRE use the TCFD WACI metrics this would represent a large change to reporting, without sufficiently

² In this context, Operational Control refers to functions of the GHG Protocol accounting standard and is, not referring to how buildings are operated.

	describing risks in an improved way. However, to enable firm-wide reporting CRE teams may need to calculate WACI using rental income as a denominator for TCFD reporting. Total carbon emissions Equity share approach is not common in CRE when calculating total carbon emissions. As mentioned above, an operational control boundary approach is more relevant for CRE than the equity control boundary used in the TCFD metric. Carbon footprint The floor area is typically used as a denominator when measuring the carbon footprint of a CRE asset. However, to enable aggregation or comparison with other investment sectors, carbon footprint intensity for CRE may need to be measured by investment value for TCFD reporting. Scope 1-3 Greenhouse gas (GHG) emissions The GHG emissions metrics are aligned with the methodology used for real estate. The existing tools and processes being adopted by CRE firms describe risks clearly and have processes already reporting to them. So, we would recommend aligning the metric requirements for CRE with these. In particular: 1. Using calculations based on open source tools like the Carbon Risk in Real Estate Monitor (CRREM) spreadsheet to communicate intensities. 2. Maintaining the operational control boundary, and making clear the different boundaries within reporting if equities and real estate are reported in a unified way. Along with other real estate related associations, in the UK and internationally, AREF would welcome liaising with the FCA and TCFD to ensure there are appropriate metrics reporting in place for real estate that achieve the disclosure requirements and aims of the consultation. Also, to ensure consistency of reporting, guidance should be put in place by either TCFD, FCA or trade bodies on how any reporting tools, such as CRREM, should be used. For example: it would be easy for firms to report the bad news of climate exposure without reporting the good news of the mitigation strategies which have been established. Investors are keen to hear the latter. Please also see Annex 1 "Metrics for Commercial Real Estate - Alignment in response to FCA CP21/17".
Q12	<i>Do you agree that firms should calculate metrics marked with an asterisk according to both formulas set out in columns A and B of Appendix 3? If not, please explain why, including any challenges in reporting in accordance with either or both regimes.</i> Ideally, AREF's members would prefer to only be calculating one set of metrics. However, we appreciate this will not be the case in practice for most members as their clients will not only be in the UK and they will have to provide reporting appropriate for the regulations in the jurisdiction their clients are based. Therefore, we would suggest that the reporting under the SFDR methodology should be optional.
Q13	<i>Do you agree that, subject to the final TCFD guidance being broadly consistent with that proposed in the current consultation, our proposed rules and guidance should refer to:</i> <i>a. The TCFD Final Report and TCFD Annex in their updated versions, once finalised?</i> In principle AREF agree with the FCA's rules and guidance referring to the TCFD Final Report and TCFD Annex in their updated versions. However, we would want them to be appropriate for real estate funds. Also, we believe that timing and scope would need to be modified accordingly. It would not be possible to meet the January 2022 deadline with the new TCFD recommendations expected to be published in Q4 2021. If scope 3 GHG is included in the TCFD recommendations, it will take a

b.	considerable amount of time before that can be implemented. Under SFDR, scope 3 GHG emissions do not come into effect until January 2023, and we believe that this should be the earliest date when scope 3 GHG should be included for any mandatory TCFD reporting. <i>The TCFD’s proposed guidance on metrics, targets and transition plans and the proposed technical supplement on measuring portfolio alignment?</i> As mentioned in our response to Q11, TCFD need to include metrics appropriate for real estate.
----	--

Q14	<u>Content of product or portfolio-level disclosures – Data availability, additional metrics & targets</u> <i>Do you agree with our approach to additional metrics and targets? If not, what alternatives would you suggest and why?</i> Climate Value at Risk and a comparable indicator such as Implied Temperature Rise are not standard reporting metrics for CRE. However, AREF believes that it would be useful to introduce these for CRE, although this should be in a way which integrates with existing tools such as CRREM and does not require more reporting processes and skills. Climate VaR We would suggest CRE use CRREM analysis of Climate Value at Risk as a snapshot of current risks accompanied with risk mitigation narrative. CRREM is preferable to other variations of the metric available in the market as we understand it is more accurate and more commonly used than other approaches in CRE. The pathway used should be clearly stated; we believe the 1.5C pathway should be used as it is in line with the recommendations of the Science Based Targets Initiative. A mitigation plan should also be provided which is aligned with the CRREM trajectories. AREF, along with other CRE trade bodies, will be encouraging CRREM to • Continue to develop the Climate Value at Risk metrics • Incorporate an Implied Temperature Metric into the tool, for an aligned metric across different investment classes • Consider improvements to the CRREM workflow, to separate climate risk assessment from the risk mitigation analyses – making it clearer what is a risk snapshot and what is a mitigation planning tool. Energy Performance Certificate (EPC) We recommend CRE provide an Energy Performance Certificate (EPC) breakdown (or comparable metrics in states not aligned with the EU’s Energy Performance in Buildings Directive), in line with the EU’s Sustainable Finance Disclosure Regulations (SFDR). This can include the so-called “Inefficient Buildings” metric of assets below and EPC of B as a key metric, and disclosing a complete breakdown of EPC ratings across the portfolio as deeper analysis of risk. Please also see Annex 1 “Metrics for Commercial Real Estate - Alignment in response to FCA CP21/17”.
-----	--

Q15	<u>Content of product or portfolio-level disclosures – Governance, strategy and risk management & scenario analysis</u> Do you agree with our approach to governance, strategy and risk management, including scenario analysis at product or portfolio-level? If not, what alternative approach would you prefer and why? AREF agrees with the FCA proposal that firms should disclose if their approach for specific products or portfolios, asset classes or investment strategies is materially different from any overarching approach described in the entity-level TCFD report. As we have explained in our response to Q6, the FCA should allow for the fact that scenario analysis is not be possible for all asset classes.
Q16	<i>What form(s) could quantitative scenario analysis outputs at product or portfolio-level take? What do you consider the cost and feasibility of producing such outputs might be? How useful would such outputs be for users' decision-making?</i> AREF agrees that scenario analysis is a useful way for investors in real estate funds to understand the potential impact of climate change risks and opportunities on the assets held by the funds. However, this analysis will only be useful for clients if funds use the same or similar methodology for their scenario analysis. AREF, along with other real estate trade bodies, would welcome working with the FCA on a clear and standard methodology for undertaking scenario analysis for real estate assets. To ensure the analysis is meaningful for clients; part of this discussion should be looking at how to address the data gap as we mentioned in our response to Q4.
Q17	<u>Specific proposals for asset managers– Reporting to clients on demand</u> <i>Do you agree with our proposed approach that would require certain firms to provide product or portfolio level information to clients on request? If not, what approach and what types of clients would you prefer and why?</i> As we mentioned in our response to Q10, where public disclosure is inappropriate, AREF supports providing annual reports to clients to enable them to satisfy their own (or their clients' or customers') climate-related financial disclosure obligation. To ensure this is not onerous for firms we propose that the firms should be able to provide the report in a standard format. We suggest the FCA engages with appropriate trade bodies, such as AREF, and provides guidance to ensure there is consistency with that format.
Q18	<u>Specific proposals for asset owners</u> <i>Do you agree with our proposed approach for life insurers when mirroring an external asset manager's strategy? If not, what alternative approach would you prefer and why?</i> AREF agrees with this proposal from the perspective that comparable products would be treated consistently under the regime.
Q19	<i>Do you agree with our specific proposals for asset owners, including the proposed threshold to exclude the smallest default schemes? If not, what alternatives would you prefer and why?</i> No response from AREF.

Q20	<u>Cost benefit analysis</u> <i>Do you agree with the analysis in our CBA? If not, we welcome feedback in relation to the one-off and ongoing costs you expect to incur and the potential benefits you envisage. Contextual information about your firm's size and structure would be helpful.</i> AREF believes that the FCA have significantly underestimated the time it will take, at 1.5 hours, for firms to familiarise themselves with the proposed requirements in the consultation paper. This is especially so as the FCA have based their estimates on the assumption that some firms would know very little or nothing at all about the TCFD's reporting framework. It has been mentioned to us that the hourly rates given for lawyers and compliance staff are on the low side too. Also, AREF believes the cost benefit analysis should focus more on the additional time and costs to firms in sourcing the data required to meet the proposed requirements.
-------------------	---

Annex 1

Metrics for Commercial Real Estate (“CRE”) – Alignment in response to FCA CP21/17

What is proposed

The metrics proposed in FCA CP21/17 follow the TCFD recommendations, which were based on funds investing in equities. They don't have strong alignment with real estate, and include metrics which are not standard for real estate reporting. AREF, IPF and other industry trade bodies welcome the opportunity to influence the outcome and provide more aligned and relevant metrics for the reporting of climate related impacts and resilience to stakeholders.

ESG 2 Annex 1 TCFD Product Report Metrics

	TCFD (see page 43 of the TCFD Final Report)	SFDR (please see annex I of the draft RTS)
Weighted average carbon intensity (WACI)	Portfolio's exposure to carbon-intensive companies, expressed in tons CO ₂ e / \$M revenue. Metric recommended by the Task Force. $\sum_i \left(\frac{\text{current value of investment}_i}{\text{current portfolio value}} \times \frac{\text{issuer's Scope 1 and Scope 2 GHG emissions}_i}{\text{issuer's \$M revenue}_i} \right)$	$\sum_i \left(\frac{\text{current value of investment}_i}{\text{current value of all investments (€M)}} \times \frac{\text{investee company's Scope 1, 2 and 3 carbon emissions}_i}{\text{investee company's €M revenue}_i} \right)$
Total carbon emissions	The absolute greenhouse gas emissions associated with a portfolio, expressed in tons CO ₂ e. $\sum_i \left(\frac{\text{current value of investment}_i}{\text{issuer's market capitalization}_i} \times \text{issuer's Scope 1 and Scope 2 GHG emissions}_i \right)$	$\sum_i \left(\frac{\text{current value of investment}_i}{\text{investee company's enterprise value}_i} \times \text{investee company's Scope 1, 2 and 3 carbon emissions}_i \right)$
Carbon footprint	<i>Description</i> Total carbon emissions for a portfolio normalized by the market value of the portfolio, expressed in tons CO ₂ e / \$M invested. <i>Formula</i> $\sum_i \left(\frac{\text{current value of investment}_i}{\text{current portfolio value (\$M)}} \times \frac{\text{issuer's Scope 1 and Scope 2 GHG emissions}_i}{\text{issuer's market capitalization}_i} \right)$	$\sum_i \left(\frac{\text{current value of investment}_i}{\text{current value of all investments (€M)}} \times \frac{\text{investee company's Scope 1, 2 and 3 carbon emissions}_i}{\text{investee company's enterprise value}_i} \right)$
Scope 1, 2 and 3 GHG emissions, disclosed separately	Scope 1 refers to all direct GHG emissions. Scope 2 refers to indirect GHG emissions from consumption of purchased electricity, heat, or steam. Scope 3 refers to other indirect emissions not covered in Scope 2 that occur in the value chain of the reporting company, including both upstream and downstream emissions. Scope 3 emissions could include: the extraction and production of purchased materials and fuels, transport-related activities in vehicles not owned or controlled by the reporting entity, electricity-related activities (eg, transmission and distribution losses), outsourced activities, and waste disposal (see page 63 of the TCFD Final Report).	The scope 1, 2 and 3 definitions are contained in the low carbon benchmark regulation: (i) Scope 1 carbon emissions, namely emissions generated from sources that are controlled by the company that issues the underlying assets; and (ii) Scope 2 carbon emissions, namely emissions from the consumption of purchased electricity, steam, or other sources of energy generated upstream from the company that issues the underlying assets. (iii) Scope 3 carbon emissions, namely all indirect emissions that are not covered by points (i) and (ii) that occur in the value chain of the reporting company, including both upstream and downstream emissions, in particular for sectors with a high impact on climate change and its mitigation.

How these indicators align with traditional reporting in CRE:

Indicator	Achieves	Alignment with CRE Reporting
WACI	Relative intensity of investment	Equity share approach is not common, nor is the use of revenue or rental income as an intensity metric.
Total Carbon Emissions	Footprint of the share of investment	Equity share approach is not common in CRE, as operational control approach is more relevant.
Carbon Footprint	Intensity of the share of the investment by value	CRE typically considers Floor Area as a denominator
Scope 1-3 breakdown	Actual footprint	This is aligned and should include Scope 3 and sum to the Total Carbon Emissions. Without Scope 3 tenant emissions, the footprint is not an accurate assessment of risk. Real estate funds should be developing Scope 3 reporting of embodied carbon into this metric as well.
Carbon VaR	Value threatened by BAU	Should be adopted using CRREM tool
Climate Warming Scenario or Implied Temperature Rise	Comparable indicator of climate risk across asset classes	This is an overlooked metric, but makes sense to be adopted – could be integrated into CRREM.

Considerations for real estate funds regarding the proposed metrics

Greenhouse Gas Accounting Boundary Definitions

The Greenhouse Gas Protocol Boundary definition the TCFD proposes using is an equity control boundary. This is indicated by “value of investment/current portfolio value” modifier on three of the metrics. CRE is better described using the Operational Control Boundary³ under the GHG Protocol, which includes complete buildings in the footprint rather than the amount of equity invested. This is standard practice for INREV (European Investors in Non-Listed Real Estate) and EPRA (European Public Real Estate) reporting, as well as the definition of reporting under GRESB (Global ESG Benchmark for Real Assets). We would ask the FCA to take this into consideration to ensure consistency in reporting.

Use of Climate Risk Assessment Tools

In many cases, the tools that are used to analyse climate risk for other asset classes do not fully describe risks in CRE. How we describe transition risks and the action taken to manage these risks should be as specific to real estate as possible. CRREM (Carbon Risk Real Estate Monitor) is a tool which has been endorsed by GRESB, the IIGCC (The Institutional Investors Group on Climate Change) and NZAOA (UN-convened Net-Zero Asset Owner Alliance) among others, and adopted widely as the de facto tool for assessing climate risks at this time.

The CRREM tool provides a real estate specific assessment of climate risks and a higher quality analysis of Climate Value at Risk and other risk analyses. CRREM has the added important benefit of being open sourced and not requiring specific consultants to manage.

³ In this context, Operational Control refers to functions of the GHG Protocol accounting standard and is, not referring to how buildings are operated.

Summary of recommendations

The metrics developed for TCFD were designed to report across equity portfolios, and there is some misalignment with the common ESG reporting metrics used by real estate portfolios. In particular:

1. WACI would represent a large change to reporting, without sufficiently describing risks in an improved way.
2. Reporting of equity portfolios using an equity control boundary makes sense, but the more direct approach to reporting under operational control for commercial real estate makes for a more complete picture.

That said, we recognise to remain aligned with overall TCFD objectives and to participate in firm-wide reporting, that real estate fund teams will probably need to prepare these figures and have them ready for reporting to investors alongside other data.

Additional Metrics

We would recommend the following metrics for Commercial Real Estate portfolios to include within TCFD reporting:

1. **Energy Performance Certificate (EPC) breakdown** (or comparable metrics in states not aligned with the EU's Energy Performance in Buildings Directive), in line with the EU's Sustainable Finance Disclosure Regulations (SFDR). This can include the so-called "*Inefficient Buildings*" metric of assets below and EPC of B as a key metric, and disclosing a complete breakdown of EPC ratings across the portfolio as deeper analysis of risk.
2. The **CRREM analysis of Climate Value at Risk** as a snapshot of current risks accompanied with risk mitigation narrative. CRREM preferable to other variations of the metric available in the market as we understand it is more accurate and more commonly used than other approaches in Commercial Real Estate. The CRREM tool should be use the 1.5C pathway (it defaults to the 2C pathway, but we recommend the 1.5C pathway which is in line with the recommendations of the Science Based Targets Initiative), and the pathway used should be clearly stated. We advise members provide that snapshot but also provide a mitigation plan which is also aligned with the CRREM trajectories. The next page has considerations of how CRREM should be used.

We acknowledge that further development will be needed to the CRREM tool, and recommend that CRREM:

- Continue to develop the Climate Value at Risk metrics
- Incorporate an Implied Temperature Metric into the tool, for an aligned metric across different investment classes
- Consider improvements to the CRREM workflow, to separate climate risk assessment from the risk mitigation analyses – making it clearer what is a risk snapshot and what is a mitigation planning tool. We expand on these considerations in greater detail below.

To provide further context for the FCA of our recommendations, this section of guidance to members has been included.

Considerations for use of CRREM to manage climate resilience

The CRREM tool provides a set of climate change risk analysis tools specifically for the Commercial Real Estate sector. The tool can provide multiple outputs which can support Net Zero alignment and assessment of climate risks. The tool has the benefit of being freely available, and also pre-populated from GRESB reporting.

CRREM provides several useful analyses, which can be applied to assets to recognise future decarbonisation risks and targets, but that a more standardised approach to how the CRREM tool is used will reduce uncertainty. AREF and IPF plan to support the improved alignment across Commercial Real Estate in how CRREM is used by providing guidance to members.

CRREM as a climate risk tool

For an assessment of an asset or portfolio's exposure to climate risk, particularly at acquisition, or as a snapshot, CRREM provides a very helpful assessment. The tool provides useful charts and insights as it stands, though more research is required to make the upgrade costs noted in the tool more relevant and complete.

CRREM for Net Zero alignment

CRREM is being used to assess Net Zero alignment, but different members will approach the tool in different ways. The WorldGBC define Net Zero as:

“A highly energy efficient building that is fully powered from on-site and/or off-site renewable energy sources and offsets.”

The challenge with CRREM is its use of Scope 2 location-based emissions factors, which are very helpful in recognising the overall climate risk of a specific asset or a portfolio. It does not, however, speak to the “on-site and/or offsite renewable energy”; the important energy procurement decisions which are vital to Net Zero. This would be calculated appropriately using Scope 2 market-based emissions factors. From a carbon emissions perspective, we believe that members should use the Scope 2 market-based emissions factors from their suppliers.

Making this adjustment, green tariffs are appropriately reported, which can make the CRREM tool's main carbon charts misleadingly optimistic. We believe that the majority of the challenge of making existing assets net zero aligned is to do with energy efficiency, and the kWh/m² pathway which CRREM provides is most helpful – until 2041.

In 2041, the CRREM energy efficiency pathways for UK offices intersect with the UKGBC's top-down Energy Use Intensity target of 70 kWh/m² (based on Net Lettable Area). From 2041, using the UK offices example, the CRREM energy targets become unrealistic and are driven by the lack of Scope 2 market based emissions integration.

The use of location-based and market-based methodologies within the tool could be confusing, but could be presented in the light of climate risk vs net zero pathway. This needs to be considered in greater detail.