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Delivering the data behind climate-related financial disclosures

How high quality data can improve regulatory reporting, investor confidence, and support the management of property-related assets

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Introduction

Disclosing climate-related financial risk is the accounting challenge of the decade.

Following the publication of its landmark Net Zero Strategy in 2021, the UK became the first G20 member to adopt mandatory climate-related financial disclosure requirements. Large listed companies now have to disclose how they identify, assess and manage climate-related risks and opportunities, as well as how these are integrated into risk management processes. Such requirements are the governments' seminal commitment to making the UK's economy the greenest in the world.

By 2025, the markets mandating disclosures will represent 56% of global GDP. They are already impacting eligible mortgage lenders, real estate funds, asset managers, and other businesses with property-related assets.

Reporting needs to align with the Task Force for Climate-related Financial Disclosures (TCFD) recommendations. These are beginning to standardise the process, helping organisations understand how and what to measure and disclose.

'A more consistent global approach to addressing climate-related risks will help both to better assess and mitigate financial vulnerabilities and to reduce the risk of harmful market fragmentation'

Financial Sustainability Board

Companies that lag behind in terms of reporting and addressing these risks will be exposed financially, legally and reputationally. Yet the property sector is still one of the slowest sectors to decarbonise, contributing to 22% of the UK's greenhouse gas (GHG) emissions. For businesses and institutions that own, finance or invest in property, measuring, disclosing and then reducing these emissions is key to avoiding negative attention from investors, regulators and customers.

Big increase in coverage, but the majority of disclosures are still rated as poor quality

Sector	Coverage* 2021	Coverage* 2022	Quality** 2021	Quality** 2022
Banks	77%	77%	46%	39%**
Financial asset owners and managers	48%	72%**	25%	35%**
Real estate	67%	83%**	36%	40%**

Source: EY Risk Barometer Survey 2022. * Coverage of TCFD recommendations in disclosures. ** Fulfilment of TCFD requirements

The quality of disclosures relies on the data used.

Disclosures with poor data leads to miscalculated emissions, mispriced assets, and misjudged climate risk. Preparations must begin immediately to ensure that the appropriate processes and governance structures are in place. These will also prepare organisations for more stringent reporting requirement, such as when the International Sustainability Standards Board's (ISSB) forthcoming global baseline standards are adopted internationally.

Yet property data is in the dark ages.

It's a major challenge for the property sector just to collect data linked to property emissions. From there it needs to be integrated with portfolios, modelled to close gaps and calibrated for accuracy. Delivering the financed emissions of property portfolios in an operationally efficient way is therefore a huge challenge. Even large data teams at major institutions struggle to deliver the high data quality scores that regulators expect.

Climate risk is financial risk

79% of investors agree that a company's approach to ESG risks and opportunities is an important factor in investment decision-making.[1]

While necessary, the disruption caused by the transition to a low-carbon future also poses an existential threat to the financial system. In the same way that the 2008 financial crisis exposed the importance of stress tests and regulation in capital markets, the climate crisis is pushing governments, aiming for Net Zero, to take another look at the data they require to be disclosed.

Physical and transition risks are projected to have material impacts on the financial value of companies and their property assets, giving policymakers, regulators, and investors reason to push demands on disclosures. Accurately measuring back book emissions, for example, grants investors insight on the route required to decarbonising a property portfolio, as well as how much it will cost. This helps differentiate a risky investment from a safe one.

This is all happening in a rapidly evolving regulatory landscape. Tightening environmental standards planned in the next few years have the potential to rebalance and revalue properties. For example, buy-to-let (BTL) lenders and investors are expected to fund an increase in the Minimum Energy Efficiency Standard (MEES) of rental properties from a grade E (2.4% of current rentals fall beneath this standard) to a grade C (62.9% of current rentals fall beneath this standard).

This dramatic transition will require £29 billion in investment, or an average of £9,872 per home; a substantial risk for both lender and borrower. Should half of UK landlords be unable to make the investment, almost £400bn in assets will no longer be able to secure the income streams that make mortgage payments, and the asset valuation, viable.

Similar difficulties are experienced in the social sector, where landlords will be required to ensure a significant proportion of residential properties are EER C by 2035. A national target has also been set to get as many fuel poor households to grade C by 2030. In the context of rising fuel prices and a cost of living crisis, many landlords won't be able to afford these expenses alongside mortgage repayments.

Investors are looking for companies to demonstrate how they will remain productive, competitive and profitable throughout the transition to a low-carbon economy. They gain confidence when companies are transparent about their risk management processes and findings. Data provides this clarity by making assumptions traceable and providing validation for any risks and opportunities identified.

Future impairment rates are much higher for properties with the lowest potential EPC ratings

Potential EPC rating	Current EPC rating		
	A-C	**D and E**	**F and G**
A-C	1.4%	1.4%	1.9%
D and E		1.1%	1.6%
F and G			35.8%

Source: Bank of England's 2021 Climate Biennial Exploratory Scenario

The Bank of England's first Climate Biennial Exploratory Scenario (CBES) released in May 2022 projected that failure to adequately respond to climate-related risks can create an annual drag on profits of up to 15% for major banks and insurers.

[1] Source: PwC

An evolving regulatory landscape

To date, the TCFD framework is the most popular reporting standard used to create policy mandates on disclosures.

It is also a useful starting point for companies deciding to build climate governance procedures, create climate-related targets and goals, and measure emissions and other relevant metrics. However, it does not determine who is required to disclose, and to what extent. This is decided by the regulatory bodies operating in the UK, and can vary by company size, back book, industry or revenue.

A network of existing and emerging bodies are working to create standards and frameworks for premium quality disclosures, but four main issues remain:

- Lack of standardisation
- Differing industry requirements
- Shifting stakeholder demands
- No consensus on data requirements

Financial Sustainability Board's (FSB) TCFD framework

Disclosure guidance for governance, strategy, risk management, and metrics and targets

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Evolving frameworks and standards

Transition Plan Taskforce

Gold standard for private sector climate transition plans that will also inform and build on disclosure standards

International Financial Reporting Standards' (IFRS) ISSB

Forthcoming reporting standards for climate- and general sustainability-related disclosures

Additional insight from Glasgow Financial Alliance for Net Zero (GFANZ), PCAF, UK green taxonomy, and other international organisations*

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UK regulation

Financial Conduct Authority (FCA)

Premium and standard listed companies in the UK under Listing Rule 9.8.6(8)R

Prudential Regulation Authority (PRA)

PRA are assessing how banks are prescribed to demonstrate effective climate risk management per SS 3/19

Department for Business, Energy and Industrial Strategy (BEIS)

1,300 of the largest-UK registered companies and financial institutions, including companies with over 500 employees and £500 million in turnover

* List is not exhaustive

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A focus on financed emissions

The UK guidelines specify that companies need to disclose Scope 1 and 2 emissions with Scope 3 remaining optional in the first year.

Time will move quickly, though, so companies will have to evolve their internal emissions accounting practices to prepare. Data collection for Scope 3 is often more complicated because it can require sourcing data directly from customers and suppliers instead of internally.

Banks and other financial institutions generally produce low Scope 1 and Scope 2 emissions, but their Scope 3 exposure is very high due to 'financed emissions'.

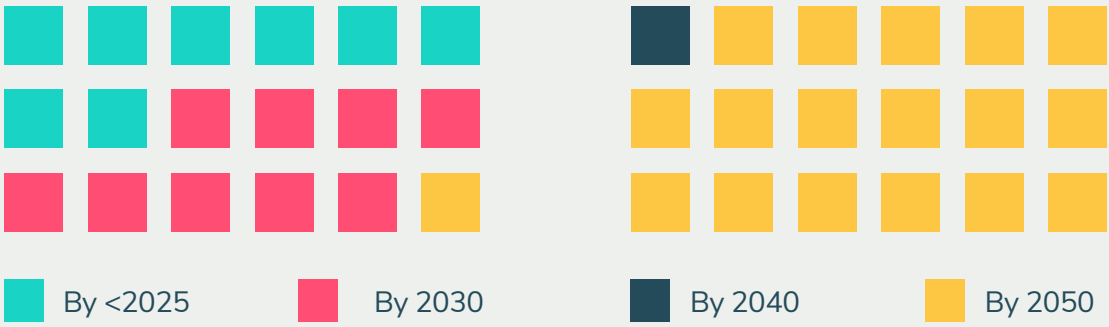
Financed emissions are generated as a result of financial services, investments and lending by investors and organisations that provide financial services. Overlooking financed emissions mischaracterises back book reporting, accelerates climate change, and exposes financers to reputational and financial risks.

Initially launched in 2015, the Partnership for Carbon Accounting Financials (PCAF), which aligns with TCFD, is designed to enable financial institutions to consistently measure and disclose the GHG emissions financed by their investments and lending activities, including real estate, mortgages and project finance. A PCAF quality score is calculated to represent the accuracy of the portfolio emissions, which is submitted as part of the disclosure. Submitting an objectively higher PCAF score offers more confidence to both regulators and investors.

'Portfolio emissions of global financial institutions on average are over 700x larger than direct emissions, per organization reporting financed emissions'

Disclosure Insight Action

Most firms have pushed Net Zero financed emissions targets far into the future, leaving room for complacency



Each cell represents a single participating firm in the 2021 CBES

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Property data problems

With such varying needs, approaches, and outputs, disclosures need reliable data.

While the Environmental Performance Certificate (EPC) register is a useful open source database that includes data for around 15 million properties in the UK, it is also missing an equivalent amount and operates under an outdated methodology.

For businesses and institutions that own, finance and invest in property portfolios, using EPC data alone to disclose on financed emissions not only leads to misrepresentative reporting, but also mischaracterises the risk exposure of the back book.

Inaccurate location data

Challenge

The lack of standardisation in how constituent parts of an address are recorded can lead to around 20% of properties not being accurately identified; a considerable blind spot. This challenge is compounded by poor EPC coverage, whereby 47% of UK properties do not have an active certificate. Together these challenges leave substantial gaps in portfolio assessment.

Impact

Inability to geolocate properties means that a greater proportion of emissions in the portfolio are derived through modelling, leaving a greater margin for inaccuracy.

Out-of-date methodology and carbon intensity factors

Challenge

EPC assessments, and much of the publicly available property data based on them, operate using a methodology finalised a decade ago. Everything from the carbon intensity of electricity to the expected fuel saving from solar panels is based on 2012 data, accounting for none of the changes in the market, or the recent spike in the cost of energy. It also means that emissions from electricity are usually overstated by a threefold average.

Impact

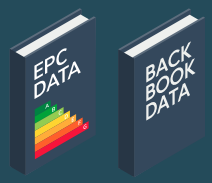
The grid has decarbonised significantly over the last ten years. Not accounting the impact this has on carbon intensity factors leads to financed emissions and risk disclosures that are significantly overstated, delivering worse PCAF scores.

The problems with EPC CO_2

Matching EPC to back book

60%

of companies report incomplete address data



EPC coverage

53%

of domestic properties currently have a valid EPC certificate

EPC carbon intensity factors

519

g CO_2/kWH

applied to all properties and tariffs

Current carbon intensity factors

173

g CO_2/kWH

average for GB over the last 12 months

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Disclosure ready data

Kamma is building the single source of truth for environmental data relating to UK property.

We've mined and modelled hundreds of information sources to create an environmental profile for all 36 million properties in the UK.

Our method calculates financed emissions metrics in line with the 2020 PCAF Global Greenhouse Gas Reporting and accounting standard with greater coverage and accuracy than elsewhere. Using Kamma's data and analysis ensures you can achieve the best possible data quality score and reflect the truest view of your company's carbon footprint.

Kamma's solution

Accurate location data

- Analysis at the property-level
- Address-matching rates of 95%
- Covers of most data gaps in the EPC register
- Models on fewer outstanding properties
- Delivers a complete view of environmental profile

Up-to-date methodology and carbon intensity factors

- Recalculates property EPC emissions based on the latest carbon intensity factor data
- Uses real-time regional data straight from the National Grid
- Adjusts for regional differences
- Incorporate heat pumps, and their carbon intensity factors, into assessments as the solution becomes increasingly common over the coming years

Use cases

Transition and physical risk analysis

- Assess energy efficiency and MEES compliance of a mortgage book or portfolio
- Integrate CBES and NGFS scenarios into analysis
- Assess flood, subsidence, and coastal erosion risk
- Demonstrate effective management of transition risk to PRA in line with SS 3/19

Road to Net Zero

- Report on the carbon emissions of a property portfolio, including Scope 1, 2 and 3 emissions, and embodied carbon
- Segment the major sources and opportunities to improve emissions
- Articulate a data-driven road to Net Zero

Reporting

- Report on financed emissions metrics in line with 2020 PCAF Global Greenhouse Gas Reporting standards
- Improve PCAF scores with a truer representation of the portfolios' carbon footprint
- Comply with ISSB, FCA, and PRA requirements with accurate data as the foundation of the optimum transition to Net Zero

Benchmarking

- Score green assets to qualify more loans for green securitisation and ESG investment
- Benchmark emissions footprint against industry, market and segment data
- Benchmark progress over time

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Contact us now to find out more about how Kamma can support your business to file disclosures, de-risk, and manage property-related assets

Get in touch

How can Kamma help

Kamma works with mortgage lenders, letting agents, local authorities, property funds, housing associations, financial services, and other property-related businesses, supporting their drive to Property Zero. We combine world-leading data collection and address-matching with insightful analysis to articulate the fastest and most cost-effective route to Net Zero. We ensure regulatory compliance, manage risk, identify green growth opportunities and qualify green assets.

Visit the site at
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