SfH Insights:

What TCFD means for social housing

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Sustainability *for* **Housing**

Introduction

As best practice and regulation relating to reporting on Environmental, Social and Governance (ESG) performance evolves, it's important that the Sustainability Reporting Standard for Social Housing (SRS) continues to adapt and align. It is essential to housing providers that there is clear interoperability between reporting requirements and standards.

In the first of our Insight Papers, Sustainability for Housing (SfH) explains how the specifics of one piece of regulation (the recommendations from the Task Force on Climate-Related Financial Disclosures) interacts with the SRS.

What are the TCFD recommendations and why were they created?

Established in 2015 by the Financial Stability Board (FSB) - an international body that monitors and advises the global financial system – the Task Force on Climate-Related Financial Disclosures (TCFD) developed a set of recommendations for disclosing climate-related financial risks and opportunities in mainstream corporate reporting[1].

The framework asks companies to report on how climate change will affect their business in a consistent, comparable, and reliable way. It aims to enable businesses, investors, lenders, and other stakeholders to make more informed financial decisions that take account of material climate-related risks and opportunities. Since publication in 2017[2], the recommendations have been praised for addressing fragmentation in corporate reporting practices and have gained significant traction globally.

The recommendations include the requirement to report on direct and indirect CO2 emissions – known as Scope 1, 2 and 3 Green House Gas (GHG) emissions. They also recommend that organisations set out their own key, quantitative targets for managing climate-related risks and opportunities.

Who oversees the TCFD recommendations?

From 2024, company reporting on climate-related disclosures will be monitored by the IFRS Foundation's International Sustainability Standards Board (ISSB) – an international standard-setting body for sustainability disclosures – into which TCFD has been subsumed[3]. The ISSB has fully incorporated the TCFD recommendations into the ISSB Standards[4], with IFRS S2 Climate-related Disclosures consistent with the TCFD's four Recommendations and 11 Recommended Disclosures[5]. Companies that apply the ISSB Standards will automatically meet the TCFD recommendations.

Companies can continue to use the TCFD recommendations should they choose (or be required) to do so, but many can use the recommendations as a good entry point as they move to use the ISSB Standards. The incorporation of the recommendations into the ISSB Standards provides yet further streamlining of the so-called 'alphabet soup' of disclosure initiatives for companies and investors.

1 TCFD, 2023
2 TCFD, 2017
3 IFRS, 2023
4 IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information; IFRS S2 Climate-related Disclosures
5 IFRS, 2023

Who do the recommendations apply to?

In 2021, the UK became the first country to make reporting mandatory for large companies[6], in order to position itself as a leader in green finance. For companies with accounting periods beginning on or after 6th April 2022, financial players (such as large banks, insurance companies, asset owners and asset managers) as well as large UK registered companies and Limited Liability Partnerships (with more than 500 employees and a turnover of over £500 million), will be required to disclose[7].

Why are the recommendations relevant to the social housing sector?

While the UK initially focused the recommendations on financial institutions and large companies, they are intended for widespread use, and can be applied to organisations across various industries. There is no specific requirement on social landlords to report against TCFD yet (unless they or their subsidiaries are governed by the UK Companies Act and meet a size large enough to be in scope) but given the threats that climate change poses to housing stock and supply chains, some organisations are beginning to voluntarily follow the recommendations. Several of the UK's largest housing associations, such as Clarion[8] and L&Q[9], have recently published TCFD reports.

With c.£130 billion of private finance supporting the UK's social housing sector, many lenders and investors who themselves are subject to TCFD compliance, will also be looking to their portfolio investees to provide climate-related information[10]. To continue to be a sector in receipt of sustainable investment, housing associations will likely have to embrace transparency and sustainability reporting going forward (e.g. sharing emissions reductions targets, and progress against them). With the UK government announcing its intention to make TCFD-aligned disclosures mandatory across the economy by 2025[11], it could be an inevitable disclosure journey.

6 UK Government, 2021
7 Department for Business, Energy & Industrial Strategy, 2022
8 Clarion Annual ESG Report, 2022
9 L&Q TCFD Report, 2023
10 Inside Housing, 2023
11 HM Treasury, 2020

What are climate-related risks and opportunities, and how are these relevant to the social housing sector?

The social housing sector is vulnerable to various climate-related risks, and addressing these challenges as a sector is crucial for ensuring the resilience and sustainability of housing developments. Climate-related risks are broken into two major categories, both of which are relevant to the sector:

- **Transition risks:** risks related to the transition to a lower-carbon economy. These include shifts in policy and litigation, technology, customer behaviour and reputation.
- **Physical risks:** risks related to the physical impacts of climate change. These can be acute risks such as extreme weather events (i.e. house flooding and overheating risk), or chronic risks such as longer-term shifts in climate patterns which affect supply chains.

On the other hand, climate-related opportunities are those that can provide organisations with long-term stability and contribute to sustainable development. These opportunities enable housing associations to address climate-related challenges, become more resilient for residents, their communities and the UK's future housing supply. These include, but are not limited to:

- Energy efficient technologies and retrofit works such as air source heat pumps, Smart meters, and automated Heating, Ventilation and Air Conditioning (HVAC) systems.
- Renewable energy integration such as solar panels, and green building design such as green roofs and rainwater harvesting.
- Access to green financing mechanisms and incentives, such as grants, subsidies, and sustainability-linked loans.

What does reporting against the recommendations entail?

The recommendations are structured around four thematic areas: governance, strategy, risk management, and metrics and targets. These four recommendations (i.e. the 'Recommendations') represent core elements of how organisations operate, and request the following information to be disclosed (i.e. the 'Recommended Disclosures')[12]:

- **Governance:** The Board's oversight on (Disclosure 1), and management's role in (Disclosure 2), assessing and managing climate-related risks and opportunities.
- **Strategy:** The organisation's short-, medium- and long-term climate-related risks and opportunities (Disclosure 3), their actual and potential impact on the organisation (Disclosure 4), and the resilience of the strategy in place to manage them across various climate-related scenarios (Disclosure 5).
- **Risk Management:** The process for identifying and assessing climate-related risks (Disclosure 6), how these risks are managed (Disclosure 7), and how this is integrated into overall risk management (Disclosure 8).
- **Metrics and Targets:** The metrics used to assess and manage the relevant climate-related risks and opportunities (Disclosure 9), including disclosure of GHG Scope emissions - Scope 1, 2, and if appropriate, Scope 3 (Disclosure 10), and the targets used to assess performance (Disclosure 11).

In addition, the Task Force published guidance to support all organisations disclose in line with the recommendations, as well as supplemental guidance for specific sectors[13]. Industries identified as having a high likelihood of climate-related financial impacts span financial and non-financial industries and include real estate development and management. Further guidance continues to be published[14].

What are GHG Scope 1,2, and 3 emissions?

As defined by the **GreenHouse Gas Protocol** – Scope 1, 2 and 3 emissions are the most commonly used standard for reporting direct and indirect greenhouse gas emissions. For reporting purposes, all emissions are converted into $kgCO_2$ equivalent.

- **Scope 1 emissions** are the Direct emissions that are owned or controlled by a company
  E.g. Fuel used in the companies vehicles
- **Scope 2 emissions** are the Indirect emissions that a company causes by purchasing and using energy
  E.g The Electricity used to heat the company offices
- **Scope 3 emissions** are the indirect emissions that are caused by a companies value chain, both upstream and downstream. In the case of housing associations, this may include emissions from the energy used by their tenants in their homes, and their supply chain.

12 TCFD, 2023
13 TCFD Guidance on Implementing the Recommendations, 2021
14 https://www.gov.uk/government/publications/tcfd-aligned-disclosure-application-guidance

Where and how do organisations report?

The Task Force recommends that organisations provide disclosures in their mainstream (i.e., public) annual financial filings to improve the linkage and consistency between sustainability performance reports and financial statements. For most UK housing providers, this would form part of their Strategic Report that goes alongside the Financial Statements. Despite being in an organisation's Annual Report, the disclosures are not subject to an auditor assurance [15].

Reporting entities are expected to apply a 'comply or explain' basis for disclosures. The Task Force also developed seven principles for effective disclosure, which should help achieve high-quality and decision-useful disclosures that enable users to understand the impact of climate change on organisations. The principles state that disclosures should [16];

1. Represent relevant information
2. Be specific and complete (i.e. also avoiding any omissions) (as aligned by the FCA to the Greenwashing Rule)
3. Be clear, balanced, and understandable
4. Be consistent over time
5. Be comparable among companies within a sector, industry, or portfolio
6. Be reliable, verifiable, and objective
7. Be provided on a timely basis

When considering how to implement TCFD recommendations, reporting entities must apply judgement in setting relevant boundaries. Their breadth will depend on the specific circumstances (e.g., their activities, relationships, stakeholders, etc.). The disclosure is likely to develop over successive iterations, as the organisation's understanding on this topic deepens.

What are the benefits of reporting against the TCFD recommendations?

There are several benefits to completing the TCFD reporting process, which include:

- Enhanced Risk Management: By being required to disclose on climate-related risks, organisations can better identify potential threats to their operations and value chains. Where risks are high, such as with stock in flood-prone areas, providers can prioritise further analysis to understand risk levels and their resilience. This enables organisations to keep their residents safe and financial values of their stock in the long-term.
- Improved Strategic Planning: Organisations are prompted to evaluate their strategies - in terms of business models, operations, and long-term financial performance - in the context of climate change, which helps inform strategic planning, mitigation steps, and budgeting.
- Improved Investor Confidence: Funders increasingly consider climate-related risks and opportunities when making investment decisions. Some funders offering sustainable financing products may prioritise or offer favourable funding terms to housing providers that can demonstrate climate risk awareness and mitigation strategies.
- Regulatory Compliance: As regulatory bodies worldwide focus more on climate-related financial disclosures, organisations that align with TCFD recommendations may find it easier to comply with evolving requirements, thereby reducing compliance costs and ensuring sooth interactions with regulators.
- Stakeholder Engagement: TCFD reporting fosters better communication with stakeholders, including investors, customers, employees, and communities. It demonstrates an organisation's commitment to transparency, sustainability, and responsible governance, which can enhance trust and relationships within and outside of the organisation.

15 UK Government, 2023
16 Appendix 3; TCDF, 2017

How does this relate to the SRS?

TCFD is a high-level reporting framework focused on reporting climate-related financial information. Launched in November 2020, the SRS provides a more holistic and detailed framework for housing providers to report on their ESG performance. Much like the TCFD recommendations, the framework asks for ESG information in a consistent, comparable, and reliable way, with the aim of enabling housing providers, investors, lenders, and other stakeholders to make more informed decisions.

The SRS is comprised of 12 themes - ranging from resource management and ecology, through to resident voice and staff wellbeing – and asks for disclosures against 46 criteria. The specificity of the TCFD recommendations, which ask for information only on climate-related risks and opportunities, rather than ESG performance more broadly, is a defining distinction between the two frameworks.

This distinction results in two differences in disclosure scope and use:

1. The SRS covers a wider range of E, S and G criteria designed to help stakeholders analyse a housing provider's impact on society and the environment, as well as how it is impacted by sustainability issues. It is therefore more closely aligned with the concept of "double materiality" under the European Corporate Sustainable Reporting Directive.
2. TCFD offers detailed climate-related risk information, but focuses on the impact of externalities on an organisation and its financial position, otherwise known as single materiality.
3. Housing providers that report against the SRS stress the importance of having a reporting framework that enables them to demonstrate the positive difference they are making to residents and their communities.
4. The specificity required in TCFD disclosures – including detailed scenario testing, case studies and practical applications - offers more targeted guidance around strategy, risk management and target setting in relation to climate-related risks and opportunities and financial reporting.

Certain disclosures appear in both frameworks; for example, SRS Criterion 5 and TCFD Recommended Disclosure 10 both request entities to report their Scope 1, 2 and 3 GHG emissions, and SRS Criterion 6 and TCFD Recommended Disclosures 6 and 7 ask how organisations identify, assess, and mitigate climate-related risks. Others align more broadly; for example, both recognise the importance of corporate governance. SRS Criterion 29 asks how the Board manages all ESG risks, whereas TCFD Recommended Disclosures 1 and 2 asks for the Board's oversight on, and management's role in, managing climate-related risks and opportunities specifically. This alignment is important and was a significant consideration during the most recent update to the Standard - SRS Version 2.0 - published in October 2023.

As reporting against the TCFD recommendations becomes more widespread, we expect disclosures against the relevant SRS criteria to evolve and improve. Such disclosures may include metrics and extracts from TCFD reports, with detailed information on climate scenarios for example, or could include summaries of, and signposting to, TCFD content. As SRS Version 2.0 now recommends, referring back to results or commitments in previous years and commenting on how these have evolved or been acted on in the past year, is seen as good practice.

Disclosure frameworks should continue to speak to, and build upon, each other, whilst appreciating the need for divergences. As TCFD can span all sectors and industries, the SRS continues to be a holistic ESG reporting framework which aims to meet the needs of the social housing sector and its funders. While the SRS provides some disclosure that is relevant to TCFD, we would recommend that providers looking to disclose against TCFD more explicitly should explore this independently of the SRS.