

## MEMO

Subject: **Lennar (LEN), The Ryland Group (RYL) and Standard Pacific (SPF)**  
Grounds for YES votes on shareholder resolutions concerning climate change

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### **Rationale for YES votes:**

1. Climate change will impact all sectors of the economy, including homebuilders.
2. Homebuilders need to assess and disclose climate risks.
3. Establishing emission reduction goals could help builders prepare for future regulation and provide a competitive advantage.

### **Climate change will impact all sectors of the economy, including homebuilders.**

Anthropogenic climate change is now generally accepted as a scientific reality. In 2007, a report by the Intergovernmental Panel on Climate Change (IPCC) concluded that warming of the climate system is unequivocal and that human activity is the main cause. Among the vast majority of scientists and governments—and a growing number of multinational corporations—debate now centers not on whether a problem exists but rather on the best means of adaptation and abatement.

With the growing acceptance of anthropogenic warming as scientific fact has come a corresponding increase in the recognition that climate change will have significant impacts across all sectors of the global economy. The IPCC has concluded that, “Taken as a whole, the range of published evidence indicates that the net damage costs of climate change are likely to be significant and to increase over time.”<sup>i</sup> Mainstream financial institutions have also begun to sound the alarm. Goldman Sachs has said it is very concerned about the threat that climate change presents to the economy<sup>ii</sup> while Alliance-Bernstein has predicted that regulation aimed at reducing GHG emissions will have profound implications for companies across a wide swath of industries.<sup>iii</sup>

No sector is immune to the risks posed by climate change. These include regulatory, competitive, physical and litigation risks, all of which could arguably impact the U.S. homebuilding industry. Physical risks, for instance, could include delays to new home deliveries caused by severe weather conditions<sup>iv</sup> such as hurricanes, droughts and wildfires, all of which are thought to be intensified by the rising temperatures associated with climate change.<sup>v</sup>

It is possible that litigation risk could also impact the homebuilding industry. The auto industry has already been the target of litigation. An action brought by the Attorney

General of California asserted that emissions from the auto companies' products have impacted the climate and damaged the state. Although a federal District Court judge dismissed the complaint, California has appealed the decision.<sup>vi</sup> With the average home responsible for at least as many emissions as the average car,<sup>vii</sup> it is not out of the realm of possibility that future climate change litigation could focus on the homebuilding industry.

Perhaps even more worrisome for Lennar, Ryland and Standard Pacific, all companies with little to no disclosure pertaining to climate risk, is the specter of shareholder derivative actions focusing on the adequacy of climate risk disclosure. According to the national practice leader for Emerging Environmental Risk at Marsh:

Increasingly, shareholder derivative actions are centering on the adequacy and fairness of management disclosure — particularly as it relates to future trends that could have a profound effect on investment performance. That being the case, it's not difficult to imagine a scenario where shareholder derivative litigation focuses squarely on the quality of a company's climate risk disclosure.<sup>viii</sup>

If this is indeed a possibility, it is conceivable that these companies are unwittingly establishing themselves as future targets of such lawsuits through their failure to provide any type of climate risk disclosure.

The homebuilding sector also faces potential regulatory risks. Homes are a significant source of GHG emissions. According to the *Washington Post*, “Buildings are the largest source of the greenhouse-gas emissions that are causing global warming, and in the United States, half of building-related emissions are from houses.” Couple this with the advent of numerous studies<sup>ix</sup> pointing to energy efficiency increases in buildings as one of the most cost effective means of reducing GHG emissions, and it's a good bet that future climate change regulation in the U.S. will look to the homebuilding industry as a potential source of emission reductions.<sup>x</sup>

In a piece examining a cost curve for greenhouse gas reduction, the *McKinsey Quarterly* suggested that policy makers wishing to implement cost-effective abatement measures should identify ways to effectively address reduction opportunities in buildings.<sup>xi</sup> While this has not yet been undertaken to a large extent in the U.S., other countries are seriously pursuing reduction opportunities associated with the residential end-use sector.

According to the European Energy Network's assessment of the implementation of the European Union's Energy Performance of Buildings Directive, 20% of EU countries already have fully operational Energy Performance Certificate programs in effect for residential new build.<sup>xii</sup> In England all new homes will be required to be carbon neutral by 2016.<sup>xiii</sup> Code level 2, requiring an 18% energy improvement over 2006 building regulations, is already mandatory and code level 3, requiring a 25% improvement over 2006 levels, is expected to go into effect for private developers in 2012.<sup>xiv</sup> According to a leading provider of independent financial information in the UK, “With the UK's housing stock responsible for nearly 30% of all CO2 emissions, the Government believes

that these measures are critical to meeting its targets of cutting CO2 emissions by 60% by 2050.”<sup>xv</sup>

In the U.S., the new energy secretary, Steven Chu, is recognized as a huge proponent of energy efficiency. In a widely quoted interview with Reuters, Chu asserted that, “If I were emperor of the world, I would put the pedal to the floor on energy efficiency and conservation for the next decade.” The same article went on to note that addressing energy waste in residential buildings is high on Chu’s priority list.<sup>xvi</sup>

Business leaders in the U.S. are also pushing for efficiency improvements and stricter building codes. The U.S. Climate Action Partnership, a coalition of leading American companies and environmental groups, recently reiterated its call for Congress to develop and implement stricter energy efficiency standards for buildings, noting that such standards must be updated on an expedited and aggressive basis.<sup>xvii</sup>

While it may seem that such regulation is a long way from becoming a reality in the U.S., it is useful to keep in mind how quickly the regulatory environment can change. The Executive Chairman of the UK Home Builders Federation made the following remarks in a speech he gave in March of 2007:

It is astonishing to see how quickly the climate change agenda has assumed a newfound primacy in today’s political narrative. It is now, I believe, the prism through which all public policy is judged...Frankly I cannot recall anything which has risen up the political agenda or seeped into the public consciousness so quickly. When I started at my role at the HBF [in 2006] it was barely on the radar screen...nothing in my lifetime has risen to prominence so quickly.<sup>xviii</sup>

If climate regulation eventually moves with such speed in the U.S., will the homebuilding industry be prepared to confront the challenge? At the moment, given the lack of disclosure at many companies within the sector, investors can only guess.

### **Homebuilders need to assess and disclose climate risks.**

In its alert “Climate Change: Business Risks and Solutions” risk consulting company Marsh observes that, “The way in which companies respond to the new operational and strategic risks and opportunities of climate change will have far reaching impacts on corporate profitability and shareholder value.” The alert then suggests that a logical starting point for businesses wishing to get a grip on climate risk is the establishment of a GHG emissions baseline covering operations, electricity use and products. Finally, the alert recommends that, “After conducting a thorough initial assessment, companies should consider adopting and enacting company-wide goals and policies—when applicable—to reduce climate risk exposures.”<sup>xix</sup> Presumably this includes the establishment of emission reduction targets for products and operations.

Marsh is far from alone in suggesting that the first step in managing corporate climate risk is the establishment of an emissions baseline. There is wide-spread acceptance of the fact that you can’t manage what you haven’t measured.

In the last year, there has been substantial movement among some companies in the homebuilding industry towards both increased disclosure and concrete action to reduce GHG emissions. Both KB Home and Centex have released sustainability reports with information on climate change and supplied information via the Carbon Disclosure Project. In addition, both companies have set targets for increasing the energy efficiency of the homes they build and KB Home has established a qualitative framework based on the WRI GHG protocol for describing its carbon footprint. Meanwhile, companies like Lennar, Ryland and Standard Pacific continue to lack even basic climate change disclosure. None of the three companies with resolutions still pending appear to be anywhere near the completion of a GHG emissions assessment, let alone the establishment of a GHG emissions baseline covering operations, electricity usage and products as recommended by the Marsh report and others.

| <b>Company</b>     | <b>Climate Change and/or Emissions Reporting</b>  | <b>Energy Efficiency Disclosure and/or Goals</b>  | <b>Carbon Disclosure Project 6</b>  | <b>Other Company Disclosure<sup>xx</sup></b>   |
|--------------------|---|---|---|--|
| <i>Centex</i>      | No overt climate reporting. 2007 Corporate Responsibility Report does briefly discuss carbon emissions.   | <b>Yes – Disclosure &amp; Goals.</b> Website includes information. All homes are built using CTX’s Energy Advantage Program, <sup>xxi</sup> estimated to increase efficiency up to 22%.   | <b>Yes - Provided information.</b> Also provided information for CDP 4.             | Company stresses energy efficiency of its homes as a major selling point throughout its website and in its marketing materials.  |
| <i>D.R. Horton</i> | No.   | <b>Yes – Disclosure.</b> “Energy Efficiency Statement” on website.  | No response. Provided information to CDP 5.   | Division level participation in several energy efficiency programs.  |
| <i>KB Home</i>     | <b>Yes – Climate Change &amp; Emissions.</b> Extensive coverage in Sustainability Report. Report also includes benchmark of energy use and estimation of operational GHG emissions. | <b>Yes – Disclosure &amp; Goals.</b> Website includes information. All homes in new communities built to Energy Star guidelines beginning in 2009. According to KB, Energy Star homes are typically 20 to 30% more efficient than standard homes. <sup>xxii</sup> | <b>Yes - Answered questionnaire.</b> Also provided information for CDP 4 and CDP 5. | My Home. My Earth. <sup>TM</sup> Initiative. CEO letter in the 2008 Annual Report includes information on Energy Star commitment. Website includes in-depth section on environmental issues. |
| <i>Lennar</i>      | No.   | No. <sup>xxiii</sup>  | No. Declined to participate. Did not respond to CDP 4 or 5.                         | <b>None found.</b>   |
| <i>Pulte Homes</i> | <b>Pending – Climate Change and Emissions.</b> Both climate change and  | <b>Yes – Disclosure.</b> Website discusses energy efficient homes. Under 2009 withdrawal agreement,   | No response to CDP 4, 5 or 6. <b>Company has agreed to respond in 2009</b>          | Web section on social responsibility includes a small section on the environment.  |

|                         | emissions disclosure are said to be pending. | Pulte will disclose the number of homes built above code and discuss strategies to increase this number. | under terms of withdrawal. |  |
|-------------------------|--|--|----------------------------|--|
| <i>Ryland</i>           | No.  | No. <sup>xxiv</sup>  | n/a                        | Website includes some information on division level participation in energy efficiency programs. |
| <i>Standard Pacific</i> | No.  | No. <sup>xxv</sup>   | n/a                        | None found.  |

**Establishing emission reduction goals could help builders prepare for future regulation and provide a competitive advantage.**

As noted above, Marsh suggests that companies follow-up on the establishment of an emissions baseline by adopting company-wide goals to reduce climate risk exposure. A piece in the *Harvard Business Review* makes a similar recommendation, urging companies that are preparing to develop a climate strategy to consider three steps, one of which is taking action to reduce carbon emissions and assessing the business opportunities associated with doing so.<sup>xxvi</sup>

For homebuilders, establishing a quantitative goal for reducing product emissions is essentially the same as setting a goal to increase the energy efficiency of their products. And there are certainly business opportunities associated with such efforts. Several U.S. homebuilders, including Pulte Homes, have used energy efficiency as a strategy to distinguish themselves from competitors and gain entry into highly competitive, and profitable, markets. A March 5, 2008 *Wall Street Journal* article proclaimed that homebuilders in the U.S. were going green out of necessity. The article quoted KB Home CEO Jeffrey Mezger as saying, “We definitely think [green building is] a selling point, and we think it’s here to stay.”<sup>xxvii</sup> As home sales have continued to decline, interest in energy efficiency among many builders has only increased. According to an article in the *Detroit Free Press*, “You have significant challenges in residential homebuilding so [energy efficiency is] a competitive tool on behalf of the homebuilder...interest in Energy Star has risen as the building boom has waned.”<sup>xxviii</sup>

Even if it weren’t for these opportunities, there would still be plenty of reason for homebuilders to set emission reduction targets for their products. Regulatory risks associated with tightening efficiency standards are arguably one of the greatest climate risks facing the homebuilding sector. In the UK, homebuilders have essentially had emission reduction targets established for them. Within the next 7 years, British builders will be required by law to build homes with NO net emissions whatsoever. Given the Obama administration’s commitment to addressing climate change and the energy secretary’s emphasis on the role of energy efficient buildings in doing so, the case could eventually be much the same in the United States.

Those companies that already have a handle on their products' emissions and have voluntarily set about increasing the energy efficiency of the homes they build will be in a much better position to respond to possible future regulation than those that are caught off guard. British builder Berkeley Homes, for instance, has said that its extensive understanding of the EcoHomes methodology, which is voluntary for those developments not receiving grant funding from England's Housing Corporation, helped to prepare the company for the introduction of England's Code for Sustainable Homes.<sup>xxix</sup>

Setting voluntary goals now will give companies the flexibility to innovate and experiment on their own terms, without the pressure of mandatory emission reduction requirements. It might also allow them to establish beneficial relationships with suppliers of energy efficient technologies. And it will certainly allow their staff to gain experience using such technologies.

Such efforts are not without precedent. In the U.S., KB Home included in its most recent sustainability report a discussion of the fact that the end use of its products generates significantly more GHG emissions than its operations and described steps the company is taking to address this problem. The company has, in effect, already committed to reducing emissions and increasing the energy efficiency of its products by committing to build all homes in new communities to Energy Star® guidelines beginning this year. Centex has also committed to building more energy efficient homes. A suite of energy efficient features is now installed in every home Centex builds nationwide. In a press release announcing the decision, Centex noted that it would result in a significant reduction in the carbon footprint of each home the company builds.<sup>xxx</sup>

Andrew Hoffman and John Woody conclude in their piece in the *Harvard Business Review* that, “[The] only question in a carbon-constrained world is this: Will you be a winner or a loser—and how are you going to figure it out?” Companies wishing to get started on answering these questions would do well to follow the recommendations of Hoffman, Woody and numerous other experts; establish a baseline, assess their risk and set clear goals for reducing it. This is just what shareholders are asking Lennar, Ryland and Standard Pacific to do.

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<sup>i</sup> Intergovernmental Panel on Climate Change. (April 2007). *Climate Change 2007: Impacts, Adaptation and Vulnerability*.

<sup>ii</sup> Goldman Sachs. (November 2005). *Goldman Sachs Environmental Policy Framework*.

<sup>iii</sup> AllianceBernstein. (January 2008). *Abating Climate Change: What Will be Done and the Consequences for Investors*.

<sup>iv</sup> It is worth noting that Lennar, Ryland and Standard Pacific all mention risks associated with severe weather conditions in their 10-Ks, but none discuss the fact that climate change is thought to increase the frequency and severity of extreme weather events.

<sup>v</sup> Associated Press. (June 19, 2008). *Climate Change to Spur Extreme Weather*.

<sup>vi</sup> <http://ag.ca.gov/globalwarming/litigation.php>.

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- <sup>vii</sup> [http://www.energystar.gov/index.cfm?c=new\\_homes.nh\\_benefits](http://www.energystar.gov/index.cfm?c=new_homes.nh_benefits).
- <sup>viii</sup> MMC Viewpoint. (January 2007). *A Change in the Weather: New Climate Change Challenges Increase the Potential for Litigation and Regulation*. Guzy, Gary.
- <sup>ix</sup> For examples see:
- Enkvist, Per-Anders, Nauclér, Tomas, & Rosander, Jerker. (2007). A Cost Curve for Greenhouse Gas Reduction. *The McKinsey Quarterly, Number 1*.
- Farrell, Diana, Nyquist, Scott, & Rogers, Matthew C. (July 2007). Curbing the Growth of Global Energy Demand. *The McKinsey Quarterly*.
- The National Commission on Energy Policy. (December 2004). *Ending the Energy Stalemate: A Bipartisan Strategy to Meet America's Energy Challenges*.
- <sup>x</sup> A January 2007 report from Citigroup ((Citigroup. (January 2007). *Climatic Consequences: Investment Implications of a Changing Climate*. Geraghty, Michael & Kerschner, Edward, CFA.)) noted that that three sectors—electricity generation, transportation and the building sector—account for fully 70% of emissions and, as such, are the focus of a number of regulatory initiatives.
- <sup>xi</sup> Enkvist, Per-Anders, Nauclér, Tomas, & Rosander, Jerker. (2007). A Cost Curve for Greenhouse Gas Reduction. *The McKinsey Quarterly, Number 1*.
- <sup>xii</sup> European Energy Network. (January 2008). *Implementation of the EU Energy Performance of Buildings Directive – a snapshot report*.
- <sup>xiii</sup> BBC News. (December 13, 2006). *Zero Carbon Homes Plan Unveiled*.
- <sup>xiv</sup> <http://www.south-facing.co.uk/building-professional-Codesandregulations.aspx>.
- <sup>xv</sup> [http://www.moneyfacts.co.uk/Ethical/articles/carbon-neutral-homes.aspx?WT.mc\\_id=343435](http://www.moneyfacts.co.uk/Ethical/articles/carbon-neutral-homes.aspx?WT.mc_id=343435).
- <sup>xvi</sup> Anderson, Leonard. (May 9, 2007). Climate Change Threatens California Water Supply. *Reuters*.
- <sup>xvii</sup> U.S. Climate Action Partnership. (January 2009). *A Blueprint for Legislative Action: Consensus Recommendations for U.S. Climate Protection Legislation*.
- <sup>xviii</sup> Baseley, Stewart. (March 22, 2007). *The House that Bjorn Built*.
- <sup>xix</sup> Walsh, Tom. (April 2006). Climate Change: Business Risks and Solutions. *Marsh Risk Alert, Volume V, Issue 2*.
- <sup>xx</sup> Excludes any disclosure contained in the companies' statements of opposition to the shareholder proposals in question.
- <sup>xxi</sup> Centex estimates that Energy Advantage homes are up to 22 percent more energy efficient than comparable homes built to the most widely used energy efficiency code, the 2006 International Energy Conservation Code.
- <sup>xxii</sup> KB Home. (February 3, 2009). KB Home to build all new homes communities to strict Energy Star® guidelines in 2009. News release. Retrieved on February 5, 2009.
- <sup>xxiii</sup> The “Why Buy New?” section of Lennar’s website does cite long-term financial savings associated with energy efficiency as a reason to buy a new home rather than an existing home. See <http://www.lennar.com/buy-a-home/Why-Buy-New.aspx>.
- <sup>xxiv</sup> The “New vs. Pre-Owned” section on the company’s website does mention energy savings as a reason to choose a new home.
- <sup>xxv</sup> In the “New vs. Used” section of the company’s website does mention that new homes tend to be more energy efficient.

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<sup>xxvi</sup> Hoffman, Andrew J. and John Woody. (February 19, 2008.) Winners and Losers in a Carbon-Constrained World. *Harvard Business Review*.

<sup>xxvii</sup> Carlton, Jim. (March 5, 2008). Home Builders Go 'Green' To Seek New Selling Point. *The Wall Street Journal*.

<sup>xxviii</sup> Guest, Greta. (January 19, 2009). Pulte to Raise Home Energy Efficiency, Hopes to be Leader. *Detroit Free Press*.

<sup>xxix</sup> The Berkeley Group Holdings, plc. (2007). *Berkeley Sustainability Report 2007*.

<sup>xxx</sup> Centex. Centex Energy Advantage Fact Sheet. Retrieved on March 12, 2009.

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