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INSIGHT

Managing climate related risk in investment portfolios

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CORPORATE

At IFM Investors, we view climate change as a significant risk we face as long-term investors. As fiduciary investors, we believe that managing this risk will help us deliver on our purpose - to protect and grow the long-term retirement savings of working people.

This is the second article in a 2-part series on climate risk. In the first article, *The investment risks of climate change*, we detailed how we assess and better understand climate related investment risks across the asset classes in which we invest – infrastructure, equities, debt and private equity. In this article, we explain how we are managing climate related risks in our investment portfolios, including what we have achieved already and what we hope to do in the future.

> **As fiduciary investors, we believe that managing climate risk will help us deliver on our purpose - to protect and grow the long term retirement savings of working people.**

Our approach

We recognise that climate change presents both transition and physical risks to our investments. Therefore, it's important to understand these dimensions of risk across our investment portfolios, and to develop plans to adapt and/or mitigate the worst impacts, and protect and increase the resilience of our assets over the long term.

As supporters of the Paris Agreement, we explicitly factor climate change risk into all of our investment decisions. We also engage and work with investee companies to support their transition to a low-carbon economy in ways that create positive environmental and social outcomes, and through those, better commercial and investment outcomes.

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In 2016, we developed our Responsible Investment Charter, which sets out the core beliefs, pillars and principles that define our responsible investment behaviours and approach. This charter acknowledges the risks of climate change and articulates our view that 'climate change impacts assets' and 'the long-term strength and sustainability of the global economy is only possible if we have a healthy environment'. Our Environmental, Social and Governance (ESG) Policy expands on this, along with other responsible investment principles, and guides our investment decisions.

In mid-2020, we developed our Climate Change Position Statement, which further articulates the beliefs and commitments underpinning our thinking and our actions as we focus on managing climate-related risks and opportunities.

In October 2020, we announced a commitment to reduce greenhouse gas emissions across our asset classes, targeting net zero by 2050. To give effect to our commitment we have established a multi-disciplinary taskforce, spearheaded by our investment and strategy teams. The taskforce will consider the following:

- Establishing further emissions reduction commitments
- Developing policies for net-zero transition plans for new and existing unlisted assets
- Enhancing investment decision-making and governance frameworks when considering climate change risks and alignment with emission reduction objectives
- Identifying investment opportunities in decarbonisation and climate-resilient assets, and ensuring that IFM continues to develop capabilities to capture these opportunities
- The evolution of technologies and better understanding of likely transition pathways, especially in the energy mix.

As part of this commitment, IFM itself will become a carbon neutral organisation. This is a natural step and an important one, as it reflects our purpose, which is to protect and grow the retirement savings of working people.

Our net zero by 2050 commitment and the remit of the taskforce is an extension of the work we have already undertaken to identify, understand and manage climate change risk across our four asset class portfolios. This work and future steps we plan to take to progress our approach are outlined over the following pages.

Reducing our infrastructure carbon footprint

Infrastructure is where we have the greatest degree of influence through our funds' ownership stake and board appointments at most investee companies.

This means we can encourage, support and drive change. Our critical infrastructure networks (toll roads, ports, airports, electricity transmission and distribution, midstream pipelines, and water and heating utilities) provide essential services to communities and economies around the world. However, we also recognise their impact on the environment and the potential climate change-related physical and transition risks they face.

Our Australian Infrastructure Carbon Reduction and Energy Efficiency Program is a tangible example of our commitment to working with assets to transition to a low-carbon world. Its overarching aim is to protect investment value and returns by creating positive commercial and environmental outcomes and mitigating future business risks associated with climate change. Key underlying objectives include:

- Reducing individual asset emissions;
- Increasing asset resilience over time by shifting to lower carbon technologies; and
- Building asset-level understanding and capacity to manage climate risk.

The program started in 2018 and initially involved participating Australian infrastructure assets setting individual emissions reduction targets and pathways through to 2030[1]. These were publicly announced in 2019[2].

During the first year of the program (FY18/19), our Australian infrastructure portfolio achieved an 8.3 per cent reduction in total scope 1 and scope 2 emissions.

The program was extended to our global infrastructure portfolio assets in 2020. Some of these assets have already set individual emissions reduction targets and pathways, whilst the remainder are expected to do so during 2021.

[1] Participating assets represent 90 per cent of the Australian infrastructure portfolio's assets under management and approximately 98 per cent of the portfolio's total scope 1 and scope 2 carbon emissions.
[2] More details are available at https://www.ifminvestors.com/about-us/responsible-investment/esg-focus-areas/#australian-infrastructure-emissions-reduction-initiative

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Building climate resilience across infrastructure assets

Many of the assets in our infrastructure portfolio have already initiated climate change adaptation and/or mitigation projects. For example, Australian airport assets have developed strategies to reduce bushfire risks, including the implementation of a two-stage seasonal and area-specific burning strategy. They have also augmented infrastructure and made commitments to measures to mitigate flood risk. Our UK water assets also have a range of mitigation actions already in place, including a £160m investment in drought planning, and they have delivered an adaptation strategy to the UK government.

Other strategies we are implementing include energy efficiency programs; behind the meter renewable energy installations; smart and energy efficient building design; low emissions vehicles; and electrification of operational plant and equipment using onsite renewable energy.

To further this process, we are continuing to engage with our assets to better understand adaptation and mitigation projects in train or planned. We are encouraging each asset to develop their own medium to long-term climate change adaptation and mitigation plans. Additional work at an asset level may also be undertaken in situations where we feel there may potentially be increased exposure to hazards.

Some detailed examples of these strategies from our infrastructure portfolio are highlighted in the breakout boxes below.

LED LIGHTING

Improving energy efficiency

One of the most cost-effective and easy to implement energy efficiency improvement strategies is the replacement of energy-hungry lighting with modern energy-saving LED equivalents. This strategy can deliver both emissions reductions and operational cost savings.

- In 2017, Brisbane Airport replaced more than 10,000 fluorescent lights with LED equivalents across three parking areas. In the first month of operation, power usage across the three car parks fell approximately 55 per cent. On an annual basis, the reduced energy costs translate to an emissions reduction of 2925 tonnes of CO_2 – equivalent to the energy use of 270 Households in a year – as well as a net operational saving of more than A$3 million for the Airport[3].

- In 2019, Melbourne's Southern Cross Station replaced fluorescent lighting in a section of its 24/7 car park with energy efficient LED lights. This led to a 17 per cent decrease in energy consumed[4].

“ In the first month of operation, power usage across three Brisbane Airport car parks fell approximately 55 per cent.

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[3] Source: IFM Investors and https://www.parking.asn.au/brisbane-airport-lighting-upgrade/
[4] Source: IFM Investors
[5] Source: NT Airport Solar Case Study

RENEWABLES

Behind the meter renewable energy installations

Operational energy cost savings, emissions reductions, and energy security and reliability are the key drivers of behind the meter renewable energy installations across many of our infrastructure assets.

The majority of our Australian infrastructure portfolio companies have installed behind the meter solar energy generation capacity. One of the early adopters of this technology was Northern Territory Airports. Solar panel installations at Darwin International Airport and Alice Springs Airport offset carbon emissions equivalent to the electricity consumption of more than 1,600 households annually and have reduced electricity costs by around A$2.3 million each year[5].

It was a significant year for renewable energy generation at Anglian Water (UK) in 2019. Through a combination of new and existing solar PV installations, wind turbines and a fleet of Combined Heat and Power engines fuelled by biogas produced at sludge treatment centres, the water utility generated a total of 131GWh across its estate – a 30 per cent increase on 2018 - and equivalent to the energy required to power 40,000 homes for a year[6]. In 2020, work was completed on an 11.6MW capacity solar PV array at Grafham. This development is expected to continue moving the company towards its 2025 target of meeting 44 per cent of its energy requirements from on-site renewable sources.

At integrated midstream infrastructure operator Buckeye Partners, the team has identified an opportunity set of up to 550MW of developable solar projects on and adjacent to existing Buckeye locations. The first stage of solar installations on sites of up to 900 acres, will provide c. 150MW of solar generated energy to directly power Buckeye locations or be sold as green energy to nearby businesses. This represents approximately 50 per cent of Buckeye's power consumption.

GREENER EQUIPMENT

Lower emissions vehicles and electrified plant and equipment

The benefits of low emissions vehicles and electrified plant and equipment can include lower running costs, emissions and noise pollution. A number of portfolio companies have deployed low emissions vehicles and electrified machinery. Examples include:

- Toll road operator Aleatica has converted 86 road maintenance vehicles in its vehicle fleet to LPG, a fuel that releases less $C0_2$ emissions than standard gasoline fuel. Aleatica's electronic tag subsidiary encourages sustainable mobility by providing a 20 per cent discount to all electric and hybrid vehicles traveling on its toll roads in Mexico City.

- Brisbane Airport operates a fleet of 11 electric buses for the landside transport operations within the airport precinct. These buses have a range of 600 kilometres on a single battery charge.

- Electricity distributer Ausgrid has deployed Renault Zoe electric vehicles as part of a trial to reduce operational and maintenance costs and explore opportunities for carbon emission reductions.

- On Earth Day 2017, Global Container Terminals (GCT) introduced the new Global Commitment seal, a visible pledge to a greener future that will be placed on all GCT heavy iron equipment that meets GCT's environmentally-friendly standards. In 2017, the seal made its debut on a fleet of electric high-efficiency cranes at GCT Deltaport and GCT's electric, dual cantilevered rail-mounted gantry cranes that service the GCT Bayonne ExpressRail. In 2019, GCT saw the completion of its Deltaport Shore Power Project, which allows vessels to plug into the clean electrical power grid at GCT Deltaport (majority power derived from hydroelectric power) and turn off auxiliary diesel engines while docked. This eliminates up to 95 tonnes of air pollutants per vessel – the equivalent of removing 20 vehicles from the road for one year.

[6] https://www.anglianwater.co.uk/siteassets/household/about-us/air-2020.pdf

SMART DESIGN

Smart and energy efficient building design

In June 2020, Indiana Toll Road (US) achieved LEED Gold certification for the environmentally conscious design of its new administration building, which opened in 2019[7]. The building was architecturally designed to drive a meaningful reduction in greenhouse gas emissions and provide a space that promotes employee wellbeing. A number of technologies were incorporated into the design, including, smart lighting, energy efficient HVAC (heating, ventilation and air conditioning), and a water conservation system. Solar PV panels installed on the building's roof are expected to offset up to 20 per cent of the building's energy costs each year.

> **The building was architecturally designed to drive a meaningful reduction in greenhouse gas emissions.**

Voting and engaging to improve climate risk transparency in listed equities

Across our listed equities portfolio, we engage directly and collaboratively with companies, and exercise our proxy voting rights with the aim of influencing and guiding corporate behaviour in ways that can protect and grow shareholder value over the long term.

Climate change is one of the key issues we expect companies to recognise and manage strategically in order to protect and enhance their long-term value.

In our direct engagement, we assess climate change-related shareholder resolutions on a case-by-case basis with consideration given to:

- Strategic-level recognition of climate risk;
- Maturity of plans in place to manage climate-related risks and opportunities;
- Existence of long-term targets and goals;
- Climate change disclosure and adoption of the Task Force on Climate Related Financial Disclosures (TCFD) recommendations;
- Climate-related lobbying activity; and
- The overall environment in which the company is operating.

Our listed company engagement focuses on encouraging companies to adopt the TCFD recommendations and to prepare their businesses for a transition to a low carbon environment.

We are also involved in collaborative engagement through organisations such as Climate Action 100+, which is an investor initiative that seeks to promote climate change action from global companies that are large emitters of greenhouse gases. We are currently part of the Australasian Climate Action 100+ working group, which is engaging extensively with 11 Australian companies on the investor initiative's "plus" list. The plus list comprises companies that investors identified as having either significant influence to impact the clean-energy transition or exposure to climate-related financial risks that may not be captured by emissions data alone.

[7] LEED (Leadership in Energy and Environmental Design, developed by the US Green Building Council is globally recognised green building rating system.

Managing climate risk in debt portfolios

Since debt investors lend money to companies but do not have any ownership rights, they typically have less ability to influence company management over the life of the investment than equity and infrastructure investors. Therefore, we believe assessing climate change risk in debt investing needs to be concentrated in the investment screening and due diligence phases, prior to entering an investment.

Managing climate risk in private equity

Within private equity, we usually hold a significant position in companies in which we invest, hence we have the ability to influence climate change strategy. Our investment approach focuses on service sector companies that are underpinned by strong technology and tend to have relatively low carbon footprints.

Any potential risks we identify pre-acquisition are integrated into post-acquisition management work plans. They are assessed on a live basis throughout the life of the investment with a view to mitigating risks and identifying value creation opportunities.

Transparency, disclosure and reporting

In recent years, the Financial Stability Board's TCFD reporting framework was developed to help companies understand what financial markets want from disclosure. The TCFD, released in June 2017, is recognised as the benchmark for climate-related reporting. It has been widely accepted and rapidly adopted by companies and investors alike.

We are committed to providing transparency to our investors and we also encourage our investee companies to improve their climate risk-related disclosures and reporting.

We have been publicly disclosing the carbon footprint of our infrastructure portfolio since 2017. This year, we reported to our investors on a transition and physical climate risk exposure assessment, which we carried out across our infrastructure assets in 2019. Other initiatives across our infrastructure portfolio are reported on annually in our Responsible Business Report.

Our listed equities voting and engagement activity is publicly reported twice each year and a searchable record of voting decisions is disclosed on the IFM website.

Next steps

Despite the challenging operating environment and the uncertainty surrounding what the post-COVID-19 world will look like, we believe it is important not to forget the huge challenge posed by climate change and the need to continually refine and improve the way we manage climate-related investment risks.

IFM's climate taskforce is working on our strategy for achieving our net zero by 2050 commitment, and we will be updating investors and other stakeholders in due course. We will also continue to drive reductions in carbon emissions consistent with the best interests of our investors and identify high-quality investment opportunities for investors, while contributing to the goals of the Paris Agreement.

As long-term investors, we recognise that we must actively manage the risks posed by climate change and we believe the actions we take will help deliver long-term risk-adjusted returns for our investors and their members and beneficiaries.

[7] LEED (Leadership in Energy and Environmental Design, developed by the US Green Building Council is globally recognised green building rating system.

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