



# ESG Integration Report

Responsible Investment

April 2023



# What is ESG Integration and Why is it Important?

AIMCo was established with a mandate to provide superior long-term investment results for our clients. Central to our fiduciary duty to the 17 pension, endowment and government fund clients we serve is a commitment to systematically integrate material environmental, social and governance (ESG) considerations alongside traditional financial analysis into our investment decision-making process to unlock investment opportunities, mitigate risk and identify drivers of long-term growth.

ESG factors cover a broad spectrum of issues including, but not limited to, climate risk, water usage, diversity, equity and inclusion, worker safety, cybersecurity, executive compensation and shareholder rights. These factors can positively or negatively impact the value of an investment — its cash flow, revenues, general risk profile and resilience to long-term structural changes taking place in the economy. By applying an investment-focused lens to how we integrate ESG risks and opportunities, these factors are assessed like any other investment risk in the analysis process to inform better long-term investment decision making. The incorporation of ESG considerations is viewed as contributing to enhanced risk-adjusted returns, not sacrificing returns. Potential investments are expected to offer accepted market level returns for any given risks, including ESG.

A growing body of research also supports this view — improved financial performance due to ESG factors becomes more marked over longer time horizons, ESG integration as an investment strategy performs better than negative screening approaches, and ESG investing appears to provide downside protection, especially during a social or economic crisis.<sup>1</sup>

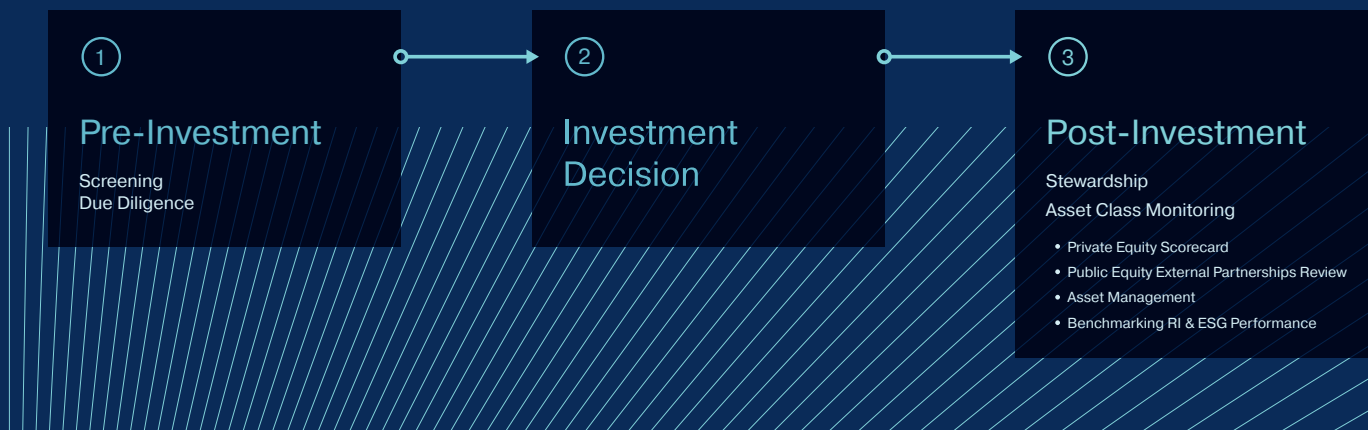
<sup>1</sup> (Whelan, Atz, Van Holt, & Clark, 2021)

# The Governance of ESG Integration at AIMCo



# ESG Integration Across the Investment Process

While each asset class requires a tailored approach to integrating ESG risks and opportunities, the approaches are aligned and span pre-investment, investment decision and post-investment stages.





# Pre-Investment

## Screening

ESG factors are considered early in the screening stage with AIMCo's Investment teams, keeping clients' [Exclusion Guidelines](#) in mind. For example, companies with revenues generated from tobacco and weapons of mass destruction are filtered out. High-level, red-flag analysis, or identification of material ESG considerations requiring deeper review, is undertaken at this stage.

## Due Diligence

The due diligence process supports better investment decision-making by providing a holistic understanding of ESG risks and opportunities. At a very high level, for any potential investment, material ESG issues are identified using the globally recognized materiality framework formerly known as the Sustainability Accounting Standards Board (SASB), now part of the IFRS Foundation. To better understand and assess ESG risks and opportunities at an individual deal level, we capitalize on our bespoke due diligence questionnaires tailored specifically to the investment type (direct or fund investment) and the asset class, following industry best practices such as the Institutional Limited Partners Association (ILPA) or the Principles for Responsible Investment (PRI).

## Incorporating Physical Climate Risks into Real Estate Investment Due Diligence

Climate change poses clear and material risks to the real estate sector. Real estate investments are at increased risk of physical damage from extreme weather hazards due to their fixed locations. These hazards, ranging from floods, fires and storms to rising sea levels and changing average temperatures, have

direct and indirect effects on an investment's revenue, operating costs and capital costs — which we believe markets have not yet priced in. Since early 2022, AIMCo has screened all private, direct equity and debt investments in commercial real estate for physical climate risk hazards as part of pre-investment due diligence.

We use MSCI's Climate Value-at-Risk (Climate VaR) product to aggregate various global warming scenarios from credible third-party sources<sup>2</sup> and quantify the cost of physical climate impacts based on a process used in most hazard models in the insurance industry. The physical risk impact on an asset is quantified by assessing the exposure of a property to a hazard and computing the costs associated with that risk using vulnerability functions specific to the real estate market.

The physical climate risk analysis provides insight around which investments may be mispriced and in what direction, informing investment, asset management and disposition choices. Over time, we believe this will provide our Investment teams with an informational edge to make the most prudent choices to deliver superior, risk-adjusted returns to our clients.

$$\text{Expected cost} = \text{vulnerability} * \text{hazard} * \text{exposure}$$

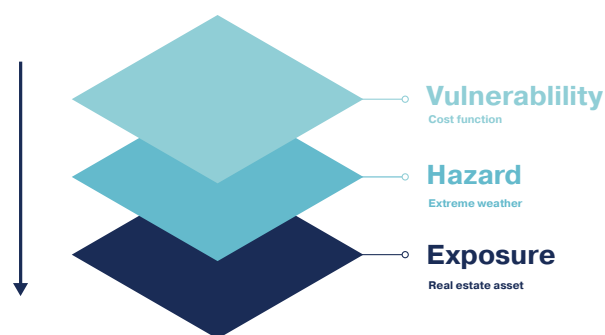


Diagram 1: MSCI Climate VaR Physical Cost Calculation

## ESG Due Diligence Assessment Framework for Fund Investments

We ask over 30 questions across three main pillars that address various ESG topics.

### Governance

- Responsible Investment policies and protocols
- Oversight and accountability of ESG

### Investment Process

- ESG materiality, due diligence, and risk assessment

### Active Magement

- Monitoring metrics, value creation plans and reporting

<sup>2</sup> Including the Intergovernmental Panel on Climate Change (IPCC) and the Potsdam Institute for Climate Impact Research.

## ESG Due Diligence Assessment Framework for Direct Investments

When it comes to public equities, AIMCo's Fundamental Equities team incorporates ESG factors into their research. When investment ideas are pitched to the team, there is an ESG section in each research report that evaluates the issuer's MSCI ESG score relative to history or versus peers, and an analysis of the ESG-related pressure points or hidden advantages. ESG factors are viewed by the team as another lens to assess risk and are used to engage with investee company management teams on a broader set of issues that can impact the bottom line.

During due diligence for private assets, we assess prospective investments with the view of identifying key ESG factors and gather the appropriate information about the target company. Evaluation of ESG risks and opportunities is coupled with on-site due diligence conducted by the Investment teams or virtual engagements by the RI team, where appropriate, and the support of external advisors where necessary. ESG-related concerns are often intertwined with other business issues that make the business more, or less, attractive for investment. In most instances, we look to determine if the investment target has significant value creation opportunities because of the way it addresses ESG issues or could have such opportunities if it were to address them in a proactive manner. More importantly, understanding the ESG challenges and opportunities of individual investments helps us determine our best strategy for working with a company in the future.

### In 2022, ESG due diligence was conducted for...

**88** deals across **6** asset classes

**93%** of Investment Committee approved deals

**\$15B+** in potential deal value

**100%** of Board approved deals

&gt;&gt; ESG DUE DILIGENCE IN ACTION

# AusNet



In 2021, AIMCo, along with a consortium of like-minded investors led by Brookfield, completed the take-private of AusNet Services Limited (AusNet), an Australian diversified utility company. AusNet owns and operates regulated electricity transmission and distribution networks, as well as a regulated gas distribution network in the State of Victoria. In addition to its regulated business lines, the company also has an unregulated business line that develops, constructs, and operates competitively tendered transmission network augmentation and connection projects.

As is typical in transactions of this scale and complexity, the consortium conducted a comprehensive due diligence program, which included the commissioning of legal, technical, commercial, financial, tax, regulatory, insurance, and public relations due diligence reports. In addition, AIMCo's Responsible Investment (RI) team conducted its own supplementary ESG due diligence to evaluate the investment opportunity from an ESG perspective to support the Investment team's understanding of the key ESG-related risk factors present in AusNet's business.

The RI team assessed a range of ESG considerations, including but not limited to:

- Environmental impact management track record
- Physical climate resilience of the company's infrastructure and exposure to transition/stranded asset risks
- Health and safety track record and performance
- Human resources management and organizational design
- Critical incident risk management

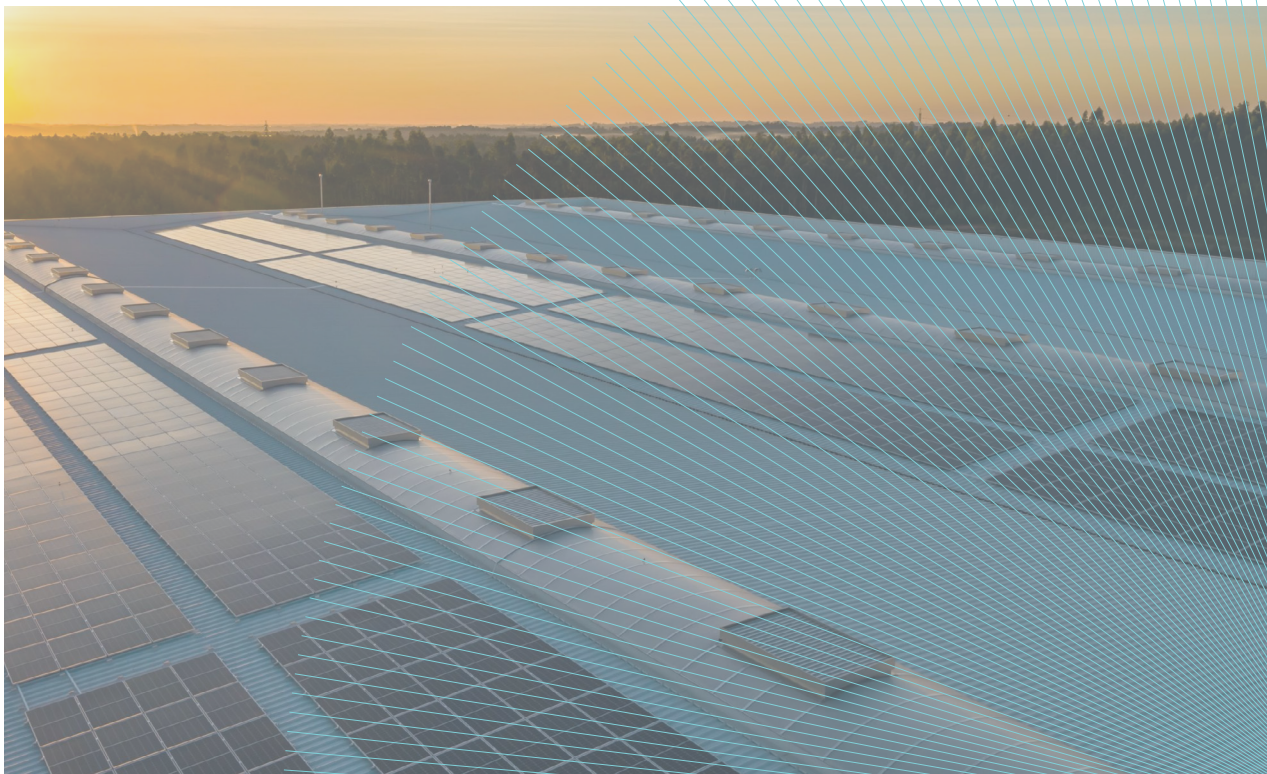
The ESG governance framework at AusNet was also evaluated to identify strengths, potential gaps and inform any potential value-creation plans.

Additionally, the Investment team sought the RI team's assistance in researching the state of energy transition in Australia, and specifically in the State of Victoria. The research piece prepared by the RI team focused on how legislated policies, such as the Victorian Climate Change Act, may impact AusNet's business segments and analyzed how the company is positioned for the future, given Victoria's decarbonization and renewable energy targets.



As part of the ESG due diligence process, the RI team also assessed how an investment in AusNet may impact the AIMCo Infrastructure portfolio's carbon footprint. The RI team used carbon impact modelling to provide a quantitative assessment of how this investment would affect the carbon intensity of the Infrastructure portfolio on a pro forma basis and confirmed an overall positive expected outcome.

The assessment of these material ESG factors and the impact on the Infrastructure portfolio's carbon footprint helped reinforce the Investment team's view that AusNet represented an attractive investment opportunity. As a result, AIMCo's clients now have exposure to a high-quality asset that is well positioned to participate in the energy transition.



&gt;&gt; ASSET MANAGEMENT IN ACTION

# Sherbourne Estates



On behalf of AIMCo and its clients, Epic Investment Services oversaw the extensive renovation of two 1970s vintage multifamily rental buildings in Toronto, Ontario — 191 and 201 Sherbourne Street (Sherbourne Estates). The goal was to ensure safe and comfortable living accommodations for residents while delivering high-performing, sustainable and cost-effective operations for the asset owner.

The residential retrofit of Sherbourne Estates was particularly challenging, given that these two fully occupied rental buildings were built in the 1970s and their building systems were at end of life. A deep renovation, including building system replacement and exterior and interior repairs was required. As construction began in March 2020, the pandemic hit which meant that residents who were now spending the majority of their time at home would be impacted during the construction.

To reduce the overall impact during the two-week construction phase in each of the 420 units, residents were provided free, temporary furnished suites and storage within the building, moving support, and a two-week rent credit in thanks for their cooperation.

The renovation of Sherbourne Estates is expected to be completed in 2023, with notable upgrades including:

- Exterior cladding finishes that will increase insulation efficiency by approximately 40%
- New mechanical systems to improve air circulation and conversion of in-suite heating and cooling systems from natural gas to electric that will result in projected energy savings of 22% and greenhouse gas emissions reductions of approximately 35%
- Double-paned energy efficient windows to improve air circulation and thermal performance

- New sliding doors to enhance city and nature views for residents
- Improved fitness centre and fibre optic internet infrastructure

Through this work, Sherbourne Estates will operate with reduced costs, less maintenance, lower energy consumption and a lower carbon footprint, while providing increased resident comfort and satisfaction. The life of the buildings has been extended by another 50 years, providing an attractive long-term, sustainable addition to AIMCo's Canadian Real Estate portfolio.





# Investment Decision

The results of ESG due diligence and the recommendations form an integral part of the information package submitted to AIMCo's Chief Investment Officer, Investment Committee or Board of Directors for approval.

# Post-Investment

Once the investment has been made, AIMCo investment professionals and the RI team have management and monitoring roles with respect to material ESG issues identified during due diligence. Depending on the asset class, investment professionals use a variety of strategies and approaches to effectively manage investment-related risks and realize value over time. From holding director roles on the boards of investee companies, to developing and monitoring an asset-specific management plan in real estate, monitoring the stated 100-day plans by the Private Equity General Partner, or attending quarterly earning calls and engaging the management teams, asset management is multifaceted.

## Stewardship

The RI team supports Investment teams with monitoring of ESG management and performance on an ongoing basis using a variety of tools to ensure we safeguard clients' investments. In the public markets space, we use the stewardship tools of proxy voting and engagements with boards and management teams to amplify shareholder voice on critical ESG matters and promote best practices that impact sustainable, long-term value. More information on proxy voting and engagement activities can be found in our annual [Stewardship Report](#).

## &gt;&gt; ENGAGEMENT IN ACTION

# DTS Corporation

Partnerships enable AIMCo to source the best investment opportunities from around the world to create sustainable, long-term value for our clients.

Our recent co-investment with Asset Value Investors (AVI) in DTS Corporation, a systems integration and information services company in Japan, exemplifies the ability of investors to unlock greater value through active engagement.

DTS is well placed to benefit from Japan's digital revolution. Our partner, AVI, has worked closely with DTS management and the board behind the scenes to rectify its undervaluation by offering detailed suggestions on critical drivers to its long-term success such as corporate governance, employee remuneration, diversity, environmental management, balance sheet efficiency and growth strategy. AVI's suggestions were accepted by DTS and included in a comprehensive mid-term 2025 plan and long-term 2030 vision announced in May 2022, in which they set out a strategy to double EBITDA by 2030, increase ROE 16% and focus on high value-added IT services.

The careful management of both people and the planet are material ESG considerations for the long-term sustainability of companies in the IT industry, and DTS has taken steps to be proactive in this regard. DTS recognizes that it operates in an industry traditionally skewed towards low female representation and doubled its diversity targets, along with setting ambitious environmental targets for validation by the Science Based Targets initiative in January 2023.

Responsible management of environmental and social issues can only be achieved with good governance. DTS strengthened its corporate governance by adopting an Audit and Supervisory Committee structure, improving board diversity and establishing a Sustainability Committee.

DTS's positive share price performance and significant outperformance versus the market is a testament to the efforts of our partner AVI and the power of active engagement to create positive financial outcomes for our clients.



## Asset Class Monitoring

### Private Equity Scorecard

Our Private Equity portfolio ESG management and performance is monitored using a bespoke Private Equity General Partners (GP) scorecard. Several industry-leading frameworks were examined to create the scorecard such as the Institutional Limited Partners Association (ILPA), a global membership driven organization that works to advance the interests of limited partners (LPs) and their beneficiaries. The scorecard, consisting of 14 indicators, covers a range of topics that deliver insights into how ESG is governed and incorporated in a GP's operations, including climate change and diversity initiatives.

#### 14 Questions

Topics covered help us assess robustness of ESG practices

#### Filled out by AIMCo and fund partner

Collaborative approach to capture as much information as possible

#### Comparable

Quantifiable scorecard enables internal comparison and assessment of progress over time

### Public Equity External Partnerships Review

On an annual basis, the External Partnerships and RI teams conduct meetings with a selection of AIMCo's segregated external managers. These meetings serve as an input to the RI team's annual ESG assessment of external managers across four categories: governance, investment process, active management and diversity, equity and inclusion. Detailed results, along with a comparison of the managers' performance against a relevant ESG-related benchmark, are shared with the External Partnerships team.

### Asset Management

Asset management may take different forms across asset classes but is fundamentally about enhancing value, ensuring alignment with best practices, and building assurance that assets effectively manage risks and opportunities, including ESG considerations. Incorporation of ESG in asset management is not new but is increasingly complex given evolving regulatory requirements and market expectations. By evaluating and monitoring the implementation of value creation plans by General Partners in Private Equity or incorporating the results of GRESB Infrastructure and Real Estate assessments into our ongoing asset monitoring, we are delivering long-term sustainable value to our clients.



## &gt;&gt; ASSET MANAGEMENT IN ACTION

# Igua Saneamento

For one of our clients' infrastructure assets, Igua, a water and wastewater service company with 18 concessions across Brazil, ESG considerations were integrated into overall corporate strategy. Igua's management-approved ESG strategy is guided and monitored by a standalone ESG committee where AIMCo now has two representatives. Overall, the ESG strategy included a range of actions aimed at mitigating ESG risks and capitalizing on opportunities. These actions are closely linked with the capital and operational budgets of the company and are captured in an ESG scorecard that tracks 21 material indicators.

Specific actions are grouped into eight key areas including climate change, circular economy, innovation and supply chain. The climate change pillar includes measures around ensuring third-party verification of Igua's greenhouse gas emissions, mapping of climate physical and transition risks aimed at better understanding of water security and resilience of the assets, and estimating capital expenditure needed to potentially commit to a net-zero target.

As part of the innovation pillar of the ESG strategy, pilots were initiated around smart metering, the use of renewable energy in operations, exploring solutions around bio-methane and bio-fertilizers, adopting the latest know-how for better leak detection and prevention, and digitization of services. These actions target cost-savings and/or developing new sources of revenue for Igua, while ensuring stringent regulatory and internal operational excellence requirements are met or exceeded.

## Benchmarking RI & ESG Performance

As the regulatory push for more robust and transparent benchmarking and disclosure around sustainability grows, AIMCo continues to use annual Principles for Responsible Investment (PRI) and GRESB assessments to provide our clients with an external assurance of our performance. These globally recognized, independent benchmarks publicly demonstrate our commitment to investing responsibly and offer valuable insights into our progress against other leading investors. We use insights from the PRI and GRESB assessments to drive positive financial outcomes for our clients by implementing market leading ESG initiatives in partnership with our investee companies, asset managers, operators and co-investors. Our [PRI Transparency Report](#) and [GRESB Report](#) are available on our website.

# Looking Ahead

Over the next year, AIMCo will focus on enhancing the post-investment monitoring process across asset classes through developing a Total Portfolio ESG Framework, expanding coverage of asset class-specific sustainability dashboards, implementing an outcomes-based engagement framework and advancing investment-focused ESG research. In addition, to support the work of AIMCo's Climate Program, the RI team will build a bespoke climate taxonomy to classify the exposure of our portfolios to green, transitioning and high emitting assets.







