

# Real Assets

## Sustainable Investment Practice Guidelines

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### Background

This document outlines the sustainable investment guidelines for integration of environmental, social, and governance (ESG) factors across the Real Assets Unit (RAU). The guidelines provide Real Assets' approach to identifying, measuring, monitoring, managing, and staying apprised of ESG related risks and opportunities that may impact the performance of investments. ESG considerations are integrated into processes around selection, contracting, and monitoring, which are subject to fiduciary principles.

The guidelines integrate and supplement CalPERS' ESG 5 Year Strategic Plan, existing beliefs, principles and policies pertaining to ESG considerations, including CalPERS Investment Beliefs, Global Governance Principles, United Nations-supported Principles for Responsible Investment (PRI), Investment Policy for Real Assets Program and the Responsible Contractor Program (RCP) Policy.

The guidelines are intended to evolve and adapt as industry best practices emerge. Where appropriate, RAU staff will participate in leading industry conversations and workgroups to ensure best practices are continually learned, evaluated, and incorporated where feasible.

### ESG Factors

As described within these guidelines, RAU staff identifies and assesses ESG factors through its investment selection, contracting and monitoring functions. RAU staff considers both potential financial and reputational impacts of ESG factors. Examples of ESG factors include, but are not limited to:

#### Environmental

- Climate risk (direct and indirect)
- Resilience of surrounding infrastructure
- Energy efficiency
- Emissions
- Resource use (including water)
- Biodiversity

#### Social

- Fair wages and benefits based on local market conditions
- RCP Policy compliance
- Diversity and Inclusion
- Safety & Wellness
- Workforce Housing
- Community and Interested Party relations
- Accessibility

#### Governance

- Alignment of interest
- Control rights
- Transparency/reporting

RAU staff recognizes there is not one single source that provides an exhaustive list of ESG factors pertinent to all of Real Asset's diverse investments and that only a subset of ESG Factors will be relevant to any particular investment. The ESG factors considered are expected to adapt over time as the industry evolves.

## Investment Review Process

### Manager Selection

RAU staff scores each new investment proposal, utilizing a two-part standardized Manager Assessment Tool (MAT). This includes ESG specific criteria. After the initial screening (Phase I of the MAT), proposals selected for further review are evaluated in a second phase which includes a Due Diligence Questionnaire (DDQ). ESG questions are incorporated into the DDQ for Real Assets. Responses to ESG questions are included in the overall weighting and when evaluating prospective Managers and mandates. RAU staff will update the ESG questions, from time to time, given that the RAU Sustainable Investment Guidelines are dynamic and intended to evolve as industry best practices emerge.

Memoranda recommending Managers to the Real Assets Investment Committee will include discussion of Managers' ESG practices and/or any ESG concerns uncovered during the due diligence process.

Another screening mechanism includes an alignment of interest analysis, to be completed by RAU staff, as a part of all new Real Assets investment recommendations to the Real Assets Investment Committee (RAIC).

### Asset Selection

Where RAU staff has discretion regarding new asset investments, staff employs an ESG Consideration Matrix tool during due diligence to ensure that ESG factors are systematically considered. In addition, where possible, the ESG factor analyses are quantified and incorporated within the financial models for value and risk assessment. Findings and conclusions from use of the ESG Consideration Matrix and financial models analyses are then communicated to the RAIC for investment decision-making.

## Contracting

Real Assets seeks to promote greater alignment with its external managers by establishing, where possible, relevant and effective, the following items in contracts:

1. Managers have, or will commit to have an investment process which incorporates an assessment of relevant long-term Sustainable Investment or ESG factors;
  - » Separate Account Managers will complete and submit an ESG Consideration Matrix for new investments upon CalPERS' request.
2. Managers will incorporate relevant ESG factors and Sustainable Investment activities into reporting, and additionally:
  - » Managers will annually participate in third party sustainability performance surveys designated by CalPERS.

## Investment Monitoring and Management

The types of monitoring and management staff will perform include, but are not limited to:

1. Reviewing Managers' compliance with ESG obligations in operating agreements and documenting and engaging with managers on any deficiencies.
2. Being responsive to ESG events and engaging on material ESG issues, where rights allow.
3. Reviewing Managers' sustainable investment processes, practices, and reporting, and identifying ESG opportunities and risks. This includes but is not limited to:
  - » Requesting that Managers respond to annual third party monitoring surveys (which may change from time to time) and discussing results with Managers.
  - » Reviewing Managers' ESG or sustainable investment reports, surveys and/or PRI reporting on an annual basis.

- » Inquiring about the status of identified ESG risks and opportunities in regular communication with Managers.
  - » Encouraging Managers to submit Energy Optimization projects for real estate assets as a part of the annual investment planning process.
4. Identifying, learning and sharing of Managers' best practices.

5. Reviewing and documenting material ESG issues that may impact the value of the portfolio.

It should be noted that the degree of information access, influence, and control that CalPERS has regarding the investments in RAU's portfolio differs amongst the investment structures in the portfolio, enabling and requiring different levels of monitoring and management. For instance, with respect to directly-owned investments and investments held through separate accounts, CalPERS will generally have the ability - through its shareholder rights - to engage more directly on material ESG or sustainable investment issues.