FY22/23 climate change update

HESTA

Super with impact

our path to net zero

FY22/23 climate change update

About this update

HESTA biennially publishes comprehensive reporting on the implementation of its Climate Change Transition Plan, in accordance with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Our last detailed Climate Change Report, covering the period 1 July 2020 to 30 June 2022, was released in June 2023.

In intervening years, we produce an update which focuses more specifically on HESTA's progress toward climate targets. This climate change update captures our progress toward climate targets from 1 July 2022 to 30 June 2023 and should be read in conjunction with the Climate Change Report, Our Path to Net Zero, which sets out our risk management approach.

Contents

Why climate change matters to HESTA

Being able to deliver strong, long-term returns to our members requires a growing, sustainable, and inclusive economy, meaning climate change remains a crucial focus for HESTA. In addition to posing a financial risk to members' investments, it is also material to our members working in health and community services.

HESTA's approach to managing climate-related financial risks in our portfolio is dynamic and multi-faceted. It is centred on the belief that engagement to influence investee companies to participate in the transition to a net zero economy is in our members' best financial interests. We consider that these interests are best served through a timely, equitable and orderly transition to a low-carbon economy. You can read more about why climate change matters to HESTA in our 2023 Climate Change Report: Our Path to Net Zero.

To guide our actions, in 2020 we developed a Climate Change Transition Plan (CCTP):

Climate Change Transition Plan

Governance

- HESTA Governance Framework
- Risk Appetite Statement; Responsible Investment Policy; Climate Change Statement
- Ongoing Board and Executive capacity building

Targets

- Net zero by 2050
- 50% normalised emissions reduction by 2030[1]
- 10% of portfolio invested in climate solutions by 2030[1]

Investment integration

- Portfolio objectives
- Climate Change Working Group
- Investment managers
- Investment opportunities

Active ownership

- Engagement and collaboration
- Escalation and exclusion
- Advocacy

Our actions are defined by

- **Net zero and interim targets**
- **Clear engagement pathways and escalation**
- **Focused industry advocacy**
- **Supporting the caring economy through the transition**

As a large and diversified asset owner, the systemic risks from climate change exist for HESTA members, regardless of portfolio assets. Systemic risks are those that threaten the functioning of the economic, financial and wider systems on which investment performance relies.[2] Actions as part of HESTA's CCTP therefore focus on change in the real economy, and not just within our investment portfolio.

1. Strengthened targets were announced in September 2022.
2. Freshfields Bruckhaus Deringer, A legal framework for impact – sustainability impact in investor decision making, report commissioned by UNEP FI, The Generation Foundation and PRI, 2021.

We prioritise the following three areas as part of implementation of our Climate Change Transition Plan:

Integration

Integration of climate change into investment decision-making and capital allocation through portfolio-wide targets to reduce carbon emissions and invest in climate solutions.

Active ownership

Engagement with portfolio companies to influence a shift in their strategy, governance and disclosure towards alignment with the goals of the Paris Agreement.

Our approach of active ownership enables us to use our shareholder voice to seek to influence companies with material climate-related risks and opportunities.

Advocacy

Advocating for targets aligned with net zero emissions by 2050 and support for an orderly and equitable transition to a low-carbon economy.

Integration

Climate targets

To manage climate-related risk and to continue to work towards alignment with the goals of the Paris Agreement, HESTA has set climate targets.

You can read more about how we measure our progress towards these targets and the assumptions made in our Climate Change Statement available on our website or in our 2023 Climate Change Report: Our Path to Net Zero.

In 2020, HESTA declared its ambition to reach net zero carbon emissions across our investment portfolio by 2050.

As part of progressing toward net zero, in 2022, we set a strengthened interim target to achieve a 50% reduction in normalised emissions[3] below the 2020 baseline, by 2030. Normalised emissions refer to the scope 1 and 2 carbon-equivalent emissions intensity of our portfolio per $AUD million invested.

We also set a target to have 10% of the portfolio invested in climate solutions, such a renewable energy and sustainable property, by 2030[4].

[3] We have chosen normalised carbon emission as it represents HESTA's share (based on Enterprise Value) of real-world emissions. Scope 1 and 2 emissions – carbon emissions are assessed based on the scope 1 (direct combustion) and scope 2 (electricity use) emissions of our investments. This is on the basis that reducing scope 1 & 2 will have flow on effects across the economy, thereby reducing scope 3 (value chain) emissions. We are still prioritising scope 3 in engagement with companies, but in terms of target setting, we note that data coverage for scope 3 emissions remains poor.

[4] We measure progress toward our 2030 climate solution target through annual measurement of investments aligned to SDG 7, 11.6 and 13 according to the Sustainable Development Investment Asset Owner Platform (SDI AOP) Taxonomy.

Investment opportunities

HESTA is seeking to have 10% of the portfolio invested in climate solutions, such as renewable energy, battery and storage technology, and sustainable property by 2030. We measure progress towards this target through annual measurement of investments aligned with the United Nations Sustainable Development Goals (UN SDGs) 7, 11.6 and 13 according to the Sustainable Development Investments Asset Owner Platform (SDI AOP) Taxonomy[5].

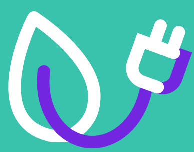
At 30 June 2023, HESTA had 7.8% or around AUD $6bn of the portfolio invested in climate solutions.

Some of these climate solutions assets include:

Sustainable property rated 5* by GRESB

- ISPT Core Fund
- Investa Commercial Property Fund (ICPF)
- ISPT Retail Australia Property Trust
- Eureka Property Fund 5
- AEW Core Property Trust
- Heitman America Real Estate Trust
- European Cities Fund

Renewable energy



- Intera Renewables
- Generate
- Taean Clean Energy
- Nitrogen Renewables
- SolSystems
- Rio Energy Wind Farm
- Vestas Wind Systems
- Sunrun

Other climate solutions

- Tesla – solar and energy solutions, electric vehicles
- Contemporary Amperex Technology Co – Lithium-ion battery development
- NIO – Electric vehicles
- Aggreko – Battery energy solutions
- Chargepoint – Electric vehicle charging stations

Data as at 30 June 2023

You can read more about HESTA's investment in climate solutions in our 2023 Climate Change Report: Our Path to Net Zero.

You will find a case study of one of these investments on page 8 of this update.

Source: Snowtown Wind Farm, Getty images

[5] https://www.sdi-aop.org/sdi-classification/

Measuring portfolio objectives

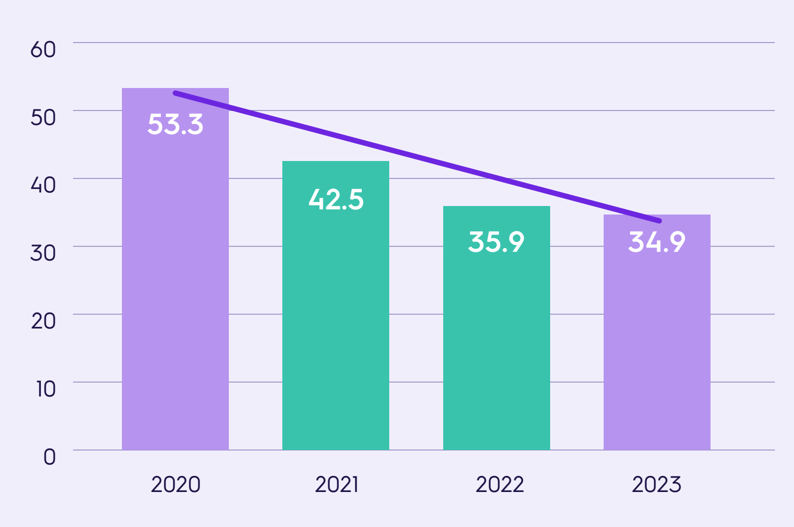
Portfolio measurement

In measuring our portfolio emissions, we have focused on the asset classes that make up the largest proportion of our assets under management and for which data and appropriate methodologies exist. HESTA's normalised portfolio emissions measurement (and therefore tracking of progress against our 2030 target) covers scope 1 and 2 emissions of investments that sit within asset classes that, as at June 2023, comprised approximately 73% of funds under management (FUM). This included Australian and international equities, infrastructure, property, private equity, and the global credit and alternative credit components of global debt. HESTA's attributed Scope 1 and 2 emissions (based on Enterprise value) for listed equities are calculated as per the Partnership for Carbon Accounting Financials (PCAF) methodology[6]. Data is based on portfolio holdings as at 30 June 2023, and is sourced from MSCI BarraOne software which reports company reported emission numbers and MSCI modelled emissions where needed. Where there is a lag in company reporting, this may be reflected in the underlying emissions and enterprise value data used in calculations for individual companies. Any further gaps in company scope 1 and 2 data are proxied using GICS sector averages taken from MSCI BarraOne. Listed equity funds' market value may include allocations of cash. Within other asset classes, due to data limitations, reporting covered 96% of infrastructure FUM and 86% of private equity FUM. Emissions associated with cash, alternatives, derivatives and global debt (excluding global credit and alternative credit) are not included due to lack of suitable emissions methodology for these asset classes. Some asset classes such as equities maintain a small cash allocation which is also excluded from the emissions measurement. HESTA will seek to extend the coverage of its portfolio emissions measurement as new emissions measurement methodologies are developed, and to lower levels of estimation within its reporting as data availability and methodologies continue to improve.

Portfolio carbon footprint

HESTA's measured normalised portfolio emissions as at 30 June 2023 continued to decline compared with previous reporting periods, decreasing by 3% from the previous year to 34.9 tCO_2e per $AUD million invested and by 35% from the 2020 baseline.

Normalised Carbon Footprint (tCO_2e/$m)



Australian equities and international equities continue to be the largest contributors to the portfolio's normalised carbon emissions. Pleasingly, emissions for both asset classes continued to decline and remain well below that of the benchmarks.

Movements across other asset classes were predominantly a result of improved data collection aligned to the PCAF standard. You can read more about the PCAF standard in portfolio measurement above. These improvements resulted in emission intensity declines across private equity and global debt, and increases within infrastructure, property and alternative credit.

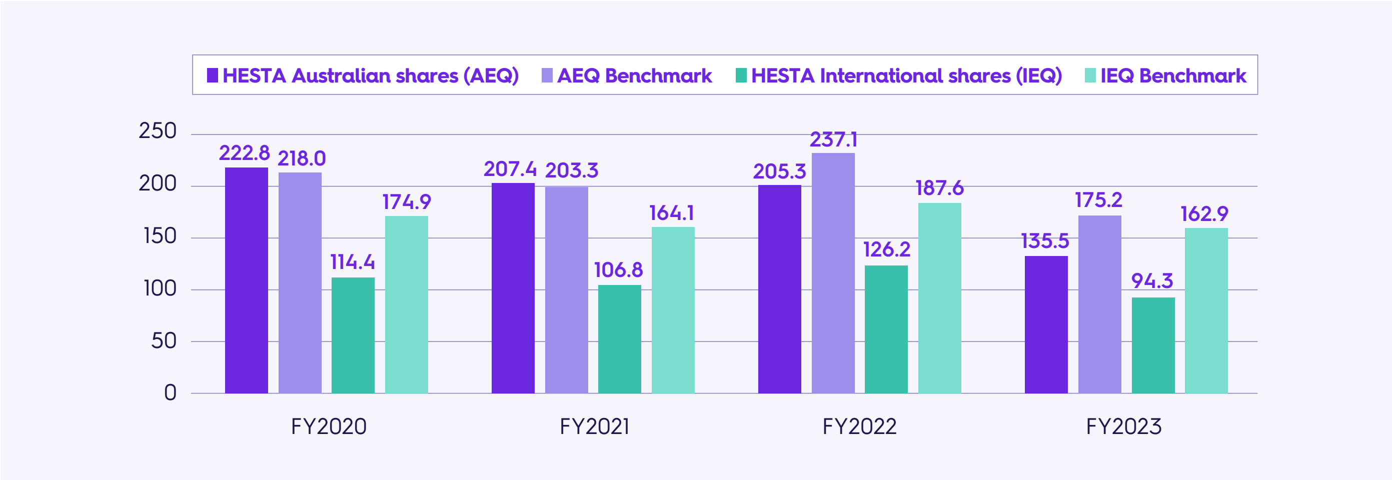
[6] https://carbonaccountingfinancials.com/files/downloads/PCAF-Global-GHG-Standard.pdf

Weighted Average Carbon Intensity (WACI)

The following table shows the weighted average carbon intensity of HESTA's Australian and international equity portfolios compared to that of their benchmark indices at 30 June 2023.

WACI – Scope 1 and 2 intensity in $tCO_2e/USDm$

Weighted Average Carbon Intensity (WACI) as at 30 June 2023



*The Australian equities benchmark is the S&P/ASX300 and the international equities benchmark is calculated by blending 95% allocation to the MSCI World Ex Australia index and 5% allocation to the MSCI Emerging Markets index.

Changes to commodity prices within the energy and materials sectors were responsible for the decline in weighted average carbon intensity (WACI) of both benchmark indices compared with the previous year. HESTA's relatively lower carbon intensity than the benchmarks is attributable to our being underweight carbon intensive sectors including energy, materials and utilities.

Fossil fuel exposure

We analyse HESTA's total portfolio exposure to companies deriving revenue from the mining, energy generation, refining, extraction and pipeline transportation of fossil fuels.

Exposure by FF type	FY23 %
Thermal coal mining[7]	0.11%
Fossil fuel-based energy generation	0.23%
Oil and gas: – refining	0.46%
– extraction	1.27%
– pipelines	1.61%
Total fossil fuel exposure	**3.68%**

With the portfolio positioned underweight to carbon intensive sectors, our exposure to fossil fuels on a look-through basis decreased to less than 4% of the portfolio, a reduction of 0.65% compared with FY22.

[7] Changes in exposure were a result of commodity price movements.

Progress towards net zero

Through the reporting period, we have continued to use capital allocation, active ownership and advocacy as part of seeking to positively influence the transition to a low carbon economy. Some of the key actions we've taken include:

Through HESTA's infrastructure portfolio, we invested in Generate, a leading sustainable infrastructure company that builds, owns, operates, and finances solutions for clean energy, transportation, water, waste, and digital infrastructure across diversified geographies, predominantly in North America.

This investment contributes to our climate solutions target and enables HESTA to capitalise on opportunities associated with the clean energy transition.

In FY2023, HESTA conducted its second assessment of the physical risks of climate change to real assets held in the portfolio – such as commercial buildings, seaports, and tolls roads – using Wellington Management's CERA tool[8].

Using a 'high emissions, extreme physical damages' scenario, we identified flooding, bushfire, water scarcity and hurricane as risks to real assets in HESTA's investment portfolio. Testing the portfolio in this way enables HESTA to identify hot spots which can then be the focus of adaptation and resilience planning.

HESTA was the first Australian super fund to join the Advisory Group for the Australian pilot of the Collaborative Sovereign Engagement on Climate Change, established by the **Principles for Responsible Investment (PRI)**.

Investors increasingly understand that sovereigns – more commonly referred to as governments – that fail to address climate change contribute to risk in investment portfolios. Being responsible for shaping climate-related policy, governments are best positioned to address climate change at the system level.

HESTA is leading engagement alongside global peers Nordea and Robeco for the sub-sovereign workstream as one of three streams of work and will engage Australian state governments with a focus on real economy change.

As a resources rich nation, Australia's significant emissions profile make it ideal for the pilot which focuses on management of climate-related risks.

Climate Action 100+ (CA100+) is a global investor initiative focused on ensuring the world's largest emitting companies take necessary action on climate change.

CA100+ has now moved into its second phase by establishing additional engagement objectives focused on company action to reduce real-world emissions. This includes calling on companies to implement robust transition plans and take action in collaboration with a wider set of stakeholders to address sectorial barriers to the net zero transition.

HESTA represents CA100+ as lead investor for South32 Limited and AGL. Engagement for these companies is focused on tracking progress against commitments, including capital expenditure, scope 3 emissions goals and support for a just transition.

8. The CERA tool integrates climate models developed by Woodwell for Wellington and their Climate Leadership Coalition partners to create deeper understanding of site-specific climate risks for assets.