LPP
Local Pensions Partnership Investments

Implementing alignment and engagement strategies across multiple asset classes: Local Pensions Partnership Investments

Background

Local Pensions Partnership Investments (LPPI) is a UK asset manager for Local Government Pension Scheme (LGPS) funds with £25 billion of assets under management across seven major asset classes. LPPI signed up to the Net Zero Asset Managers initiative in 2021 and has since set targets on an asset class basis to better integrate and reflect the nuances of each strategy into the target setting process. LPPI believes net zero is a commitment to stewardship and has focussed efforts on setting alignment and engagement targets as a priority, while ensuring decarbonisation targets can reflect engagement efforts where possible. You can find more information here.

This case study, authored and provided by LPPI, outlines LPPI's alignment approaches, targets and engagement strategies across multiple asset classes: real estate, listed equities, corporate fixed income and multi-asset credit.

Real estate

Alignment approach

For direct real estate assets, LPPI's alignment framework is based on the supplementary guidance on target setting for the Net Zero Investment Framework and asset data modelled using the EU Carbon Risk Real Estate Monitor (CRREM). The alignment definitions and example CRREM outputs are as follows:

Alignment definitions:

Net zero: An asset which is already achieving the energy and emissions intensity required by the CRREM 1.5C pathway at 2050

Aligned: An asset which is on track with the current energy use and emissions intensity levels that are consistent with achieving net zero and is expected to remain consistent with the CRREM 1.5C pathway based on projected performance including planned retrofits

Aligning: An asset with a target to achieve consistency with the CRREM 1.5C pathway and evidence of a strategy to achieve this

Not aligned: All other assets

Figure 1: **Aligned/Net zero: The emissions of the asset in 2022 are under the CRREM target pathway. The asset (including retrofits) has a plan to reach net zero by 2050. This means it is Aligned in 2022. It will be net zero by 2034. Source: LPPI, CRREM**

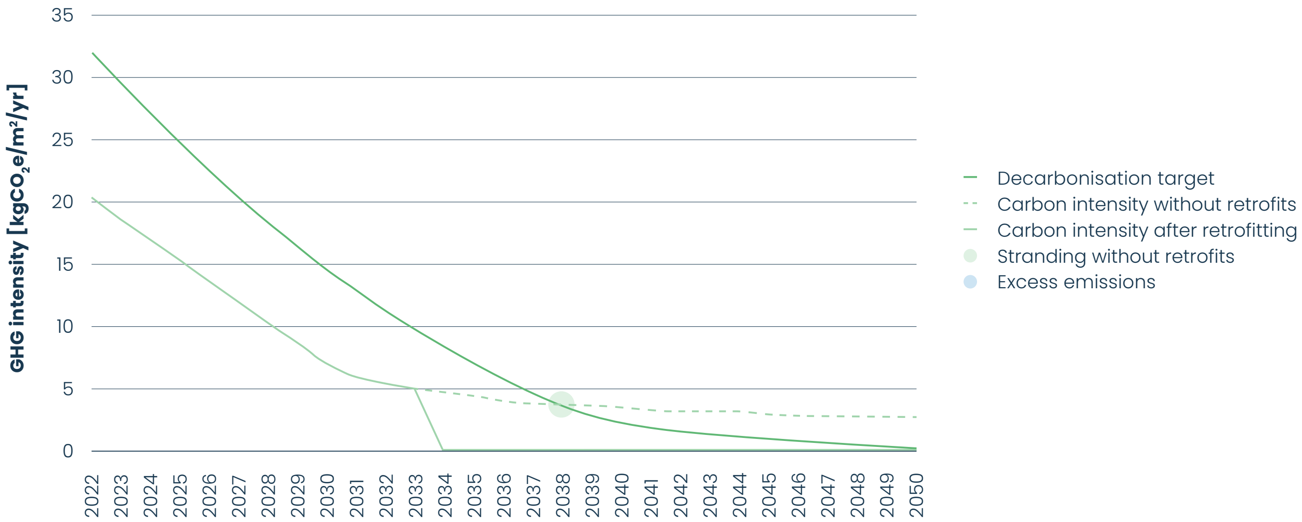


Figure 2: **Aligning/Net zero: The emissions of the asset in 2022 are above the CRREM target pathway. The asset (including retrofits) has a plan to reach net zero by 2050. It will be net zero by 2033. Source: LPPI, CRREM**

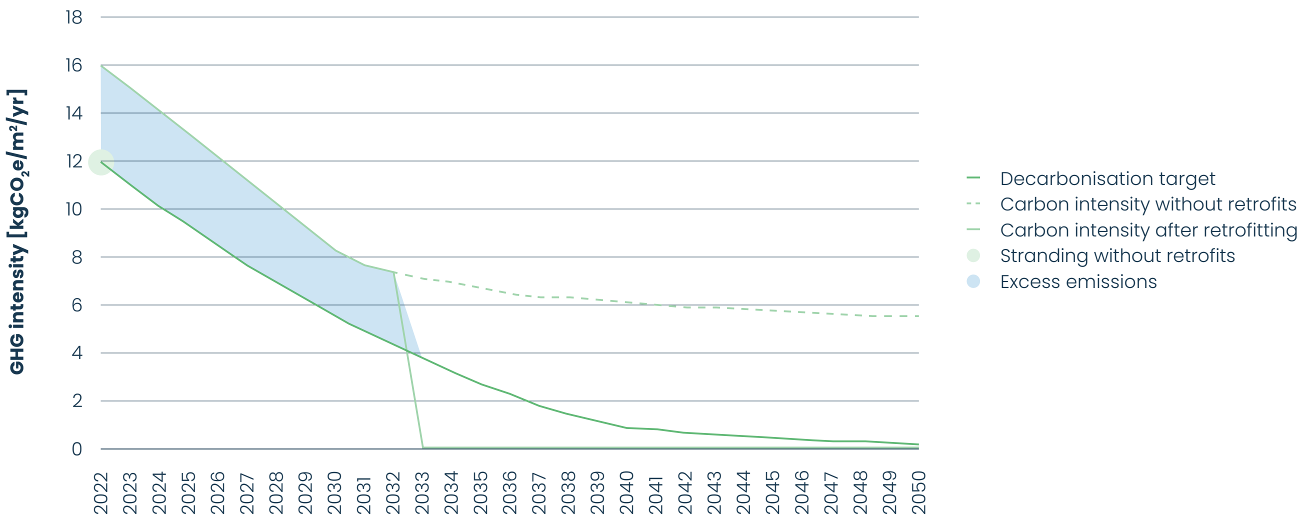
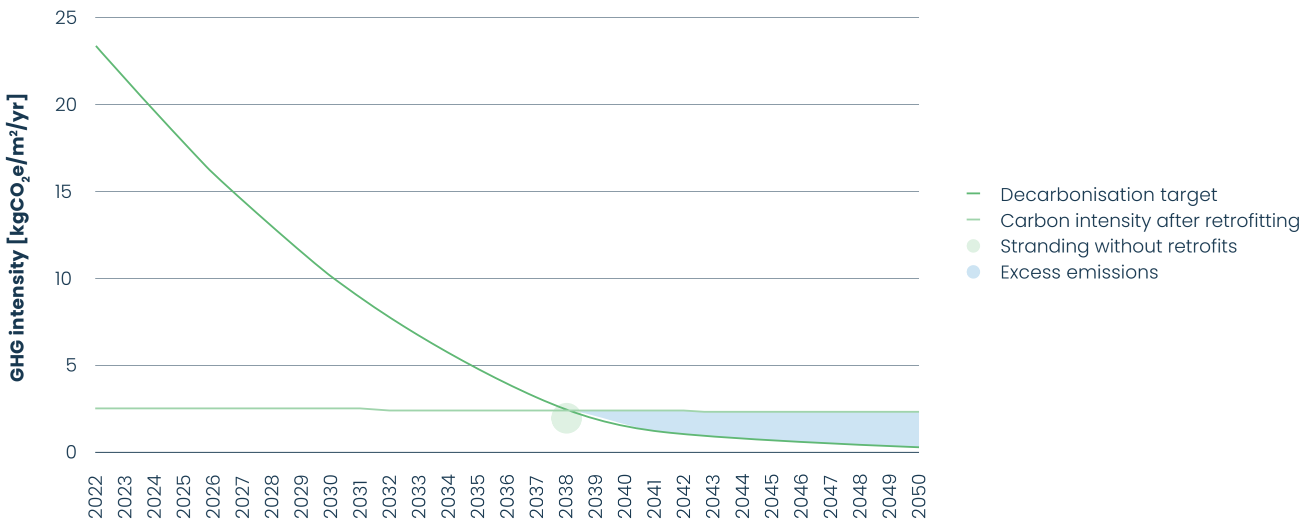


Figure 3: Not aligned: The emissions of the asset in 2022 are under the CRREM target pathway, but the asset has no plan to reach net zero by 2050. Source: LPPI, CRREM



Target setting

The LPPI Real Estate Fund IPV is considered two thirds directly invested via a delegated asset manager who recommends and manages existing assets for a diversified portfolio of UK real estate. LPPI set targets for the direct portfolio first due to greater data coverage, degree of leverage and asset level reporting compared to the externally managed funds.

LPPI has set two coverage (alignment) targets:

- At least 90% of the direct portfolio will be assessed as net zero, aligned or aligning with a net zero pathway by 2025
- The overall ambition is for 100% of assets in the direct portfolio to be assessed as net zero or aligned to a net zero pathway by 2040.

In 2022, LPPI's delegated asset manager launched a tenant engagement survey and completed a smart metre installation exercise which enabled Scope 3 emissions to be reported for the first time. Supported by green clauses in lease agreements, data coverage reached 95% reported and 5% proxied across Scope 1, 2 and 3. Over 2022/23, a transition strategy for each asset was modelled and agreed with LPPI's delegated asset manager based on retrofits occurring on current assets at lease expiry to reach an EPC[1] target of 'A'. EPC 'plus' reports were utilised to assess retrofit requirements and costs for a selection of assets with proximal stranding risk. Immediate capex costs have been built into the business plan and will be progressively assessed across the remainder of the portfolio over time.

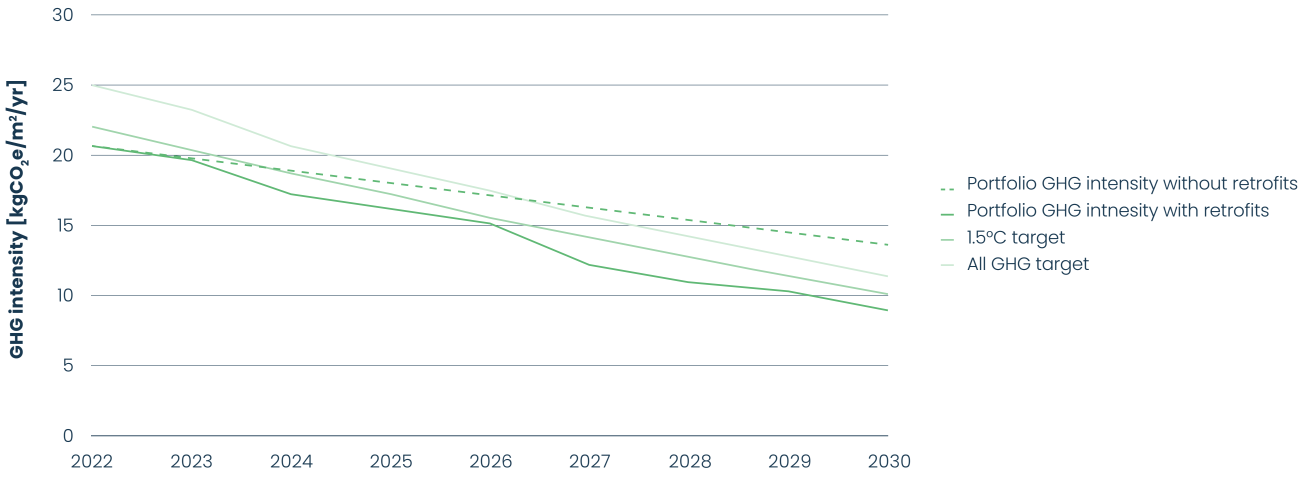
Alignment baseline (2022):

- Net zero: 0%
- Aligned: 51%
- Aligning: 45%
- Not aligned: 4%

The resulting decarbonisation plan was used to set LPPI's 2030 decarbonisation target based on CRREM modelling as depicted below. The 1.5°C pathway for the fund requires a reduction in GHG intensity of 48% between 2022 and 2030. The LPPI Real Estate Fund plans to achieve 50% by December 2029.

1 Energy Performance Certificate (EPC): Indicates energy efficiency of a building with assessments branded from A to G, where A (or A+ for non-domestic properties) represents the most efficient in terms of likely fuel costs and carbon dioxide emissions

Figure 4: Real Estate decarbonisation pathway



Source: LPPI, CRREM

Engagement strategy

LPPI assesses any asset within its delegate manager's portfolio as under engagement, hence it chose IIGCC's higher engagement threshold as its target (90% of financed emissions to be net zero, aligned or under engagement, achieved by 2024). LPPI has been engaging with its delegate manager for a number of years to develop their overall ESG capabilities, and specifically their climate change awareness and related activity. For example, a carbon footprinting exercise and a tenant engagement survey were key priorities in 2021/2022. They have since developed their own net zero strategy including short-, medium- and long-term targets which was integral to the net zero analysis used for LPPI's target setting. LPPI will continue to engage with them to implement its respective net zero strategy.

Ongoing due diligence of new direct assets include:

- The expectation of a net zero readiness assessment carried out by its delegate manager, covering building certifications and energy mix
- A transition plan for the asset to be established within a year
- Minimum standards for refurbishments (BREEAM[2] 'Very Good') and for new developments (BREEAM 'Very Good' or where viable 'Excellent').

Engagement baseline (2022):

- Net Zero: 0%
- Aligned: 30.5%
- Under engagement: 69.2%
- Not committed: Remaining 0.3%
- Total: 99.7%

2 Building Research Establishment Environmental Assessment Method (BREEAM): A sustainability assessment method used to evaluate the environmental performance of buildings during design, construction, and operation.

Listed equities

Alignment approach

The LPPI Global Equities Fund also has several mandates managed externally and internally, representing nearly 50% of LPPI's total assets under management. LPPI created its own LPPI alignment framework based on the IIGCC alignment criteria as set out below:

Target setting

LPPI has improved its methodology over time based on data availability and the development of 1.5C aligned methodologies. Analysis now uses data from MSCI, augmented using Net Zero Tracker, Climate Action 100+/TPI and the Scope 3 materiality framework from CDP. To set the alignment target, LPPI followed the linear pathway method proposed by the IIGCC from its baseline amount of 14% (2021) to set the following targets:

- 32% of assets under management in material sectors will be assessed as net zero, aligned or aligning with a net zero pathway by 2025
- 55% of assets under management in material sectors will be assessed as net zero, aligned or aligning with a net zero pathway by 2030
- The overall ambition is for 100% of assets under management to be assessed as net zero or aligned to a net zero pathway by 2040.

Alignment category	Criteria for assessment
Committed	Ambition: A long term net zero goal
Aligning (material but not high impact)	**Meet committed +** **Targets**: Short- and medium-term emissions reduction target (Scope 1, 2 and material Scope 3) **Disclosure**: Disclosure of scope 1, 2 and material scope 3 emissions
Aligning (high impact[3])	**Meet committed +** **Targets:** Short- and medium-term emissions reduction target (Scope 1, 2 and material Scope 3) **Disclosure**: Disclosure of Scope 1, 2 and material Scope 3 emissions. **Decarbonisation strategy:** A quantified plan setting out the measures that will be deployed to deliver GHG targets, proportions of revenues that are green and where relevant increases in green revenues
Aligned (material but not high impact)	**Meet aligning +** **Emissions performance:** Current emissions intensity performance (Scope 1, 2 and material Scope 3) relative to targets
Aligned (high impact)	**Meet aligning +** **Emissions performance:** Current emissions intensity performance (Scope 1, 2 and material Scope 3) relative to targets **Capital allocation alignment:** Clear demonstration that the capital expenditures of the company are consistent with achieving net zero emissions by 2050
Net zero	Achieving the emissions intensity required by the sector and regional pathway for 2050 Ongoing investment plan or business model will maintain net zero performance

3 Material: NACE codes A-H and J-L. High impact: Company focus lists of Climate Action 100+ and TPI, plus banks, real estate, agriculture, forestry, and fishing

Engagement strategy

LPPIs listed equities are engaged through a number of avenues, including:

- External engagement partner, Robeco
- Collaborative initiatives, for example the Net Zero Engagement Initiative and Climate Action 100+
- An internal investment team
- External managers on LPPI's behalf
- Through voting its shares for both sections of the fund in house

LPPI has an engagement threshold of 70% of financed emissions to be net zero, aligned or under engagement (achieved by 2022) and has developed an in-house priority matrix which identifies the companies most material to engage. Where the company is not already engaged with externally, these become priority companies for LPPI's internal portfolio and for external managers to engage with directly on its behalf. The alignment criteria form the basis of engagement expectations for LPPI's managers, internal portfolio and shareholder voting. The LPPI voting policy includes minimum thresholds which can trigger an escalation with a company and a vote against relevant parties at their AGM – more details can be found here.

Corporate fixed income

Alignment approach

LPPI's corporate bonds exposure is split between two funds, the LPPI Fixed Income Fund and the LPPI Credit Fund, which are both 100% externally managed. LPPI's strategy for alignment has been led significantly by its managers' capabilities in this area with regards to reporting and target setting.

Within the LPPI Fixed Income Fund, the managers have a net zero strategy at firm level developed in accordance with the Net Zero Asset Managers initiative and SBTi alignment criteria which includes a significant focus on engagement and alignment monitoring at fund level. LPPI chose to adopt its managers' alignment frameworks and worked closely with them to translate these into the IIGCC categories of net zero, aligned, aligning and not committed.

Alignment Baseline (2022):

- Net zero: 0%
- Aligned: 2.4%
- Aligning: 43.3%
- Not committed/aligned or no data: 55.3%

Target Setting

LPPI has set two coverage (alignment) targets:

- To increase the portion of assets under management in material sectors that are net zero, aligned or aligning by 2025
- The overall ambition is for 100% of assets under management to be assessed as net zero or aligned to a net zero pathway by 2040.

In setting the short-term alignment target, no specific quantum of percentage increase was used. The straight-line methodology used for listed equities was not appropriate as the variability of the portfolio means the Fund's trajectory to the target is unlikely to follow a linear pathway and the investment team did not want to create incentives for LPPI's managers to exclude based on alignment to meet a specific target at this time. LPPI plan to review its target and reassess the framing over time based on progress and experiences from implementation.

Engagement strategy

LPPI has an engagement threshold of 70% of financed emissions to be net zero, aligned or under engagement (achieved by 2025). The approach taken by LPPI's managers is to engage with companies in material sectors which contribute the most to the benchmark's Weighted Average Carbon Intensity. This results in a small list of priority companies as emissions are highly concentrated. As the fund follows a benchmark driven approach, this approach makes the engagement strategy more robust to changes in the portfolio as carbon-intensive companies will be covered whether their corporate bonds are in current holdings or not. Engagement is linked to alignment predominantly through the pursuit of holdings setting SBTi targets which would increase the proportion considered 'aligning'. LPPI sourced emissions data in-house from MSCI to establish the decarbonisation target.

Engagement baseline (2022):

- Net zero: 0%
- Aligned: 0%
- Under engagement: 43%
- Other (not net zero, aligned or under engagement): 57%

Multi-asset credit

The LPPI Credit Fund holds diversified exposure to multiple security types across both public and private markets, including the largest portion of LPPI's corporate bonds exposure. Emissions and alignment data are not readily reported and the net zero capabilities of managers are less consistent. At this stage, LPPI has taken a pragmatic approach to establish an engagement strategy which prioritises the most material exposures in the portfolio and targets improvements in reporting as a first step.

For managers with >75% of their portfolios in corporate fixed income (or otherwise determined to be material and in scope) managers are expected to report detailed holdings information with GHG emissions at the portfolio level and to engage with the highest emitters in their portfolios and provide reporting on this to LPPI. Due to the concentration of emissions in a few holdings, over time this is expected to mean engagement with the top 10 emitters and/or contributors in the portfolio based on contribution to financed emissions, but requirements will be determined according to context. LPPI will continue to develop its approach to target setting in this asset class over time.