Appendix 2: Integrating ESG into a typical investment process

An investment vehicle could adopt a variety of different investment approaches, depending on its ambition toward environmental and social impact and the appetite for environmental risks and opportunities.

Traditional investment strategies are assumed to be executed for the sole purpose of financial return with no environmental and social impact objectives. They may consider certain risk management or regulatory factors relevant to ESG, but this is likely to be based on the intention to avoid loss, rather than the positive shareholder benefits of incorporating ESG into investment decisions.

Investment managers may consider sustainability risks in their investment decisions-making processes without necessarily pursuing a sustainable investment objective. On the other hand, a vehicle might have an objective to promote environmental or social characteristics but not necessarily have a sustainable investment objective. By integrating ESG into their decision-making processes, investment managers systematically and explicitly include ESG factors in their financial analysis, risk assessment, and monitoring.

A vehicle might also have sustainable investment as its primary objective. This means it invests in economic activities that contribute to a specific environmental or social objective.

ESG considerations related to important components of a typical investment process include but are not limited to the following:

- **Market analysis:** Include considerations of ESG risks and opportunities in market-level analysis. For example, consideration of feasibility of net zero carbon pathways for certain asset types could be relevant;

- **Portfolio Allocation:** Consider the impact of a transaction on the balance of the overall portfolio from the point of view of ESG risks and opportunities. The investment manager could use ESG checklists to identify ESG risk exposure and assess its financial impact. Identify specific initiatives to be included in asset management programmes related to the mitigation of specific ESG risks, such as achieving net zero carbon;

- **Running scenario analysis:** Integrate scenario analysis outcomes into investment strategy and asset business plans, including commitments to specific outcomes (eg net zero carbon, science based targets etc). The resilience of the investment and asset portfolio should be tested regularly for selected scenarios and transition risks monitored;

- **Due diligence:** Conduct adequate due diligence prior to making investments and assess ESG issues and specifically climate-related physical and transition risk factors in preliminary and advanced stages of due diligence. INREV DDQ provides a consistent due diligence framework, helping potential investors achieve a high level of scrutiny when entering a vehicle. The investment manager should enable potential investors to fully utilise the INREV DDQ when considering an investment opportunity and consider the adoption of the INREV DDQ and answer all its questions appropriately and in a clear and precise manner;

- **Investment decision-making:** Fully consider ESG findings identified during due diligence into the decision-making process and ensure they are fully understood by investment committees;

- **Developing Asset Management plans:** The investment manager should assess issues that might emerge during the operation of the asset. ESG risk assessment should be conducted for the management of operational assets as well as for planning new developments and major renovations. ESG issues should be considered when selecting and appointing a property manager. This should include identifying and documenting specific ESG performance targets and related action plans.