

Top 10 with...

Interview with REPM private markets experts on **ESG investing**

October 2021

Key REPM ESG facts:

> 90%

4* and 5* GRESB rated strategies (2021 GRESB Real Estate and Infrastructure Assessments)¹

A+

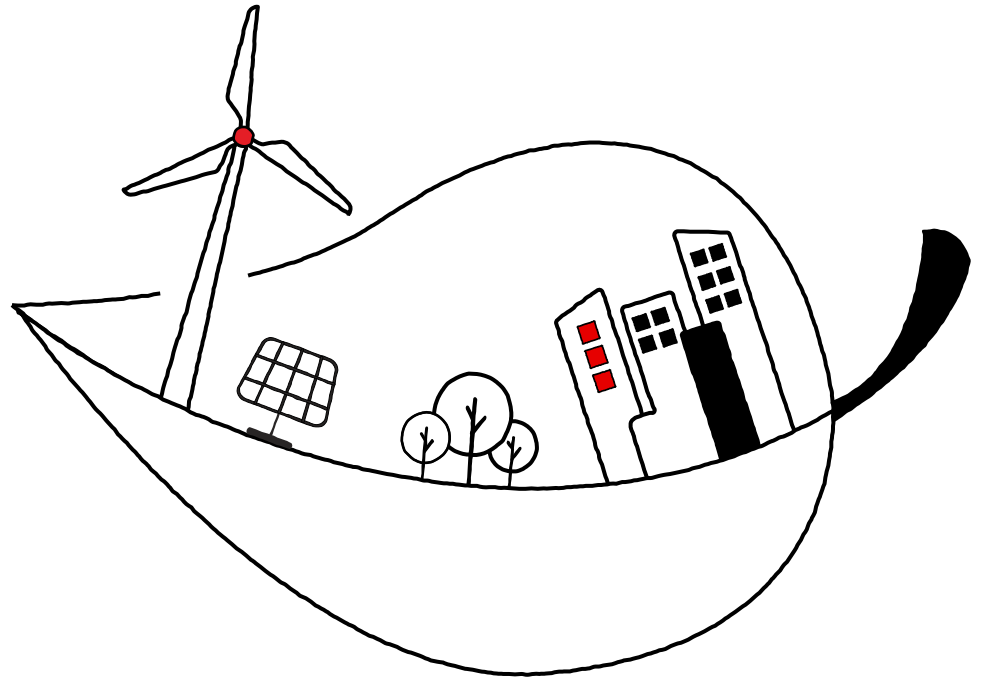
for Property and Infrastructure (2020 UN PRI Assessments)

100%

invested target private equity funds assess ESG aspects on underlying investments²

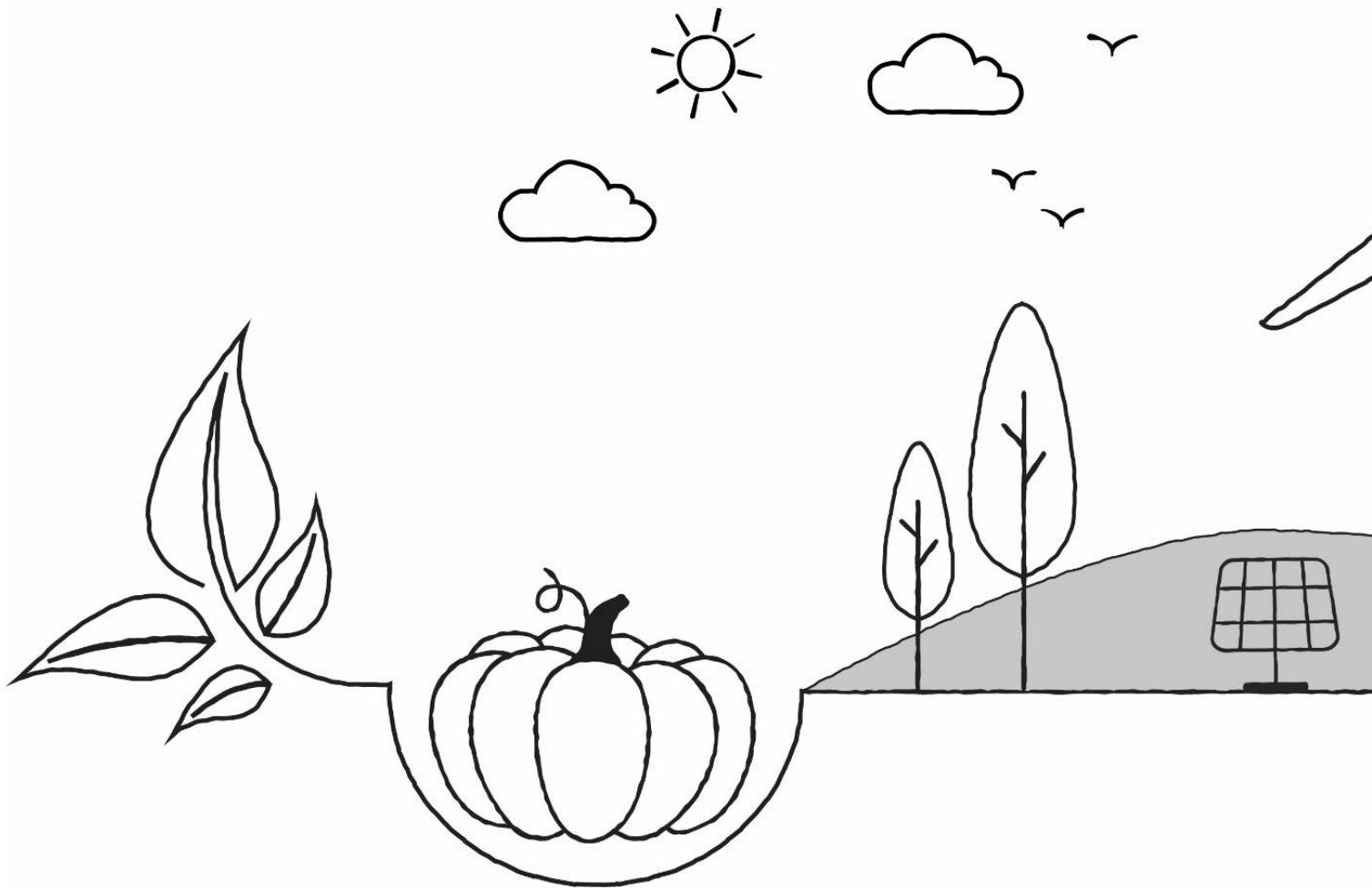
100%

farmland enrolled in Leading Harvest³



ESG changing the game in the private markets space

Institutional investors are increasingly recognizing the potential for ESG factors to affect the valuation and financial performance of their portfolios. The recent boom can be viewed as both an economic and ethical opportunity to draw together expertise across a wide range of real asset investments. Our experts provide a cross-asset view on how ESG investment is transforming the private markets space.



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1

What is ESG investing?

DR: Environmental, Social and Governance (ESG) considerations are three criteria which can influence a company's performance and competitiveness. The E, for environmental, can cover issues related to the environment such as global warming, pollution etc. The S, which looks at social factors, can cover topics which impact health & wellbeing of e.g., building occupants, employees.

While the G, for governance can look at factors such as the policies a firm has in place. ESG has become increasingly integral to investment management. Investors are now looking at new ways to integrate ESG into their decision-making processes and analysis of investments.

Analyzing ESG can help investors to analyze the resilience of companies. And by looking at investments through this lens, they can factor in economic, social and environmental trends as well as material risks into their decision making.

There is increasing awareness that material ESG factors can be tied to a company's long-term performance. As such, more and more investors are looking to integrate sustainability insights and data into their traditional investment processes. By expanding access to data, insights and learning on material ESG risks and opportunities in investment processes across the board, we can become better overall investors.

2

How can ESG be measured?

DR: ESG scores are calculated by several different companies using varying methodologies, meaning there is no one authority on ESG scores. Most providers outline specific ESG indicators, such as climate change effect and political contributions, but those indicators often differ depending on the provider. The way providers acquire their data differs as well.

We measure the sustainability performance of individual properties with recognized external benchmarks, such as the GRESB key performance indicators, ratings (UN PRI) and third-party certifications (LEED, ENERGY STAR, Fitwel, BREEAM, IREM, MINERGIE®, Leading Harvest).

For infrastructure, we also use the GRESB Infrastructure key performance indicators and benchmark reports and UN PRI ratings for our individual investee companies. The majority of this data is collected by third-party ESG consultants that collect the data directly from our properties utilizing the consultants' proprietary systems or the consultants directly license, as they collect this data for multiple clients.

As far as third-party data vendors, we recently signed an agreement with 427 to provide forward looking Climate Risk Measurement data (floods, sea level rise, wind, heat) for all funds globally.

In addition, to assess and seek to improve the social value of our property assets, we recently commenced a pilot within our core UK real estate strategy. We commissioned a third-party, the Social Value Portal, who use an independent measurement framework, to collect data and generate the social, economic and environmental value of a property.

The social value produced reflects the property's value to the community as well as the financial return to investors and is used to measure our contribution to the United Nations' Sustainability Development Goals (SDGs). Further properties in Europe will also be piloted, with the aim of having a social value across the UK portfolio as well as for other properties held by Real Estate & Private Markets (REPM) globally. This data provider is engaged on a property-by-property basis.

EB: For our Multi-Managers business, across real estate, infrastructure and private equity, information on target funds' ESG policies and efforts are collected as part of the due diligence process during our underwriting. In addition to reviewing a fund's ESG policies, we consider how it incorporates these policies into the fund strategy, how it reports its ESG strategy to its investors, what relevant laws and regulations impact the fund, and any sustainability initiatives the fund is already participating in. We also review the ESG scores achieved by the target fund, at the asset, fund and company levels (e.g., LEED certifications, GRESB scores, UN PRI Assessment, other environmental accreditations).

We believe such scores may indicate risks and opportunities that could impact current and future investment returns and liquidity.

In addition, we have developed ESG questionnaires that integrate sustainability topics as part of the due diligence of new investments and the ongoing review of existing investment firms. Further to this, the teams will engage with the investment firms to address areas where sustainability performance is lagging such as low GRESB and UN PRI scores.

3 What is your business doing in the area of ESG?

DR: Our business is one of the US's leading managers of institutional agricultural investment portfolios starting in 1990. Our portfolios are all enrolled in the Leading Harvest Farmland Management Standard, a newly developed ESG standard for farmland portfolios designed to optimize sustainable farmland management as part of a comprehensive assurance program.

It addresses economic, ESG issues and includes measures to efficiently use water, agricultural chemicals and energy to grow crops for useful agricultural products; minimize waste; and conserve soils, water resources and biodiversity. It also takes into consideration the well-being of farmland tenants, employees, contract management company employees, contract farm labor and local communities.

EB: ESG considerations are integrated within the entire investment process of our Multi-Manager business areas across real estate, infrastructure and private equity. We consider ESG factors in due diligence of new investments and ongoing ownership of existing investments. Our responsible investment strategy is embedded throughout the ownership cycle of a Multi-Manager investment because we believe that a significant positive impact is also possible indirectly, on society, the environment, and in the returns generated for our clients.

BS: We are already building ESG into our business plans in infrastructure. We have refined our investment strategy as we have become more focused on decarbonization and digitalization, and that is reflected in our recently acquired and soon-to-be acquired assets. In fact, we have targeted a portion of our portfolio to be sustainable investments and to achieve a minimum level of the GRESB benchmark. In addition, we have a list of excluded investments, specifically oil, coal and nuclear.

4

What does ESG cost investor and can it affect risk / return?

DR: While pressure is growing on fund managers to pay greater attention to ESG issues, many also realize that ESG and impact investing can generate strong financial returns. For years, investors assumed a commitment to ESG performance would automatically lower profits, with many investors still believing that. ESG now makes sense for the risk and return-focused investor.

Indeed, the most common tail risks are environmental and carbon risks, while the social and the governance factors can influence a firms' reputational risk. These are all long-term factors that can affect a company's performance. Incorporating good corporate citizenship should create long-term value.

EB: In the past, private equity funds typically addressed ESG through exclusion policies. Today, the shift to sustainable portfolios and impact investing reflects growing public concern about global challenges such as climate change, social inequality etc. By investing at the early and growth stage, private equity funds can facilitate positive environmental and social impact in the areas of healthcare, energy transition, education, food & agriculture. Currently, the industry shows private equity funds returns are typically not compromised with this approach and can still offer competitive advantages, with target returns usually in the 20%+ range.

5

What impact can ESG have on portfolio characteristics?

DR: ESG investing can be a great way to compliment a portfolio with strategies that reflect your standards and ethics while providing good returns. What many investors really want to know, is whether a preference for sustainable, socially responsible investing means giving up on opportunities for portfolio performance. There is a monumental shift in how individuals are living their lives and their sensitivities to the environment "E", their views on social impact "S" and expectations on how private and public companies conduct themselves "G".

This behavioral shift is creating tremendous investment growth opportunities as businesses adapt. If you invest in a new office building, one must think about creating an environmentally *better* building. This potentially attracts higher paying tenants and ultimately creates higher economic value for the building. Encouraging economic investment in historically underinvested areas promotes long-term growth while at the same time *having impact*. And finally, better governance will encourage companies to incorporate environmental and social consequences into their business objectives, which ultimately can have a positive impact on their valuations.



Which private markets sectors can be effective in delivering an ESG outcome?

ZG: Awareness is growing that real estate can have a significant social impact either through the form of social measurement work, strategies for multitenant shared spaces or life sciences (where REPM is currently active in and hits the sweet spot between delivering a strong sustainable investment return but also supporting breakthroughs in health research). The Social side of ESG is the hardest to measure, but is by no means any less important than the Environmental and Governance aspect.

As a result, we hear a lot of greenwashing around the topic and it will be important for investors to cut through the marketing to extract the positive difference that a scheme genuinely does (or doesn't) deliver. ESG, aside from fostering environmentally friendly buildings, also allows space to include considerations about the impact of properties on the community. The real estate industry must respond to this challenge by creating opportunities through social impact investing, like multitenant shared spaces or the transformation of underutilized buildings into enthusiastic venues.

In practice, the major obstacle is that investors will need to reinvent their traditional investment models to match the needs of the local community. Real impact policies rather than buzz words carry far more weight. One example would be owners of commercial buildings ensuring all staff employed on site are paid at least the living wage for that area.

BS: Infrastructure and ESG are two sides of the same coin. The push towards social infrastructure had already started pre-COVID-19. Historically, managers invested in PPP type social infrastructure where there was a concession with the government. Today, managers are investing in care homes, childcare facilities and diagnostics or healthcare assets. If managers can point to high barriers to entry or a look through to government funding, they are investing in it as infrastructure.

DO: There are opportunities in the transportation sector, which has made little to no progress in decarbonization over the last decade when compared to electricity which has reduced carbon footprint by around 50%.

There is currently a keen focus on electric vehicles and charging infrastructure, although there is still significant investment needed in the heavy good vehicles and maritime sector. The maritime sector has less than 2% of vessels which use low carbon fuel. Despite this, the International Maritime Organization is targeting reductions of 70% by 2050. Shipping is likely to be included in the EU Emissions Trading System and opportunities may arise around fleet and ancillary refueling infrastructure.

Responsible investing has gained in momentum in recent years, and we don't expect it to slow down any time soon.

7

What does ESG look like regionally? Is this impacted by the evolving regulatory environment?

DO: Europe is a bit ahead on the environmental side, while the US has focused more on the social and governance issues. In Europe, the risk of owning less-environmentally friendly assets is rapidly growing. For example, the price of carbon has almost doubled in Europe in the past 12 months, so owning assets with a large carbon footprint will become increasingly expensive. You are also seeing rapid energy transition, with more and more governments signing up to net-zero targets.

On top of that, you have regulation, such as the EU Sustainable Finance Disclosure Regulation (SFDR). While it remains unclear whether enforcement is going to be a carrot or a stick, it is clear that the European Commission didn't go to the trouble to design all of this regulation to then have it ignored. There are also societal elements, where Europeans are more anti-hydrocarbon than Americans. With all of that working together in Europe, it leaves the US quite a long way behind.

But things are moving in the right direction. If you look at carbon pricing, for example, certain US States do have a carbon-pricing market. These prices are still probably too low to make a meaningful difference, but they have been increasing, and even the National Institute of Petroleum says they would potentially support carbon pricing. However, given how cheap gas is at the moment, it is very difficult politically to sign up for anything like the same sort of commitments that Europe is able to make.

I think Europe has got a lot to learn from the US in terms of some of the social metrics, but clearly in terms of the environmental side of things, Europe is quite far ahead. And if they manage to implement a carbon border, the EU will only provide further impetus to the ambitious decarbonization plans.

8

What are some of the challenges you see in ESG integration?

EB: Tenant engagement through active ownership can be a huge challenge and without it achievements can only ever be limited. Getting an occupier to engage on ESG topics will depend on things like whether it aligns with their own corporate strategy and their own long-term intentions for occupying the asset. Topics such as health & wellbeing, or indoor environmental quality are prominent, while engagement with property managers can help focus conversations around tenant satisfaction or collecting data as it relates to sustainability performance. Done well, engagement with tenants can provide a transparent report on the property's progress as a whole and identify areas for improvement while aligning investment priorities and strategies for the long-term to suit both owner and occupier.

DR: Managers are seeing significant growth in the ESG investing segment. However, to leverage off of this growth managers also need to demonstrate a real commitment to the cause beyond lip service. E.g., How they incorporate ESG aspects into their investment processes. As an extension on this, are accusations of greenwashing which are also on the rise. European regulators have enforced reporting requirements which requires firms to show the clear steps they are taking to achieve their ESG targets. The challenge here will be balancing both easy to measure quantitative factors, with just as important well thought out, but harder to assess qualitative factors when measuring ESG results.

9

How can an investor gain exposure to ESG?

JA: I like the way you phrased the question. You could have inserted the words real estate, infrastructure, private equity or private credit at the end of that question. It reads as if ESG is an asset class. *Is it?* Maybe it is. Or maybe it should be. In private markets ESG could be an asset class. I would think investors would want to have a large allocation to assets that improve society. And assets that make society cleaner, safer, smarter healthier, richer and fairer should produce better returns than assets that do none of that, or assets that do the opposite of that.

Buying, improving, building or financing beneficial assets or entities should have a dedicated allocation, especially if it will help to create more of them. We need more safe and affordable housing. We need more clean energy. We need less carbon emission. We need more clean water. We need improved food security. We need better healthcare and we don't need another pandemic. Call it ESG or call it something else. But call it something and give it a very large strategic allocation, and we might be pleasantly surprised by the outcome.

DR: Responsible investing has gained momentum in recent years, and we don't expect it to slow down any time soon. A 2020 survey by Global Impact Investing Network (GIIN) estimates the size of the current global impact investing market at USD 715 billion². Although there are vast opportunities for investors in this space, knowing how to allocate funds can prove tricky.

Investors should start by establishing their investment goals: whether they're looking to align investments with their own values (e.g., addressing climate change, fighting hunger), or considering adding sustainability factors to their portfolio. What it really boils down to, is how a portfolio is structured, what impact you want to have and what types of returns you're looking to achieve. This will help to dictate the best approach for your objective.

EB: A good starting point for investors looking to construct a portfolio around impact investing, are the 17 UN SDGs. Today, strategies in private markets are increasingly aligned to certain UN SDGs such as: good health & wellbeing; affordable & clean energy and sustainable cities & communities. The risk and return profile of the investments will also vary. For example, the health & wellbeing theme can be invested in via private equity funds focusing on supporting the R&D of vaccines and medicines.

Currently in the industry, there is a typical private equity return profile of 15%+ reflecting the venture and growth profile of the investments. It can also be invested in via real estate investments in life sciences, medical housing, and aged care living. The industry shows that this can provide real estate development type returns of low double digits and stabilized returns of 7-8% made up of mostly income. The affordable & clean energy theme can be invested in via strategies focusing on clean energy and water as well as climate action elements.

This will provide typical more stable long-term infrastructure returns with a much higher yield according to current industry levels. The final example is sustainable cities & communities, which can be accessed via investments in real estate funds primarily focusing on regeneration and affordable / social housing. There is a choice here to focus on development and higher capital gains focused returns or stabilized assets with a bigger income focus. Today investors are spoilt for choice, they can either invest in a diversified portfolio of funds hitting 6-8 UN SDG's or have a narrower investment focus and select an impact theme and risk & return profile that suits them.

10

What is next for ESG investing?

DR: ESG is no longer a nice to have but is now a requirement of any real asset investment firm. Private markets investments provide a unique opportunity for investors to express their ESG objectives and control the related positive outcomes. At the same time, more investors are looking to integrate ESG into their investment processes. The growing relevance of ESG issues is further driven by recent legislative developments, such as the EU Sustainable Finance Disclosure Regulation – SFDR, 2015 Paris Agreement on Climate change and third-party industry benchmarks such as TCFD and GRESB, reflecting the urgency to mitigate environmental risks related to climate change.

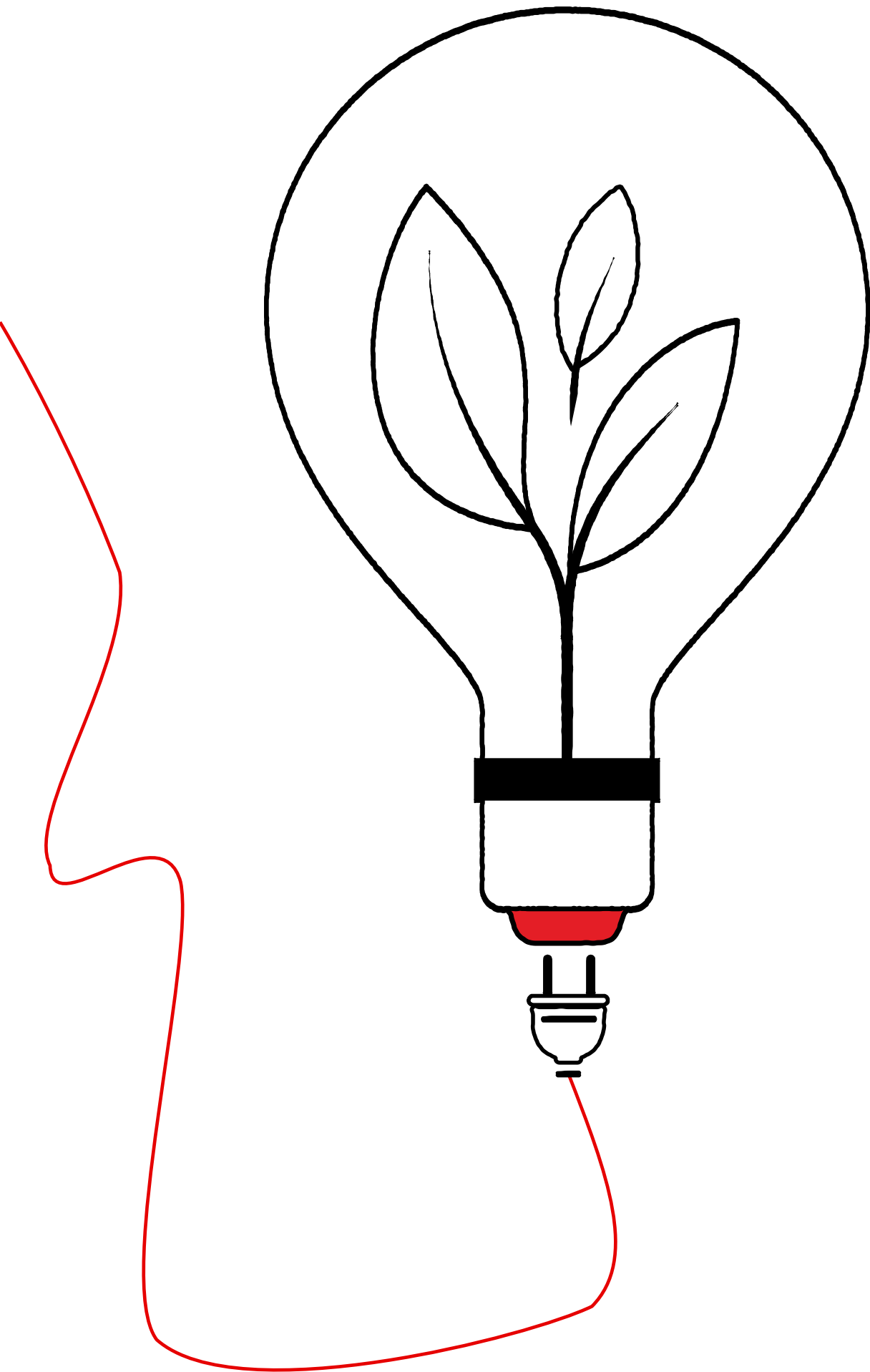
DO: The options for institutional investors to gain exposure to ESG have never been greater. The public markets, for example, have seen net new money into sustainable investment funds increase from USD 17.5 billion in the first quarter of 2018 to almost USD 140 billion by the fourth quarter of 2020⁴. That is more than the total capital raised from all real asset funds. Real assets are also experiencing an increase in sustainable offerings, though that sector is at an early stage of maturity so a bit harder to track.

We can easily see that real estate is leading the way, due to more efficient buildings, and the increase in both subsidized housing and measurement of the social impact of assets. However, infrastructure is beginning to catch up and, potentially, offers more interesting opportunities in the future to take advantage of the more secular trends in the economy, such as decarbonization, digitalization, the need to support aging demographics, as well as healthcare and housing.

The ability to directly invest in and control these assets to target sustainable outcomes is an advantage of this sector. When you invest directly in infrastructure, you aren't just investing in a company with favorable ESG ratings, you are investing in assets in the real economy that can have a positive environmental and social impact.

ESG investing can be a great way to compliment a portfolio with strategies that reflect your standards and ethics while providing good returns.

1 Of assets under management for all strategies eligible to participate in the GRESB Assessments; Includes three submitted infrastructure strategies. **2** Figures relate to fourth Global Private Equity Growth strategy's underlying target funds, as of 30 September 2021. **3** Data as at 30 September 2021. **4** Preqin; UBS ISS Market Intelligence (SI), May 2021 * Real assets capital raised based on Real Estate, Infrastructure and Private Debt. **Past / expected performance is not a guarantee for future results.**




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