Top 10 with...

Interview with Olivia Muir on ESG in private markets

November 2022

Key facts:

4 and 5 stars

in GRESB for 100% submitted discretionary strategies[1]

4 and 5 stars

for Real Estate & Infrastructure in UN PRI[2]

100%

farmland assets enrolled in Leading Harvest[3]

"Our clients care about ESG and are becoming increasingly vocal – which is great as it is such a powerful way to generate meaningful and impactful change."

Olivia Muir, Head of ESG – Real Estate & Private Markets

ESG is center stage

In recent years, ESG issues have moved from somewhere near the bottom of many investors' priority list, up towards the top. Real Estate & Private Markets' (REPM) Head of ESG, Olivia Muir, explains how this complex landscape has evolved, the benefits and challenges of investing through an ESG lens in private markets and the business' current priorities.

Important information

GRESB is a third-party organization that provides ESG data to financial markets. GRESB collects, validates, scores, and independently benchmarks ESG data to provide business intelligence, engagement tools, and regulatory reporting solutions for investors, asset managers, and the wider industry. UBS has been a member of GRESB for over a decade. For more info about GRESB, please consult the webpage here and learn more about GRESB's scoring methodology here. GRESB is compensated annually by its members for the assessments, find out more here. The **PRI** sets a benchmark for asset managers and asset owners within the industry for responsible investing and provides a year-on-year comparative analysis. UBS-AM has been a signatory of PRI since 2009. For more info about PRI, please consult the webpage here and learn more about PRI's scoring methodology here. The PRI is funded primarily via the annual membership fee payable by all signatories, find out more here.

1 ESG is not a new theme but is increasingly prevalent in our world. How has ESG evolved as a topic in recent years?

We have witnessed the evolution and growth of ESG over recent years and now for many investors it is front and center on their agendas and a growing part of the overall picture. The science (as it relates to the environmental component in particular) has never been clearer: we must act fast to combat the most devastating effects of climate change. The COVID-19 crisis has also emphasized the importance of ESG as stakeholders observed first-hand the effects of fragile supply chains, poorly-managed health and safety risks and labor welfare issues, to name just a few other social and governance topics.

ESG is now at the top of many investors' priority lists for the risks and opportunities that it brings which influence how we manage capital. It is a topic that affects everything that the investment management industry is doing and is only going to grow in breadth, depth and importance in the next few years.

2 Will green buildings outperform brown?

Yes. And this isn't new; research has for years identified this link between sustainability and performance across multiple real estate markets and sectors. The last decade or so has focused on the 'green premium' discussion, but as the market has become increasingly concerned with its environmental footprint the perception of the green premium concept is fading (as the norm has evolved and is greener today), while brown discounts come again to the fore as buildings that fall short of higher market expectations see less demand and thus weaker values.

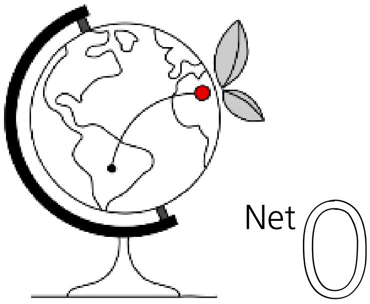
There are countless factors that appear to contribute to this trend, that green outperforms brown (either via green premium or brown discount). To name a few: higher rental values and lower vacancy downtime due to higher demand from tenants for greener space (and more productive healthier employees), lower operating costs (including insurance), lowered cost of regulatory compliance and potentially more favorable tax consequences.

Is it more expensive to develop or to buy a 'green' building, compared to a 'brown' building? Often the answer there is yes.

But learning and competition has driven down both design and construction costs hence the difference is often smaller than one might expect. Once you consider the future cashflows of your building (both costs and benefits, including unknown cashflows such as possible future carbon taxes) it is evident in the countless academic studies and data analyses that green outperforms brown on a risk adjusted basis.

We, UBS REPM, believe that there is a direct link between sustainable investment and long-term returns, while ignoring ESG may lead to worsened performance and risks. For example, failing to consider social aspects of a business can have a big impact on a firm's reputation (and consequently, financials) if poor practices are uncovered. In real assets, the risk that is obvious to many is the physical risk of climate change and extreme weather events, where clearly failing to consider changed weather patterns in the construction of a building or infrastructure asset is a poor business decision. In addition to the financial benefits gained by investors, we believe the incorporation of ESG characteristics in our business and investment process positively impacts all of our stakeholders including our employees, and the communities we operate in.

3 How are you approaching net zero in REPM?

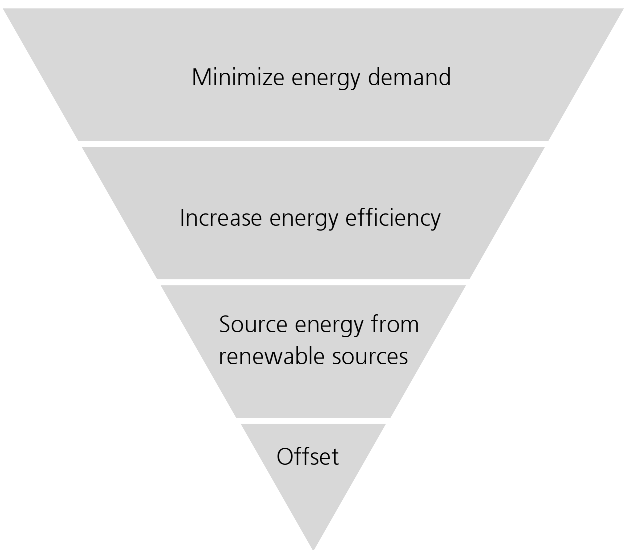


Net zero means achieving net zero greenhouse gas emissions (GHG) by 2050 and reaching a 50% reduction by 2030. This is what scientists believe needs to be achieved in order to limit the rise of global temperatures below 1.5°C and mitigate the most catastrophic impacts of climate change. Clearly 2050 is a long time from now, so it is critical to have interim goals before then, which collectively make up the pathway towards net zero.

We all know that the real estate sector is a very big contributor to global GHG emissions. Estimates vary, but this industry is responsible for around 39%[4] of all emissions and therefore as real estate owners and investors, we clearly have an important role to play in ensuring our real estate (and real assets more broadly) is being managed in line with those science-driven net zero ambitions.

For the real estate industry, the approach towards net zero is generally agreed to comprise four prioritized key actions. The reduction of energy consumption is the first improvement which needs to be implemented (e.g. use of smart energy sensors), followed by increasing energy efficiency (such as upgrading building equipment to modern standards, upgrading insulation, etc.). After the first two approaches are pursued and maximized, renewable energy sources must be secured to meet the remaining energy use of the building (ideally on-site, but this is not always practical). The final step, which is very much a last resort, is offsetting in some way.

Real estate pathways towards net zero in priority order



Source: UBS Asset Management; Real Estate and Private Markets (REPM), September 2022

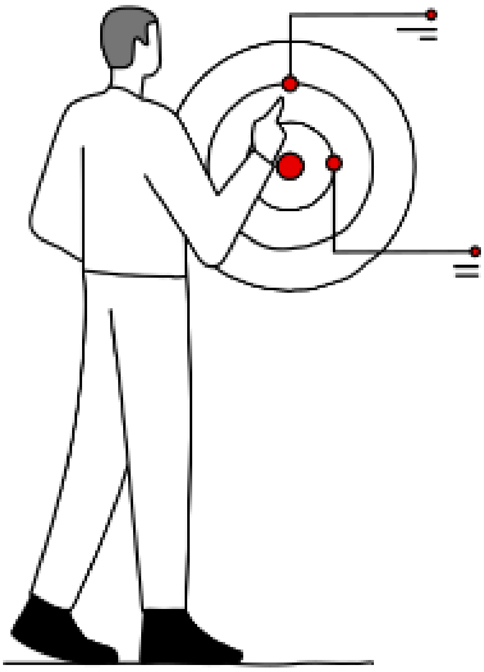
At REPM, we have been working hard over the last 12 months to crunch all the data we have on many of our real estate assets and determine their energy consumption and GHG emission performance, compared to a benchmark, in order to determine their net zero status.

This is quite complicated for a global real estate portfolio across many regions and asset types (offices, industrial sheds, residential blocks, student housing, etc.) and hundreds of buildings. We engage numerous companies for the collection, management and checking of this data which all ends up in the dashboard built by our inhouse team. I am delighted to say that this exercise has now been completed for all our core GRESB-participating real estate strategies and all were ahead of the CRREM pathway[5] in 2019 and 2020 (2021 data is still being assessed, but also appears to remain ahead of the pathway based on initial analysis), and therefore in line with a net zero by 2050 target based on our assessment (not third party verified). But clearly to remain ahead of the pathway, we have a lot of work to do over the coming years and this will form a critical part of all business planning looking forward as well as our reporting to ensure continued transparency and progress measurement.

It is also worth mentioning the Net Zero Asset Managers Initiative, started by an international group of asset managers (including UBS Asset Management), that has committed to supporting the goal of net zero throughout their activities. This initiative includes a series of targets, such as creating investment solutions supporting net zero, and providing asset owner clients with substantial information on net zero investing, among other initiatives supporting investing aligned with net zero emissions by 2050 or sooner.

4 Where do you see challenges in implementing ESG practices, especially in private markets?

The ESG landscape is a complex and fast-evolving field largely as a result of increasing regulation around the world (e.g. SFDR in Europe, MAS ERM in Singapore, upcoming SDR in the UK), increasing scrutiny and expectation of transparency of ESG by stakeholders and a lack of standardization in ESG reporting and scoring (especially true in private markets). These are some of the key challenges in the industry today that we are all contending with.



At REPM specifically, our challenges in implementing ESG practices revolve around three key areas:

- Diversity and scale of our activities: our global business includes real estate, food & agriculture, infrastructure, private equity, and private credit investments, plus evolving sectors such as cold storage, energy storage, global living, life sciences – each a distinct asset class with a unique set of ESG priorities, challenges, targets, and initiatives (in terms of cost, resources, etc.). Thus, the material ESG topics and challenges facing different areas of our private markets business varies significantly (e.g. the challenges surrounding real estate will vary from private equity). Therefore, each area requires a tailored approach to ESG.

- Rapidly evolving regulatory landscape: as our business operates globally, we comply with all applicable ESG regulatory requirements which vary in scale and complexity. A constantly expanding set of rules, taxonomies, and standards (which are rarely perfectly aligned) renders meeting these requirements a significant challenge, especially as the regulations have historically catered to ESG in the traditional space such as equities and fixed income, rather than private market assets.

- Explosion of ESG frameworks, terms and tools: most private market stakeholders will be familiar with the 'alphabet soup' of ESG terms discussed and reported on by investment professionals. GRESB, GRI, SASB, TCFD, UNPRI, etc. are just some of the ESG tools and frameworks often used to report (and assess) ESG performance in private markets. A lack of consistent standards often gives rise to very different snapshots of ESG performance – a portfolio or asset scoring highly in one framework might score only moderately using another framework. At REPM, the challenge is two-fold as many of our private markets strategies (e.g. our indirect private equity) can't be assessed using these conventional frameworks. While we see a number of tools and standards establish themselves as 'leaders' in their respective offerings, for example CRREM, TCFD and GRESB, the future looks likely to remain fragmented from a regulatory perspective which may hinder the further standardization of reporting/assessment frameworks.

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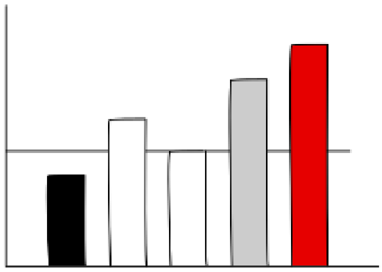
Where does the REPM business stand on ESG?



We place extremely high importance on ESG as an issue. We see a clear link between sustainable investment approaches that carefully consider ESG, and long-term returns. And we can (and do) look at ESG through two lenses; ESG is a risk, but it is also an opportunity. It is a risk because we can see the downsides of failing to consider ESG issues in our investment management; natural disasters caused losses of around USD 280 billion in 2021, less than half (USD 120 billion)[6] were insured (according to Munich RE).

It is also an opportunity, in many senses of the word, to channel capital towards supporting the UN's Sustainable Development Goals (SDGs) and contribute to a cleaner and happier planet, as well as satisfying investor demand for risk-optimized returns.

As a result, our strategies consider ESG and our processes and internal governance have ESG content embedded throughout. These processes are constantly evolving as new best practice emerges and REPM strives to stay ahead of the fast-moving ESG curve through our industry engagement and various inhouse working groups.

The importance of the ESG issue to REPM is illustrated by the fact that I sit on the REPM Management Forum. This means that ESG has a seat at the table of every C-suite level business decision and there is top to bottom commitment to ESG as a result.

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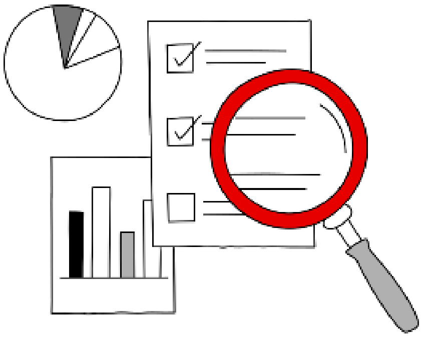
How can we measure ESG, and is there anything in place to guarantee accountability?



ESG is generally quite hard to assess in terms of measurement, comparability and accuracy especially given the complexity and breadth of our REPM business. We have several strong tools at our disposal which will evolve in the future, and REPM is actively involved in improving those tools over time through our participation in various industry bodies.

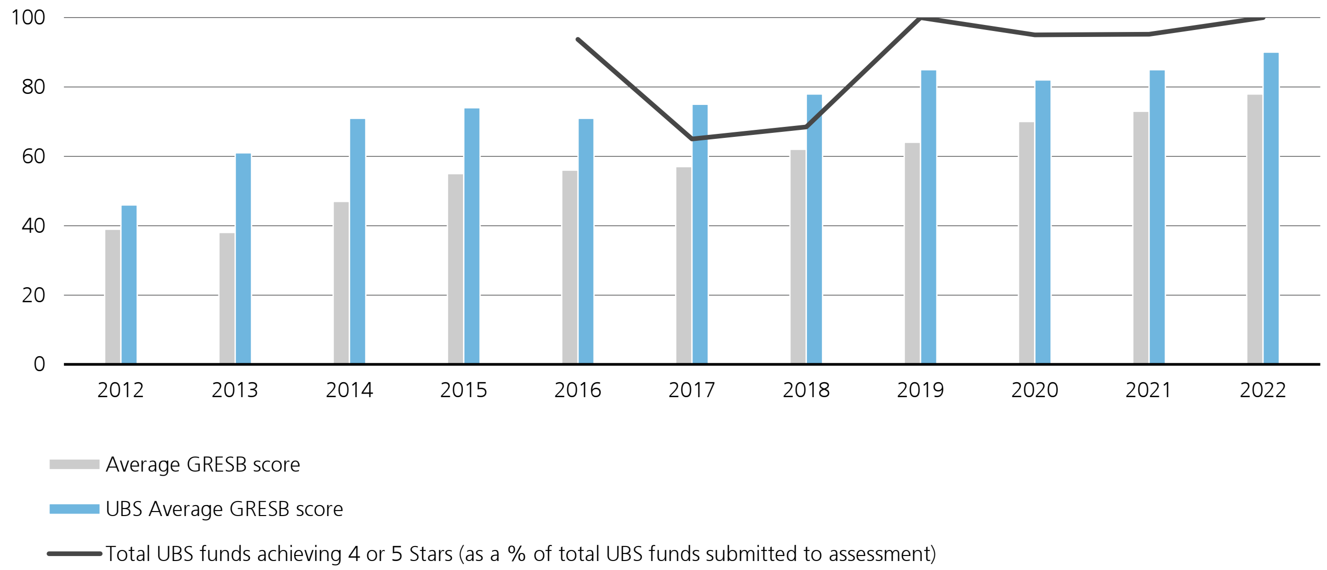
Today, we measure the sustainability performance of our strategies and individual properties with recognized external benchmarks, such as the GRESB key performance indicators and third-party certifications (LEED, ENERGY STAR, Fitwel, BREEAM, IREM, MINERGIE, Leading Harvest). GRESB has become the leading ESG benchmark for real assets and has been adopted very broadly across private and listed managers and investors and therefore is one of the most used tools in real estate especially.

It is a benchmarking tool that also collects and standardizes many data points such as GHG emissions, energy usage, waste, water as well as various social and governance factors. REPM has had sustained strong performance in GRESB's annual assessments for over a decade. Our open-end core German logistics strategy received a 5-star rating for the third year running and our open-end core European office strategy also sustained great results with 5 stars for the seventh year running, ranking first in its European Office peer group.

Also, our open-end core UK commercial property strategy retained its leadership position in the UK Diversified category for the sixth year running and is the only strategy in its peer group to have received 5 stars. These are only some of the strong results we achieved in the latest annual GRESB assessment. Based on results from these tools listed as well as a number of our internal processes, we are able to benchmark and compare the ESG performance of many of our investments and prioritize efforts on certain assets where needed.

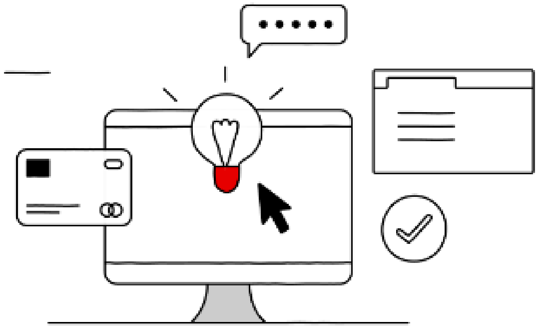
In terms of accountability, the key is always transparency. We are striving to more clearly define our environmental and social targets at a platform level (many of our strategies already have clearly defined targets); the ongoing transparency of performance against those targets is then the top way that our investors and stakeholders will be able to hold us accountable for our ESG performance. As many of our strategies are open-ended, ultimately we are also accountable to ourselves for our own survival to achieve those targets because otherwise our investors do have the ability to vote with their feet.

Absolute improved performance year after year



Source: UBS Asset Management, Real estate & private markets (REPM), scores based on 2012-2022 GRESB Assessment data, October 2022; In 2022, 4 submissions to the GRESB assessments were non-discretionary mandates and therefore excluded from the summary; The GRESB Rating, revised in 2016, is based on the GRESB Score and its quintile position relative to the GRESB universe. If an entity is placed in the top quintile, it will be a GRESB 5-Star rated entity; if it ranks in the bottom quintile, it will be a GRESB 1-Star rated entity. As the GRESB Rating is calculated relative to the global performance of reporting entities, it shows an entity's position on a global scale; Prior to 2016, GRESB scores were based on a Green Star designation, which was only provided for Real Estate Assessment participants scoring higher than 50% of the points allocated to each relevant component.

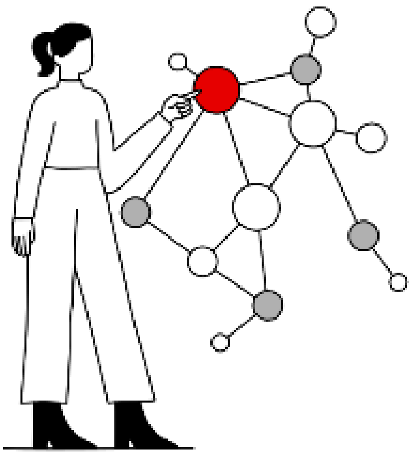
7 ESG education: what does it take to become ESG-savvy?



As ESG represents a key commitment and focus area across UBS, we place a lot of importance and emphasis on ensuring our employees are always up to date with the latest trends, requirements, and challenges in the ESG space. We strongly believe a well-informed REPM platform is key to achieving our clients' short and long-term investment objectives, including their sustainability priorities and targets as well as financial performance.

Staying up to date with the latest trends and regulations surrounding ESG can seem like an overwhelming task, so to make it easier for our team we have created our own internal REPM-specific training, built by REPM for REPM, to ensure bespoke and highly relevant content is available. This training is also being integrated into teams' KPIs and personal objectives, to ensure staff across our businesses are well informed and incentivized to keep learning. This course will evolve over time, as the landscape continues to change and new challenges and topics arise, that our team must know about.

8 How do you see the evolution of ESG in the near term? Any emerging trends?



As ESG continues to grow in importance and become critical in the near future, we expect the following topics and issues to continue to occupy the top spots on the global ESG agenda:

– Growth of regulation and disclosure frameworks: over the next few years there is going to be a barrage of (even more) regulation coming to the industry globally and this is today, and will continue to be, a top priority for all of us in the investment industry, requiring significant time and resource. The industry certainly hopes that the future will bring some alignment of these many regulations and standards, as the complex web we find ourselves in today makes disclosure and regulatory compliance an enormous challenge and potential distraction from the hands-on work needed to save the world!

- Development and performance against interim net zero targets: while a large number of financial institutions establish science-driven net zero targets, we believe stakeholders will scrutinize and demand greater transparency on how these institutions are planning on achieving these long-term targets, and more importantly will demand reporting on how (and if) interim targets are being achieved.

- Data: is already critical and will only become more important really in every aspect of ESG. Regulation will require even more data disclosure and evidence. Investors need more data for their own decision processes, regulatory compliance and reporting. Setting targets and assessing progress requires data too, transition-relevant data and metrics in particular are critical here. Top of many real asset and private market players' mind is how to effectively collect, handle, manage and monitor that data and how to get the most value out of it. On the whole it remains a relatively manual process but huge efforts are underway to automate and modernize many of the systems and processes that are widely used in our industry today.

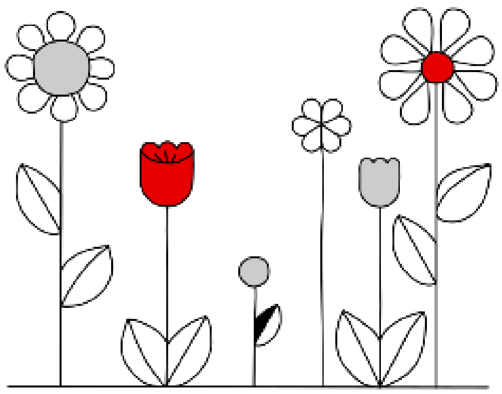
- Innovation: advanced technologies such as machine learning and blockchain capabilities will be repurposed and tailored to solving critical sustainability challenges in the financial sector including in private markets. Verification of GHG emissions, ability to detect climate risks, construction of customized ESG-integrated portfolios are just some of the potential use cases of these technologies.

- Social themes and issues: historically deprioritized behind environmental topics, S issues are rising up ESG agendas. We expect this to continue and to see significant improvement in quantitative and qualitative measurement in this space.

9 Do your clients care about ESG?

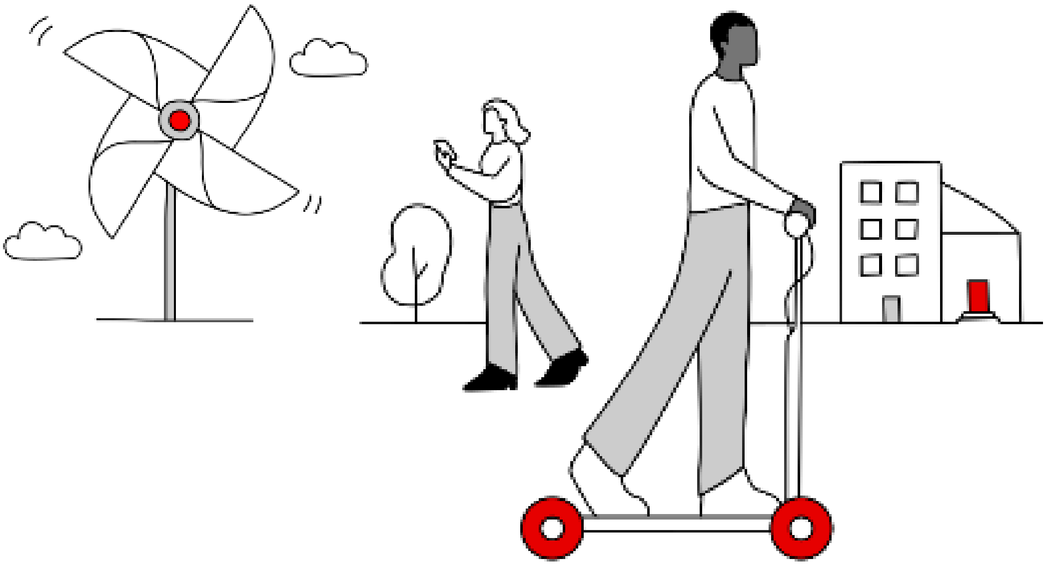
In a word, yes. However, there is of course variation that we see across client groups most notably depending on where investors are from. In general terms, we see growing concern for ESG factors across the board as more and more investors become educated on both the risks and opportunities of sustainability, that honestly today are impossible to ignore.

These clients are predominantly driven by financials (which as we know are closely linked to ESG factors), but also increasingly concerned that their capital is not doing harm to the world given they have their own reputations to uphold.



So, yes our clients care about ESG and are becoming increasingly vocal – which is great as it is such a powerful way to generate meaningful and impactful change.

10 We talk a lot about the E in ESG, what's your approach on the S?



The S, or the social component of ESG, is harder to assess and has in past years been lower on many private markets players' agendas. However, that is now changing and without doubt there is a growing focus on social issues today across the industry, and methods of measurement are evolving which is key to being able to manage towards social goals.

Within some of our real estate teams, we've started a pilot to assess the social value of investments, that is the benefits assets offer to the communities in which they sit. We have worked with tenants to measure important social factors, such as local employment levels, jobs for young offenders and volunteering, among others.

We have used an independent third party to collect data and calculated a social value (as well as an environmental value) for a number of our UK and European assets. In simple terms, this calculated social value reflects the property's contribution to its community and the UN's SDGs.

As just one example, our first piloted asset, a UK outlet mall, has an estimated social value of GBP 3.4 million which was linked to several SDGs; attributing this financial value is one way we can really gain attention for this issue, measure it and compare across different assets and geographies.

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[1] 2022 GRESB Real Estate and Infrastructure Assessments, includes 19 submitted discretionary strategies
[2] 2022 UN PRI Assessments, September 2022
[3] As of 2020, 100% of the farmland acres managed by UBS-AM are enrolled in the Leading Harvest Farmland Management Standard
[4] World Green Building Council, https://www.worldgbc.org/our-mission, October 2022
[5] The Carbon Risk Real Estate Monitor (CRREM) provides the real estate industry with transparent, science-based decarbonization pathways aligned with the Paris Climate Goals of limiting global temperature rise to 2°C, with ambition towards 1.5°C. Visit crrem.org/ for more info.
[6] Munich RE, *Hurricanes, cold waves, tornadoes: Weather disasters in USA dominate natural disaster losses in 2021,* published January 2022, https://www.munichre.com/en/company/media-relations/media-information-and-corporate-news/media-information/2022/natural-disaster-losses-2021.html

Important information
Leading Harvest is a nonprofit organization that mobilizes the entire value chain to accelerate the transition to a more sustainable and resilient global agricultural system. It provides third-party audited standards that create trust throughout the business ecosystem while driving and validating improvement across the supply chain. UBS is a founding member of Leading Harvest. 100% of UBS's farmland acres under management are enrolled in the Leading Harvest Farmland Management Standard as of 2020, the inaugural year. 100% of UBS's enrolled farmland acres are certified to the Standard by an independent, third-party auditor as of 2023. For more info about Leading Harvest, please consult the webpage *here* and learn more about the Standard *here*. UBS's certification and surveillance audit reports are publicly available *here*. Enrollment fees based on acreage and crop type are paid to Leading Harvest by program users annually.

For more information, please contact:

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