



Sustainable Investments

Quarterly Newsletter of J. Safra Sarasin Asset Management | January 2019

Editorial

Sustainability – a key factor for real estate

Dear reader

Electromobility is on everyone's minds: as an investment theme, as a fun factor, but above all as a solution to climate change. However, it is less well known that the real estate sector is also an important jigsaw piece in the fight against global warming. According to figures from the Climate Panel (IPCC), real estate is directly and indirectly responsible for almost a fifth of global greenhouse gas emissions. This is more than the emissions generated by the entire transport sector. The 2-degrees target of the Paris Agreement is therefore not achievable without including real estate.



Interactions with climate change

While the impact of real estate on climate change is being slowly recognized, its repercussions on real estate are still underestimated. One of these effects stems from the rise of the sea level. The Research of the real estate portal Zillow is already predicting that 300 cities in the US will be threatened with losing half of their real estate. This would affect 1.9 million properties worth almost USD 900 billion. Zillow calculates an already noticeable effect on real estate prices in coastal areas, such as the Gade County in Florida. Another effect of climate change is the measureable increase in

the incidence of storms, which depress prices in storm-prone areas and increase building insurance premiums. According to the Lloyd's City Risk Index, Asia's cities are the most affected from Taipei to Tokyo. But places inland are not safe either. Bushfires from Australia to California have caused considerable damage. Rising heat levels increase the cost of air conditioning and ventilation.

climate goals, drastic measures will be necessary.

Integrating sustainability into the analysis

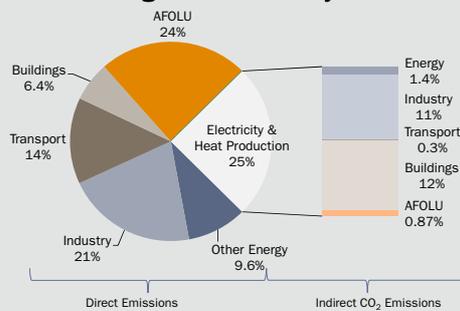
The conclusion is clear: Real estate owners need to be aware of the consequences of climate change and integrate them into the analysis of properties and real estate investment trusts. Investors are facing the choice to make their properties ready for the future at an early stage or to have to accept expensive renovations later. At the same time, the selection and planning of sustainable buildings also offers considerable financial opportunities: rents can be increased and the need for renovation reduced, which has a positive effect on the value of real estate. This newsletter gives you an overview of the tools of sustainable real estate management to unlock the potential of real estate and reduce the risks of global trends. I wish you a lot of interesting insights reading this newsletter and a happy and blessed New Year 2019.

Best wishes,

Jan Amrit Poser

Chief Strategist and Head Sustainability

Greenhouse gas emissions by sector



Source: IPCC, "Climate Change 2014"

Significant transition risks

However, if the signatories of the Paris Agreement implement their commitments, while the physical risks of climate change can be contained, we will be facing the so-called transitional risks. In order to bring about a drawdown of CO₂ in the atmosphere, prices for heating oil and electricity are required to rise. Building regulations will increasingly enforce energy efficiency measures. Already, some cities have started restricting the sale of high-energy-usage buildings to force property owners to refurbish them. In order to achieve the

Green Real Estate Labels – Financial Benefits and Sustainable Impact

Green Building Labels offer a certified approach to address issues of sustainability in real estate, potential financial benefits and reduction of risks for investors and a number of co-benefits for tenants or society at large.

A brief history of green building labels

The aim to reduce the negative environmental impacts in the Real Estate sector saw the introduction of Green Building Labels about 30 years ago. Namely, the Environmental Assessment Methodology by the Building Research Establishment (BREEAM) in the UK and the Leadership in Energy and Environmental Design (LEED) by the U.S. Green Building Council were two early examples of certification schemes. In many countries labels were developed to meet the needs of their specific context. LEED and BREEAM, however, found success internationally, where they would often compete with local labels. In parallel to Green Building Labels, Energy Labels were emerged around the same time e.g. EnergyStar in the US and Minergie in Switzerland. In some instances they developed into Green Building Labels of their own right, e.g. Minergie-P.

Shifting approaches from green to holistic

In the last ten years, an important shift towards sustainability or sustainable construction took place. New labels were developed, e.g. in Germany, by the German Society for Sustainable Construction (DGNB) and in Switzerland as the Standard for Sustainable Construction Switzerland (SNBS). While Energy labels mainly seek to mitigate environmental impacts through the reduction of energy consumption and increase of energy efficiency, Green Building labels include social aspects, covering criteria on the building's operational energy and thermal comfort. Sustainability labels in turn, follow a holistic approach considering the three sustainability pillars of society, environment and economy. In addition to the above aspects, others include health, lifecycle phases, infrastructure, mobility and spatial flexibility. While cohort labels, e.g. the 2000-Watt-Areal in Switzerland certify whole neighbourhoods, benchmarks like the Global Real Estate Sustainability Benchmark (GRESB) compare and rate entire building or real estate portfolios based on ESG criteria.

World map of selected real estate labels



Source: S. Cisar et al. 2017, ETH Zürich

An overview of financial benefits

Several studies and reports¹ provide empirical evidence of the link between financial performance and Green Building labels:

- **Marketability:** The buildings are more easily rented out or sold
- **Prices:** Higher (resale) values (up to 30%), lower price volatility
- **Cost and income:** Rental income can be higher (up to 10%), maintenance and potentially energy cost savings which requires monitoring to optimize the building
- **Lifecycle cost:** While planning and construction costs can be higher, lifetime costs of operation and maintenance are expected to be lower, sustaining the building's valuation

Furthermore, several co-benefits for tenants and the building's occupants are listed:

- **Health:** Increased indoor air quality
- **Comfort:** Thermal insulation and maintenance of adequate temperature levels
- **Customer and talent attraction and retention:** Customer and employee satisfaction can be increased, employee turnover and absences can be reduced
- **Productivity:** Better workplace environment positively impacting the productivity of employees
- **Brand and reputation:** Value, ranking and perception attributed to occupying sustainable buildings

To conclude, sustainable buildings can create significant added value.

¹Selected sources: Meins et al. 2010, Schuster 2016; Matisoff et al. 2016; World Economic Forum 2016; Dar-ko et al. 2018.

Sustainability pillars of labels/benchmark

Label	Dimensions	Date	Location
EnergyStar*	Env	1992	USA, Global
Minergie*	Env/later: Soc	1988	CH
BREEAM*	Env/Soc	1998	UK, Global
LEED*	Env/Soc	1992	USA, Global
DGNB*	Env/Soc/Eco	2005	D, EU
SNBS*	Env/Soc/Eco	2016	CH
2000-Watt*	Env/Soc/Eco	2012	CH
GRESB**	Env/Soc/Gov	2009	NL, Global
*label	** benchmark		

Source: J. Safra Sarasin

Already building a positive impact?

The building sector is confronted with increased environmental and energy standards. Therefore, Green Labels have to continuously develop to stay ahead. Current labels have started addressing societal challenges such as the 17 Sustainable Development Goals (SDG's) or Climate Change. While Green Building labels seek to reduce negative impacts and Sustainability Labels aim at a net-zero impact, many labels started including criteria that create a positive impact. Especially Sustainability Labels display how they contribute to individual SDGs or mitigate Climate Change. They can have an environmental or social benefit and are often described as a remedy to past negative impacts: For example, a bicycle parking can enable low carbon mobility. An abundant production of renewable energy can provide for neighbouring buildings. Finally, the use of bio-based construction materials can help store carbon during the life cycle. In order to meet societal challenges and achieve the Paris Climate Goals, the real estate sector needs adopt more rigorous labels, embrace better practices and push towards positive impacts.



Sasha Nikolaus Cisar
Sustainability Analyst
Real Estate

Metropolitan Rating provides better insights

As a first step in our analysis, we assess the sustainability of metropolises in order to get a better understanding of the potential of cities. Cities labelled as sustainable according to our methodology have a high forecasted population growth, therefore higher expected demand for residential or office space and so help us to identify metropolitan areas with higher returns for real estate investments

A systematic and transparent method of defining the investment universe is an important ingredient to a coherent strategy with reduced risks and a long term perspective. We have developed a rating that combines economic and sustainability criteria. The ranking is based on five categories (see graph) and takes into consideration quantitative aspects such as air-traffic and population forecast, qualitative aspects such as education and R&D and finally forward looking criteria such as digitalisation.

Clear trend for big & sustainable cities

The demographics of cities play a key role in the demand for real estate within the commercial and residential sectors. Big cities have maintained their momentum and have experienced further growth. However, our research indicates that not all big cities have a positive growth forecast. Moreover there are also smaller cities that are well positioned for the future. We cluster the European cities in terms of population in three categories: micro, middle and mega. We rate the cities in terms of sustainability according to the colours red, yellow and green. Sustainable cities have a high population growth forecast in all size categories.

Table 1: Growth forecast 2020 – 2030

	Red	Yellow	Green	Avg
Mega	0%	1%	6%	3%
Middle	-3%	1%	7%	2%
Micro	-4%	1%	5%	1%

Source: BJSS, Eurostat

Highlighted Mega Cities (Europe)

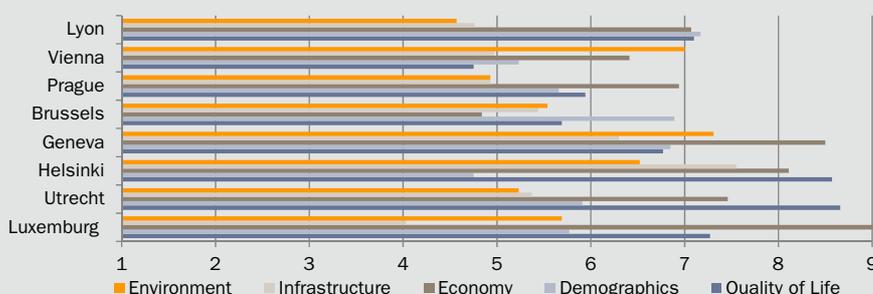
In the following table, we highlight metropolises from the category Mega Cities that are rated highly in our ranking.

Table 2: Office Returns – Prime Location

City	Rank	Yield	Vacancy
Lyon	10	3.9%	6.0%
Vienna	18	3.9%	5.2%
Prague	22	4.6%	8.0%
Brussels	22	4.6%	8.3%

Source: BJSS – BnP, C&W, JLL, Savills

Bank J. Safra Sarasin Metropolitan Rating (selected cities)



Lyon holds the leading position in France after Paris and has received a high score in online economy and household income. Currently, prime rent is increasing and the shortage of new supply resulted in a further increase in office investments.

In **Vienna** a high percentage of R&D personnel and the positioning of the airport as a European hub provide competitive advantages. The demand from investors continues; high supply of development projects may create a correction in the short term.

Prague which has a very low unemployment level attracts foreign graduates and employees. 2017 was a record year for investors. Czech investors dominated the market with 80% of transactions. Prime rents continue increasing while vacancy decreases.

Brussels with a low median population age and strong digital market create a dynamic environment for the future. The level of vacancies is at its lowest since 2008 and prime rents remain stable.

Highlighted Middle Cities (Europe)

Cities with smaller population are ranked separately, so that we have a better understanding of the competitive advantages.

Table 3: Office Returns – Prime Location

City	Rank	Yield	Vacancy
Geneva	2	3.0%	5.5%
Helsinki	4	3.8%	5.8%
Utrecht	10	5.0%	8.1%
Luxemburg	11	4.5%	4.0%

Source: BJSS – BnP, C&W, JLL, Savills

Geneva has strong GDP per capita and high air traffic. The city is from a long term perspective a core investment destination due to strong banking sector and high international presence. The office market was under pressure during last years. As signs of stabilization appear, opportunities arise.

Helsinki ranked highly in the category of education and university graduates, as well as, online economy and air transportation, factors that provide further long term growth. Currently, Real estate demand continues rising, while prime yields decrease.

Utrecht has high online connectivity and online economy, while located only 30 mins away from Amsterdam airport. Its stable economy and strong growth creates a positive environment for investments.

Luxemburg received top position in many categories of our sustainability ranking with high household income, very positive population forecast and high R&D. The economic forecast is positive with high quality development projects coming into the market.

As a conclusion, our methodology confirms the positive forecast for London, the top 7 German cities, Paris, Amsterdam and Copenhagen. Finally, we identify cities that are out of investors' main focus and have an attractive return-to-risk ratio. This strategy proves valuable in a low interest rate environment with compressed yields.



Alexandros Gratsias

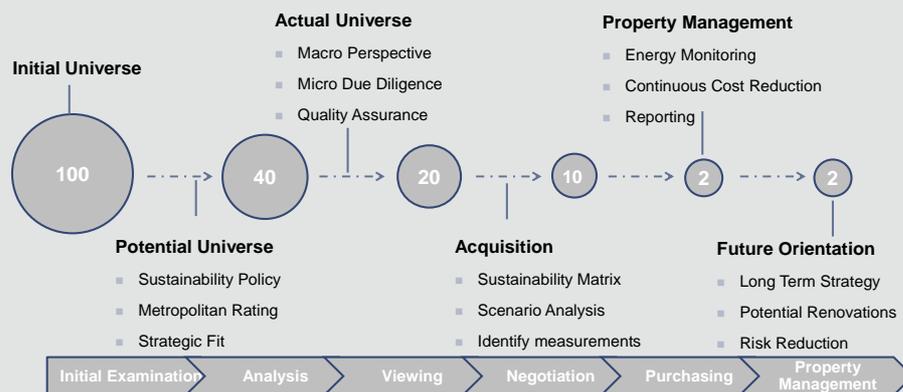
Sustainable Investments
Real Estate Research

A comprehensive approach to identifying well-performing sustainable Real Estate

We believe that real estate management should follow a well-defined process in order to reap the benefits of sustainable buildings and to mitigate risks in the portfolio. Therefore we have developed a structured approach to analyze, acquire and manage property over the entire life cycle. Active management means for us not simply to sell and buy property, but to set objectives and to improve the quality of the assets over time. The following article explains our approach to active sustainable real-estate management.

Over the years, our Research team has developed a **customised strategy for direct sustainable real estate investments**. The methodical and systematic approach is based on tools that we have developed internally. These evaluation tools are based on “best practice” examples in the industry. We use measurable indicators to assess every real estate and compare it with its relevant peer group. Our methodology assures the integration of sustainability criteria throughout the whole life cycle. The graph on the right-hand side shows the steps that we are following and which are being explained in more detail below:

Bank J. Safra Sarasin’s approach for assessing real estate



Source: Bank J. Safra Sarasin

Step 1 Initial Examination

The initial examination is performed on a universe containing around 100 objects per year. It serves as a general screen to filter out properties which do not fit the minimum sustainability criteria. The starting universe is reduced by up to 60 percent leaving around 40 properties eligible for the next step of the property analysis.

Step 2 Property Analysis

The filtered properties should be aligned with the given financial criteria and the expected risk-adjusted yield. All properties are subject to an initial and ongoing sustainability analysis in accordance with ecological, social and economic aspects. From a top-down perspective the sustainability analysis focuses on the following elements:

- Macro location, international connectivity & perspective
- Micro location, regional connectivity, social aspects
- Property level quality & comfort
- Building future orientation & multitenant perspective
- Operational costs & tradability
- Energy consumption & CO2 output
- Green elements and surroundings

The most important cut off criteria are occupancy rate, yield, energy requirements and supply, public transport network. In this step, another 20 percent of the screened properties are being promoted to the individual property analyses. This leads to a further concentration of the universe.

Step 3 Viewing & Due Diligence

Once attractive objects have been identified, we do onsite visits. During the viewings, a careful individual evaluation of the building itself, its surroundings is performed. The due diligence process also includes the demographics and regional economy. This step cuts the eligible number of real estate further down by around 10.

Step 4 Bidding Process & Negotiations

The bidding process is based on the value of the property that includes also an estimate of the necessary refurbishment for the sustainability strategy and objective. As sustainable investors, we are also very price conscious and would not buy at any price.

Step 5 Purchase

The negotiation process will not always lead to a mutual agreement. This usually leaves usually less than 3 properties for purchase.

Step 6 Property Management

The process does not end with the acquisition. Life cycle management is essential to preserve the value of a property in the long-term. We analyze and benchmark them with the aim to identify value added measures. This analysis is based on a holistic approach of sustainability criteria. Moreover, we monitor the properties' energy consumption to minimize additional costs.

Investing for the long term

This comprehensive process for acquisitions helps to create an attractive portfolio of properties, well positioned for the future. We create impact and add value to the properties by identifying setting objectives and developing an object strategy for each asset. Energy monitoring and life cycle costs management is essential. This, together with a close relationship with tenants helps to ensure a steady flow of above average returns.



Martin Isler
Co-Head
Real Estate Hub

Selected real estate company sustainability profiles and ratings in the fourth quarter of 2018

American Tower: Enabling access to communication in emerging markets

American Tower is one of the largest global REITs and provides antenna infrastructure to wireless carriers. The company's expansion strategy into emerging markets, notably in India, creates positive impact by contributing to the availability of mobile services in these areas. Due to geographic exposure and the fact that tower assets are often closely tied to governments, strong anti-corruption and ethics practices are key to ensure business preservation and to maintain the rights to operate. American Tower has a detailed formal policy on bribery and anti-corruption in place that also covers subsidiaries. On the social risk side, the health impact of radio transmissions is not yet fully clarified. New regulations in this area would certainly pose challenges to tower companies (e.g. obsolete towers, modification requirements, and higher compliance/legal costs). From a corporate governance perspective, we note certain limits on shareholder rights - such as the unilateral right of the board to amend the bylaws or restrictions on shareholders' ability to convene a special meeting. Overall, the company receives an above average sustainability rating.

Capitaland: Leading green building capabilities in Asia

Capitaland is a large Singaporean real estate company that shows a strong relative performance with regards to all three ESG pillars. 55% of the properties are certified according to green building standards, the aim is 100% by 2030. Among meaningful sustainability measures are air-conditioning upgrades, the installation of solar panels, lighting retrofits, daylight harvesting lighting controls upgrades and other smart building features such as smart metering. As one of the few companies in the industry, Capitaland's operations are fully ISO18001 certified and safety performance requirements are included in executive compensation. These measures result in a significantly lower lost time injury frequency rate compared to peers. For shareholders it is worth noting that the Singaporean government

holds a 40% stake in Capitaland. This exacerbates corruption risks that are anyway prevalent in this sector. According concerns are mitigated by Capitaland's strict zero tolerance policy on bribery and corruption that is accompanied by compliance and implementation procedures formulated at business unit level. Overall, Capitaland is well prepared to address current and future sustainability challenges. We assign a high sustainability rating.

Segro: Prioritising sustainable business practices in warehousing

Segro is a UK real estate company that owns, manages and develops modern warehouses and light industrial property. The company has more than 40% of its properties certified to a green building standard, which is a considerably higher proportion than that achieved by its peers. The company also started to use the tool of "green leases" in order to incentivise property managers and tenants to improve the water, waste and energy figures. We also note the programs and policies which address risks related to the potentially low occupancy rates of industrial properties. Real estate companies typically rely on skilled employees and face according talent recruitment and retention risks. To mitigate such risks, the company conducts regular employee satisfaction surveys and offers employee stock ownership plans to employees. This instrument helps to link employees' interests to the success of the firm. Segro's corporate governance structure of the organisation is aligned with shareholders' interests and the board of directors is well organised to provide effective strategic oversight on behalf of shareholders. In summary this results in Segro being a global sustainability leader in the real estate space.

Swiss Prime Site: Improved green certification levels

Swiss Prime Site (SPS) has a stakeholder-based sustainability approach and addresses all material environmental, social and governance aspects (in accordance with the GRI sustainability reporting standard and also mentioning the UN Sustainable Development

Goals). SPS' performance with regards to sustainability key issues varies. The company's corporate governance set-up is well aligned with shareholders' interests. A fully independent pay committee would be the preferred option (currently one executive board member is part of this committee). Within SPS' sustainability materiality matrix, human capital management is identified as one of the most important topics. Around 1% of total employee costs are invested in training and development activities. Nevertheless, the annual employee turnover figure of 21.6% in 2017 is at higher end of the range in the peer group. Some of SPS' project developments meet the qualification of green property labels. It remains unclear if it is a goal for the company to increase the percentage of buildings with certification. The company has not yet disclosed efforts on formal tenant engagement initiatives ("green leases" to incentivise tenants to act more sustainably). All in all, an average sustainability rating is assigned for SPS.

Sarasin Sustainability-Matrix®



Sustainable Investment Universe

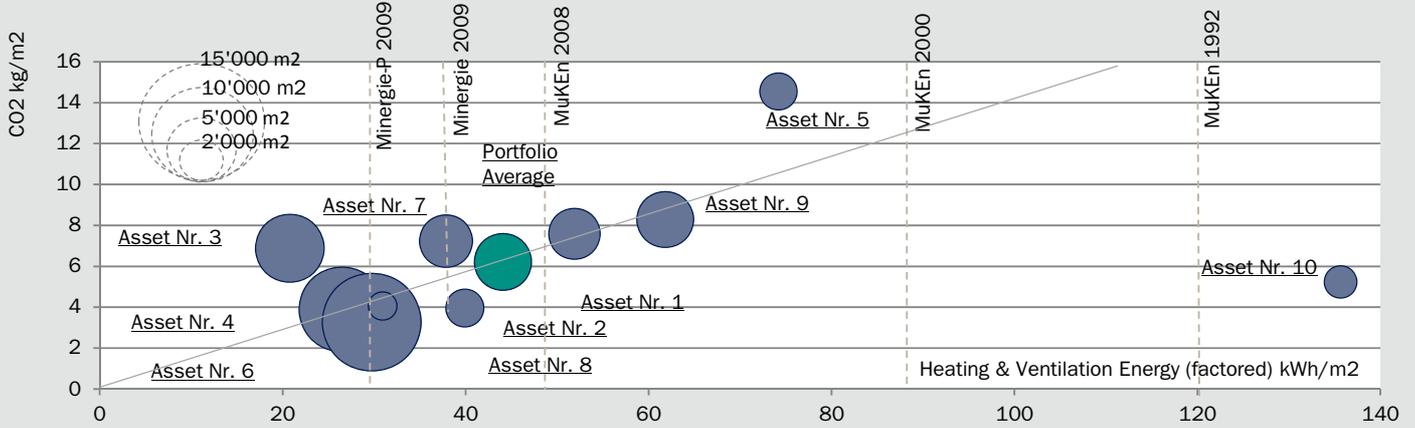
Source: Bank J. Safra Sarasin, Information on companies is shown for illustrative purposes only and does not constitute an offer, solicitation or recommendation to buy, hold or sell investments and does not consider the circumstances of any individual investor. The information shown may change without notice.

Sustainable Investment Research

Energy optimisation can lower costs, and increase returns while reducing carbon emissions

Energy consumption and additional costs of properties are an important factor for long-term performance of real estate. Our methodology provides the steps to reduce these costs and monitor carbon emissions.

Bank J. Safra Sarasin Carbon Footprint Reporting Example for Real Estate Portfolio

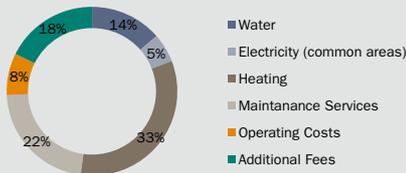


Source: Bank J. Safra Sarasin

The Importance of energy costs

The total rent paid by tenants consists of two components: the net rent and the additional costs. According to the Swiss Federal Office for Statistics the additional costs are 12.6% of the total rent. Real estate funds that can reduce the additional costs provide positive effects for the tenants and may over the long-term increase the net rent received and thus the return. Our analysis, based on the Swiss residential sector, shows that a 10% reduction of the additional costs including energy consumption costs would result in 5bp per year higher fund performance over the longer term.

Chart: Additional Cost Analysis Residential Properties



Source: Source: BJSS, SVIT – Immobilien

The above diagram provides a breakdown of the additional costs for properties. The costs related to the consumption of electricity, water and heating surpass 50% of the total additional costs.

Energy Monitoring in practise

In the diagram above, we present the methodology on how to efficiently control and optimize the variable costs of a property via an energy and CO2 monitoring system. Properties should be monitored based on annual bookkeeping numbers for heating, electricity and water consumption. The results are analyzed in three dimensions:

- Benchmarked over a portfolio average
- Intensity compared with previous years
- Controlled according to local design regulations of the construction year.

The diagram at the top of the page shows the CO2 emissions and the energy consumption of a portfolio on a property level per square meter for 2017. The size of the circles indicates the rentable area per property. Bigger circles have higher influence on portfolio level. All properties are benchmarked according to the average portfolio CO2 output and their energy consumption. Moreover properties, that report annual heating consumption above their expected value, are controlled to determine optimization measures. The expected annual value for each property is determined based on local design regulations or green building certificates. The local energy consumption regulations for different time periods are indicated on the above diagram as grey vertical lines.

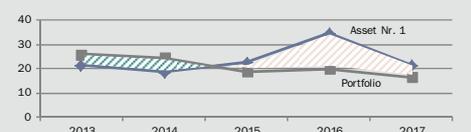
Better ventilation and heating

Properties with extended ventilation systems or high energy intensity office buildings may also be monitored on a quarterly basis to identify further potential. Our collaboration with Siemens helped us to identify a potential of approximately 12% energy reduction per year. The related measures concentrate on the ventilation and heating configurations, as well as the energy consumption during the hours that the property is not used during the night and the weekend.

Reducing electricity consumption

Another example is shown on the graph below. Our Energy Monitoring report indicated that a residential property had very high electricity use caused by a faulty configuration of the heating pump. After the identification of the inefficiency and the appropriate correction, the consumption of the following year was reduced by 10%.

Chart: Energy Heating Pump kWh/m2 per year of asset no. 1 in the portfolio



[kWh]	2013	2014	2015	2016	2017
Energy	96'685	83'055	101'186	154'701	96'732

Source: Bank J. Safra Sarasin

Proposals for Real Estate funds

1) We recommend an Energy Monitoring system based on the annual consumption bookkeeping data for simple buildings, as described above. Office and commercial buildings with high energy consumption and controlled ventilation may need further analysis and collaboration with experts to optimise the variable costs.

2) Funds should determine targets of average energy consumption and average CO2 output on a portfolio level.

3) In terms of electricity consumption, we would recommend the replacement of older lighting system with LED and instalment of movement detectors.

4) In case that an automatic ventilation system exists, we propose a testing and con-

figuration every two years with focus on optimising the operating time frames (e.g. during the night and weekends), as well as, the air temperature.

5) For renovations or project developments, Real Estate funds should aim to invest in efficient energy systems. Gas and oil heating systems for new buildings will be diminished as the regulations move towards a CO2 neutral strategy. Heating pump in combination with photovoltaic is appropriate for a low CO2 and efficient energy cost strategy, even if the maintenance costs are higher than the gas heating system or the district heating. District heating is an efficient system; throughout the years, the proportion of renewable energy consumption within district heating has increased.

Finally, real estate funds from the core and core plus universe focus on high-quality properties, established locations and long-term rental agreements. We believe that such funds with **a buy and hold strategy should be transformed into a buy and actively managed strategy** in order to reduce costs, CO2 emissions, engage with the tenants and increase the value of the properties.



Alexandros Gratsias
Sustainable Investments
Real Estate Research

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Sustainability Rating Methodology

The environmental, social and governance (ESG) analysis of companies is based on a proprietary assessment methodology developed by the Sustainable Investment Research Department of BJSS. All ratings are conducted by in-house sustainability analysts. The sustainability rating incorporates two dimensions which are combined in the Sarasin Sustainability-Matrix® :

Sector Rating: Comparative assessment of industries based upon their impacts on environment and society.

Company Rating: Comparative assessment of companies within their industry based upon their performance to manage their environmental, social and governance risks and opportunities.

Investment Universe: Only companies with a sufficiently high Company Rating (shaded area) qualify for Bank J. Safra Sarasin sustainability funds.

Key issues

When doing a sustainability rating, the analysts in the Sustainable Investment Research Department assess how well companies manage their main stakeholders’ expectations (e.g. employees, suppliers, customers) and how well they manage related general and industry-specific environmental, social and governance risks and opportunities. The company’s management quality with respect to ESG risks and opportunities is compared with its industry peers.

Controversial activities (exclusions)

Certain business activities which are not deemed to be compatible with sustainable development (e.g. armaments, nuclear power, tobacco, pornography) can lead to the exclusion of companies from the Bank J. Safra Sarasin sustainable investment universe.

Data sources

The Sustainable Investment Research Department uses a variety of data sources which are publicly available (e.g. company reports, press, internet search) and data/information provided by service providers which are collecting financial, environmental, social, governance and reputational risk data on behalf of the Sustainable Investment Research Department.

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