Climate Transition Assessment

PSP Swiss Property

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Location: Switzerland **Sector:** Real estate

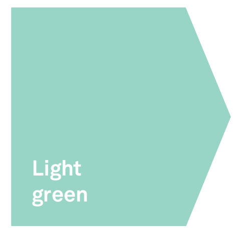
Climate Transition Summary

We believe real estate company PSP will continue to decarbonize its existing portfolio, with clear targets and actions by 2035 to improve the energy efficiency of its buildings. The portfolio includes mainly historical buildings in city centers, about 60% of which use direct fossil fuel heating. Currently, 64% of PSP's revenue comes from energy-efficient buildings that we assign a Light green shade. We have used the Future Shade time horizon that aligns with PSP's transition plan until 2035. Based on the transition plan and PSP's current status, we anticipate an increase in PSP's share of Light green revenue and a decrease in the share of Orange revenue (linked to buildings with direct fossil fuel heating), which is positive. We assign a future shade of Light green based on the expected performance of the company's portfolio performance and revenue in 2035.

We see PSP's transition targets' focus on its operational footprint as ambitious; however, the limited coverage of value-chain emissions as a material constraint. PSP does not yet have a full scope 3 inventory, and these emissions are not included in its 2025 or 2035 climate goals. Its 2050 net zero target includes emissions from tenant-obtained electricity but no other scope 3 sources. PSP's investment plan through 2035 focuses on reducing emissions related to building heating and on energy efficiency. PSP is taking steps to calculate and manage value-chain emissions. We acknowledge data challenges for scope 3 and that the real estate sector lags others in understanding and managing these emissions. However, we still view it as a limitation that PSP has not yet determined a roadmap to reduce scope 3 emissions in the medium to longer term.

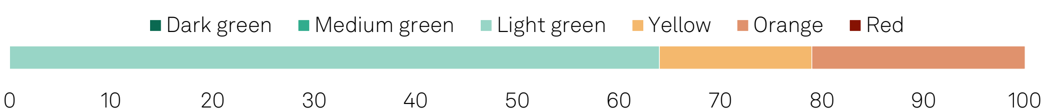
We believe PSP has sufficient governance mechanisms and stable financing plan to facilitate its transition strategy, but relies to some extent on tenants and suppliers to achieve decarbonization across its value chain. Execution of PSP's transition plan is supported by the Swiss regulatory environment. We believe PSP is well equipped to deliver on its plans but will need to work with its value chain to achieve full decarbonization.

Future Shade
by 2035

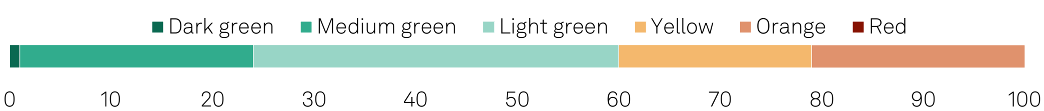


A Climate Transition Assessment shows the expected alignment of a company's activities with a low carbon climate resilient future once its planned transition changes are realized, considering implementation actions and risks.

Current activity: Revenue 2023 (% of total)



Investments: Capital expenditure (capex) 2023 (% of total)



Strengths	Weaknesses	Areas to watch
PSP has a clear plan to reduce greenhouse gas emissions from its operations. We therefore view its plans to phase out about 70% of its current direct fossil fuel or biogas heating systems by 2035 as positive. Efforts to improve building energy efficiency are also positive steps, particularly for historical buildings that can be more challenging and expensive to retrofit.	**PSP does not yet have full visibility on scope 3 emissions and has not fully factored them into its climate targets and investment plans.** Embodied emissions from renovations, tenant adaptations, and construction projects, as well as emissions from tenant-obtained electricity, are likely material to PSP's decarbonization pathway. Any increase in these activities could result in a rise in embodied emissions.	**In 2035, the energy performance required for a Light green shade will likely be higher than today.** The energy threshold for Light green is based on relative performance and we expect efficiency improvements across the real estate sector. PSP expects to upgrade 19 of the 33 buildings in its portfolio with relatively low energy performance, But it is uncertain whether these improvements will ensure these buildings will be among the top performing in 2035. **There is no clear market standard for defining the most energy efficient building in Switzerland.** Use of currently available modelling and estimates, which have limitations due to the assumptions involved, makes assessing a building's energy performance complex.

Company Description

PSP Swiss Property is a Swiss real estate company. As of 2023, it owned 162 investment properties as well as 11 sites and development sites, primarily in Zurich (59% by total portfolio value), Geneva (15%), and other major Swiss cities. Its portfolio includes offices (64% by rent), retail spaces (15%), restaurants (6%), and parking facilities (4%). PSP's building portfolio is focused on historical buildings in city centers, with the age of buildings averaging 90 years. In 2023, PSP's average building energy intensity was 84 kilowatt hours per square meter (kWh/m^2) and 64% of its buildings' heating came from gas, oil, or biogas boiler systems.

PSP is publicly listed on the SIX Swiss Exchange and its major shareholders in 2023 were BlackRock Inc. (5.95% of total shares), Credit Suisse Funds AG (5.20%), and UBS Fund Management (Switzerland) AG (5.09%). As of 2023, PSP's portfolio was valued at approximately Swiss franc (CHF) 9.6 billion (about $11.28 billion), with annual rental income of CHF331.9 million. As of the first half of 2024, the portfolio value was about CHF 9.7 billion, with rental income at CHF176 million.

Current Activity

Activity by shade in 2023 (% of total)

We assign a green shade to 64% of PSP's revenue, 63% of its operating expenditure (opex), and about 60% of its capex in 2023.

Shade	Revenue (%)	Opex (%)	Capex (%)
Dark green	0	0	<1
Activities: Solar panels			
Medium green	0	0	23
Activities: Renovations achieving a significant, quantified improvement in energy performance			

Light green	**64**	**63**	**36**
Activities: Energy efficient existing buildings compared to today's national building stock, together with a Wüest Partner environmental score of 3.0 or higher; or LEED Gold certified existing buildings with a Wüest Partner environmental score of 3.0 or higher; or existing buildings with a Wüest Partner environmental score of 3.5 or higher; or biodiversity measures			
Yellow	**15**	**18**	**19**
Activities: Existing buildings with a Wüest Partner environmental score of 3.0 or higher, or without direct fossil fuel heating, that do not meet the green criteria above			
Orange	**21**	**19**	**21**
Activities: Existing buildings with direct fossil fuel heating that do not meet the green criteria above or parking facilities			
Red	**0**	**0**	**0**
Activities: None			

Opex--Operating expenditure. Capex--Capital expenditure. The Wüest Partner environmental score is one component in the Wüest Partner ESG score, which is a third-party analysis that scores buildings from 1.0-5.0, where a score of 3.0 denotes "average," while 3.5 represents "above average." Source: S&P Global Ratings.

We consider revenue and opex linked to PSP's energy efficient buildings to be Light green. Additionally, because buildings are inherently exposed to physical climate risks, we find it positive that PSP has conducted physical climate risk assessments for its portfolio using future climate scenarios. To identify buildings with greater energy efficiency performance, we used two approaches:

- **PSP's buildings that have achieved a Wüest Partner environmental score of 3.5 or higher are assessed as Light green.** We believe the score indicates good performance in areas material to this Shade of Green, including modelled energy demand and greenhouse gas emissions. There are uncertainties in final building energy performance inherent to points-based certification systems. Nevertheless, we believe the score sufficiently identifies energy-efficient buildings.
- **Furthermore, buildings with top energy efficiency performance relative to the Swiss building stock have been identified using a benchmark provided by PSP**. Although there is not yet a robust regulatory or market standard for evaluating existing buildings' energy performance against Switzerland's national building stock, PSP has used a modelled benchmark from a third party. We note several caveats to the threshold. For example, assumptions are made to exclude tenants' electricity use on a standardized basis to allow for comparability with PSP's data, while tenants' actual electricity use varies widely across PSP's portfolio. In addition, using unaudited measured energy also has limitations because it may fluctuate depending on the building's usage, for example, if a building is empty between tenants. This implies that buildings could meet the set threshold in a particular year without being truly energy efficient. Given these caveats, existing buildings need to have both top energy efficiency performance based on the benchmark and a Wüest Partner environmental score of 3.0 or higher for a Light green shade. A small proportion of properties that have received LEED Gold certifications have been assigned a Light green shade if they also have a Wüest Partner environmental score of 3.0 or higher.

It is positive that PSP is actively seeking alternative benchmarks that may be more appropriate for identifying the most energy efficient buildings compared to the national stock in the future. As better data on the Swiss national building stock's energy performance becomes available, thresholds to identify energy-efficient buildings may change.

We assign a Medium green shade to capex for building renovation projects that achieve at least a 30% reduction of energy use. In the transition to a low-carbon society, it is essential to renovate and improve existing properties. Achieving meaningful energy-efficiency benefits in existing buildings is an important measure to reduce greenhouse gas emissions and energy use in the real estate sector.

Other smaller investments in renewable energy and biodiversity are also considered green. Dark green activities included onsite solar power that supports the transition to renewable energy use in buildings. Investments in biodiversity measures are considered Light green.

For PSP's existing buildings that do not have high energy efficiency performance, with no direct fossil fuel heating, we assign a shade of Yellow. Use of heat pumps or district heating connections are lower-emission alternatives to gas or oil boiler systems. In addition, buildings that have Wüest Partner environmental scores higher than 3.0 are assigned a Yellow shade regardless of the heat source.

We assign an Orange shade to revenue and opex of existing buildings that do not have high energy efficiency performance or above-average Wüest Partner environmental scores, and have oil or gas boilers are onsite, due to greater associated greenhouse gas emissions. Parking facilities are also assigned a shade of Orange based on their links to fossil fuel vehicles. In our view, PSP is not currently engaged in any activities corresponding to a shade of Red.

Climate Transition Plan

Metrics And Targets

Transition targets

Transition metrics	Baseline metric (2019)	2022-2023	2025	2035	2050
Absolute greenhouse gas emissions--Scope 1, scope 2, and operational scope 3 emissions from tenant-obtained electricity	10,509 tCO_2e (scope 3 only business travel)	8,415 tCO_2e (scope 3 only business travel)	--	--	Net zero
Greenhouse gas emissions intensity--Scope 1 and 2, landlord only	11.75 kg of CO_2e/m^2	8.91 kg of CO_2e/m^2	--	6 kg of CO_2e/m^2 (50% reduction)	Net zero
Share of renewable electricity (of total landlord electricity, market-based)	98%	99%	100%	100%	100%

PSP references the Swiss national definition of net zero, and offsets are not part of its plan. PSP's energy-related data is shifted by half a year compared to financial data following the calendar year. Thus, the figures above reflect performance from July 1, 2022, through June 30, 2023. PSP calculates square meters (m^2) following the definition of lettable space under European Public Real Estate Association guidelines. tCO2e--Tons of carbon dioxide equivalent. kg--Kilograms.

We see PSP's transition targets' focus on its operational footprint as generally ambitious, but the limited coverage of value-chain emissions as a material constraint. The company aims to achieve net zero for absolute operational emissions by 2050. Although this target includes scope 3 emissions related to tenant-obtained electricity, it does not include embodied emissions related to renovation, tenant adaptations, and new construction. PSP's greenhouse gas emission reduction targets have not been externally verified by a standard-setting body, though they have been assessed by a consultant.

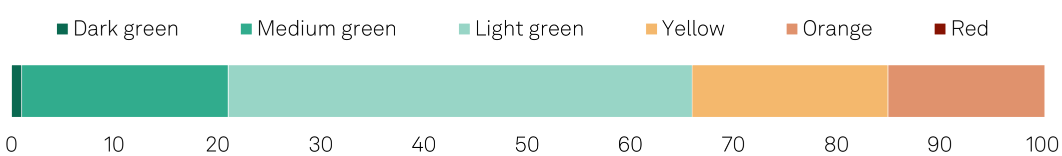
PSP's near-term targets to reduce emissions from its operations are ambitious and positive milestones on the path to net zero, though there are some limitations. These include that these targets cover only emissions intensity (by 2035) and renewable electricity procurement (by 2025), not absolute emissions. PSP's transition targets are supported by clear investments and actions, described further in the “Actions and investments” section. In setting its targets, PSP has referenced relevant external standards, such as the Carbon Risk Real Estate Monitor's (CRREM) decarbonization pathway. PSP’s scopes 1 and 2 emissions intensity--excluding tenants' emissions--is currently well below the CRREM pathway and grid emissions factors are relatively low in Switzerland, which we view as a strength. This implies tenant-obtained electricity would have to be quite high for nonalignment with the CRREM pathway. We therefore consider PSP’s scopes 1 and 2 emissions reduction plan for existing buildings aligned with the Swiss reference CRREM emissions reduction pathway. However, we note that PSP’s projections of future energy use are not reducing as quickly as envisaged by the Swiss reference CRREM energy performance pathway. Part of the climate transition for real estate relates to reducing energy use and greenhouse gas emissions so that renewable energy resources can be deployed effectively across all sectors. PSP has not assessed whether it would meet CRREM’s pathway based on energy performance rather than emissions, which may be easier to achieve given low grid-emission factors in Switzerland. We see limitations in PSP's intensity-based targets for 2035 compared to its absolute emissions reduction targets, since they allow for increases in absolute emissions if PSP increases the size of its portfolio. PSP’s intensity-based targets to reduce scopes 1 and 2 emissions by 50% by 2035 also does not cover scope 3 emissions relating to embodied emissions or tenant-obtained electricity. If emissions from tenant-obtained electricity were included in PSP’s current greenhouse gas footprint, which excludes embodied emissions, they would represent about 14% of total emissions.

PSP’s 2025 target to increase the proportion of landlord-obtained electricity from renewable sources to 100% by 2025 could help reduce its scope 2 greenhouse gas emissions. However, the target is already nearly achieved, with the figure being 98% or higher going back to 2018. Furthermore, the target does not cover energy sources beyond electricity, with the proportion of total landlord-obtained energy from renewable sources at only 52% in 2023, due in part to continued direct fossil fuel heating in many of PSP's buildings. Additionally, the target does not include tenant-obtained electricity, although PSP’s intention to increase the proportion of green leases with sustainability clauses may help reduce emissions related to tenants.

Although new construction is not PSP’s main activity, it may still entail high emissions. PSP has taken steps to measure embodied emissions for some recent new construction projects. The biggest of these is estimated to have embodied emissions equal to about two years’ worth of scopes 1 and 2 emissions. Noting that, because construction projects take multiple years, these emissions would be associated with the lifetime of the construction project, and not represent emissions for only one year. However, even with very few construction projects, this can represent high emissions for the company especially because PSP aims to reduce direct emissions. Furthermore, research published by the European Commission suggests that embodied emissions from renovation projects can be about 40% of those from new construction. Therefore, since PSP expects to invest a significant amount in renovation projects, these activities could likely represent a material source of emissions for the company.

Actions And Investments

Capex breakdown by shade in 2023 (% of total)



Source: S&P Global Ratings.

PSP has developed and begun to implement a clear strategy for improving its buildings' energy sourcing. This includes replacing direct fossil fuel or biogas heating in 83 of 118 buildings, or more than 70% of its properties that currently rely on boilers between 2020-2035. This includes upgrading to heat pumps or connections to district heating and cooling systems. We view efforts to phase out fossil fuel and biogas use as a strength of PSP's approach. Although biogas generally releases lower emissions than natural gas, the Swiss government's guidance on decarbonization pathways for the real estate sector suggests phasing out biogas' use in buildings for better prioritized use in other sectors where lower-carbon alternatives are not as readily available. PSP has also committed to avoiding any direct fossil fuel heating in new buildings, plans to increase onsite solar panel installations on its buildings where possible, and expects to promote green leases to support more renewable electricity sourcing by tenants, all of which are positive steps.

PSP allocated 60% of its capex in 2023 to activities assigned a green Shade. These activities include retrofitting buildings to improve energy efficiency performance, replacing oil and gas heating systems with lower-emission alternatives, installing onsite solar panels, and implementing biodiversity measures on properties. We view these investments as important steps toward reducing greenhouse gas emissions and fossil fuel lock-in risks. They are well-aligned with PSP's climate transition targets and strategy. Other capex related to renovation planning, where energy efficiency improvements are not certain, is assigned a shade of Yellow. Renovations undertaken without efficiency or heating system improvements are assigned a shade of Orange.

In terms of energy efficiency, PSP expects to invest in retrofits that achieve improvements for 19 of 33 buildings currently with lower energy performance by 2035. We view this as a good approach for PSP to improve energy efficiency and help meet its climate goals. PSP's strategy is focused on renovations and modernization measures, including building envelope and insulation improvements; heating, ventilation, and air conditioning systems; windows and lighting upgrades; smart metering, and energy monitoring systems. Furthermore, PSP aims to only acquire buildings that already are aligned with its energy-efficiency improvement or greenhouse gas emissions reduction plans, or will soon be renovated to meet those goals.

PSP's approach to managing its scope 3 emissions, beyond those related to tenant-obtained electricity, is at an early stage. The company has not yet established a full inventory of scope 3 emissions across all material categories. The company is taking initial steps to manage these emissions by developing an approach for calculating embodied emissions, working with tenants on lower-emission adaptations and waste reduction, and is considering lower-emission materials substitutes for renovations and new construction. Medium- to longer-term actions and investment planning have not yet been identified. Furthermore, suppliers are unlikely to provide lower-emission materials without a clear demand signal from purchasers, due to higher costs or limited availability given the technological challenges of decarbonizing some industries such as steel and cement. Despite this, it is positive that PSP is taking steps to estimate its scope 3 emissions from tenant-obtained electricity, and engage with tenants through green leases and other awareness measures; such emissions are covered under the company's long-term targets.

Implementation Drivers

We believe PSP has good governance mechanisms in place to execute on its current transition strategy. The Chief Investment Officer's (CIO's) responsibility for PSP's portfolio investment plan and role in leading the Sustainability Taskforce link PSP's goal of reducing its portfolio's carbon emissions with its investment decisions. The CIO leverages the Sustainability Taskforce, comprising representatives from across the business, to report to the wider executive board on sustainability matters. Since 2024, executive compensation is influenced by environmental, social, and governance considerations, including the climate transition.

PSP's capex, aimed at reducing its portfolio emissions, is not expected to increase significantly and relies on proven technologies successfully implemented in the past. PSP has a long-standing strategy of focusing on the quality of its asset portfolio and currently has an investment plan through to 2035. Anticipated investments related to maintaining and improving the quality of buildings include updating heating sources to lower-emission options and increasing the energy efficiency of buildings. These emissions-reduction actions are already factored in to planned capex.

All outstanding bonds and credit facilities are linked to sustainability criteria that support PSP's emission-reduction targets. This motivates management to continue to build, acquire, or renovate buildings meeting these criteria. We understand PSP does not expect to materially increase its leverage, and may undertake acquisitions using retained earnings.

Execution of PSP's transition plan is supported by the Swiss regulatory environment. In June 2023, the Swiss electorate voted in favor of The Climate and Innovation Act, committing Switzerland to climate neutrality by 2050. This act outlines targets for the main emitting sectors, including the building sector, where emissions should be reduced by 82% by 2040 compared to 1990 levels. PSP's portfolio includes primarily historical properties in city centers, so many buildings are protected under legislation, underscoring their historical significance and cultural value. This can both support and complicate PSP's transition plan. For example, there could be limitations to the energy efficiency improvements it is allowed to perform on such buildings. PSP has long experience working with historical buildings, and has factored this into its transition plan. Therefore, in our view, this is unlikely to hinder implementation of the plan. PSP may also be able to reduce heating-related emissions in line with wider city plans in Geneva and Zurich to increase the use of lake water for heating and cooling in district networks. The company's ability to capitalize on these opportunities depends on the extent to which its renovation cycle aligns with wider city plans and whether it can secure approvals for renovations involving protected historical buildings. To help manage this, PSP is monitoring opportunities with the aim of aligning its long-term plans with wider city plans.

S&P Global Ratings' Shades of Green

Assessments	Dark green	Medium green	Light green	Yellow	Orange	Red
Description	Activities that correspond to the long-term vision of an LCCR future.	Activities that represent significant steps toward an LCCR future but will require further improvements to be long-term LCCR solutions.	Activities representing transition steps in the near-term that avoid emissions lock-in but do not represent long-term LCCR solutions.	Activities that do not have a material impact on the transition to an LCCR future, or, Activities that have some potential inconsistency with the transition to an LCCR future, albeit tempered by existing transition measures.	Activities that are not currently consistent with the transition to an LCCR future. These include activities with moderate potential for emissions lock-in and risk of stranded assets.	Activities that are inconsistent with, and likely to impede, the transition required to achieve the long-term LCCR future. These activities have the highest emissions intensity, with the most potential for emissions lock-in and risk of stranded assets.
Example projects	Solar power plants	Energy efficient buildings	Hybrid road vehicles	Health care services	Conventional steel production	New oil exploration

Note: For us to consider use of proceeds aligned with ICMA Principles for a green project, we require project categories directly funded by the financing to be assigned one of the three green Shades.

LCCR--Low-carbon climate resilient. An LCCR future is a future aligned with the Paris Agreement; where the global average temperature increase is held below 2 degrees Celsius (2 C), with efforts to limit it to 1.5 C, above pre-industrial levels, while building resilience to the adverse impact of climate change and achieving sustainable outcomes across both climate and non-climate environmental objectives. Long term and near term--For the purpose of this analysis, we consider the long term to be beyond the middle of the 21st century and the near term to be within the next decade. Emissions lock-in--Where an activity delays or prevents the transition to low-carbon alternatives by perpetuating assets or processes (often fossil fuel use and its corresponding greenhouse gas emissions) that are not aligned with, or cannot adapt to, an LCCR future. Stranded assets--Assets that have suffered from unanticipated or premature write-downs, devaluations, or conversion to liabilities (as defined by the University of Oxford).

Related Research

- Analytical Approach: Climate Transition Assessments, July 18, 2024
- FAQ: Applying Our Integrated Analytical Approach For Climate Transition Assessments, July 18, 2024

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