OBLIGO

Infrastructure Investment Strategy

Research note 2-19

Introduction

The purpose of this research note is to illustrate important aspects of developing and executing our infrastructure investment strategy. We will look into investment objectives, pillars of our strategy, implementation and return generation from our investment process.

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JMW/Obligo team research

May 2019

Signatory of:

PART ONE: INFRASTRUCTURE INVESTMENT STRATEGY

Investment Objectives

Our main mission is to create competitive returns for our investors providing a heavy yield component with downside protection. We split our investment objectives into financial and social return.

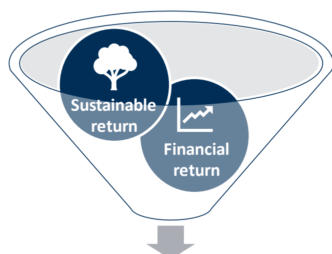
Financial return on investment

We use a modified version of the Capital Asset Pricing Model (CAPM) to generate return expectations for our infrastructure portfolios[1]. Depending on the level of systematic risk in the different infrastructure portfolios, the annual net return expectations vary from 6 to 10 percent[2].

Sustainable return on investment (SROI)

SROI is a principles-based method for measuring extra-financial value such as environmental or social value not currently reflected or involved in conventional financial accounts. Examples include carbon footprint, energy consumption, product recycling rate, water footprint, waste reduction rate and waste recycling rate. It will be used by Obligo to evaluate impact on stakeholders, identify ways to improve performance, and enhance the performance of investments by calculating key performance parameters based on sustainability reporting from underlying managers.

Figure 1: Investment Objectives



$$E(Rp) = Rf + \beta_{pM}(E(Rm) - Rf) + \beta_p I + \beta_p S + \beta_p C$$

I: Illiquidity premium
S: Obligo Selection premium
C: Climate change mitigation premium

Key performance indicators for sustainable return:

- Carbon footprint (GHGs total emissions)
- Energy consumption
- Product recycling rate
- Water footprint
- Waste reduction rate
- Waste recycling rate

Defining Investment Strategy

Our infrastructure investment strategy is a set of rules, behaviors and procedures, designed to guide our selection of infrastructure portfolios and the trade-off between expected return and risk. We implement our strategy in the investment process to increase the probability to achieve defined investment objectives.

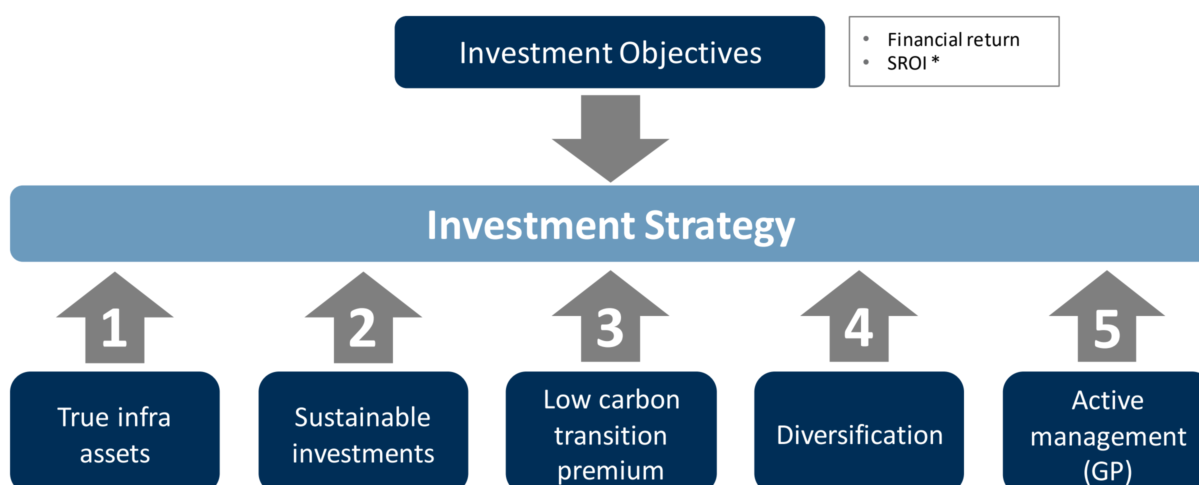
The investment strategy rests upon five pillars (see figure 2 on next page) where each of the pillars is expected to drive investment performance. The five pillars are based on investing in

1. True infrastructure assets
2. Sustainable investment managers and funds
3. Active management by the GPs
4. Portfolios tilting towards climate change mitigation
5. Diversification

[1] "Expected return for Obligo Qualified Infrastructure by applying adjusted CAPM," Obligo Research Note 1-19

[2] Obligo runs two different investment strategies; one being structured to take Solvency II capital charges into account through Qualified Infrastructure Investments (QII), the other with no such constraints. The QII strategy involves lower systematic risk and hence lower return expectations.

Figure 2: Obligo's Five pillars of investment strategy



1. <u>True infrastructure assets</u>

Over the last few years we have experienced that the definition of infrastructure has been inflated sometimes to include what we normally would not consider to be true infrastructure assets. We have to look into the characteristics and properties of the underlying investments in order to evaluate the true infrastructure component of the asset.

First, assets should be *essential public services* defined as services that meet people's most important needs and are crucial to their well-being[3]. The quality of people's lives depends on these services. Examples of such services are waste management, urban planning, energy supply, health care, emergency services (fire, rescue operations, immediate help), public transport, public buildings, justice, social services (social welfare, food programs) telecommunications, transport infrastructure, water supply and education.

Second, the business in which an asset operates should be characterized by *high entry barriers,* i.e. the amount of fixed cost that must be incurred by a new entrant, regardless of production or sales activities, into a market that incumbents do not have or have not had to incur. As barriers to entry protect incumbent firms and restrict competition in a market, they can contribute to distortionary prices and high operating profit margins. Barriers to entry often cause or aid the existence of monopolies or give companies market power.

Third, cash flows from these assets should be *stable and predictable*. What differentiates infrastructure assets is not their physical but their financial attributes. The central requirement is cashflows that are reasonably stable and predictable for at least, say, ten years into the future. It is in part this characteristic that allows for relatively inexpensive leverage to be applied to the asset, in turn enabling the business to pay equity investors a generous running yield.

[3] This definition is taken from the Cambridge Business English Dictionary

Figure 3: Obligo's infrastructure test

Fourth, assets should be *protected by inflation* meaning investments that provide a hedge against the rise in prices of goods and services over time. An inflation protected portfolio, for example, will have assets that perform well in times higher inflation, for example containing some kind of adjustment mechanism that periodically implicitly ratchets the payouts up and down according to the rate of inflation.

Finally, assets should have *downside protection*. Downside protection is an important aspect of risk management and its purpose is to reduce the frequency and/or magnitude of capital losses, resulting from significant asset market declines.

All assets must pass the Obligo infrastructure test in order to be considered as a potential investment in our infrastructure portfolios.

2. Sustainable investments (ESG)

According to Deutsche Bank research the evidence is compelling: Sustainable investing can be a clear win for investors and companies. "We believe that ESG analysis should be built into the investment process of every serious investor and into the corporate strategy of every company that cares about shareholder value."[4] Sustainable infrastructure investment is an investment philosophy that considers environmental, social and governance factors (ESG) as an integral part of the investment process in order to create expected superior risk adjusted returns through ESG screening, exclusions and active ownership. We define sustainable investment through:

a) Function of capital market
Capital markets play an important role in allocating capital to businesses that have the willingness and ability to behave as good corporate citizens[5].

b) Returns and Impact
ESG investing seeks to deliver attractive returns while evaluating, at every stage of the investment process, the long-term impact of a company's business practices on society, the environment and the performance of the business itself.

c) Deeper Insight
The incorporation of non-financial data about ESG practices may identify risks and opportunities and provide ESG ratings which can offer deeper insight into company performance than traditional investment analysis alone.

d) Return Potential
High ESG ratings are correlated with a lower cost of capital, market-based outperformance, and accounting-based outperformance.

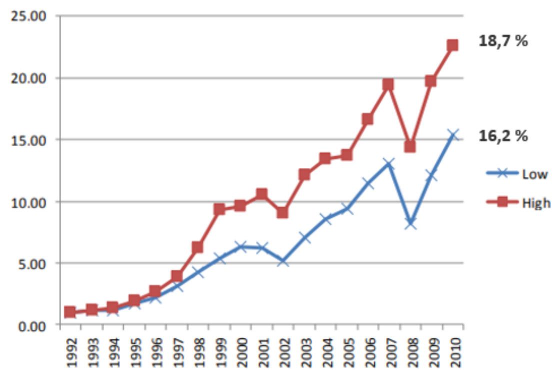
A large number of empirical studies[6] indicate significant outperformance by high quality sustainable companies generating significantly higher profits and stock returns, suggesting that developing a corporate culture of sustainability may be a source of competitive advantage for a company in the long-run. High quality sustainable companies operate like good corporate citizens. Good corporate citizenship involves the social responsibility of

[4] "Sustainable investing: establishing long term value and performance," DB Climate Change Advisors, June 2012
[5] See below for a definition

[6] "The impact of Corporate Culture of Sustainability on Corporate Behavior and Performance", Working Paper 12-035, Harvard Business School

businesses and the extent to which they meet legal, ethical and economic responsibilities, as established by shareholders. Good corporate citizenship is growing increasingly important as institutional investors begin to seek out companies that have socially responsible orientations such as their environmental, social and governance (ESG) practices. One such study[7] finds an annual outperformance of 2,5 percentage points in the 1992-2010 period (figure 4 below) from high performing sustainable companies and more than 100 academic papers overwhelmingly suggest a positive relationship between high sustainability and high stock performance[8].

Figure 4: performance of high and low sustainable companies



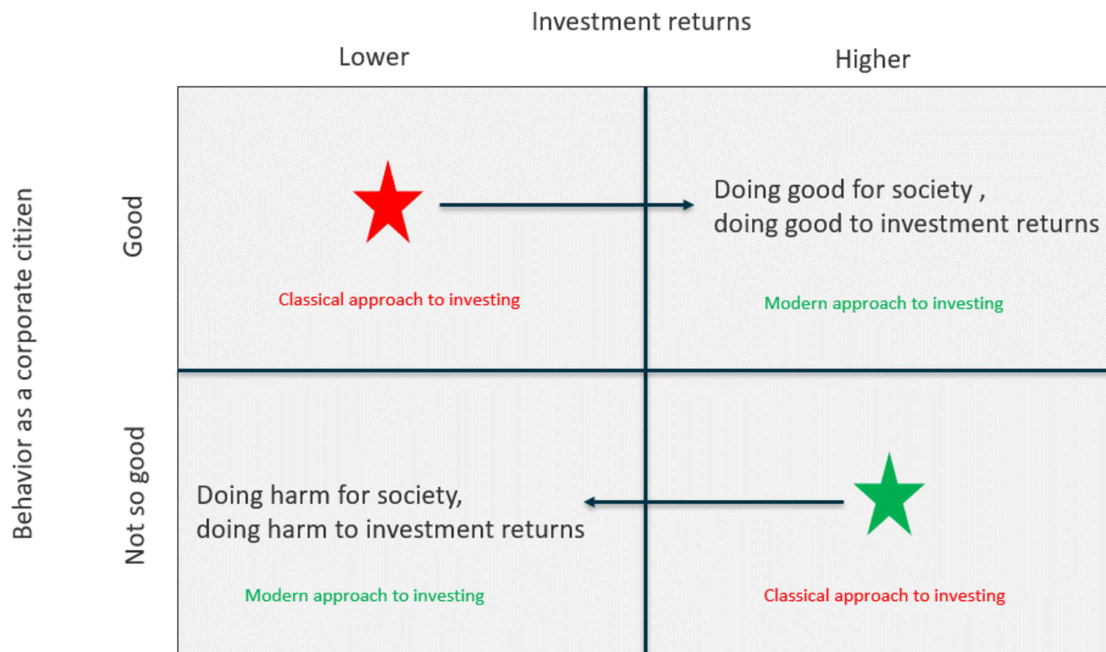
The policies of high sustainable companies include environmental management systems, policy to reduce emissions, safer working conditions, stakeholder engagement and executive compensation. These companies do not treat the elements of sustainability (E -S - G) as separate items. Rather it is being considered part of the organizations' philosophy, culture and DNA. The "classical" approach to investing considered a negative tradeoff between behavior as a corporate citizen and investment returns. High investment returns were not associated with being a good corporate citizen and vice versa. However, a more modern approach to investing considers the opposite: Being a good corporate citizen is doing good to investment returns (see figure 5).

Using a set of simplifying assumptions, we can estimate the incremental return from high sustainability companies to 130 bps. annually relative to average performance.[9] Hence, sustainability is important in driving portfolio performance. In our investment strategy, we target funds and managers with well-developed ESG policies and systems, assigning them a high ESG rating[10] as we believe these managers and funds will have lower investment risk and create excess return over time.

[7] Harvard Business School op. cit.
[8] Deutsche Bank op.cit.
[9] Calculated as the excess return for high sustainability companies in figure 3 compared to the average return for both high and low sustainability companies

[10] Include PRI and GRESB rating as well as Obligo's Corporate Sustainability Assessment

Figure 5: Relationship between investment returns and sustainability



3. Low carbon transmission premium

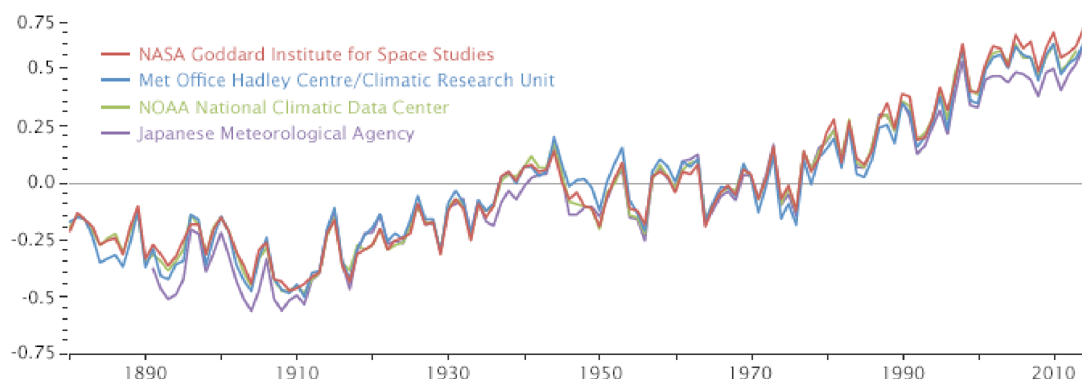
Climate change represents one of the largest economic and political challenges of the 21st. century. Nations, individuals and collectively, are developing policy responses to mitigate or manage risks poised to society[11]. Climate change is expected to have significant influence on asset and portfolio returns.

Climate change occurs when changes in the Earth's climate system result in new weather patterns that last for at least a few decades, and maybe for millions of years. The climate system receives nearly all of its energy from the sun, with a relatively tiny amount from earth's interior. The climate system also gives off energy to outer space. The balance of incoming and outgoing energy, and the passage of the energy through the climate system, determines the Earth's energy budget. When the incoming energy is greater than the outgoing energy, the earth's energy budget is positive, and the climate system is warming. If more energy goes out, the energy budget is negative and earth experiences cooling.

In 2013, the Intergovernmental Panel on Climate Change (IPCC) Fifth Assessment Report[12] concluded, "It is extremely likely that human influence has been the dominant cause of the observed warming since the mid-20th century."[13] The largest human influence has been the emission of greenhouse gases such as carbon dioxide, methane, and nitrous oxide. Climate model projections summarized in the report indicated that during the 21st century, the global surface temperature is likely to rise a further 0.3 to 1.7 °C to 2.6 to 4.8 °C depending on the rate of greenhouse gas emissions and on climate feedback effects[14].

[11] Climate change investment strategy, New Zealand Superfund white paper, March 2019
[12] Climate Change 2013: The Physical Science, Intergovernmental Panel on Climate Change
[13] Wang, Jianliang; Feng, Lianyong; Tang, Xu; Bentley, Yongmei; Höök, Mikael "The implications of fossil fuel supply constraints on climate change projections: A supply-side analysis." February 2017
[14] Rutledge, David (2011-01-01). "Estimating long-term world coal production with logit and probit transforms". International Journal of Coal Geology.

Figure 6: Annual Temperature Anomaly[15]



Future climate change effects are expected to include rising sea levels, ocean acidification, regional changes in precipitation, and expansion of deserts in the subtropics. Surface temperature increases are greatest in the Arctic, with the continuing retreat of glaciers, permafrost, and sea ice. Predicted regional precipitation effects include more frequent extreme weather events such as heat waves, droughts, wildfires, heavy rainfall with floods, and heavy snowfall. Effects directly significant to humans are predicted to include the threat to food security from decreasing crop yields, and the abandonment of populated areas due to rising sea levels. Environmental impacts appear likely to include the extinction or relocation of ecosystems as they adapt to climate change, with coral reefs, mountain ecosystems, and Arctic ecosystems most immediately threatened. Because the climate system has a large "inertia" and greenhouse gases will remain in the atmosphere for a long time, climatic changes and their effects will continue to become more pronounced for many centuries even if further increases to greenhouse gases stop.

Based on industry research[16] the Mercer report questions how big impact climate change would have on a portfolio. The report demonstrates the following:

a) Investment impact

Climate change, under the scenarios modelled, will inevitably have an impact on investment returns, so investors need to view it as a new systematic risk factor.

b) Industry sector impact

Industry sector impacts will be the most meaningful. For example, depending on the climate scenario which plays out, the average annual returns from the coal sub-sector could be lowered by 5 % over the next 35 years (negative risk premium) with effects more pronounced over the coming decade. Conversely, the renewables sub-sector could see average annual returns increase by 3,5 % over a 35-year time horizon (positive risk premium).

c) Asset class impact

Asset class return impacts could also be material – varying widely by climate change scenario. For example, a 2°C scenario could see annual return benefits for emerging market equities (0,4 %), infrastructure (0,6 %), real estate (0,3 %), timber and agriculture (0,8 %). A 4°C scenario could negatively impact emerging market equities, real estate, timber and agriculture. Growth assets are more sensitive to climate risks than defensive assets.

[15] Source: NASA
[16] "Investing in a time of climate change," Mercer, 2015

Carbon risk should be considered a "new" systematic risk factors that is being priced by the market. Research shows that this factor might be underpriced by investors. Hence, our strategy involves tilting the portfolio towards a neutral effect on climate change and increased exposure to investment projects and managers that exploit carbon risk opportunities and manage this risk efficiently.

4. Portfolio diversification

Diversification is a risk management strategy that mixes a wide variety of investments within a portfolio. The rationale behind this technique is that a portfolio constructed of different kinds of assets will, on average, yield higher long-term returns and lower the risk of any individual holding or security. Our portfolios are diversified across different sectors, investment stages (brownfield vs. greenfield), geographies, currencies and deal size in order to reduce unsystematic portfolio risk.

5. Value creation through active ownership by the general partner

Investors who believe in value creation through active ownership do not follow the efficient market hypothesis[17]. They believe it is possible to profit from the stock market through any number of strategies that aim to identify mispriced securities. In the listed stock market, the consensus view is that it is very hard to outperform the market over time and the market is considered to be fairly efficient. In the unlisted market the flow of information is less opaque and there may be more opportunities to identify managers and funds that do outperform the average performance over time through fundamental analysis[18]. This is Obligo's view. Therefore, we employ sophisticated research techniques, models and extensive due diligence processes to identify managers that have the potential to create excess performance. Active management is defined outside the scope of restructuring the balance sheet (i.e. change debt to equity ratio) and is more related to corporate culture development through engagement, compliance, governance and the skillset being developed over several years. We believe value creation comes from identifying and managing a set of risk factors in a professional manner and to exploit selected market opportunities in line with the manager's unique skills or competitive advantages. We have defined ten risk factors[19] crucial to investment performance that the managers would have to control and mitigate. Our research shows[20] that managers mitigating risk professionally and that exploit selected market opportunities create additional return of 170 bps. per year. We denote these as high performing managers and are the only ones considered for our infrastructure portfolio investments.

[17] The Efficient Market Hypothesis, or EMH, is an investment theory whereby share prices reflect all information and consistent alpha generation is impossible. Theoretically, neither technical nor fundamental analysis can produce risk-adjusted excess returns, or alpha, consistently and only inside information can result in outsized risk-adjusted returns

[18] In the unlisted market for infrastructure, underlying investments and funds are not traded and priced continuously unlike the listed market for infrastructure stocks. Rather, the value is based on accounting information and a net asset value (NAV) is calculated e.g. once every quarter

[19] These factors will be described and analyzed in part two of this research note

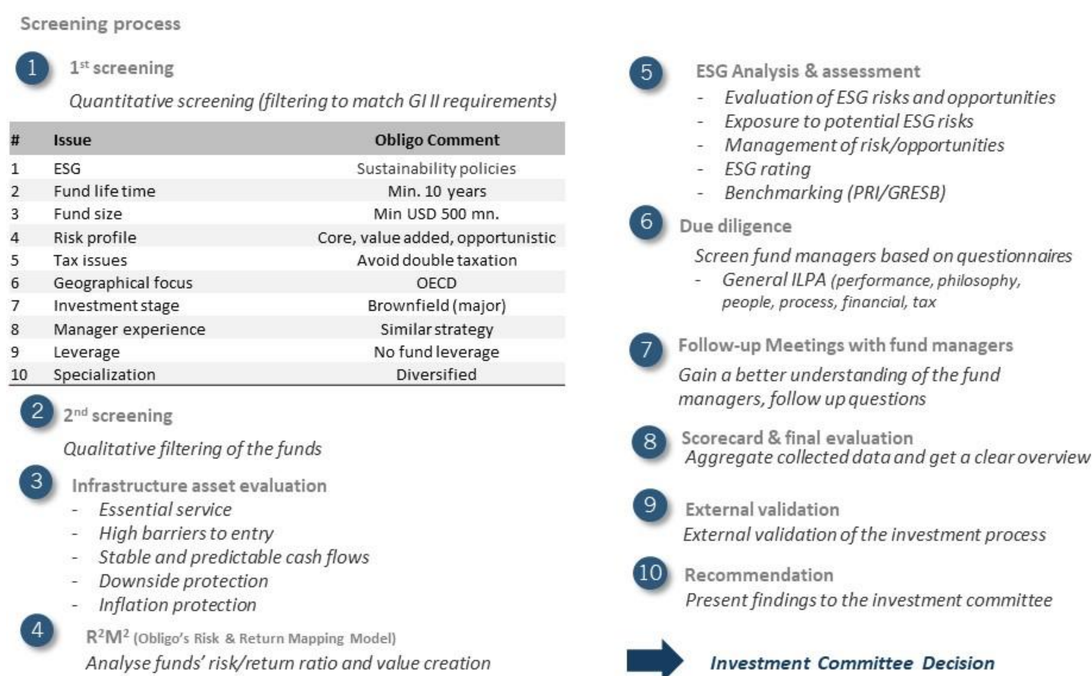
[20] See chapter on Obligo's Risk & Return Mapping Model – R^2M^2

PART TWO: INFRASTRUCTURE INVESTMENT STRATEGY IMPLEMENTATION

Value Creation Through the Investment Process

Superior performance from our infrastructure portfolios is expected to be achieved through our GP screening and selection process. This is a 10 step-process[21] starting with a basic screening and culminating in the investment team's recommendation to the Investment Committee[22] illustrated in figure 7:

Figure 7: The Art and Science of Fund Manager Selection



1. First Screening

The first screening involves analysis of potential investment alternatives and whether these meet Obligo's criteria and the fund's investment mandate. This initial screening is of a quantitative nature, such as investment goals, geography and sector exposure, phase, debt ratio, asset management experience and ESG policies. In our second infrastructure fund – Obligo Global Infrastructure II - 31 funds have passed the first screening and is included in the next round as of the date of this research note. This number will vary over time.

2. Second Screening

The second screening is of a qualitative nature. Funds are filtered to other criteria such as the Fund's investment strategy and risk profile. These criteria may be exposure to some geographical sectors, level of regulatory risk or construction risk. 25 funds and managers remain after having passed this screening.

[21] Only the most significant elements are described in this research note

[22] For Qualified Infrastructure Investments there will be an additional layer of research related to an eligibility analysis. We use independent third-party research to classify infrastructure projects as most likely "within" or "outside" the qualifying criteria put forward by EIOPA for lower capital charges

3. Infrastructure Asset evaluation

We run the Infrastructure Test described at page 3. All assets must pass the Obligo infrastructure test through screening in order to be considered as a potential investment in the infrastructure portfolio.

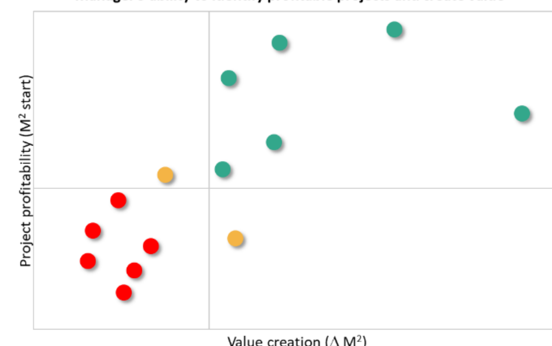
Figure 8: Obligo's R^2M^2 Model

4. Obligo's Risk & Return Mapping Model (R^2M^2)

Obligo has developed its own proprietary risk and return model for infrastructure projects and managers – the Risk & Return Mapping Model (R^2M^2). The model identifies (1) the managers' ability to identify profitable projects on a risk adjusted basis and (2) the managers' ability to create value throughout the life of the funds. Obligo's hypothesis is that in infrastructure management, most of the return is a function of how managers implement their sustainability policies, industrial and financial infrastructure expertise, including balance and tax optimization, acquisitions/mergers (add-on investments) and rationalization for more efficient operations through active management.

The manager must make a quantitative assessment of various risk factors for each individual project in the portfolio. In addition, each project's expected return must be defined. This information is converted into different ratios for risk (volatility) and return and is the foundation for a calculating benchmark performance comprising all infrastructure project in the Obligo database.[23] Each project is ranked based on risk-adjusted returns. Further, projects are ranked on how the infrastructure manager has managed to add value throughout the life from acquisition to exit. The managers must quantitatively re-evaluate the various risk factors related to the last valuation/exit price and must show actual return figures for the projects. Armed with this information value creation can be assessed by comparing expected and actual risk and return figures. The output from the Obligo's risk and return mapping model - R^2M^2 - can be illustrated as followed:

Figure 9: Output from the R^2M^2 model[24]



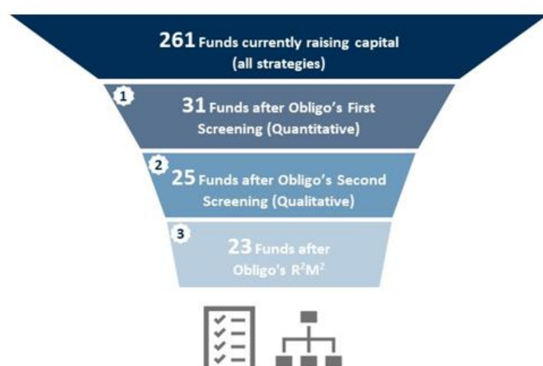
[23] The database consists of more than 200 global infrastructure projects diversified by geography, sector, investment stage, revenue models and project size

[24] We use a modified version of the Modigliani performance indicator M^2. This measure evaluates the annualized risk adjusted performance of a portfolio in relation to the market benchmark, expressed in percentage terms. Returns are earned

The figure shows an assessment of different fund managers. Managers located in northeast quadrant (green zone) have identified projects with high expected risk adjusted returns and have managed to bring these expectations into high actual risk adjusted returns through active management. These are managers we want to work with. Funds located in the southwest quadrant (red zone) have the opposite properties and are managers we want to avoid. Funds placed in the orange zone have either good project choices and lower value creation (not able to exploit the potential), or less good project choices and high risk-adjusted returns (returns can be based on chance). These are managers that are subject for more research and investigation.

The fund screening can so far be summarized as follows:

Figure 10: Obligo screening process



After starting out with 261 funds in our database, only 23 funds are promoted to stage 5 – ESG analysis and assessment.

5. ESG Analysis & Assessment

Obligo is a signatory of the United Nations Principles of Responsible Investments - PRI and as such must comply with the six principles of responsible investment.[25] Further, Obligo has identified three Sustainability Goals (SDGs) as a long-term guidance for our ESG initiatives:

Combining the SDGs with underlying megatrends of rapid urbanization, climate change and resource scarcity, demographic and social change and technological breakthroughs, we develop our ESG strategy to identify sustainability risks and opportunities.

We strongly believe that sustainability pays off in terms of lower portfolio risk and enhanced returns. Hence, we put a lot of efforts into analyzing ESG issues of underlying managers and infrastructure projects. We investigate the following elements of sustainability to identify investment risks and opportunities:

assuming the portfolio risk taking on the same level of risk as the benchmark portfolio which allows to rank different expected and actual returns and associated risk. See Modigliani F. and Modigliani L., “Risk-Adjusted Performance”, Journal of Portfolio Management, winter 1997, pp.45-54

[25] Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
Principle 5: We will work together to enhance our effectiveness in implementing the Principles.
Principle 6: We will each report on our activities and progress towards implementing the Principles.

Table 1: ESG criteria

Definition	How it works
Environmental criteria to consider how a company performs as a steward of nature	✓ Company's energy use, waste, pollution and natural resource conservation ✓ Evaluating any environmental risks, a company might face and how the company is managing those risks ✓ Issues related to its ownership of contaminated land, its disposal of hazardous waste, its management of toxic emissions, compliance with the government's environmental regulations
Social criteria examine how a company manages relationships with employees, suppliers, customers and the communities where it operates	✓ Company's business relationships. ✓ Suppliers that hold the same values as it claims to hold ✓ The company's working conditions show a high regard for its employees' health and safety ✓ Other stakeholders' interests considered
Governance deals with a company's leadership, executive pay, audits, internal controls and shareholder rights	✓ Company uses accurate and transparent accounting methods ✓ Stockholders given an opportunity to vote on important issues ✓ Companies avoid conflicts of interest in their choice of board members ✓ Don't use political contributions to obtain unduly favorable treatment ✓ Don't engage in illegal practices

In order to efficiently analyze these criteria and execute the ESG strategy, Obligo has developed a toolbox to assist in identifying high sustainability managers. The toolbox consists of the following elements:

A. The "House in order principle"

Obligo´s specific requirements and processes[26] on how to manage ESG factors are set out in internal guidelines:

- ✓ Responsible investment policy (RI policy)
- ✓ ESG guidelines
- ✓ Code of conduct

The guidelines shall apply to all our investments including external fund managers. The clean house principle regulates areas such as the investment process, ownership, monitoring and reporting.

For example, the RI policy[27] refrain investments in funds contributing to or being responsible for:

- ✓ Serious or systematic human rights violations such as forced labor

[26] See the appendix for a detailed description of internal guidelines

[27] Potential managers would have to accept, comply to and sign our RI policy

- ✓ Violations of international law including in situations of war or conflict
- ✓ Severe environmental damage
- ✓ Unacceptable greenhouse gas emissions; or
- ✓ Corruption

B. Corporate Sustainability Assessment (CSA)

The CSA is an evaluation of infrastructure managers' sustainability practice and we assess managers according to their exposure to industry-significant ESG risks and their ability to manage those risks relative to industry peers. Further, the CSA indicates how the managers contributes to a global Sustainable Development (SD). The CSA consists of a questionnaire with more than 50 ESG questions. The feedback from the questionnaire provides a basis for calculating the managers' sustainability score and is a vital input to our selection methodology.

C. ESG rating

Obligo is a member of GRESB®[28] Infrastructure and as such have access to fund and asset assessment from the GRESB® database. These assessments give a clear guidance to sustainable behavior and rating among various infrastructure managers and comparing infrastructure managers to a well-defined sustainability benchmark.

Further, Obligo is a UNPRI signatory and have access to assessment and transparency reports. These reports are used in evaluating ESG polices, programs and initiatives of various managers.

Finally, Obligo uses the output from the CSA assessment to rate underlying managers. We assign a score to each manager that is being used in the manager selection process.

D. ESG due diligence

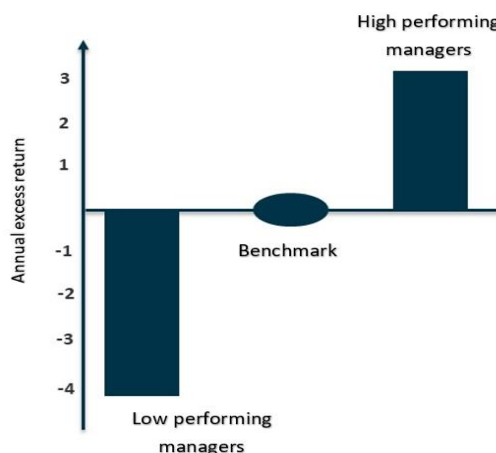
The ESG due diligence process is a structured initiative to further evaluate sustainable behavior and to identify the good corporate citizens. Our DD process starts after we have evaluated the CSA. Typically, we meet the manager on site and have follow up questions to the CSA, followed by an ESG checklist. In this manner, we increase the likelihood of picking manages that can transform ESG behavior into a sustainable competitive advantage.

[28] Global Real Estate Sustainability Benchmark. See gresb.com

PART THREE: RETURN GENERATION FROM THE INVESTMENT PROCESS

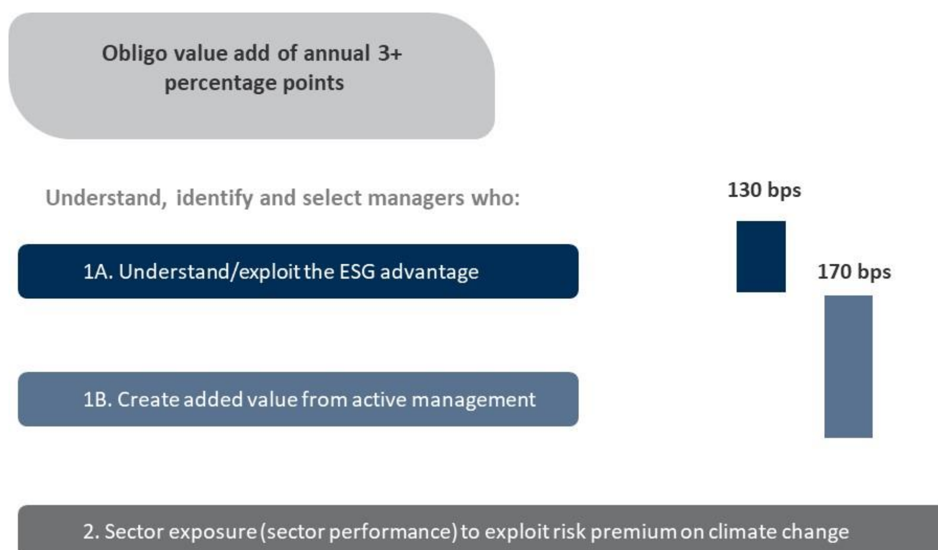
Our investment process is expected to generate excess returns[29] or alpha compared to a well-diversified benchmark of infrastructure projects.[30] The managers in the upper right quadrant of figure 8 on page 10 (high performing managers) have over time managed to create an annual additional return of 3 percentage points compared to benchmark, whereas the managers in the lower left quadrant (low performing managers which we seek to avoid) have underperformed by 4 percentage points compared to benchmark generating lower risk adjusted returns over time. The annual difference in return between the high performing managers and the low performing managers is a staggering 7 percentage points, see Figure 11.

Figure 11: Excess return of high and low performing managers



Hence, we expect our investment process to increase the probability of excess return and higher nominal returns. As far as the return attribution of the excess return is concerned, we can split the excess return into active management and sustainability as illustrated in Figure 12:

Figure 12: Excess return attribution



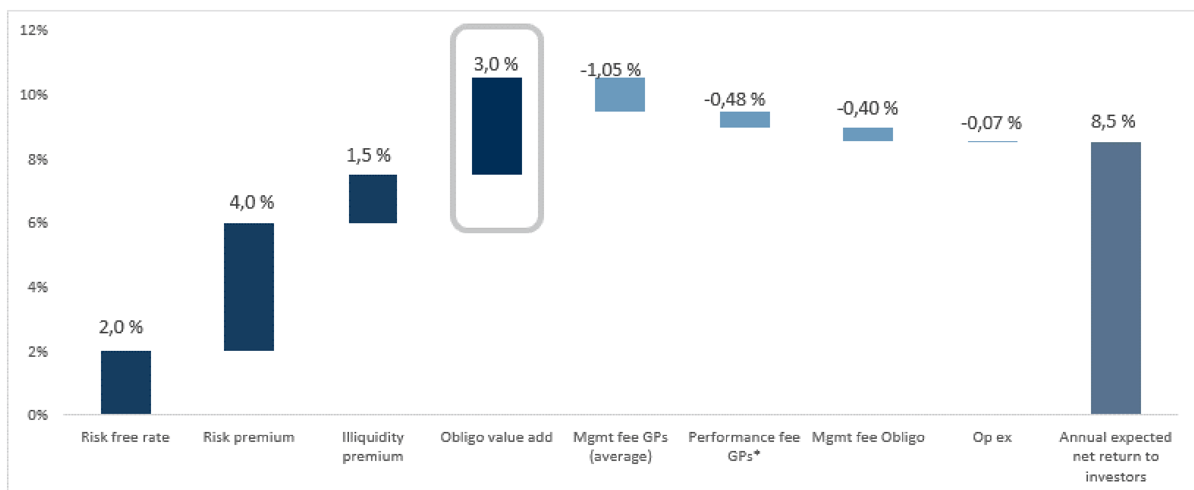
[29] Excess return or alpha, is a measure of how much a fund/manager has under or outperformed the benchmark against which it is compared. By using excess return and volatility risk investors can evaluate a fund/manager's total performance on a risk-adjusted basis.

[30] The benchmark is an equal weighted return series consisting of more than 200 global infrastructure projects from the Obligo database. The projects are diversified by geography, sector, investment stage, revenue models and project size

The figure illustrates that our excess return can be attributed to identifying and selecting the managers that (1) understand and exploit the ESG advantage and that (2) create value through active management. The ESG part creates 1,30 percentage points whereas active management provides 1,70 percentage points of excess return. Next, Obligo is tilting part of the infrastructure portfolio towards the carbon price risk factor (climate change) which is expected to generate further excess returns. Figure 12 illustrates how Obligo is expected to generate investment returns for a sample infrastructure portfolio

We use a modified version of the Capital Asset Pricing Model (CAPM) to generate return expectations for our infrastructure portfolios.[31] We have defined the risk-free rate at 2 percent, the infrastructure risk premium of 4 percent, illiquidity premium of 1,5 percent and the Obligo premium of 3,0 percent. This gives a gross annual expected return of 10,5 percent. After adjusting for different cost elements (management fee to underlying managers, expected performance fees to underlying managers, Obligo flat management fee and operating expenditures) the net annual return is expected at 8,5 percent and 5,5 percent for the benchmark assuming a similar cost structure.

Figure 13: Waterfall – gross and net expected returns



SUMMARY

This research note has explained in detail the elements of Obligo's investment strategy and how we go about implementing it. The strategy rests upon five pillars that all are significant in driving investment performance in terms of expected return and risk. Our exposure to high sustainable infrastructure managers that have the ability to execute efficient active management, we believe, are important in creating superior risk adjusted returns for infrastructure investors.

[31] "Expected return for Obligo Qualified Infrastructure by applying adjusted CAPM," Obligo Research Note 1-19

APPENDIX:

OBLIGO

RESPONSIBLE INVESTMENT POLICY

PURPOSE AND PRINCIPLES

The purpose of this policy is to describe Obligo's commitments and expectations as a responsible investor. A structured approach to environmental, social and governance (ESG) factors help investors, asset managers and individual companies align their interests to create a better portfolio and a thriving world.

We consider ESG issues as a core component of our mainstream investment process; from the identification of new opportunities, due diligence to responsible ownership. Obligo factors in material ESG risks during the investment process to help identify value creation opportunities and generate a high-quality return stream that is likely to be more stable over the long term.

Signatory of:

Obligo is a signatory and committed to implementing the UN Principles for Responsible Investments (PRI).

ACCOUNTABILITY

The Responsible Investment Policy is approved by Obligo's board of directors. The CIO is the owner of the policy and is responsible for the policy being implemented. The CIO is responsible for ensuring that the policy is integrated in all investment analysis and decision-making processes. Obligo sets expectations for its asset managers and portfolio companies.

Obligo´s specific requirements and processes on how to manage ESG factors are set out in our ESG guidelines. The guidelines shall apply to all our investments including external fund managers.

Approved by the Board of Directors:

Obligo Investment Management AS	March 22nd 2019
Obligo Real Estate AS	March 22nd 2019

TRANSPARENCY AND REPORTING

Obligo is committed to the guidelines of the Norwegian Corporate Governance Board. Obligo adheres to high ethical standards and combat all forms of corruption. Obligo shall be transparent and accessible; the company shall engage in dialogue with relevant stakeholders. Obligo will report to the public and investors on its ESG work in accordance with the UN Principles for Responsible Investments.

ETHICAL GUIDELINES

Obligo will not invest in companies contributing to or being responsible for:

- serious or systematic human rights violations such as forced labour;
- violations of international law including in situations of war or conflict;
- severe environmental damage;
- unacceptable greenhouse gas emissions; or
- corruption.

OBLIGO

ESG GUIDELINES

ESG-GUIDELINES IN THE OBLIGO GROUP

PURPOSE AND PRINCIPLES

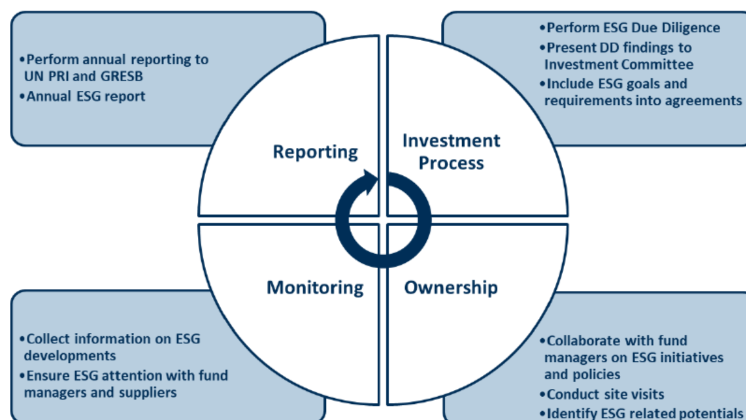
The Obligo Group´s general commitments and expectations are set out in our Responsible Investment Policy. The guidelines describe our specific processes and requirements for considering environmental, social and governance (ESG) factors. Obligo invests in and manages investments in different asset-classes with different investment processes and potential ESG-issues. While the ESG guidelines are developed to apply to all type of investments, the differences between the asset-classes will vastly affect the relevance and hence, implementation of the different parts of the ESG-guidelines.

Obligo is a signatory to the UN Principles for Responsible Investments (PRI). We will:

1. Incorporate ESG issues into investment analysis and decision-making processes
2. Be active owners and incorporate ESG issues into our ownership policies and practices
3. Seek appropriate disclosure on ESG issues by the entities in which we invest
4. Promote acceptance and implementation of the Principles within the investment industry
5. Work together to enhance our effectiveness in implementing the Principles
6. Report on our activities and progress towards implementing the Principles.

INTEGRATING ESG FACTORS

Obligo uses the following model for integrating ESG factors in the investment process:



A. INVESTMENT PROCESS

DUE DILIGENCE

Screening

- Obligo has established an exclusion list for high-level checks and will not invest in companies contributing to or being responsible for:
  a) serious or systematic human rights violations such as forced labour
  b) violations of international law including in situations of war or conflict
  c) severe environmental damage
  d) unacceptable greenhouse gas emissions
  e) corruption

- Obligo has developed checklists for the different asset-classes to screen for high-level ESG factors to identify potential concerns. The checklist includes issues such as environmental impact, litigation, ISO certification, community involvement projects, reputational risks, corruption related incidents, code of business ethics, etc.

Investment deep dive

- Obligo follows a structured process to evaluate ESG risks and opportunities, exposure to potential ESG risks, management of risks and opportunities and benchmarking through GRESB and PRI

- Obligo uses various tools for the ESG analysis:
  a) Due diligence-questionnaires
  b) Obligo's Risk and Return Mapping Model
  c) Management meetings
  d) Site visits
  e) Tailored ESG meetings with external managers

- Use of industry standard ESG due diligence questions from PRI and ILPA

- ESG analysis for specific industries
  a) Infrastructure
  b) Private equity
  c) Real estate
  d) Shipping

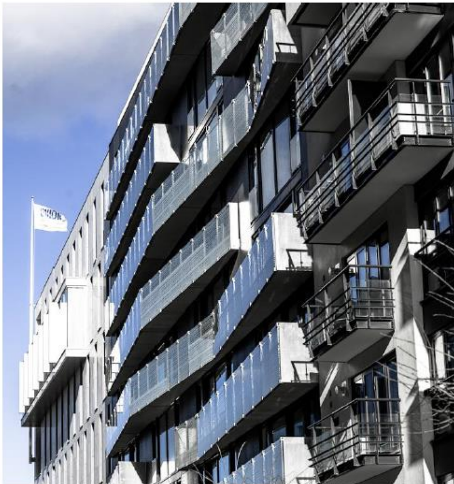
- Enhanced due diligence processes in case of uncertainty or red flags.

INVESTMENT DECISION

- The investment team includes ESG considerations and analysis as standard practice in discussions with investment committee (IC)/external investor
- The IC discusses underlying ESG assumptions, approach, findings and quality assurance procedures
- Unresolved issues are analyzed further and where necessary- external expertise is sought
- All investment decisions have to be in aligned to ESG policies, investment mandate and strategy.

INVESTMENT AGREEMENT

- Obligo shares ESG objectives, policies and practices with portfolio company and/or external manager with the expectation that Obligo's norms and values are adhered to.
- Obligo will share templates from existing industry toolkits with the expectations to integrate ESG clauses into investment agreement
- Obligo seeks formal commitment from portfolio company or external manager by incorporating ESG considerations into the deal documents or through side letters.
- Obligo's goal is to be a leading sustainable investment manager. Hence Obligo will formulate an ESG roadmap with a 3-5-year horizon for external managers or portfolio companies seeking to improve their ESG practices through measures such as PRI signatory, GRESB membership, etc.



B. OWNERSHIP

- Exercise our ownership as an active investor
- Use various approaches to follow up investments through:
  a) Site visits and management presentations/discussions
  b) Collaborate with other shareholders to promote ESG initiatives
  c) Investment committee participation
  d) Promote sector memberships (GRESB, SIFs etc.)
- Develop and implement ESG programs for direct investments
- Collaborate with external manager or portfolio company to set up an ESG programme
- Leverage external manager or portfolio company board to implement ESG initiatives
- Leverage ESG expertise and experience across the portfolio
- Identify and encourage external manager or portfolio company to participate in relevant ESG industry events or processes.

C. MONITORING

- Identify sector or portfolio wide ESG indicators
- Prioritise ESG issues and focus on the most important issues in the short/medium term.
- Ensure ESG considerations are consistently on the external manager or portfolio company's board agenda.
- Provide external manager or portfolio company with tools to monitor and measure ESG practices.
- Collect information on ESG developments from portfolio companies and assetsy through visits/surveys and enquiries to service providers and include in annual review.
- Monitor ESG developments in annual review meetings.

D. REPORTING

- Quarterly Periodic reporting and follow up discussions with external managers/portfolio companies and service providers
- Reporting is based on agreed monitoring parameters and indicators, dependent upon sector and geographical exposure
- External managers and portfolio companies to provide necessary ESG disclosures for Obligo to comply with its reporting requirements to PRI and GRESB
- ESG reporting will form part of Obligo´s annual report

OBLIGO

CODE OF CONDUCT

PURPOSE AND SCOPE

The ethical standards that Obligo Group's employees must respect in their work and in interactions with external parties is defined in this document. The purpose of the Code of Conduct is to maintain and protect the trustworthiness of the group while also encouraging ethical awareness. Obligo's Code of Conduct apply primarily to members of the board of directors, managers, employees, contracted consultants, and others acting on behalf of Obligo. It also applies to persons who provide services to Obligo.

GENERAL PRINCIPLES

Obligo expects all its employees to practice high ethical standards in their work for Obligo and must, at all times, act in accordance with all relevant legislation and with the group's internal rules and investment practices. Loyalty to investors and customers lies at the core of Obligo's license to operate and employees must place client interests before their own.

DISCRIMINATION, HARASSMENT AND BULLYING

Obligo shall be a good and professional place of work with an including working environment and there is a zero-tolerance policy towards all forms of bullying, harassment and discrimination. As an employee at Obligo you shall behave with respect and integrity towards anyone you come into contact with through your work. This includes interactions with the group's business contacts and other external parties.

CONFLICTS OF INTEREST

Personal interests are not to affect your work or lead to personal gain ahead of any work at Obligo. Wherever possible, conflict of interest should be avoided. Conflicts of interest could potentially involve customers, suppliers, partners, present or prospective employees, competitors or other business activities. If there is any risk of conflict, or if an employee is not sure if such situation exists, the employee shall evaluate the situation and notify the immediate superior of the situation arisen.

CORRUPTION

Obligo is opposed to all forms of corruption, including bribery and improper trading in influence. Corruption is illegal and undermines lawful business activities and distorts competition. Obligo shall act in an open, transparent and accountable manner and will work against corruption in all its forms making sure that it has no place in the group's business activities.

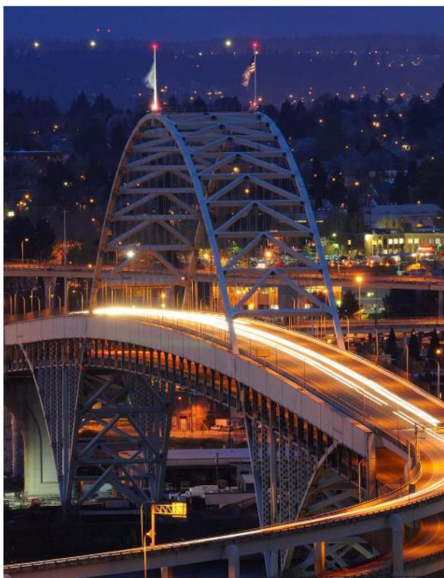
GIFTS AND OTHER BENEFITS

Employees of Obligo or persons acting on behalf of Obligo must avoid receiving personal benefits of any kind with the potential influencing their actions, how they present a case, or make decisions. Obligo is covered by the same requirements when Obligo is the giver of gifts or benefits. Gifts or benefits of a not inferior value should not be given or accepted.

REPORTING AND WHISTLEBLOWING

If anyone at Obligo becomes aware of circumstances where someone in service of the group violates laws, regulations or the Code of Conduct, or displays questionable ethical standards, they are obligated to report it.

If employees do not feel comfortable reporting an unacceptable situation through the formal chain of command or if raising concern here does not lead anywhere, they can use the group's whistleblowing channel. Whistleblowers can choose to remain anonymous.



PERSONAL TRADING IN FINANCIAL INSTRUMENTS

Rules concerning personal trading in financial instruments is covered by the Norwegian Securities Trading Act, Chapter 8 (*Finanstilsynet*). Employees are expected to stay updated with, and follow, all relevant legislation and regulations on this matter, as well as internal rules. This includes, among other things, limitations in trading in companies and funds managed by Obligo and derivatives and reporting of trading in listed and other unlisted instruments.

RESPONSIBLE INVESTMENT POLICY

Obligo has established a policy describing its commitment and expectations as a responsible investor. The policy and associated guidelines set out different processes for considering environmental, social and governance factors and by this assisting the employees to make investment decisions on a more comprehensive and well-informed basis. Obligo expects all its employees to act in accordance with this policy and guidelines.

BOARD OF DIRECTORS AND CEO'S RESPONSIBILITY

All Board of Directors of Obligo Group are responsible for implementing Codes of Conduct that adequately address the principles included in this Code of Conduct in their respective companies. Further, CEOs shall ensure that employees are aware of and comply with this Code of Conduct that adequately addresses the principles herein. Also, CEOs shall ensure that annual Code of Conduct training is conducted for the company's employees, and that all employees, as part of such training or other suitable process, sign that they have read and understood the Code.