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Social Impact Roundtable

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Making an impact in hard times

Fundraising for impact strategies is tough. But as the cost-of-living crisis hits society's most vulnerable people, there is a growing need for private investors to step up.
By Stuart Watson

In spite of the current uncertainty in global markets, delivering positive social and environmental impacts remains high on the agenda of many institutional real estate investors. And tough economic times only serve to intensify the social ills that impact investors are striving to alleviate. For the four managers attending *PERE*'s impact investing roundtable discussion, the opportunities for making profit may be scarcer, but opportunities for doing good still abound.

Social and environmental impacts are inextricably bound with the business of investing in buildings, notes Maya Savelkoul, director, Dutch impact investments at Bouwinvest Real Estate Investors. "Buildings will always have an environmental impact. We cannot avoid that, although we can mitigate it. But buildings are made for people, so there is always potential for positive social impact. The question is, how do you define and measure that?"

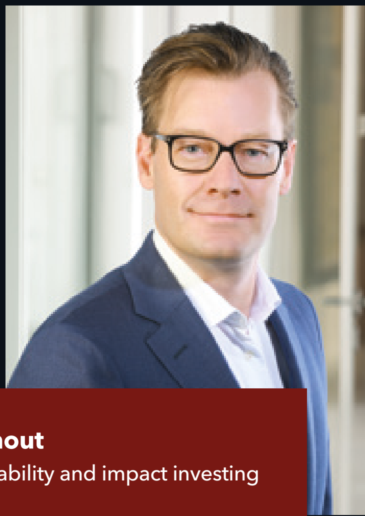
Chris Santer, fund manager for Schroders Capital's Real Estate Impact Fund, argues that when defining impact, a distinction can be drawn between 'social impact' and 'social value.' "Social value is created incidentally to your day-to-day business," he says. "Social impact investments are made with the intention to generate positive, measurable social and environmental impacts alongside financial return. Intentionality is key."

Investors should not get too fixated on the definition of impact investing, suggests Mathieu Elshout, head of sustainability and impact investing at Patrizia. "We all feel intuitively that impact investing is about focusing on the challenges that we face. Housing affordability, for example, is a huge societal challenge in which real estate investors can definitely play a role in the solution. So is the social infrastructure to support education and care. I don't see governments being able to deliver all of that."

Tough fundraising environment

Given the supportive rhetoric around delivering on ESG goals, some managers might have held out hope that investors would continue to allocate plentiful equity to impact strategies despite the turmoil in capital markets and the recent drop-off in fundraising. However, the participants observe that, in reality, impact strategies have been affected along with the rest of the private real estate market.

"The equity raising environment is tough, and impact strategies are not immune. But they do benefit from a tailwind as more investors become interested in impact investing in real assets," says Elshout. "The denominator effect is playing a huge role, so for



Mathieu Elshout
Head of sustainability and impact investing
Patrizia

Elshout joined Patrizia in 2021. The Germany-headquartered global investment manager launched a pan-European impact investment strategy in February 2022 which supports affordable housing, social inclusion and environmental targets. The strategy aims to raise €500 million in equity and has already invested in social and affordable housing development in Dublin, Ireland.

Michel Greter
ESG real estate lead
Partners Group

Greter joined Switzerland-headquartered private markets manager Partners Group in June 2022. ESG considerations, with a focus on occupant wellbeing, are embedded in the firm's due diligence and value creation approach across its $17 billion portfolio of real estate assets.

Maya Savelkoul
Director, Dutch impact investments
Bouwinvest Real Estate Investors

Savelkoul joined Bouwinvest in 2021. She was tasked with overseeing the launch of the Netherlands-headquartered manager's impact initiative in December 2022. The strategy aims to create sustainable real estate that also has a positive social impact by improving community wellbeing through creating affordable and healthy homes, care homes and public amenities.

Chris Santer
Fund manager, positive impact investment, real estate
Schroders Capital

UK-based investment manager Schroders Capital hired Santer in June 2022 to lead its real estate impact strategies. Its first such vehicle, the UK Real Estate Impact Fund, was launched in November and aims to address regional inequality through investment in real estate assets in more deprived areas of the country.

some investors it is difficult to allocate to new real estate strategies. Fortunately, there are still investors looking for social impact who are willing to crack on and commit to a fund."

Delivering environmental and social benefits has moved "a notch down on the priority list" for some investors, says Michel Greter, ESG real estate lead at Partners Group. "If an investor needs to refinance a substantial chunk of their portfolio in the midst of this challenging environment, then they are going to find it difficult to commit to a new kind of product. Allocation and reallocation will continue to be the key topic for the next few months, or potentially longer."

Investors are currently erring on the side of caution, particularly because impact funds are still at a relatively early stage in their evolution, so there is relatively little data to establish their track record. That will build up over time, says Santer. Meanwhile, investors still have an appetite to learn more about the characteristics of this kind of investing, which they may find offers commercial benefits at this point in the economic cycle.

> *"In times of stress, the need for impact investing increases, while the rationale for it becomes clearer"*
>
> **CHRIS SANTER**
> **Schroders Capital**

"In times of stress, the need for impact investing increases, and these funds can produce attractive returns, which are generally less correlated to the economic cycle and less volatile than those for some regular real estate investments. In addition, there are currently opportunities to invest at entry prices well below replacement cost, which provides further downside protection," he argues.

Elshout notes that while this is a tough environment for investors to make commitments, some are using the breathing space to establish a better understanding of how impact investing works. They are also examining how to generate positive impacts across their existing portfolios, especially through decarbonization.

This is a good moment to be raising equity for value-add funds, he argues, because the market has already corrected, and decarbonization is a crucial element in most such strategies. "Those themes do resonate with investors and are well received. Even though that is not an impact product, that kind of initiative will have an impact for sure."

In the Netherlands, decarbonization is now an established part of the standard investing method, says Savelkoul, but investors' grasp of social impact is less well developed. "It is new, and each investor has their own way of doing it, so it is hard to get them all aligned on a shared approach to social impact."

Impact as a theme

Real estate impact investing is still a nascent segment of the market, and consequently, managers have yet to settle on a standardized approach to fund structuring. Should impact funds be standalone vehicles, or should impact apply across portfolios as a whole? Should structures be open- or closed-end? And what can be properly branded an impact strategy?

Three of the managers participating in the roundtable have dedicated real estate impact strategies. The fourth, Partners Group, has so far taken a different tack, explains Greter. "We look at impact as an investment and operational theme, and try to integrate it across our activities." As an example, he cites the provision within a larger scheme of a coffee shop that provides jobs and training for homeless people.

Investor emphasis has gradually shifted from responsible investing to sustainable investing, and now to impact investing, observes Elshout. Large investors increasingly add impact to their investment considerations, weighing risk, return and impact in so-called '3D' investing, he argues. "For

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> **MATHIEU ELSHOUT**
> **Patrizia**

many investors the UN Sustainable Development Goals are very important, and they want all or part of their investments to contribute to them. They don't just want to create an impact investing portfolio; they want to demonstrate impact throughout the portfolio."

Patrizia recognizes that aspiration by applying the framework it uses for pure-play impact funds across its mainstream funds, so that the firm can demonstrate the contribution to positive impact that those strategies are generating as well.

Bouwinvest has adopted the same approach, says Savelkoul: "The whole industry is changing. I hope that what is impact investing now will be the market standard in five years."

The key distinction between a cross-portfolio approach and a dedicated impact fund remains intentionality,

Highly valued, hard to value

Participants consider the measurement issue

While benchmarks for the environmental aspects of impact investing are increasingly widely recognized, a shared set of metrics for social impact are still some way off. Elshout, a board member at the GRESB Foundation, says that while benchmarking can be a powerful tool, investors are more focused on KPIs linked to each individual strategy. "They want measurements that allow them to demonstrate tangible results, rather than industry-wide standards," he argues.

Santer agrees being able to show a strategy is delivering on its intentions is crucial. "We work through a checklist of potential impacts focused on people, planet and place. How we can best measure those intended outcomes and report on them is a core part of our governance," he says.

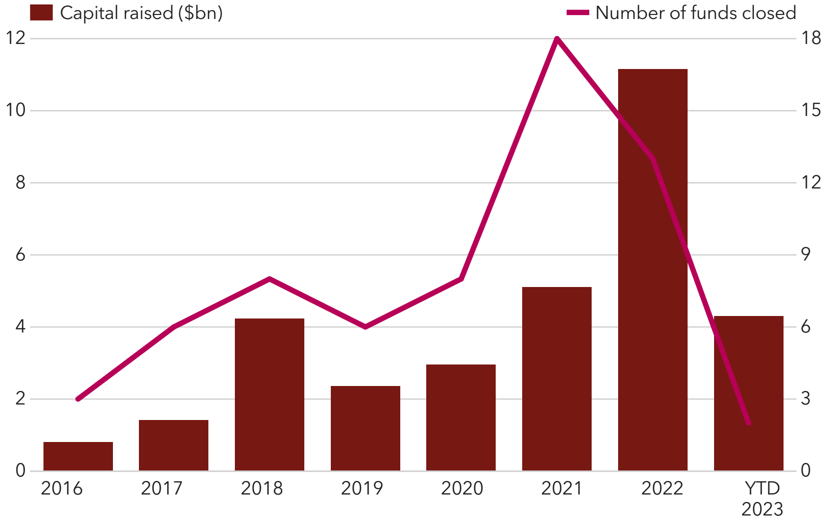
Savelkoul raises the question of how to evaluate impact over time: "Affordability is defined in relation to the proportion of their income that the people occupying homes spend on housing costs. To create affordable homes, you need to know about the incomes of the people occupying them. But you only check that at the beginning. Is it desirable or possible to do so later, when the impact is a work in progress? And if we keep that information, how do we address the issue of data privacy?"

"Measuring impact is always going to be hard," says Santer. "I heard a great phrase coined: 'highly valued, hard to value.' I am sure measurement will evolve and improve as we do more impact investing though, so that eventually we will be able to measure it like we can measure environmental impacts today."

Greter believes a GRESB-like benchmark for social impact will emerge, and that evolution will be quicker than for environmental factors. "It will be a similar transition. But a lot of things we do on the environmental aspect of ESG also touch the social side because they are linked, which will increase the speed of the learning and knowledge trajectory among investors."

however, argues Santer. "Like everyone else here, we are incorporating social value and social impact throughout our real estate funds. But, for example, those funds would not identify the local authorities in the UK with the 10 longest waiting lists for social housing and then work with the local housing associations to address that. By having an impact fund with a distinct decision-making process, we can find different, more impact-focused investment opportunities."

Article 9 and impact-focused funds are on an upward trajectory, but 2023 may prove to be a difficult year for capital raising



Source: PERE, data as of June 13

Structure follows strategy

As a group, the participants are agnostic on the issue of open- versus closed-end structures. "It is possible to have a positive and measurable social and/or ecological target in both," says Savelkoul.

"Structure follows strategy," is Elshout's view. Investors in Patrizia's affordable housing development strategy preferred to recycle their capital within a limited period of time rather than retaining assets, so the manager chose a closed-end structure. "An open-ended vehicle could also work, but then you would need to get to substantial scale quickly to create liquidity, and that is quite difficult if you are only focused on development."

Schroders Capital opted for an open-end structure and a diversified strategy for its impact fund. "Every situation requires slightly different solutions and time horizons. We didn't want to be constrained by benchmarks or timelines. We can trade assets once we have optimized impact and want to reinvest in different projects," says Santer.

"That open-ended structure is also more amenable to some of the stakeholders that we deal with, like local authorities, housing associations and community groups, because they understand that we are making a longer-term commitment."

Greter also sees the appeal of longer-term structures: "With social impact you sometimes need a longer

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> **MAYA SAVELKOUL**
> **Bouwinvest Real Estate Investors**

timeframe to make a measurable difference."

Classifications and taxonomies

Not all funds with 'impact' in their title qualify as genuine impact funds, argues Savelkoul. In one case, she observes, a manager branded a vehicle as impact because the assets within it had good Energy Performance Certificates, reducing tenants' energy bills. "That is not really social impact. Green-, or in this case social-, washing is a big risk. Merely putting an impact label on a fund is not the Holy Grail. It does not change the world."

The UK Financial Conduct Authority asked Schroders some "probing questions" before accepting that its strategy could legitimately be labeled an impact fund, says Santer. He identifies variations of emphasis between the EU Sustainable Finance Disclosure Regulation and the proposed UK equivalent, the Sustainability Disclosure Requirements, as a potential headache for funds that invest in the UK with EU capital. "The sooner we can get these classifications and taxonomies sorted, the sooner we can allay concerns that some organizations may be greenwashing and move forward."

There is a widespread and erroneous belief among investors that for a strategy to be an impact fund it must qualify for SFDR Article 9 status, adds Greter. "That is the epitome of what is wrong, because it involves requirements that a legitimate impact fund may find impossible to meet. The fund manager needs to clearly define what their intention is, so that if an investor really wants to make a proper evaluation of the impact the strategy is producing, they can do so."

However, Patrizia went to considerable effort to ensure that its impact strategy qualifies as an Article 9 fund, says Elshout. "Many investors looking for an impact product believe it should be Article 9, but it is definitely also possible for an impact fund to be Article 8. The investor should be questioning the manager and really getting into the detail so they can decide if the fund is delivering the specific impact they are looking for."

Coordinated action

There is much that real estate investors can potentially contribute toward solving some of society's problems. But the participants acknowledge they cannot do it alone. National governments, municipal authorities and other public sector bodies all have a crucial role to play. Construction costs have soared, while both the availability and affordability of debt finance have been squeezed by rising interest rates and turmoil in the banking sector.

Patrizia is investing in Ireland, where the government is launching a program to support affordable home building. "It is a lot more difficult to deliver affordable homes without government support, so all actors need to be working in an orchestrated way, to create the

> *"Impact investing requires stability. There needs to be long-term transparency from government around what the rules will be"*
>
> **MICHEL GRETER**
> **Partners Group**

Atelier Gardens, Berlin: once upon a film studio

SOURCE: MVRDV

Social entrepreneurship in action

Participants select projects demonstrating how real estate development can have a positive impact

Michel Greter: Sistrunk Marketplace and Brewery, Florida, US. Situated in a historically African American neighborhood of Fort Lauderdale, two converted warehouses are home to a dozen South Florida food concepts: "It is a redevelopment that really brought together the whole community to support it, creating jobs through entertainment and hospitality to help the transformation of the area."

Maya Savelkoul: Developer Ardstone's projects in Dublin, Ireland. Ardstone's Residential Impact Fund focuses on addressing the undersupplied social housing and mid-rental segments across Ireland: "It is a great example of how public and private sectors can work together, with both the developer and the city of Dublin contributing toward ensuring that the housing is affordable."

Mathieu Elshout: Atelier Gardens, Berlin, Germany. A 110-year-old disused film studio is being transformed into a social entrepreneurship campus due for completion in 2024: "It brings people on site that want to make a change, are creative and work on local social and environmental initiatives. It is also designed to renature the site through the creation of rooftop gardens and using naturalistic planting for soil decontamination and remediation."

homes for which there is such a clear need," says Elshout.

Delivering a wide-ranging initiative like the UK's Levelling Up agenda requires coordinated action, says Santer. "Schroders is seeking to play a core role in regenerating areas. That requires the integration of infrastructure investments, optional finance structures and other things like renewable energy generation. We are a part of the jigsaw. Government, through initiatives like the Town Centres Fund and the High Streets Fund, is often also investing into areas where we are involved, aiming to spark that virtuous circle of further development and improvement."

Predictability of policy is crucial, says Elshout. "We are all aware of places where the market has come to a halt almost overnight, because when returns are modest, if there is a sudden shift in regulation, that can quickly render a business plan unviable. That pushes out capital because investors sit on their hands and wait to see what changes might happen before they are willing to step into the market again."

In some cases, legislative change can be beneficial, but it is a fine line, notes Savelkoul. In the Netherlands, real estate investors mostly serve the higher end of the housing market, and social housing serves the lower-cost segment, but there is very little provision in the lower middle.

"New regulation is on the way aimed at increasing the number of mid-market affordable homes.

"However, the real estate market is also faced with rising costs and staff shortages," she says. "By increasing regulation, the government may increase the short-term pressure on the market. Regulators should focus on consistency of policy and reducing risk."

Relationships with the public sector are enhanced if there is understanding and transparency on both sides, argues Greter. "Impact investing requires stability. There needs to be long-term transparency from government around what the rules will be. But there also needs to be an understanding that there will be disclosure and ethical conduct from the private market player. Undertaking joint projects is difficult without that alignment."

Impact investing remains a modestly sized niche within the wider market. However, there is no doubt that it is drawing increased investor focus, despite, or perhaps because of, the tumultuous times.

If the roundtable participants are correct, and social impact follows a similar growth trajectory to environmental improvement, then within a short period of time it could become embedded in the mainstream real estate investing practice. ■