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Natural capital focus:

Investing today for tomorrow's planet

Gresham House head of UK institutional sales, Claire Glennon

Turning to natural capital

Claire Glennon explores the strong institutional demand for natural capital investments

Investors are turning their attention to natural capital as the depletion and damage to global natural resources are fast translating into financial risks. Nature has subsidised our growth to its serious detriment, creating another existential threat, inextricably linked with climate change.

Furthermore, as a result of new regulation and the introduction of voluntary frameworks that place a value on nature, it is becoming apparent that it is possible to deliver a financial return by investing in nature.

Natural capital markets

The WWF (WFF) estimates that, globally, nature provides services worth around US$125 trillion a year.[1] Yet, nature markets today are valued at only $9.8 trillion, 11% of global GDP, which is mostly derived from commodity production including agriculture and timber.[2] The difference between these two values shows we are far from understanding the true value of nature.

Investors are also recognising that existing nature markets are not always good for nature. Currently close to $7 trillion is invested globally in activities that have a direct negative impact on nature, compared with approximately $200 billion in flows into nature-based solutions.[3]

New nature markets are establishing themselves and growing, for example carbon credits and sustainability linked bonds. Looking forward, it is expected that future nature markets will vary significantly from where they are today. Climate change commitments will be a key driver of these changes. These new nature markets will either be based in regulatory requirements or through voluntary ambitions from businesses to do better for nature, both with differing underlying risk profiles for investors.

Recent research

We recently teamed up with mallowstreet, a community for the institutional investment industry, to look at investor appetite for natural capital investments in institutional portfolios. mallowstreet spoke to 22 UK asset owners representing more than £360 billion in assets; half said they already invest in natural capital or will do so within the next 18 months.

Key findings include:

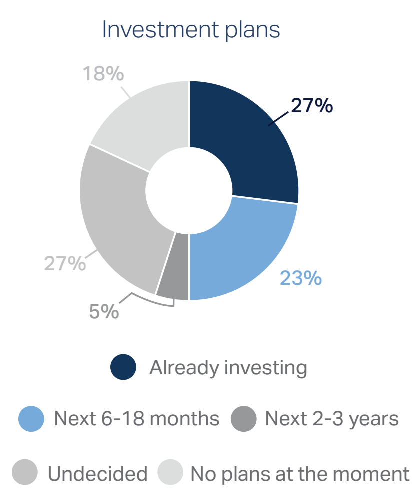
- 50% of UK asset owners are either already investing in natural capital or will do so within the next 18 months
- 73% of UK asset owners would invest in natural capital to support climate adaptation
- 59% would allocate up to 3% of assets to natural capital

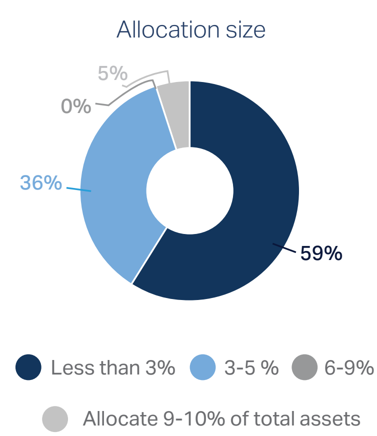
The research shows strong backing for the asset class, as investors become increasingly aware of natural capital's potential to deliver resilient, impactful returns.

Alongside financial performance, the report found that supporting climate adaptation and mitigation was the biggest driver of investment in natural capital, followed by the good stewardship of members' assets and reducing nature-related investment risk. Allocations to natural capital are likely to comprise 3% to 5% of total assets, with 59% of the surveyed asset owners saying they would invest up to 3% and an additional third potentially investing up to 5%.

The survey revealed a range of approaches to investing in natural capital among institutional investors. Local government pension schemes would typically invest in natural capital via illiquid assets, with 33% putting an allocation in real assets and a further 25% would put an allocation in the private markets bucket.

23% of UK investors would allocate to the asset class via growth assets, while 18% would align it to an impact





allocation, highlighting the need for a wide range of liquid and illiquid strategies to cater to different investors' requirements.

The study also explored institutional investors' attitudes to carbon and biodiversity credits, finding overwhelmingly that investors prefer to generate their own credits from their investments, rather than buying them. 52% of investors said they would primarily generate credits to offset nature loss or emissions in their portfolio, while 48% would sell the credits they generate to deliver a return. However, investors remain keen to see a more formal international market and consistent global standards to increase confidence in trading these assets.

Conclusion

Society cannot continue to extract from nature at its current pace and prosper. The loss of nature globally is rapidly becoming a financial risk that investors are starting to take note of and therefore, want to find ways to allocate to assets that create positive outcomes for nature, and also meet their return ambitions.

As we better understand how to place a value on nature, the opportunities for investors to allocate to natural capital assets are increasing. This is not just a trend, but we believe to be a crucial aspect of a modern investment strategy. The ability of institutional investors to invest for the long term at scale uniquely positions them to allocate capital to make a difference to nature.

Gresham House is the world's ninth largest natural capital manager by value, offering clients a platform of varied return-generating natural capital assets with established track records, including sustainable forestry, sustainable agriculture, carbon forestry and biodiversity creation.

Written by Gresham House head of UK institutional sales, Claire Glennon

In association with

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[1] WWF Living Planet Index, October 2018
[2] Taskforce on Nature Markets, Global Nature Markets Landscaping, December 2022
[3] Study UNEP State of Finance for Nature 2023 report

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Investments that root for nature

As awareness of climate and nature-related risks grows, natural capital investments are on the rise. Niamh Smith explores how to invest in this theme to benefit both members and the planet

Summary

- While biodiversity investments aim to protect and restore ecological diversity, natural capital investments focus on ecosystems, both on land and in water.
- The emerging nature of the investment theme poses certain barriers to investment, however innovation is helping to overcome them.
- Investing in projects to protect natural capital benefits members, by generating financial returns, and the planet by preserving natural landscapes and mitigating climate change.

Looking to the future is an intrinsic aspect of pensions. From the moment someone starts contributing to their pension pot, they naturally start to envision what retirement might look like.

However, increasing numbers of members are expanding their forward-looking focus beyond personal financial outcomes and are now considering how their investments of today will have an impact on the planet of tomorrow.

As a result, environmental, social and governance (ESG) investments have boomed over the past few years, with biodiversity gaining attention even more recently. Now, however, a new consideration is coming into play: Natural capital.

This shift has also been spurred on by the Taskforce on Nature-related Financial Disclosures. These guidelines encourage businesses to assess, report and act on their nature-related dependencies, impacts, risks and opportunities, effectively bringing the topic of natural capital into the spotlight.

So far, Local Government Pension Schemes (LGPS) are leading efforts to invest in the protection and restoration of the natural landscape, with several funds allocating to tailored strategies in recent months.

What are natural capital investments?

Nature-based investments aim to protect, sustainably manage, or restore natural ecosystems – whether that be land-based or water-based – and address challenges related to climate change, human well-being, and biodiversity, according to Redington vice president of manager research, Celine Grace Legaspi.

Gresham House CEO, Tony Dalwood, adds that current natural capital investment strategies include forestry and carbon credits, sustainable agriculture, ecosystem services and voluntary and mandatory biodiversity net gain investment.

He highlights the importance of investing to protect natural capital because it encompasses all the world's natural assets, which, combined, provide a flow of benefits to people.

"From clean air and water to fertile soil and pollination, every component of nature sustains life. These benefits have tangible economic and societal value that is not accurately reflected in existing and traditional financial markets," he says.

The additional benefits of investing in natural capital include the regeneration of ecosystems, such as forests and rivers, which provides essential services like flood mitigation, water purification and carbon sequestration, adds Rebalance Earth CEO, Robert Gardner.

"Natural capital becomes an investable asset class by recognising nature's capacity to deliver measurable economic value. This approach addresses both climate adaptation and mitigation while supporting nature restoration," he says.

Gardener notes that natural capital differs from purely biodiversity-focused investment strategies, which are typically narrower in scope, focusing on protecting and restoring specific species and habitats to maintain ecological diversity.

"While biodiversity is a crucial element of natural capital, natural capital investments take a more holistic view, encompassing the full range of ecosystem services that directly benefit businesses, cities, and communities," he says.

In addition, the term 'natural capital' is typically used when referencing real asset investments, such as forestry farmland, carbon projects and blue economy, adds Legaspi.

Practicalities

As with many emerging investment

themes, natural capital investment faces barriers due to its nascent stage, namely the lack of maturity that means there are gaps in knowledge and uncoordinated approaches to data collection, measurement and monitoring.

However, Legaspi notes that this shouldn't deter investors from considering it as an option, instead highlighting how it is important to look beyond track records.

Gardener agrees that investors need to adapt their thinking when approaching these strategies, noting that a longer-term investment perspective is particularly is helpful.

"Investors must also adopt a patient capital mindset, as returns from natural capital investments may take longer to materialise but deliver significant long-term benefits in terms of climate resilience, risk reduction, and ecosystem restoration," he says.

Getting it done, despite the challenges

Even though practicalities exist, asset managers are actively investing in natural capital, demonstrating that these barriers can be overcome.

In addition to maintaining a long-term vision, asset managers are utilising innovative financial instruments, adapting their offerings and developing new solutions to meet the demand for these investments.

Gresham House, which is the ninth largest natural capital manager globally by value, facilitates investments by providing clients with a platform of return-generating natural capital assets.

"Each asset has different risk and return profiles and outcomes for nature. We work with our clients to provide access to these options to create their natural capital portfolios, which promote the transition towards a more sustainable economy," Dalwood says.

Benefitting members and the planet

Investing in natural capital offers dual benefits: It has the potential to deliver financial returns for members, while actively contributing to the preservation and enhancement of the environment.

Financially, investing in projects to restore natural capital generate returns through carbon credits, biodiversity net gain units and payments for ecosystems, Gardner says.

Legaspi adds that nature-related sectors are also backed by strong market fundamentals, such as population growth and decarbonisation, have low correlation to traditional asset classes, and may act as an inflation hedge, in the case of forestry and agriculture.

Dalwood agrees that the targeted sectors typically provide opportunities for investors.

"With growing demand, constrained land resources and agriculture's historically stable returns could provide a unique investment opportunity that has the ability to preserve investor capital through economic cycles relative to other sectors," he says.

Gardner adds that, from an environmental perspective, these investments help mitigate climate-change risks, such as flooding, droughts and biodiversity loss, while enhancing ecosystems.

"For instance, investing in natural flood defences allows cities and companies to protect valuable assets while reducing reliance on costly grey infrastructure," he says.

Gardner notes these projects often have broader social benefits, such as creating green jobs, improving public health, and restoring ecosystems that provide cleaner air and water for communities.

However, Dalwood cautioned that measuring the impact on nature can present difficulties.

"Putting a value on nature is complicated, but market participants can be incentivised to avoid causing further damage, to reduce unavoidable impacts and take action to restore and regenerate nature, whilst at the same time demonstrating good stewardship of clients' assets," he says.

Investing in natural capital goes beyond generating returns for members and protecting the natural landscape; it's also about tapping into a rapidly growing trend that shows no sign of slowing down.

Legaspi says population growth, the growth of the middle class, the shift to a low-carbon economy and rising land prices are among the primary factors driving the growth in value of natural capital investments.

The growing need for climate adaption and resilience, combined with ambitious net-zero and nature conservation targets are also accelerating demand for nature-based solutions, adds Gardner.

"As climate and nature-related risks gain wider recognition, asset owners, such as the LGPS, defined contribution schemes and wealth managers, increasingly seek to build resilience into their portfolios," he says.

Gardner notes that pension funds are well-positioned to lead this movement by allocating capital toward nature-based solutions that align with their long-term investment horizons and sustainability mandates.

Dalwood agrees that asset managers are at the forefront of this initiative, noting that Gresham House's research, in collaboration with Mallowstreet, revealed that 50 per cent of asset managers are either already investing in natural capital or will do so within the next 18 months.

"The expected allocation would be between 3-5 per cent of the total investment portfolio and we expect this to grow meaningfully over time given the nascent nature of this market," he says.

Written by Niamh Smith, a freelance journalist