Social infrastructure: A framework for measuring and managing impact

Investments in social infrastructure can deliver market rate, or better, financial returns while making a positive contribution to communities and the environment. But to achieve this dual return, investors need to be able to measure and manage their social and environmental goals, writes John Levy

The investment opportunity in social infrastructure

Since the 2008 financial crisis and its aftermath, governments across Europe have been struggling to meet the growing demand for the building blocks of strong communities – affordable housing, schools and libraries, and hospitals and nursing homes. Government cutbacks opened an investment gap in social infrastructure estimated at €150 billion a year, according to the EIB. Institutional investors are stepping into the breach.

Between 2009 and 2016, private investment in social infrastructure grew to €247 billion, according to Preqin data and McKinsey. Of the 1,264 deals completed globally, 71 per cent were in Europe – the top region for this growing asset class.

These assets are particularly attractive to long-term investors because they offer a dual return: a market rate financial return that typically comes from long-term lease contracts, and an impact return, which is the measurable improvement in the quality of life of communities resulting from investments that upgrade a school or a hospital, for example, or increase the supply of social housing.

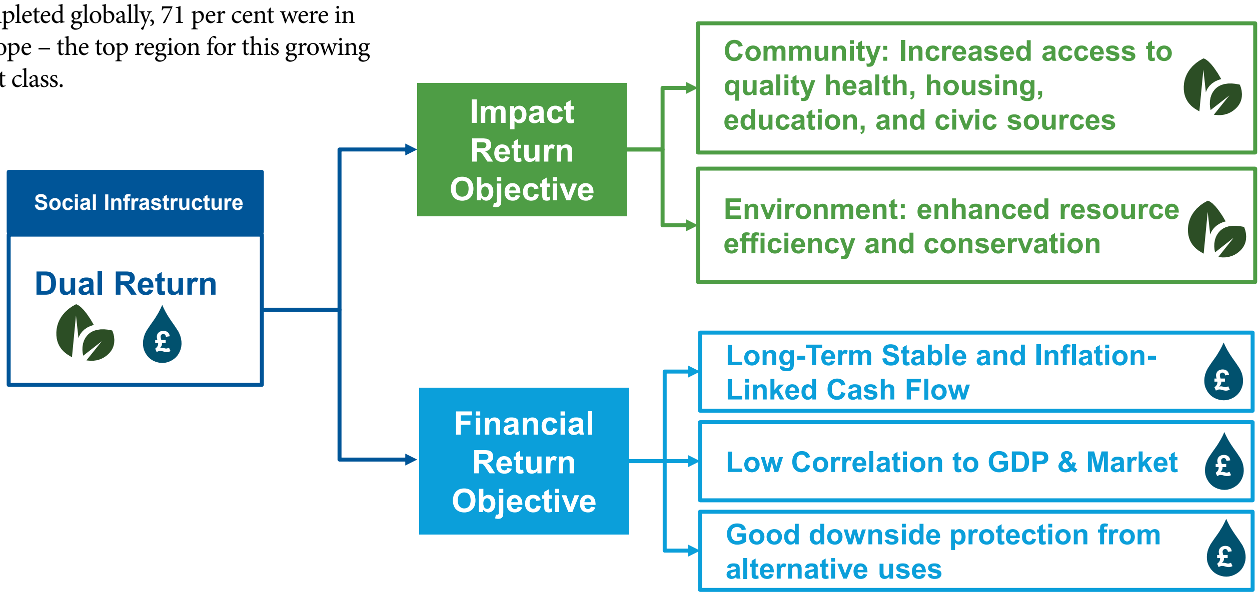
The tools we have to measure financial performance are straightforward. But how should we measure the social and environmental impact of investments in social infrastructure?

Towards a framework for measuring impact

Impact investing is a relatively new field, and like many frontier disciplines, it suffers from varying expectations of investors, a fragmentation of approaches and a lack of standardisation for measuring and managing the social and environmental outcomes of investments.

Efforts are under way to define potential and actual impacts but we still lack the long-term data that would allow investors to compare the results of different approaches to impact investing.

At Franklin Templeton, our real assets team adopts a three-step framework for the impact opportunity



in social infrastructure investments: identifying the challenges, defining our potential contribution to solutions, and finally achieving an impact, which we measure and manage throughout the life of each asset.

The challenge

It is important to begin by identifying the challenges we seek to address. We group these challenges into two categories – community and environment. All the challenges we seek to address are aligned with the United Nations' Sustainable Development Goals.

The community challenge is clear: there is an inadequate supply of quality social infrastructure in Europe. The environmental challenge has many dimensions – global warming, water scarcity, biodiversity, to name but a few.

Take climate action. By many measures, buildings use more energy than either industry or transport and account for 20 per cent of global greenhouse gas emissions, according to the World Economic Forum. Buildings also generate 30 per cent of all the waste in the EU. Our climate challenge, therefore, is to reduce the climate footprint of social infrastructure assets.

The contribution of investors and managers

Once we have identified the challenges, we need to define the ways in which we can make a difference. Here are five broad ways in which we can do so.

1. Aligned long-term capital

First, as investors and managers of social infrastructure assets, we can align our long-term capital in order to be reliable stewards of the assets we hold. In some arrangements, like a buy-and-lease-back, we can free up much-needed public capital and provide liquidity to municipalities.

2. Function enhancements

Second, we can create a positive impact through renovations and upgrades. Examples include creating more useable space, improving the comfort and utility of space for tenants and service users and finding alternative uses that benefit the broader community.

3. Environmental upgrades

Building upgrades can also create a positive environmental impact by reducing pollution, saving water and materials and supporting biodiversity. Examples include installing energy efficient systems, creating green space, promoting recycling and responsible disposal of waste and many others.

4. Purpose-driven development

Select investment opportunities may arise for purpose-driven developments, such as converting a warehouse or factory into buildings with a social purpose.

5. Tenant & community partnerships

Stakeholder engagement is the fifth, crucial, way in which social infrastructure investors and managers can make a difference. Tenant and community partnerships, for example, can help investors identify the need for co-working spaces or childcare facilities.

By ensuring that investments include one or more of these five actions, it is possible to track how investments are better serving communities and the environment.

Impact must be managed, not just measured

We believe that achieving positive outcomes requires fully integrating impact management into the investment process. At Franklin Templeton, we do this with tools that give us continuous feedback on our impact objectives, measuring our progress in a way that allows the roadmap to be corrected or reassessed as needed. We believe this is the best approach to align investment and impact considerations at every step.

We are clear that we will not be able to pursue all possible avenues of impact, since some may not be economically viable. To this end, we have created an internal impact rating system that measures the current and projected state of each asset's community and environmental performance. Progress can be quantified by tracking key performance metrics over time.

Social infrastructure plays a critical role in the health and vibrancy of local communities. As physical assets, they also have an impact on the health of our planet. By bringing impact-focused private capital to the social infrastructure space, the community and environmental performance of these assets can be markedly improved. But in order to achieve social infrastructure's full potential for positive outcomes, non-financial impacts must be measured as well as managed.

More information: franklintempleton.co.uk

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The value of investments and any income received from them can go down as well as up, and investors may not get back the full amount invested.