IMPACT LENS
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Impact investment performance – a UK asset owner & investment consultant perspective

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Impact investment performance

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Executive summary

Impact investment performance – a UK asset owner and investment consultant perspective

Pensions for Purpose's latest research paper, co-sponsored by *Aquila Capital*, *AXA Investment Managers*, *Baillie Gifford*, *Franklin Templeton*, *Resonance* and *Vontobel Asset Management*, seeks to show the financial performance of impact funds under the generally accepted definition of impact investments:

Definition

impact investments *n.*
investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return

The report compares impact funds' performance with the broader universe to establish whether 'impact investment' does indeed meet trustees' fiduciary duties to deliver the best risk-adjusted returns over time.

Data collection

We gathered investment performance data from 17 asset managers with UK pension fund clients, based in either Europe or the US, collectively £18.6bn in impact assets under management (AUM).

The objective of the data collation was to dispel the myth investing with an intentional impact goal alongside financial return is detrimental to performance. The data collected covered listed equity, bonds, private equity, real estate and infrastructure funds across a number of different geographies.

Table 1 | Summary of our results

Asset class	Principle focus of impact	Cumulative investment performance *(net of fees)*
Listed equity	Renewable energy, energy efficiency, green buildings	**Outperformed** *FTSE All-World Index*
Bonds	Sustainable agriculture, renewable energy, energy efficiency and health	**Outperformed** *FTSE Euro Broad Investment-Grade Bond Index* **Performed broadly in line with** *FTSE World Broad Investment-Grade Bond Index*
Private equity	Renewable energy, energy efficiency, health and sustainable forestry	**Outperformed** *FTSE All-World Index*
Real estate	Affordable housing and green buildings	**Outperformed** *Acadata Index + 2.5% annual rental yield and FTSE EPRA NAREIT Global Index*
Infrastructure	Renewable energy, health, affordable housing and education	**Performed broadly in line with** *FTSE Global Core Infrastructure Index* (GBP and EUR)

Data until March 2023

Additionally, we interviewed six UK pension funds and four investment consultants for qualitative analysis to supplement our performance data findings.

We reviewed the cumulative average performance of impact funds in each asset class, since inception, and compared this to an appropriate benchmark that would be a close proxy for measuring performance for a non-impact fund – *see table 1, on page 4*.

Investment performance results

The cumulative investment performance results are consistent with academic research, which suggests there is no reason why impact funds should not achieve competitive risk-adjusted returns compared to conventional funds.

Pensions for Purpose disclaimer

To the extent that anything in this report constitutes a financial promotion it is exempt from the general prohibition in S21 of FSMA on the basis that the report is only intended for investment professionals as such term is defined in S19 of the Financial Promotions Order. Please note that Pensions for Purpose does not provide consultancy services, advice or personal recommendations on any of the investment opportunities mentioned in this research. We collaborate on research projects with our members, we do not endorse any underlying funds.

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1 Introduction

Why did we conduct this research?

There are myths around why some asset owners do not invest with a positive impact objective alongside generating a financial return.

The first misconception is impact investing and fiduciary duty are incompatible, particularly for private pension funds. However, there is plenty of evidence to suggest legal considerations can be overcome if a robust process is followed[1]. Additionally, our previous research shows while some asset owners and investment consultants are unaware of impact investing opportunities, this position is changing. Indeed, we hope this report will help to continue the trend.

The second myth is investing with a positive impact objective is detrimental to generating a financial return commensurate with funds that do not have an explicit positive impact objective. This paper seeks to address this question while also considering the additional benefits, apart from implicit positive environmental and/or social advantages, an impact allocation brings – for example, diversification, lower volatility and member engagement.

While it is true many funds with an explicit impact objective are relatively new and therefore lack a long-term performance record, our researcher contacted 80 asset managers, received 33 responses to our initial survey and collated data on 17 impact managers' performance across five asset classes:

- Listed equity.
- Bonds.
- Private equity.
- Real estate.
- Infrastructure

(One criteria for a manager to be included in our research was that they had current AUM from UK pension funds in their impact fund. Others were excluded as they were unwilling or unable to share performance data).

The 17 asset managers were based in Europe and the US. Asset managers in the sample managed up to £18.6bn in impact AUM with an average of £337.6-£142.9mn at the median – showing significant differences in the size of AUM across participating firms. These findings were then supplemented by interviews with six UK pension funds and four UK-based investment consultants to gain their insights into the financial performance of impact investment funds.

REFERENCE

1 Impact Investing Institute

The GIIN's experience and previous research

What do they think is important for the UK pension fund sector?

Institutional asset owners are increasingly pursuing impact, transitioning from portfolio carve-outs to holistic approaches of applying an impact lens across their total portfolios. Pension funds globally are navigating a world in which the social and environmental context of their investments ultimately affect portfolio value. And pensioners are demanding that their pension funds and trustees consider social and environmental factors that will affect the world into which they retire. As such, the impact investing industry is seeing greater flows of capital from pension funds and insurance companies – who hold significant pools of capital and wield immense power – toward impact strategies. According to the 2023 GIINsight: Impact Investing Allocations, Activity & Performance report, in 2022, pension funds accounted for the greatest proportion of impact investment managers' capital at 20%, followed by family offices (15%), development finance institutions (14%), insurance companies (7%) and banks (7%), demonstrating the role that pension funds can – and do – play in driving social and environmental outcomes[1].

Pension funds and insurance companies together grew their funding by a compound annual growth rate of 32% between 2017 and 2022, indicating that momentum for impact is reaching mainstream markets with a growing appetite for active approaches to generate impact on issues that matter to pensioners[2].

Emerging regulations in the UK are shaping how pension funds incorporate social and environmental impact into investment decisions alongside risk and return[3]. It is clear that global macro-level events, such as the climate crisis and deep social inequities, intersect with pension funds' fiduciary duty by threatening the long-term value of assets, in addition to the well-being of pensioners. Integrating an impact lens across a portfolio can help pension funds to align interests of preserving and growing value for retirement savings and solving broader social and environmental challenges that will affect beneficiaries. UK pension funds have a strong opportunity to approach portfolio construction holistically adding to the investment thesis an impact thesis and associated set of impact priorities to inform the investment philosophy and resulting policies, which in turn can shape asset class mandates, asset manager selection, investment selection, impact measurement and management and reporting[4].

Engagement with asset managers is a critical component of driving impact results. By articulating specific impact objectives or priorities, codifying impact in formal investment and legal documents, relying on standardised impact measurement, management and reporting systems, and establishing expectations for rigorous impact reporting, pension funds in the UK can better align with asset managers, preserve the long-term value of their portfolios, and serve the interests and needs of their pensioners[5].

REFERENCES

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2 Ibid.

3 **Impact Investing Institute, London 2023**, *Impact Investing Institute's response to the Financial Conduct Authority's DP23/1: Finance for positive sustainable change*, viewed November 2023 <https://ow.ly/bHj650Q99cL>.

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5 Sunderji S, & Ringel, B, **The Global Impact Investing Network (GIIN), New York 2022**, *Institutional Asset Owners: Strategies for Engaging with Asset Managers for Impact*, viewed November 2023 <https://ow.ly/pAQG50QaKYu>.

2 Impact funds' allocation

2 Impact funds allocation

In our data collection, we asked for information about each impact fund to identify their allocation in terms of geography, strategy, impact theme, risks, market type (public or private), asset class and targeted sustainable development goals (SDGs).

2.1 Geographic allocation to impact investments

Investors allocate their investments around the world and impact investment is no exception. For example, over half the impact funds in our survey invested globally, followed by 20% in the UK and 20% in developed markets (DMs). Only 2% of impact funds, primarily private-sector, focus on emerging markets (EMs) – *see figure 1.*

Although the proportion of impact funds allocated in the UK and DMs is 20% for both locations, the total AUM assigned in DMs is 21.2% compared to 16.2% in the UK. This difference indicates the size of impact funds in DMs is larger than those focused only on the UK market. Additionally, the 2% of impact funds in EMs represented just 0.13% of total AUM – *see figure 2.*

We noted a difference in the geographic allocation between listed and unlisted funds. For example, in private markets, 35% of impact funds are invested globally, 35% in the UK, 27% in DMs and only 4% in EMs. On the other hand, in public markets, asset

Fig 1 | Geographic allocation by percentage of funds

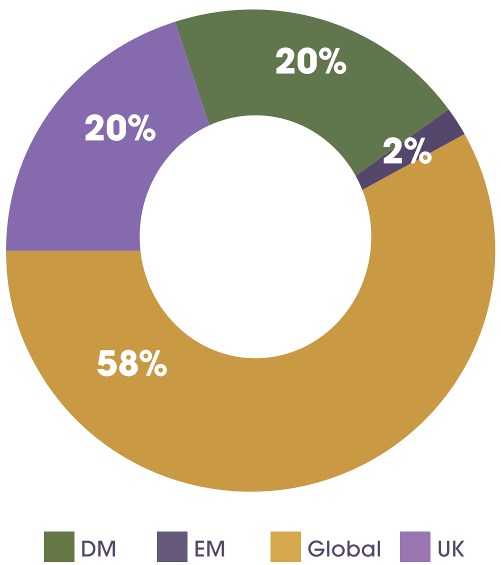
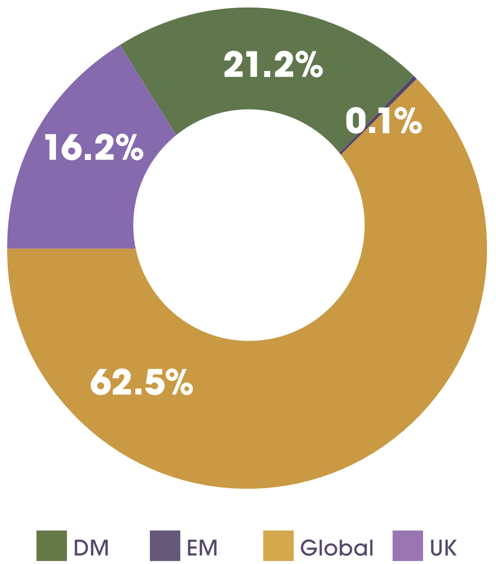


Fig 2 | Geographic allocation by percentage AUM



managers tend to allocate more investments at a global level, so 79% of impact funds compared to just 14% in DMs and 7% in the UK only – *see figure 3*.

As the bar chart in *figure 4* illustrates, the size of impact funds in the private markets varies significantly among geographies regarding the number of impact funds in each location. DMs account for 44% of AUM in this market, followed by 43% in the UK, 13% globally and just 0.4% in EMs .

Fig 3 | Geographic allocation by market and funds

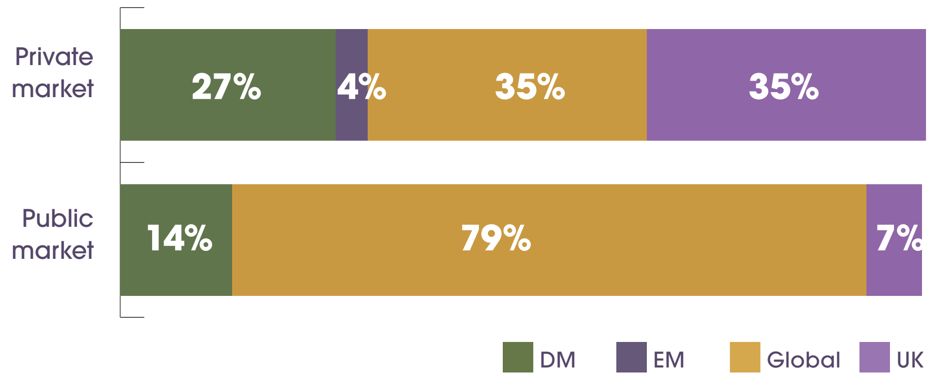
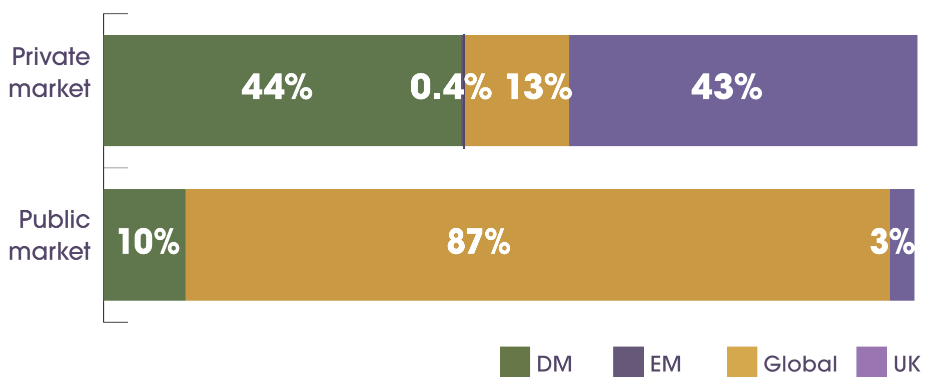


Fig 4 | Geographic allocation by market and AUM



2.2 Theme allocation in impact investments

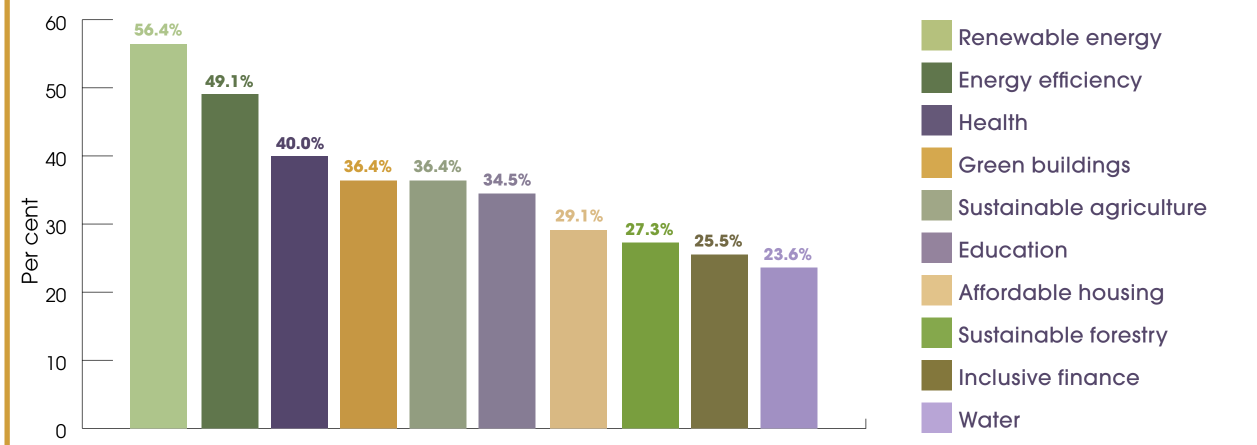
Impact investments are distributed across a variety of themes. For our research, we referenced the 10 thematic investments the Principles for Responsible Investment (PRI) use in their Impact Investing Market Map. On average, we noted impact funds tend to allocate assets to four themes. Renewable energy is the most popular, targeted by 56.4% of impact funds, followed by energy efficiency at 49.1% and health at 40% – *see figure 5.*

Different topics were targeted by listed versus private markets managers. For example, the five most popular impact themes in listed assets were:

- Renewable energy (82.8%).
- Energy efficiency (75.9%).
- Sustainable agriculture (65.5%).
- Health (55.2%).
- Green buildings (55.2%).

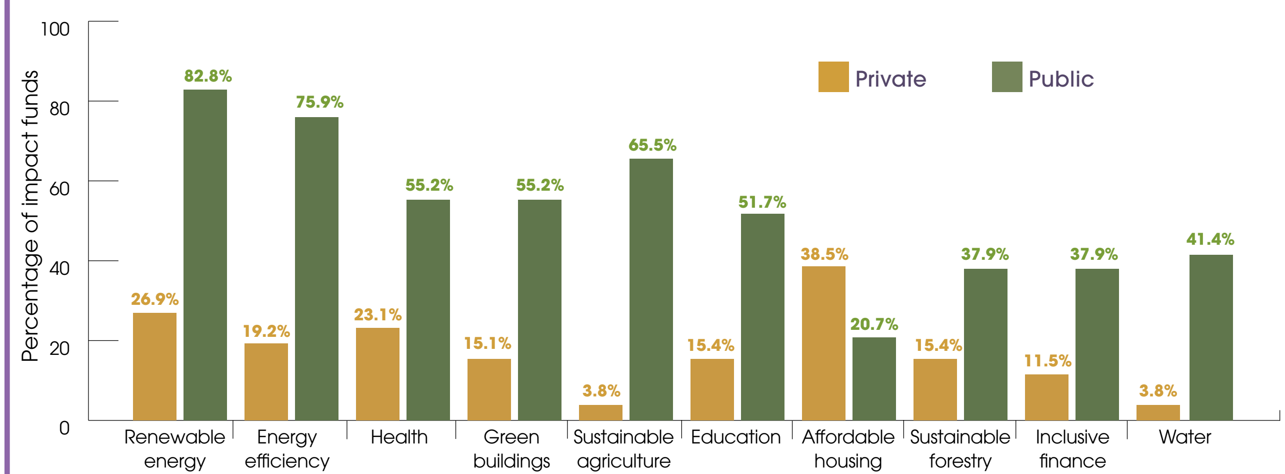
By contrast, affordable housing was the most popular in the private market, with 38.5% of impact funds targeting this theme – *see figure 6.*

Fig 5 | Impact theme allocation by funds



Impact funds may invest in multiple impact themes

Fig 6 | Impact theme allocation by market



Impact funds may invest in multiple impact themes

2.3 Impact investment strategy

We asked asset managers whether they would describe their impact fund as environmental (climate or biodiversity focused), social or blended impact. Managers were asked to assign one strategy for each impact fund.

As expected, the blended approach was the most popular, accounting for 40% of impact funds, followed by social with 32.7% – *see figure 7*. However, the percentage allocation of AUM within investment strategies again varied between the private and public markets. For example, blended approaches ranged from 59.4% of AUM in public markets to 30.2% in private markets. In contrast, social investment strategies accounted for 59.1% of AUM in private markets and only 4.8% in public markets. This shows market type significantly influences the investment strategies used by impact asset managers – *see figure 8*.

Fig 7 | Strategy allocation by funds

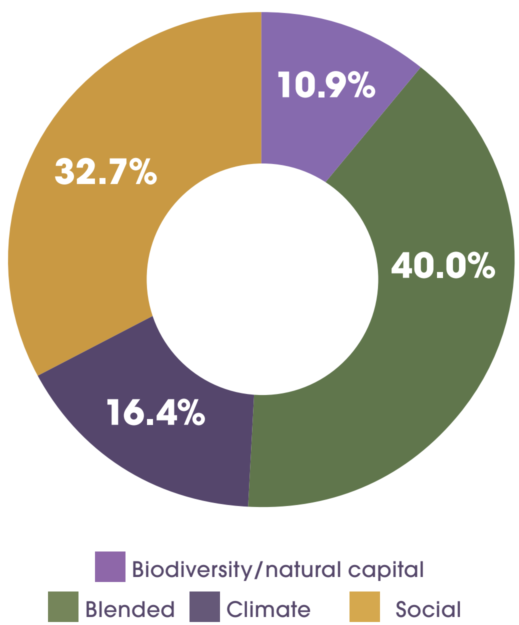
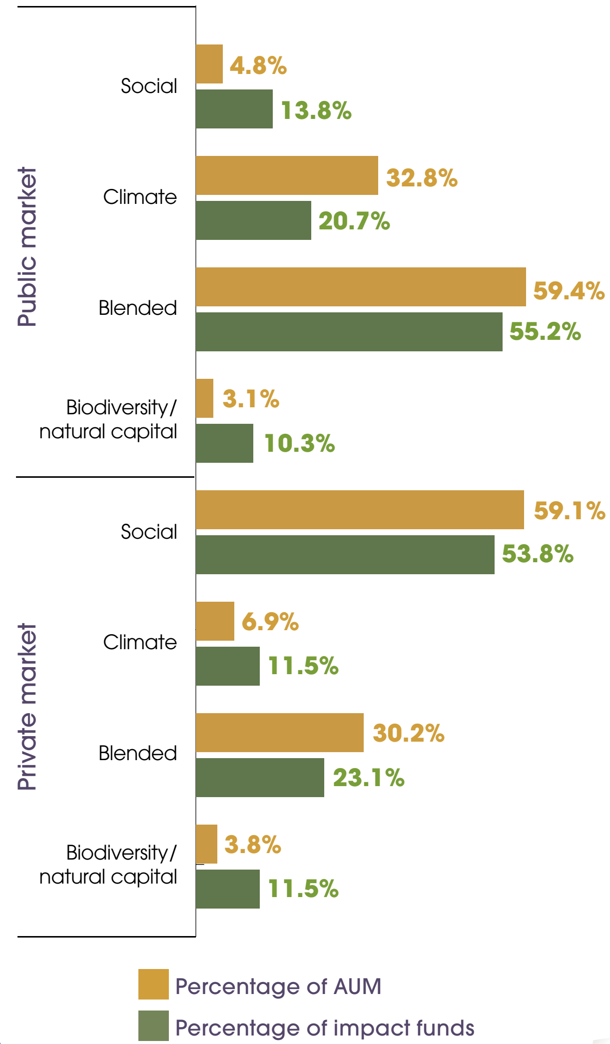


Fig 8 | Strategy allocation by market and AUM

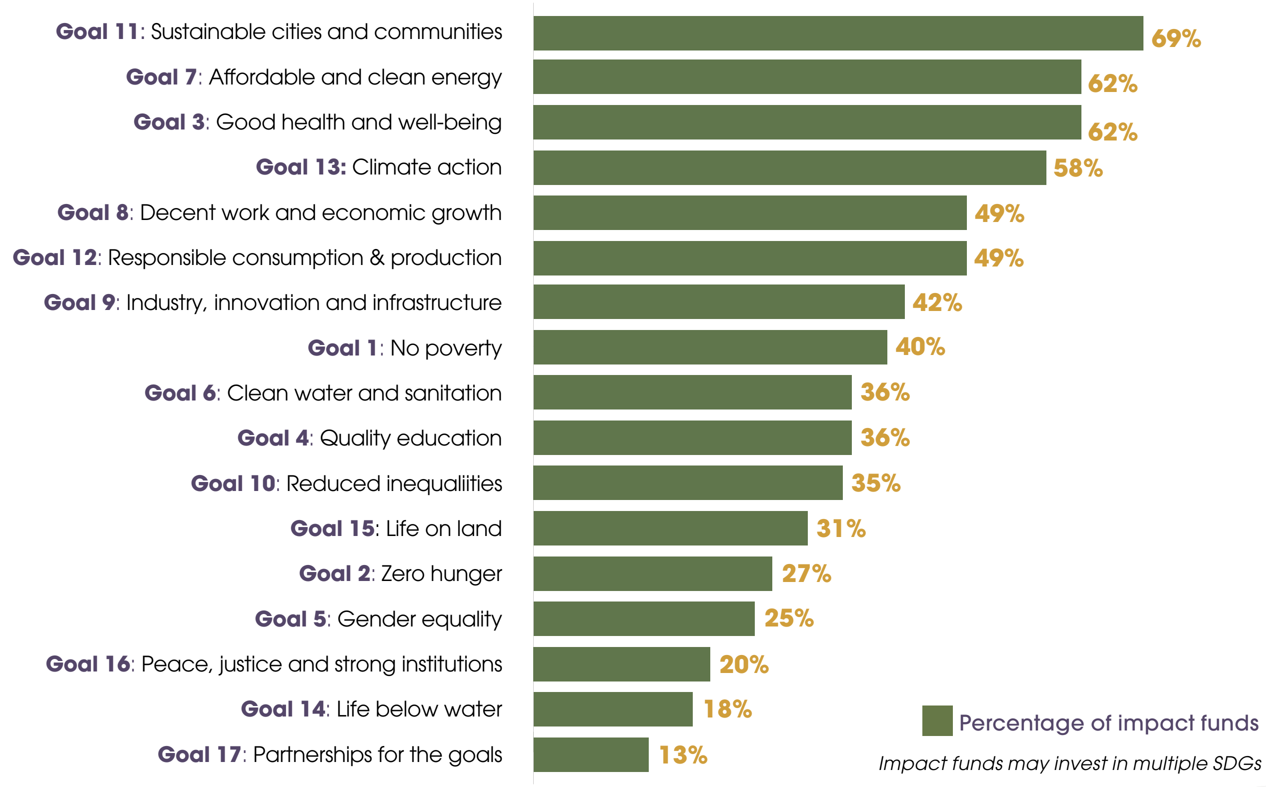


2.4 Use of the SDGs in impact allocation

Despite the available *PRI* Impact Investing Market Map, most impact asset managers use the *UN* sustainable development goals (SDGs) as a framework to achieve a range of impact objectives. Impact funds may select more than one SDG; in our sample, funds targeted at least one and seven on average. The most common was **Sustainable cities and communities (SDG 11)**, which accounted for 69% of impact funds, followed by **Affordable and clean energy (SDG 7)** and **Good health and well-being (SDG 3)**, both on 62%, and **Climate action (SDG 13)** with 58% – *see figure 9.*

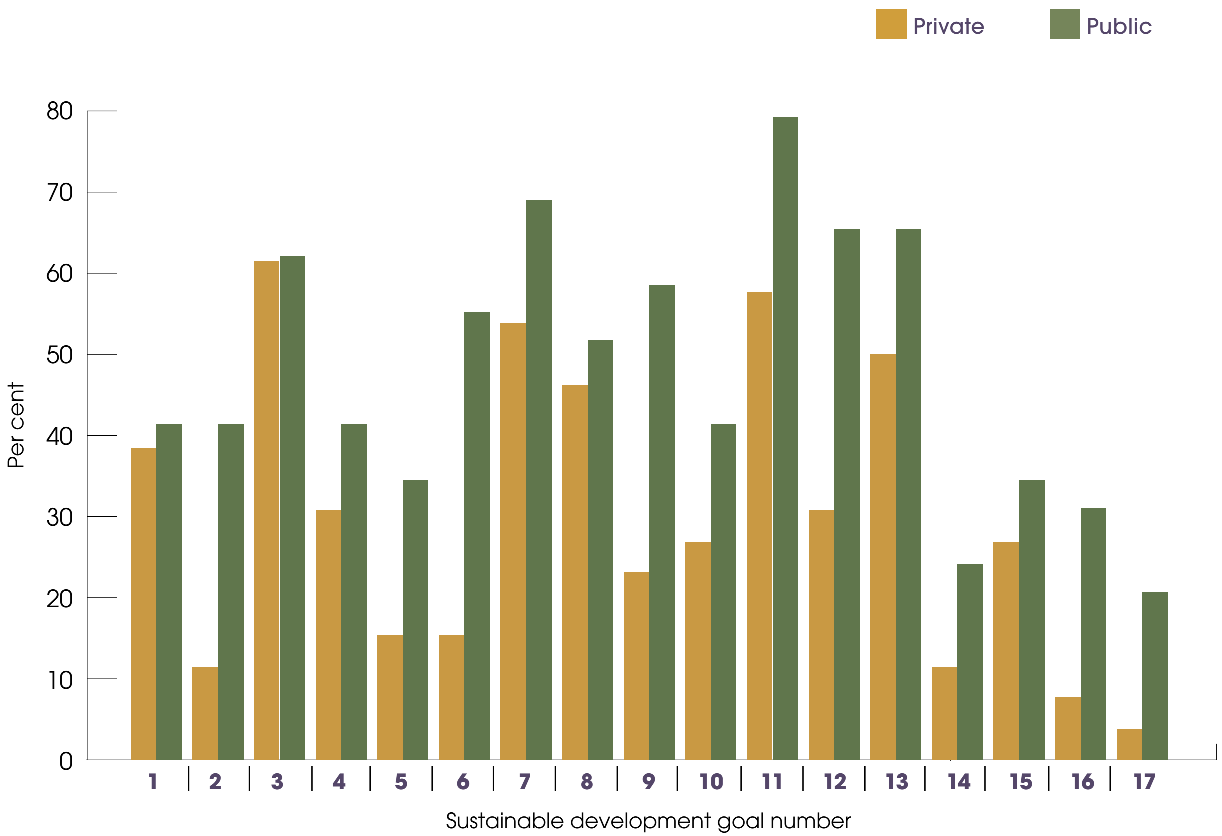
Impact investors targeting these four SDGs cover a variety of economic sectors, such as infrastructure, renewable energy, climate solutions and quality jobs, which may reflect the crucial nature of the climate crisis and growing inequalities in setting impact investment strategies. It is also relevant to mention how **Clean water and sanitation (SDG 6)** accounted for over a third of impact funds (36%) in the sample. Despite global recognition that **Life below water (SDG 14)** is critical to tackling the climate crisis, under a fifth of impact funds (18%) are positively allocating investments to impact the ocean. However, as biodiversity begins to feature more frequently in pension fund agendas, we expect this to increase over time.

Fig 9 | Impact allocation by sustainable development goals (SDGs)



As mentioned in section 2.2, impact investment allocation targeting the SDGs differs between private and public markets. For example, **Clean water and sanitation (SDG 6)** accounted for 55.2% of impact funds in the public market compared to just 15.4% in the private market, while **Industry, innovation and infrastructure (SDG 9)** was targeted more than twice as much by public market funds (58.6%) compared to private markets funds (23.1%) – *see figure 10.*

Fig 10 | Impact allocation by sustainable development goals (SDGs) and market



Impact funds may invest in multiple SDGs

2.5 Risks in impact investments

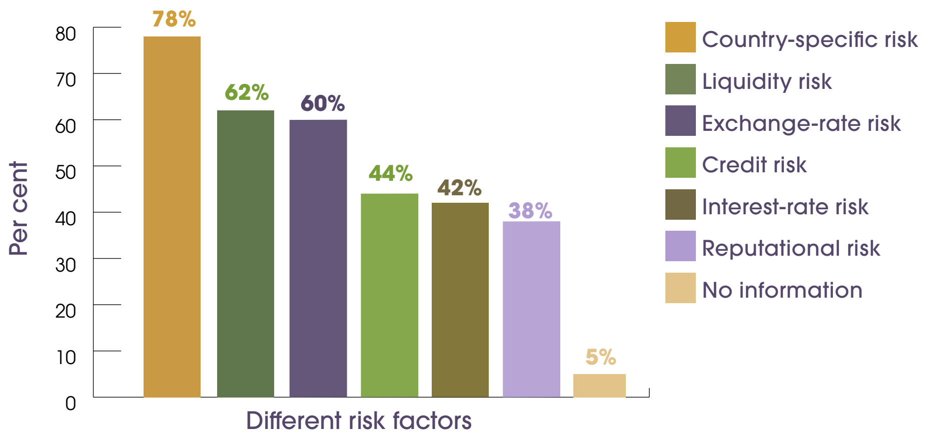
Asset managers were asked to highlight risks associated with their impact funds, selecting from:

- Country-specific risk.
- Credit risk.
- Exchange-rate risk.
- Interest-rate risk.
- Liquidity risk.
- Reputation risk.

Unsurprisingly, each fund highlighted more than one risk. Country-specific risk was the most identified at 78% of impact funds – this may explain the low allocation to EMs given higher country risk - followed by liquidity risk at 62% and exchange-rate risk at 60% – *see figure 11*.

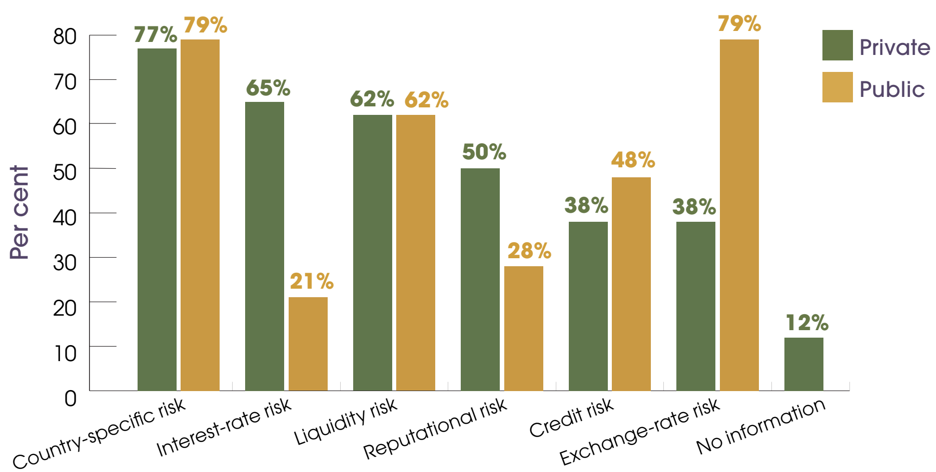
Although the perceived risks for impact funds vary depending on the type of market (listed versus unlisted), the country-specific risk is the most relevant in both, affecting 79% and 77% of impact funds respectively. However, in the public markets exchange-rate risk is as relevant as country-specific risk (79%) due to its high international exposure. Unexpectedly, liquidity risk was identified as a concern for public impact funds as well as private, affecting 62% in each market. While reputational risk might be considered crucial in public markets due to regulatory obligations on companies to declare data publicly (impact washing); the sample showed more impact funds in the private market (50%) were concerned with reputational risk versus the public market (28%) – *see figure 12.*

Fig 11 | Impact allocation by risks



Impact funds may experience multiple risks.

Fig 12 | Risk allocations by market and funds



Impact funds may experience multiple risks.

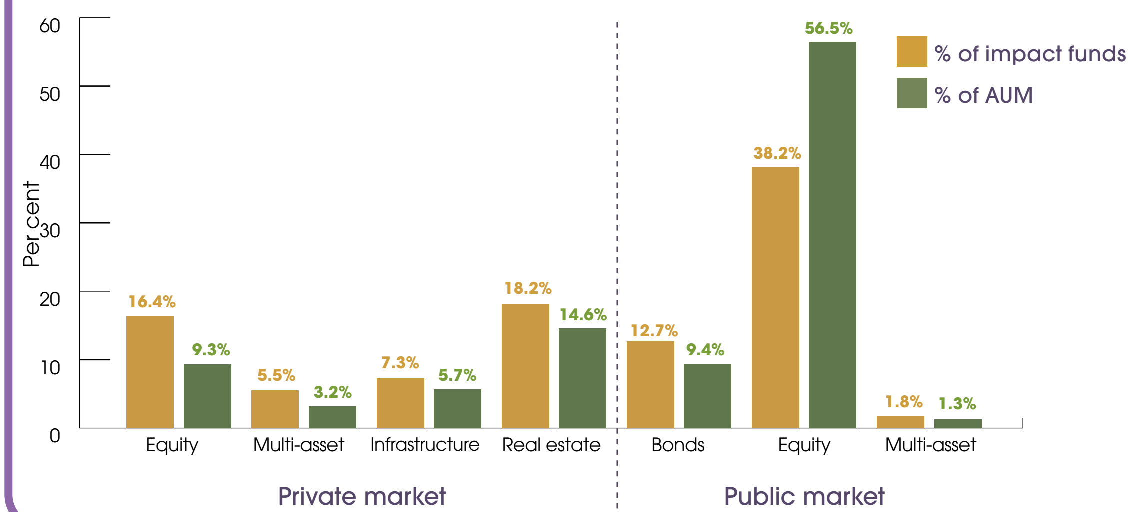
2.6 **Impact allocation across asset classes**

Impact investment strategies can be applied to different asset classes and markets. In this sample, impact funds were allocated to five asset classes:

- Private equity.
- Listed equity.
- Infrastructure.
- Real estate.
- Bonds.

In private markets the most significant portion of impact funds by number and AUM was in real estate at 18.2% and 14.6% respectively, followed by private equity at 16.4% of impact funds and 9.3% of AUM. In contrast, in public markets, equities attract the most impact investment at 38.2% of impact funds and 56.5% of total AUM – *see figure 13.*

Fig 13 | Allocation by asset class, market and AUM



3 Financial performance of impact funds

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We asked for each impact fund's quarterly net return from inception until the end of the first quarter of 2023. To compare the financial performance of impact funds to the conventional market, we chose appropriate benchmarks for each asset class.

The benchmark data was provided by *FTSE Russell*. We then calculated and compared the cumulative performance since the inception of each impact fund against the relevant index / benchmark.

3.1 **Listed equity**

As mentioned in section 2.6, listed equity is the most common asset class in the sample, accounting for 56.5% of total AUM and 38.2% of impact funds. Geographically, 90% of AUM in listed equity is allocated globally, followed by 10% in DMs and just 0.13% focusing only on the UK.

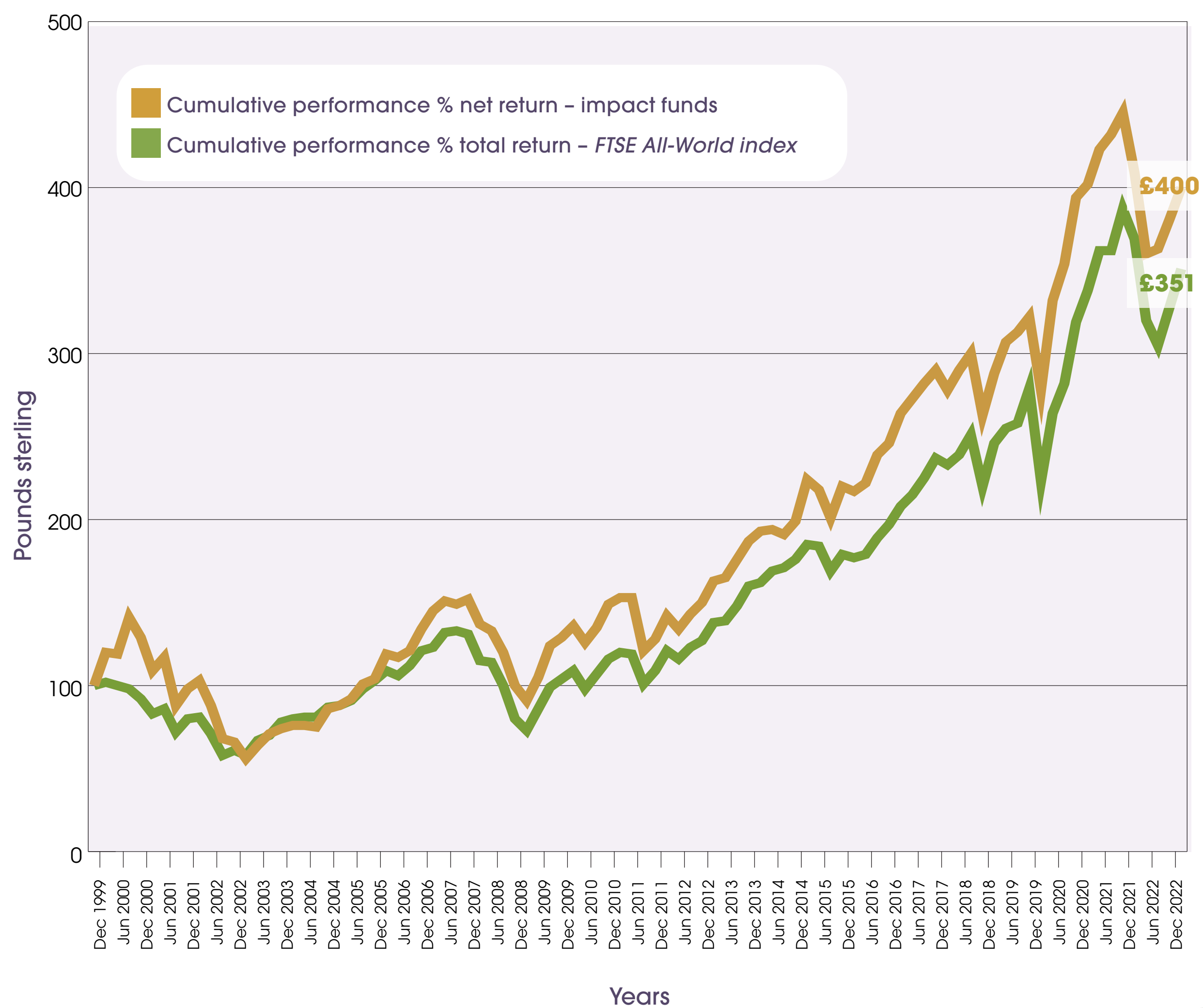
Renewable energy, energy efficiency and green buildings were the principal focus for over 65% of listed equity impact funds. Most impact managers in listed equity use a blended investment approach by 68% of AUM – compared to 29% in climate, 2% in biodiversity and only 1% in social impact.

Across the submissions, impact managers targeted all the SDGs to a greater or lesser extent. The most targeted SDG appeared in around 16 funds. **Responsible consumption and production (SDG 12)**, **Affordable and clean energy (SDG 7)**, and **Sustainable cities and communities (SDG 11)** appeared in over 70% of impact funds in this asset class. Even the least popular SDG appeared in three listed equity impact funds **(SDG 17: Partnerships for the goals)**.

The most frequent risks in listed equity are exchange rate risk and country specific risk, represented in 80% and 75% of listed equity impact funds, respectively.

In the sample, many impact investors in the listed equity market allocated their investments globally. Therefore, we selected the *FTSE All-World Index*, which represents the performance of the large and mid-cap stocks in DMs and EMs. The chart above provides the listed equity funds' cumulative performance (quarterly % net return) from inception to the first quarter of 2023. At the end of March 2023,

Fig 14 | Cumulative performance percentage net return – listed equity



impact funds outperformed the conventional market by 49 percentage points and, on average, 24 bp over the past 22 years – *see figure 14.*

Since 2000, the average quarterly net return of impact funds was 1.93%, at a median of 3.18%, compared to the conventional market, where the average was 1.69% and 3.36% at a median. Although the performance of impact funds has been better than the traditional market, especially since 2006, the volatility of impact funds was 103 bp higher. Over this period, impact funds achieved a maximum quarterly percentage net return of 20.2% and a minimum of -24.7%, compared to 18.4% and -20.6% for listed equity funds in the conventional market. It is relevant to mention that, despite the boost of fossil fuel companies between 2020 and 2023 due to international factors such as the Ukrainian war, impact funds in the listed equity market have performed in line with impact investors' expectations, highlighting the substantial diversification benefit.

Baillie Gifford's view on listed equity

The investment returns of many listed-equity impact funds over the decade have shown attractive investment returns and impact can go hand in hand. In recent years, our world has weathered a global pandemic, regional conflict, natural disasters, rising interest rates and inflation.

Against this unsettling backdrop, the sense of purpose dual objectives provide can act as an anchor as we navigate these more troubled waters. If anything, this environment has reaffirmed our belief that companieswho deliver positive change are critical in helping address environmental and societal challenges.

We are encouraged that a number of listed companies have continued to harness technological progress and innovation to enable them to grow their businesses and continue to contribute to a more sustainable and inclusive world.

Vontobel's Asset Management's view on listed equity

We are often asked whether investors can achieve the 'double-dividend' of performance and measurable impact through a global equity (listed equities) portfolio – our experience gained over the last 15 years demonstrates investors can, and that investing to achieve a positive environmental and social impact does not mean sacrificing return potential.

Delivering performance over the market cycle and achieving measurable impact are two equally important goals which can be achieved through one consistent approach.

From a performance perspective, investing in problem-solving companies creates long-term growth opportunities and strong financial returns and, if anything, the opportunity is now greater than ever due to increasing public awareness of the challenges presented by climate change and the increasing regulatory agenda, which should offer attractive secular opportunities for impactful companies in future.

Achieving real impact requires intentionality and measurability, and this also provides clear objectives which clients can understand and see. It is essential to provide transparent reporting to make the impact tangible, enabling clients to relate to the non-financial outcomes their investments are supporting.

3.2 Bonds

The public market's second most common asset class is listed bonds, accounting for 9.4% of total AUM and 13% of impact funds. Geographically, almost two-thirds of AUM in bonds is allocated globally, followed by 23.4% in the UK and 11.2% in DMs.

Impact investing themes in bonds are principally focused on sustainable agriculture, renewable energy, energy efficiency and health represented in over 75% of impact funds in this asset class.

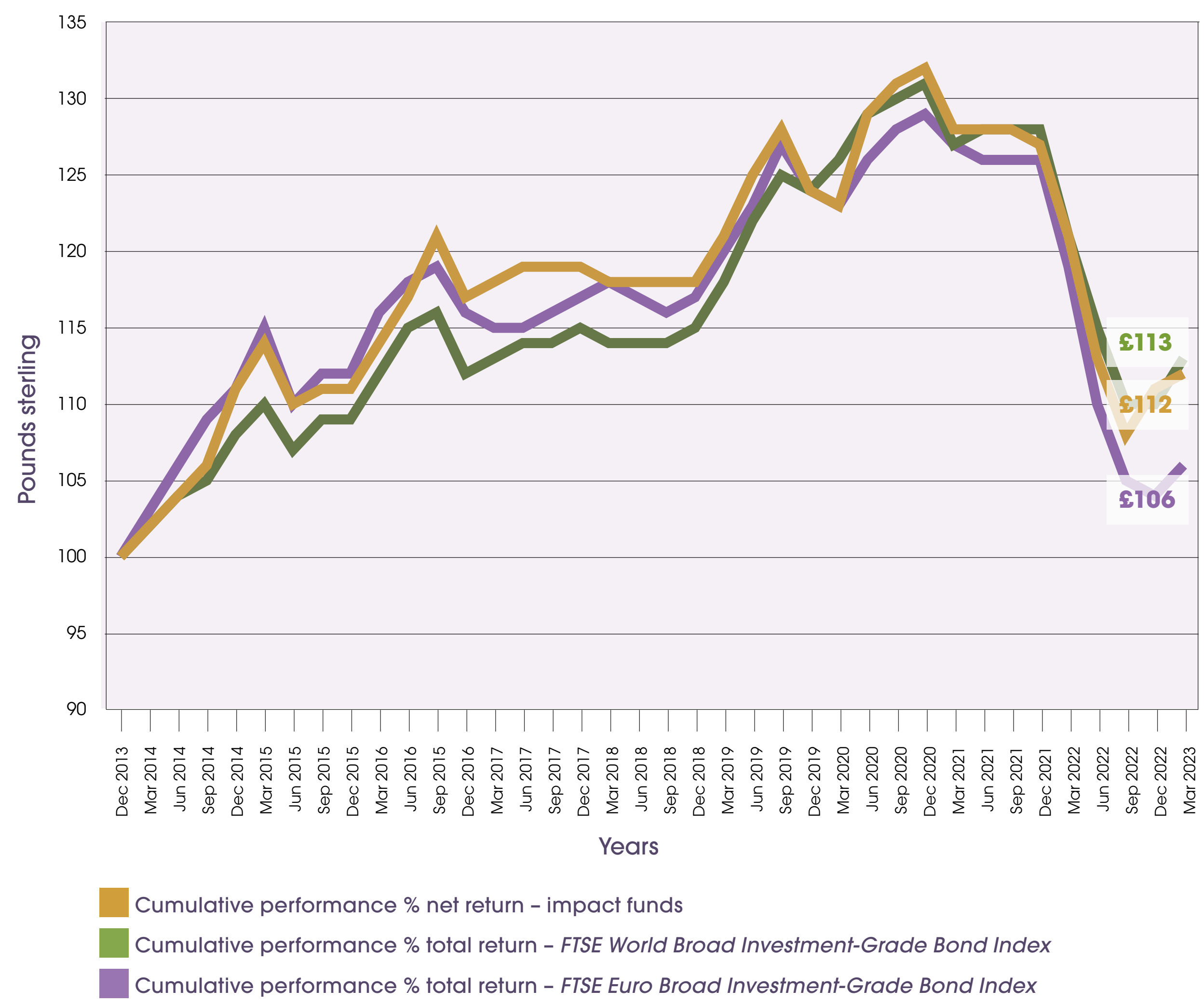
The most common strategy for bonds is climate, with 61% of AUM, compared to 26% in social, 11% in biodiversity/natural capital and just 2% in blended.

Across impact bond managers in our sample, all the SDGs were being targeted; at least three impact bond funds targeted one SDG, and the most targeted SDG appeared in eight funds. **Sustainable cities and communities (SDG 11)**, **Climate action (SDG 13)**, **Decent work and economic growth (SDG 8)**, and **Good health and well-being (SDG 3)** appeared in more than 88% of impact bonds funds.

The most frequent risks identified by impact bond managers were country-specific risk, credit risk and liquidity risk, which were identified by 88% of impact bond funds in our sample.

Managers allocated most of the impact bond funds globally and in Europe. Thus, *FTSE* suggested we use their two fixed-income indexes for better comparison: the *FTSE World Broad Investment-Grade Bond Index (WGBI)* and the *FTSE EU Broad Investment-Grade Bond Index (EBIG)*. The *WGBI* measures the performance of fixed-rate, local

Fig 15 | Cumulative performance percentage net return – bonds



currency, investment-grade sovereign bonds from over 20 countries denominated in various currencies. The *EBIG* estimates the performance of Euro-denominated fixed-income bonds. *Figure 15* provides the listed bond funds' cumulative performance (quarterly percentage net return) from inception to the first quarter of 2023. At the end of March 2023, impact bond funds' cumulative financial performance has been in line with the conventional market. For example, impact funds outperformed the *EBIG* index by 600 bp and underperformed the *WGBI* index by just 100 bp. Over shorter periods, on average, impact bond funds outperformed both indexes by 1 bp vs *WGBI* and 16 bp vs *EBIG* over the past eight years.

Since 2014, the average quarterly net return of impact bond funds was 0.4%, at a median of 0.6%, compared to the *WGBI* and *EBIG* indexes, where the average was 0.4% and 0.8% at a median and 0.2% and 0.7%, respectively. It is important to mention impact bond funds did not have a significantly higher volatility than the conventional market. Over eight years, the volatility of impact funds was +49 bp vs *WGBI* and +13 bp vs *EBIG*. Despite the international affectation of the fixed-income market due to high-interest rates to control inflation levels, this result shows that fixed-income impact investments can perform in line with or even better than the conventional market, and investors do not need to give up financial returns to achieve impact objectives.

Franklin Templeton's view on bonds

We do not see any notable performance differences between a Euro green bond and a Euro bond in the same sector with a similar duration and maturity profile. There can, at times, be a green premium for green bonds that can lead to minor out/underperformance. However, the main differences in performance between Euro green bond funds and benchmarks vs European aggregate funds and benchmarks will be driven by differences in the respective opportunity sets.

For example, the average duration of a Euro green bond benchmark is higher than standard European aggregate benchmarks, which was the key driver of the relative underperformance of green bonds in 2022. Nevertheless, there are wider differences to be aware of. For example, there is a higher proportion of utilities in green bonds vs European aggregate bonds. There is also a much smaller market of high-yield green bonds and far fewer green sovereign bonds to build out full curve positioning in a fund, so you tend to have a more bulleted structure.

These structural differences have, of course, been driven by the sectors and markets that have prioritised green bond issuance and increased projects requiring funding. However, such differences have reduced over time as green bond issuance has continued to grow and we expect those differences to continue to narrow going forward.

AXA Investment Manager's view on bonds

Expansion of the green bonds sector has brought a lot of new issuances to market. This is good news on many levels – as the pool of investible assets increases so does the possibility of regional and sectoral diversification as noted in the report. When *AXA Investment Managers* launched one of the first green bond strategies in 2015, the market was dominated by quasi-sovereign issuance, but the split of sovereign-related to credit issuers has since moved to about 50/50 and the number of issuers rests at around 600. Banks remain key, but we have also seen a substantial contribution from sectors such as real estate, telecoms, autos, chemicals and consumer goods. This is now a dynamic market and one that we think rewards active management – not all green bonds are created equal, whether from a valuation or ESG-credentials perspective. This is the fundamental issue behind fears of 'greenwashing' (and 'social washing') and there is no shortcut solution. We think the best approach is to rigorously apply our standards to every investment call and seek out credible, consistent and verifiable impact key performance indicators (KPIs). Measurability and transparency are perhaps the two most crucial considerations wherever we are invested.

3.3 Private equity

Private equity (PE) is the second most relevant asset class in the private market in this sample. It accounts for 9.3% of total AUM and 16.4% of impact funds. Geographically, 61.3% of AUM in private equity is allocated in DMs, followed by 38.7% globally. It is important to note EMs did not receive investments from private equity impact funds.

Impact investing themes in private equity are predominantly focused on renewable energy, health, energy efficiency and sustainable forestry, with over 33% of private equity impact funds.

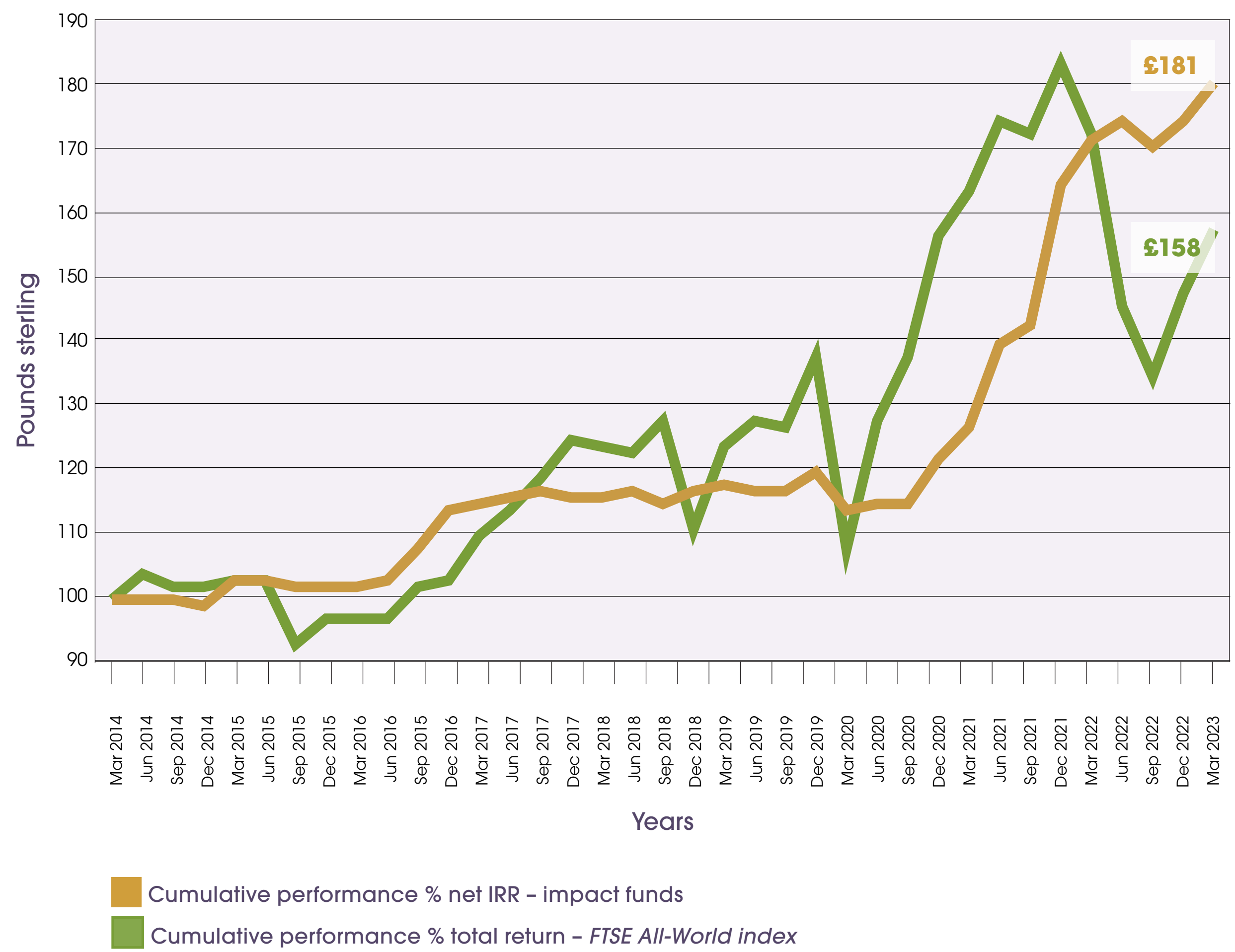
The most common private equity strategies for impact are blended strategies, adopted by 72% of AUM in this asset class, compared to only 10% in biodiversity / natural capital, 16% in social and just 1% in climate.

Private equity impact asset managers targeted 15 SDGs, with **Climate action (SDG 13)**, **Life on land (SDG 15)**, **Good health and well-being (SDG 3)** and **Affordable and clean energy (SDG 7)** being the most popular, appearing for 67% of private equity impact funds.

The most predominant risks in private equity impact funds are interest-rate risk, presented in all of private equity impact funds, while country-specific risk, liquidity risk and exchange-rate risk were present in 89%.

PE managers assigned their investments primarily in DM and globally. For benchmarking purposes, we selected the *FTSE All-World Index*, which represents the performance of the large and mid-cap stocks in DMs and EMs – *see note overelaf. Figure 16* provides

Fig 16 | Cumulative performance percentage net IRR – private equity



the private equity funds' cumulative performance (quarterly % IRR net return) from inception to the first quarter of 2023. Although, at the end of March 2023, impact funds outperformed non-impact counterparts by 23 percentage points, there were periods where impact funds were lagging listed equities funds.

Since June 2014, the average quarterly net IRR of PE impact funds was 1.71%, at a median of 0.66%, compared to the conventional market, where the average percentage net return was 1.6% and 3.2% at a median. The data suggests that PE is less volatile than the traditional public market. The latter presented a volatility of 8%, compared to PE impact funds' 3.5%, which may be explained because of the less frequent valuation of PE. Over eight years, impact funds achieved a maximum quarterly percentage net IRR of 15.4% and a minimum of -5.4%, compared to 18.6% net return and -21.8% for listed equity funds in the conventional market. These results reflect that impact investors focusing on the PE market do not need to sacrifice financial returns to have a positive and localised impact.

Note

We aimed to compare private equity impact funds to private non-impact funds but, due to data constraints in the private market, we had to use the FTSE All-World Index as an alternative.

3.4 Real estate

In this sample, the private market's most common asset class is real estate, accounting for 14.6% of total AUM and 18.2% of impact funds. Geographically, 90% of AUM in real estate is allocated in the UK, followed by 10% in DMs.

As expected, impact investing themes in real estate are principally focused on affordable housing and green buildings, reflected in 90% and 30% of real estate impact funds, respectively.

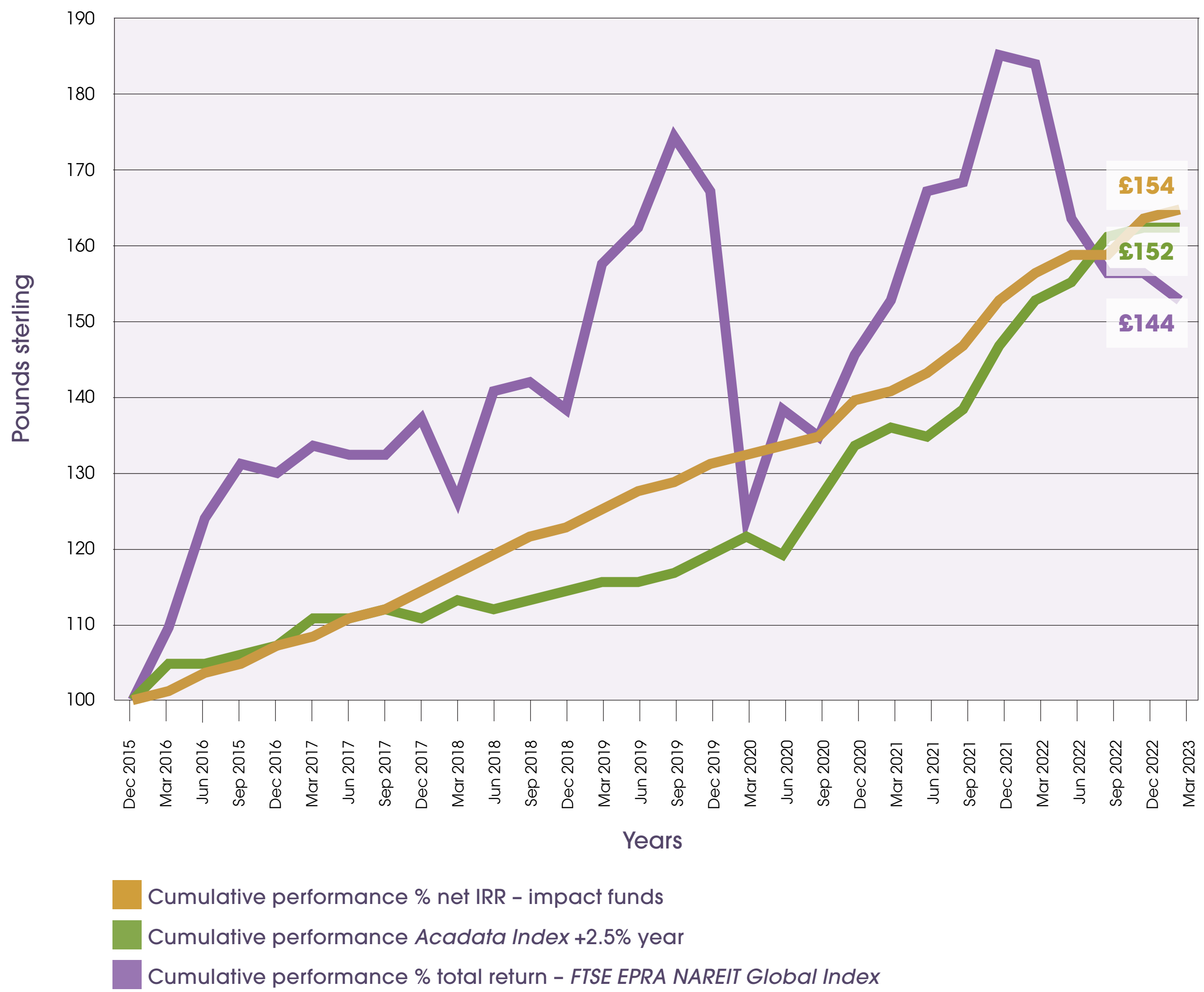
The most common strategy for real estate is social, accounting for 94% of AUM in this asset class, compared to 4% in climate and 2% in biodiversity/ natural capital.

Impact real estate managers targeted 13 SDGs, and the **Sustainable cities and communities (SDG 11)** was targeted by all real estate impact funds, followed by **Good health and well-being (SDG 3)** and **No poverty (SDG 1)**, which appeared in over 60% of impact real estate funds.

The most frequent risks for real estate impact managers were reputational, liquidity and country-specific risks, which were present in over 50% of impact real estate funds.

In the sample, real estate impact investors invested predominantly in the UK. Therefore, we used two references to evaluate the financial performance of real estate impact funds: the *Acadata Index* plus a nominal 2.5% annual rental yield, which is based on every residential property transaction in England and Wales, to measure house price inflation accurately, and the *FTSE EPRA NAREIT Global Index*, representing the performance of traded real estate companies

Fig 17 | Cumulative performance percentage net IRR– real estate



that own, and in most cases, operate income-producing real estate such as apartments, shopping centres, offices, hotels and warehouses – *see note below*. *Figure 17*, on page 27 shows the real estate funds' cumulative performance (quarterly percentage IRR net return) from inception to the first quarter of 2023. At the end of the first quarter of 2023, real estate impact funds outperformed both indexes: by two percentage points vs the *Acadata Index* + 2.5% and by 10 vs the *FTSE EPRA NAREIT Global Index*.

Since March 2016, the average quarterly net IRR of real estate impact funds was 1.50%, at a median of 1.40%, compared to the conventional market, where the average net return was 1.47% and 1.07% at a median for the *Acadata Index* + 2.5% and 1.54% and 0.98% for the *FTSE EPRA NAREIT Global Index*, respectively. As expected, both indexes showed higher volatility than impact funds due to their market niches, especially in the public market where the *FTSE EPRA NAREIT Global Index* presented a 7.4% volatility compared to 0.77% for impact funds. These results reflect that impact investors concentrating on the real estate market can execute risk-adjusted returns in line with the conventional market.

Note

We aimed to compare real estate impact funds to real estate non-impact funds but, due to data constraints in the private market, we had to use the FTSE EPRA NAREIT Global Index and the Acadata Index + 2.5% annual rental yield.

Resonance's view on real estate

The housing market crisis is affecting people all over the UK. More than one million households are on waiting lists for a social home and levels of homelessness are rising. Significant capital is needed to address these issues, and we believe social impact investment can help address some of this shortfall and improve the housing system.

Investment into the impact-led social and affordable housing fund market has grown substantially from virtually zero in 2013, when *Resonance* launched its first pioneering social impact Property Fund (RLPF1), to an estimated £3.8 billion by the end of 2021 (£2.9 billion: 2020). Increased appetite for private capital has been driven largely by investors seeking diversification within investment portfolios that offer attractive risk-adjusted returns.

Within this wide market, transitional supported housing funds, such as *Resonance's* range of social impact property funds, work with expert housing partners to provide homes and support, bridging the gap from homelessness to permanent housing over several years. Government temporary accommodation statistics confirm a current need in the UK for over 100,000 homes, equivalent to a £20 billion investment to safely and securely house individuals and children who face a housing crisis. Some of the benefits that impact-led residential housing funds can offer include:

- Low correlation to other property markets and the broader economy.
- Predictable long-term income, often supported by government-backed rental incomes.
- Long-term asset-backed capital growth.
- Low voids.
- Genuine, measurable real-world social impact.

Aquila Capital's view on real estate

Despite conventional thinking, investment in logistics does not need to be carbon intensive. We have shown that incorporating sustainability features into the creation and management of logistics centres can provide a unique avenue for financial growth and environmental responsibility.

We invest in logistics centres with energy-efficient features and sustainable supply chain practices that yield stable, long-term rental income and capital appreciation. As e-commerce continues to expand, the demand for well-located, sustainable logistics hubs has surged, further enhancing the potential financial performance of the investments. Simultaneously, our commitment to sustainable construction practices has reduced carbon emissions and a smaller environmental footprint, aligning with our clients' carbon reduction objectives.

Our experience in logistics centres demonstrates the synergy between financial success and sustainability in infrastructure and real estate investment sectors, which, while not yet officially earmarked as impact investing, paves the way for a greener and more profitable future.

3.5 Infrastructure

The private infrastructure asset class accounted for 5.7% of total AUM and 7.3% of impact funds. Geographically, 100% of AUM in infrastructure is allocated to DMs, primarily in Europe.

Impact investing themes in infrastructure are principally focused on renewable energy, health, affordable housing and education, appearing in 25% of infrastructure impact funds.

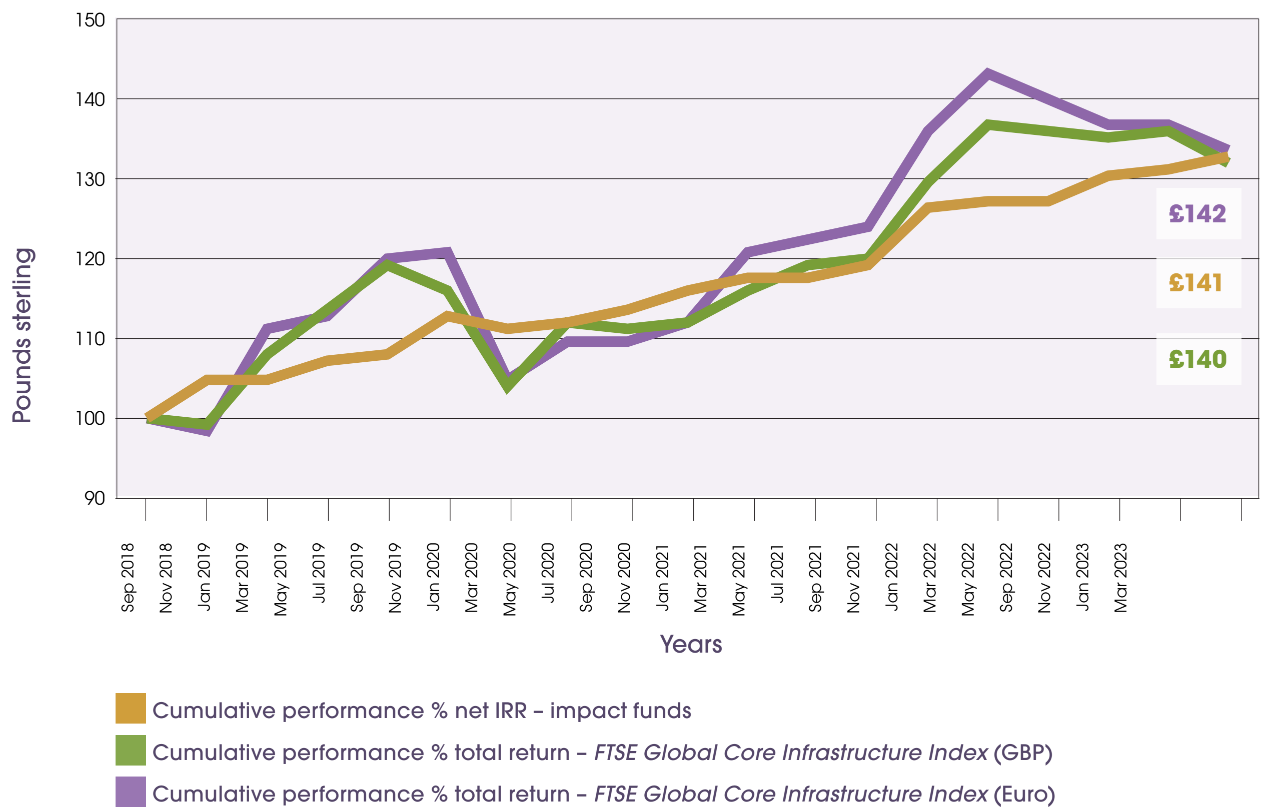
The most common impact infrastructure strategy is social with 68% of AUM in this asset class – compared to 32% in climate.

Impact investors in infrastructure aim to tackle seven SDGs; the most common being **Affordable and clean energy (SDG 7)**, addressed by 50% of infrastructure impact funds.

The most frequent risks in this asset class are interest-rate and country-specific risks, presented in 100% of infrastructure-impact funds, followed by liquidity risk found in 50% of infrastructure-impact funds.

Infrastructure managers allocated their investments to DMs, primarily in Europe. Nevertheless, we used the *FTSE Global Core Infrastructure Index* in EUR and GBP, representing the performance of companies that own, manage or operate structures or networks to process or move goods, services, information/ data, people, energy and necessities in developed and emerging markets – *see note below. Figure 18* shows the infrastructure funds' cumulative performance (quarterly percentage IRR net return) from inception to the first quarter 2023. At the end of March 2023, infrastructure impact funds outperformed the conventional market in GBP by

Fig 18 | Cumulative performance percentage net IRR – infrastructure



100 bp and underperformed by 100 bp in EUR. On average, the traditional market outperformed by just 8 bp in GBP and 24 in EUR over the past four years.

Since December 2018, the average quarterly net IRR of infrastructure impact funds was 1.96%, at a median of 1.60%, compared to the conventional market, where the average was 2.04% and 1.32% at a median in GBP and 2.20% and 1.50% in EUR, respectively. As expected, both indexes in the public market presented higher volatility, 5.78% in GBP and 7.08% in EUR, compared to impact funds' 2.29%. These results reflect that impact investors focusing on the infrastructure market can achieve risk-adjusted returns in line with the conventional market.

Note

We aimed to compare infrastructure impact funds to infrastructure non-impact funds, but due to data constraints in the private market, we had to use the FTSE Global Core Infrastructure Index, which reflects the infrastructure public market.

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See page 5 for our full disclaimer

Franklin Templeton's view on infrastructure

Social infrastructure assets have historically provided stable cash flow generation, with revenue from long-term lease contracts. This asset class includes indexation, which helps protect against inflation while the tenant is in occupation. Social infrastructure has historically also been less vulnerable to volatility because it provides necessary services; these assets have proven to be relatively resilient in economic downturns. Another benefit is that social infrastructure assets typically have low correlations to commercial real estate and traditional asset classes such as equities and fixed income. Including exposure to social infrastructure in a portfolio will likely enhance diversification and support risk-adjusted returns.

Aquila Capital's view on infrastructure

Our experience is that achieving a financial reward does not need to come at the expense of the environment. Our infrastructure investment strategy, even though not defined formally as 'impact', focuses on sustainable forestry practices which have generated substantial returns while at the same time contributing to the preservation of vital ecosystems. By partnering with responsible forestry management companies, we have witnessed a long-term appreciation in the value of our timberland assets. These investments also offer diversification benefits to client portfolios. Demand projections for sustainably sourced wood products are rising, which can translate into stable cash flows and attractive returns for investors. Moreover, responsible forest management practices, such as reforestation and carbon offset initiatives, have provided a way for investors to reduce the carbon footprint of their portfolios, which is becoming more important for asset owners and managers with net zero commitments. Our experience with forestry investments underscores the potential for financial success while promoting a sustainable and greener future.

Many clients seek to include renewable energy allocations in their portfolios to support the world's journey to net zero. Through investments in wind, solar and other renewable energy sources, we can demonstrate strong cash flows and consistent returns. Furthermore, by supporting renewable energy projects, our investors have contributed to reducing carbon emissions and advancing the transition to a low-carbon economy. The global transition towards clean energy solutions has created a strong market for renewables, making these investments profitable and a cornerstone of a portfolio's resilience. While not labelled as impact investments, our experience in renewables illustrates that thoughtful allocations to these sectors can be financially attractive while steering a more sustainable and environmentally responsible future.

4 Investment consultants’ views

Investment consultants' view

As part of our research, we asked four UK-based investment consultants to speak about their experiences of investing in impact funds and their view of the financial performance of these investments. The interviews were conducted through online meetings and were based on a questionnaire covering 17 questions. A summary of the findings follows

Q1 What kind of impact and themes do pension fund clients typically try to tackle?

All the investment consultants interviewed referred to climate as the most common and influential theme for impact investment strategies. It has been influenced by the *Task Force on Climate-related Financial Disclosures (TCFD)* reporting requirements and was top of the agenda for many of their pension fund clients.

Climate is often seen as a broader theme than carbon emissions alone and includes sub-themes, such as adaptation, biodiversity, sustainable forestry and agriculture, and the evolving technologies found in renewable energy and battery storage.

Investing in climate is often regarded as a secondary priority, especially for local government pension schemes (LGPS) that have social objectives to fulfil. Investment consultants highlighted how the size of a pension fund could influence the topics selected for their impact investment strategy. Consultants always consider the target return, risk budget and liquidity profile of the client's portfolio when they embark on selecting an area of investment. Also, pension fund clients often have a specific impact goal in mind which aligns with the rest of their investment objectives.

> "Climate as an impact investing theme goes beyond carbon emissions. It is about investing in managers while taking advantage of opportunities that look to contribute in a positive way to the environment more broadly rather than simply reducing emissions."
>
> INVESTMENT CONSULTANT

Q2 Are the impact themes aligned with the sustainable development goals?

Most investment consultants see the SDG framework as a way to plan and define investment strategies, especially in the impact universe. Moreover, they revealed only some of their clients use the SDGs, as it is not a standard framework. The reoccuring feedback we received was that there are still SDG questions to answer. For example, how many goals can be invested in? Investors can map their capital allocation using the SDGs as a reference, but it does not mean their impact investment funds are based on the goals.

Q3 When advising a pension fund client on an impact strategy, where is your typical focus between the UK, emerging markets and developed economies?

Investment consultants have been attempting to keep geographical allocation at the most impactful level, educating their clients and engaging with them to create a balance between UK-focused and global investment strategies. Discussions with their clients over the risk and return of investing in DMs as opposed to EMs are ubiquitous.

Most of the investment consultants interviewed highlighted EMs as one of the most popular themes due to their relevance in the path to a net-zero economy. There will not be real-world change or positive progress in emissions reduction without supporting the deployment of capital to projects in EMs. Also, in many of these countries, the impact of the transition to net zero may cause huge social and environmental upheaval.

"Managers are often able to identify interesting projects where they can have a positive impact which might not necessarily be as common in developed markets."

INVESTMENT CONSULTANT

To have a more diversified portfolio, investment consultants tend to advise their pension fund clients to consider global investment strategies. They believe allocating funds to a specific region is less diversified and higher risk. Although some LGPS seek to make an impact with local place-based investing, this is quite unusual. The allocation of capital geographically is often dependent on the type of asset class. Investment consultants tend to favour managers with global opportunities because these offer investors the broadest spectrum in impact investing.

Q4 Do investment consultants undertake specific due diligence on impact asset managers as part of the selection process?

Most investment consultants use due diligence on asset managers' impact investment strategies to verify if they meet selection criteria.

Investment consultants have evolved traditional due diligence by adding questions on impact objectives and metrics. However, some consultants apply the same due diligence for all their managers regardless of whether they label themselves as impact managers. Therefore, they screen out the managers who do not have a viable impact product or where it is not investable for their pension funds clients. In the listed market, consultants have embedded due diligence into their research questions to evaluate how managers generate ideas on business management, philosophy and stewardship strategies. In the private markets, it has been more bespoke analysis based on the investment consultant's dimensions of impact to differentiate one manager from another.

Investment consultants look for clear competitive advantages in the impact investment universe compared with other managers. They seek the best answers and evidence to understand how managers measure their investments' impact and if they can give investors tangible examples of positive outcomes.

"If you have got an impact objective within your strategy, how do you evidence that in the same way that you would evidence your investment risk and return?"

INVESTMENT CONSULTANT

Q5 Do investment consultants seek impact funds to diversify pension fund clients' portfolios, uncorrelated to listed and private markets? Is this a primary motivation for investing or a secondary benefit?

Investment consultants see the impact investing universe as an interesting form of diversification. Impact funds offer the opportunity to see the world and markets differently through various companies and initiatives. They find impact investments attractive, primarily when they can use new ideas to invest in sustainable themes, while still having the benefit of diversification. However, any investment strategy is built to diversify the entire portfolio, not only impact funds. One investment consultant noted they do not specifically look at impact investments as a diversifier; instead, they seek to ensure funds, including impact options, are diversified and whether they are suitable for the entire portfolio. For example, real estate assets offer diversified properties and inflation protection. It depends on the type of asset class included in the impact investment strategy.

> "There will be periods of time where impact investments are lagging the wider market, but we do like the fact that they are quite diversifying."
>
> INVESTMENT CONSULTANT

Diversification is one of many motivations when considering impact investments. It could be an additional driver to promote these kinds of assets. Some clients have a specific impact goal that aligns with their general investment objectives. These clients are willing to incorporate new themes into their investment portfolios that do not affect other impact goals. As a result, they see the broader benefits of including impact investments in their portfolios, such as higher diversification.

> "Impact funds have been looked at in silos without saying how they contribute to the total portfolio. Impact investments' contribution in terms of diversification could have a role to play. Even if they perhaps are slightly below market rate risk adjusted returns at the total fund level, it could actually be additive."
>
> PENSIONS FOR PURPOSE

Q6 Which of these asset classes: listed equity, fixed income, infrastructure, real estate, private equity or private debt are the most attractive for a pension funds' impact investment strategy?

The most attractive strategy varies from one client to another. For example, closed pension funds tend to be limited to looking at more illiquid investments. For funds not restricted this way and able to look into the liquid market, the most common asset class has been listed equities because it allows companies to influence management through voting. If the client seeks to have impact, a robust governance structure which enables investors to participate is important. Also, when liquidity is required, there is a small but growing number of corporate bonds in the impact investment universe.

When there are no liquidity or fee constraints and the scheme is still open to new members, the private market gains high relevance, given the benefits of additionality can be more explicit and tangible. However, it is unsuitable for many closed corporate pension funds clients because of their shorter time horizons and path to buyout. In the private market, there has been more interest in nature-based solutions, infrastructure, affordable housing and forestry, especially from LGPS funds because of their ability to invest long-term.

> "Nature-based solutions like sustainable forestry have a very long-time horizon before they start to demonstrate environmental impacts. So, investors do need to make sure that aligns with their own investment horizons."
>
> INVESTMENT CONSULTANT

Q7 What challenges do pension funds clients face when impact investing, for example, lack of liquidity, limited size and impact measurement?

All the investment consultants interviewed indicated how challenging it is to find a shared or standardised definition of impact among clients and managers.

Pension funds must define how wide or narrow the impact universe is and then understand their ideal impact.

Liquidity is seen as a significant constraint for impact investments due to the limited investment horizon for most pension funds, especially defined benefit (DB) pension schemes. These kinds of clients are often unable to access real estate asset impact strategies, for example.

> "The whole private markets piece is a big challenge for investors because, once you are in, you cannot get out or it is very difficult to get out. So, if you are a medium to small sized investor, how do you do private markets?"
>
> INVESTMENT CONSULTANT

Although both have improved over the years, there is still room for improvement in consistency and standardisation for impact reporting and measurement. The size of the market remains limited and is in its infancy. From the investment consultant's point of view, there are a limited pool of managers with viable impact-based products despite many managers claiming to have them.

Q8 How do investment consultants assess the value of impact investing?

There was a mix of responses on how to best assess impact. For example, in the listed market, understanding the company's philosophy and considering how the investment contributes from beginning to end were raised; are they part of the idea generation?

In order to evidence there is genuine impact, investment consultants expect convincing and consistent responses from managers regarding the rationale for an investment. This could be tricky in private markets because most of the value will be generated over long periods. Consequently, consultants recommend not focusing too closely on short-term metrics.

> "When we think about net-zero pathways, lots of things need to happen at the global economic level before managers even have the opportunity to be proceeding along that pathway."
>
> INVESTMENT CONSULTANT

Q9 How are results measured?

The measurement process usually starts with selection. The criterion includes questions and recommendations to set objectives and KPIs which link to primary goals. By evaluating the KPIs over time, investment consultants can assess whether managers are meeting their objectives. They look at metrics such as the percentage of revenues within a portfolio generated from companies contributing to clean energy or electrification. Metrics and KPIs apply to the asset level and the overall fund level.

Q10 Do investment consultants consider the additionality of clients' impact investments? If yes, how do you assess this in listed assets?

One of the criticisms of listed impact portfolios is the lack of additionality. Investment consultants highlighted engagement as a significant factor to evaluate additionality, especially in the listed market.

> "It is not just about investing your capital; it is about the way managers interact with managing corporate management."
>
> INVESTMENT CONSULTANT

Through the engagement process, investment consultants raise questions including: How is additionality addressed with managers? What is the specific impact of this investment? Is the engagement influencing other investors in the fund? If the driver of the investments is to provide additional capital in these companies, how is that being used to have a positive impact? They try to avoid recommendations based only on good environmental, social and governance (ESG) metrics because there is no evidence of tangible change. Additionality is a challenge all investors face and investment consultants should focus on it.

> "We do not just want investments that change hands in the secondary market and end up with other investors who are less committed to impact factors."
>
> INVESTMENT CONSULTANT

Q11 What is the investment horizon when considering impact investments?

It depends on the kind of pension fund client and the intended length of their investment. On average, the horizon for impact investments is 10 years and most of the demand comes from LGPS funds.

Q12 How has inflation affected investment consultants' willingness to recommend investing in the impact investing sector?

In the current economic situation of high inflation and interest rates, impact investments and client communication are seen as more challenging. For example, in early 2021, impact investments performed well compared to the broader market; however, from late 2022 to 2023 the opposite has happened. Portfolios are being designed to give clients the most robust and broadest possible range of economic scenarios. Consultants highlighted how the diversifying characteristics of impact investments could be a constructive alternative in improving resilience in the economy.

> "We are in an environment where there's expected to be heightened macroeconomic volatility. We could have another resurgence and inflation, or we could have the impact of interest rate rises start to type economies into recession and deflation."
>
> INVESTMENT CONSULTANT

On the other hand, investment consultants noted clients who are interested in impact investments often have a long horizon, which allows them to invest in asset classes such as affordable housing and renewable energy. These asset classes come with inflation linkage, which is designed to harbour investors from inflation by offering explicit or implicit protection.

> "Overall, if clients have trust in the manager over the long term, then there is a bit more comfort."
> INVESTMENT CONSULTANT

Q13 Which do investment consultants prioritise, impact or return?

Priorities tend to depend on the client's objectives. However, investment consultants look for managers with clear financial and impact goals for the portfolio.

Q14 What percentage of pension fund clients have an impact investment strategy?

The percentage of clients with an impact investment strategy is between 5-10%. Nevertheless, investment consultants think there is growing interest in impact investment strategies or at least the willingness to consider them – this is especially evident with the LGPS sector.

Q15 Of those who have already invested, what is the typical percentage of your clients' portfolios allocated to impact investing strategies?

Investment consultants report this at about 5-10% of the client's total portfolio.

Q16 When did investment consultants first start to research impact strategies?

Some consultants started to consider and design impact strategies in 2018. The asset classes encompassed in these strategies have expanded over time. Initially, the focus was on the public equity space but it has evolved to look at illiquid assets in the private market while – in the public market – interesting alternatives in fixed income and credit have started to appear.

Q17 Overall, how have investment consultants' clients' impact investing portfolios performed across the years?

From the investment consultants' perspective, impact investment has performed well and in line with their expectations, especially for clients who have been investing since the embryonic days of impact strategies – for example, since the early 2000s with renewable energy assets. Any strategy can have its ups and downs, but impact has performed well overall. The fact that early clients are still investing in the impact investing universe is a good indicator of its success.

Some impact asset classes, such as growth stocks and bonds, have been impacted recently by the war in Ukraine and the high inflationary environment. The performance in real assets has been relatively resilient due to inflation protection. However, investment consultants reminded us that the impact investing space is still in its infancy.

> "We always look at whether the risk and return profile is in line with the discussions that we had with the client. There haven't been any uncomfortable conversations with clients where we have had to say this return profile has been radically different to what was discussed initially."
> INVESTMENT CONSULTANT

5 Pension funds' views

Pension funds' views

As part of our research, we interviewed six UK pension funds to learn about their experiences in investing in impact funds and their view of the financial performance of these investments. The interviews were conducted through online meetings and were based on a questionnaire covering the following 16 questions. A summary of the findings follows

Q1 What kind of impact and themes does your investment strategy seek to tackle?

Addressing climate change was a consistent theme among asset owners. Water scarcity, biodiversity and social factors (such as affordable housing) were also highlighted as major themes to tackle.

Q2 Are the impact themes aligned with the sustainable development goals?

There was a range of answers to this question. While some asset owners specifically align their impact themes and strategy with the SDGs, others are cognisant of them but may limit their use – for example, just concentrating on avoiding excessive harm.

Q3 What is the focus of the fund's impact approach between the UK, emerging markets and developed economies?

Again, there was a diverse response to this question. Some asset owners focused their investments on EMs or DMs, while others had a UK-specific focus.

The breadth of replies illustrates the wide variety of impact investing opportunities available, from sub-Saharan African sustainable agriculture to the European energy transition.

Q4 Do your investment consultants undertake due diligence on your impact asset managers?

The practice of utilising investment consultants was mixed. Some asset owners had sufficient in-house experience while others used investment consultants to a lesser or greater degree. Where an investment consultant is called upon, it may be to access their expertise to avoid investment manager greenwashing.

Q5 Do you seek impact fund to diversify your portfolios, uncorrelated to listed and private markets? Is this the primary motivation for investing or a secondary benefit?

Impact funds are seen as supporting diversification of the overall pension fund. However, while some see this diverseness as a primary motivator for using impact funds, others see it as a secondary benefit.

Q6 Which of these asset classes: listed equity, fixed income, infrastructure, real estate, private equity or private debt are the most attractive for your impact investment strategy?

Asset owners access most of these asset classes for impact investment, although there was more focus on private markets.

Q7 What impact investing challenges do you face for example, lack of liquidity, limited size or impact measurement)?

A variety of challenges were highlighted, ranging from how quickly the capital allocated to impact investments can be deployed, to the cost to access different impact funds, the small size of niche managers (restricting capital inflows) and the improvements still required in impact measurement reporting.

Q8 How do you assess the value of impact investing and how do you measure the results?

Some asset owners rely on their managers' impact reports and how they set KPIs to assess impact. Others measure their impact using metrics such as the tons of CO_2 emissions avoided, the number of jobs created or preserved, and housing units built. However, some pension funds have been unable to assess the impact of their investments because they are at an early stage; in these cases, the impact calculation must be projected.

"Despite a great deal of activity being undertaken on this front, it is more challenging to collate and quantify/present in a meaningful way."

ASSET OWNER

Q9 Do you consider the additionality of your impact investments? If yes, how do you assess this in listed assests?

All asset owners confirmed they consider additionality as a relevant part of their impact investing strategy. It is developed by regular sessions with their asset managers to dive deep into the additional value of their investments. Assessment is also conducted using the 'theory of change'.

"(Our consultants) do dive quite deep into those strategies with managers. Asset managers are really good at providing impact examples within their investment strategies and we want to see them doing more."

ASSET OWNER

Q10 What is the investment horizon of your impact investments?

Most asset owners had a long-term investment horizon, ranging from 10 to 30 years, the specific length being highly dependent on the nature of the pension scheme.

Q11 How has inflation affected your willingness to invest in the impact investing sector?

Inflation was not cited as a barrier to allocating to impact investments. It was noted inflation applies to all funds, impactful or not. While inflationary pressures must be managed carefully on assets such as infrastructure, some asset owners pointed out that their impact funds offer inflation hedging.

"Inflation is a very important consideration overall given that pension liabilities are inflation linked."

ASSET OWNER

Q12 What are the most important SDGs for your fund to create and promote an impact strategy?

Most asset owners highlighted **Climate action (SDG 13)** as the most important SDG in their impact strategy. However, they also indicated the relevance of the 'investable' SDGs which relate to environmental, social, housing and local community factors.

"We favour SDGs that are investable and where we can make the biggest impact through our investments."

ASSET OWNER

Q13 Which do you prioritise, impact or return?

All asset owners interviewed prioritised investment return over impact. That said, there was a strong desire to have a positive impact and often this could be achieved simultaneously by generating the best risk-adjusted returns.

Q14 What percentage of your portfolio is allocated to impact investment strategies?

Answers to this question ranged from between 1% and 25% of assets.

Q15 When did the fund begin to look for impact investment strategies?

Some asset owners reported they have held impact investments for over 10 years. Others (such as master trusts) are relatively new to the space and have only set up their impact investing strategies in the last few years.

Q16 Overall, how has your impact investing strategy performed over the years?

Asset owners with longer track records have been satisfied with the performance of their impact investment assets, while the performance of strategies for newer asset owners has been too short to form meaningful conclusions. Early performance indicators have been mixed, although it was noted some impact funds still need to complete an entire investment cycle.

6 Academia’s view

Academia's view

What does academic literature say about the financial performance of impact investments (market-rate-seeking funds)?

Rigorous academic research and industry data demonstrate that impact investments across major asset classes can achieve competitive risk-adjusted returns compared to conventional counterparts (Bugg-Levine & Emerson, 2011[1]; Gray et al, 2015[2]; Pane[3], 2021; Jeffers et al 2022[4]).

Evidence from private markets shows private equity, venture capital and debt impact vehicles generate returns rivalling or exceeding mainstream funds, with top-tier impact managers consistently outperforming. In real assets, collateral value and demand/supply imbalances allow impact real estate, infrastructure and timber to return in line with or above benchmarks.

Emerging research on public equities indicates that incorporating impact goals need not restrict performance. As data develops across geographies and asset categories, further analyses can strengthen performance benchmarks to support the impact investing industry as it matures. With a solid track record, the field appears poised for significant growth as more investors adopt impact-intentional approaches.

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7 The GIIN's view

The GIIN's view on the research

As the industry continues to evolve, investors around the world are exploring opportunities to meet our globe's growing social and environmental challenges across a diversity of investment strategies, asset classes, sector and geographies. Investors typically target a range of financial returns, with a majority of impact investors seeking risk-adjusted, market-rate returns.[1] *Pensions for Purpose*'s research findings reflect financial performance across impact funds for each asset class, demonstrating the potential to achieve market-rate returns through impact funds, though returns vary as they do in traditional markets. The findings suggest less volatility in private equity impact funds compared to traditional public markets, even though returns reflect widespread dispersion. Research on the financial performance of impact funds, such as that conducted by *Pensions for Purpose* can enable informed allocation and management decisions for asset managers and asset owners. Further, it serves as laudable intelligence for these actors providing insight that has the potential to unlock the increasing application of impact investing strategies.

Optimise performance

While financial performance is one critical consideration when driving decision-making, it is not the only one. Impact investors are exercising a variety of choices to optimise portfolio performance and data-driven decisions across a range of variables at the intersection of financial performance, impact performance and risk. 'Impact Investing Decision-making: Insights on Financial Performance' explores the financial performance of impact funds and additionally offers insight into six facets that investors consider as they make portfolio construction, strategy and investment decisions: financial return, impact return, financial risk, impact risk, liquidity, and resource capacity.[2] By using this dynamic model, investors can consider which choices they wish to make to ensure that their investments are efficient relative to their intended returns thesis. Across a variety of goals and mandates, including those of pension funds, impact investors can achieve financial returns in line with their expectations as illustrated in the '2023 GIINsight: Impact Investing Allocations, Activity & Performance', where 79% of respondents reported that their portfolio performed in line with or exceeded their financial performance expectations.[3]

Global challenges

External factors will influence the performance of any portfolio, as highlighted in the *Pensions for Purpose* research findings. The climate crisis, COVID-19 pandemic and growing economic pressures are likely global macro events affecting financial markets and society. This is also reflected in the *GIIN's* recent research; on the financial performance side, 52% of impact investors indicated that global macro events have worsened their financial performance in 2022, 32% indicated that performance stayed the same, and 6% reported that these events have improved their financial performance.[4] Given the compounding effects of global macro challenges in 2022 – such as the COVID-19 pandemic, escalation of regional conflicts and war, inflationary pressures and supply chain issues among others – investors may be factoring volatility into their financial performance expectations, adjusting expectations downward. Thus, performance is still within an expected range even though the range is subdued.

Further research

The findings presented in this report help to enhance transparency in the industry. Investors are encouraged to continue to share data on both the financial and impact performance of their funds to expand the industry's knowledge of performance. Expanding the body of research drives toward greater market insights for investors, especially sizeable asset allocators such as pension funds, and ultimately leads toward more efficient and effective decision-making.

This research opens an opportunity for additional researchers, academics, and field-builders to continue to not only explore financial performance, but also probe the intersection between impact and financial performance. Insights into financial and impact performance will better equip investors to direct capital toward investment strategies that enable people and planet to thrive.

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4 Ibid

8 Co-sponsor’s view

Co-sponsor's view on the research

Feedback from our sponsors

Vontobel Asset Management

We are encouraged by this report's findings, which concur with our experience over the last 15 years and demonstrate that investing for positive impact through public equities does not require investors to expect a lower return. Listed impact equities provide the same flexibility as traditional global equities, enabling all pension schemes to consider allocating to impact without affecting their portfolio's liquidity or risk/return characteristics.

In this study, impact through listed equities has the longest track record of any asset class, which should be reassuring for investors. We were an early adopter of impact investing, primarily because our majority owner - the *Vontobel* family – was decisively committed to positive change.

We recognise many of the observations noted by investment consultants and pension schemes in this report and we agree that to really deliver for clients, impact needs to be embedded in the investment manager's decision-making process, with the impact measurable and tangible for clients. This can be helped by setting clear objectives, demonstrating the rationale for investment and monitoring KPIs. Metrics, such as the percentage of revenues within a portfolio generated from companies contributing to goals, can increase client confidence that impact investments are genuinely focused on these important objectives and should overcome the challenges of greenwashing. Clear, relatable reporting aligned to the strategy's stated investment objectives should demonstrate that clients can invest purposefully and achieve the double-dividend of positive impact and attractive risk-adjusted returns.

Baillie Gifford

Within the *Baillie Gifford* Positive Change team, we have long believed that profit complements purpose. This research provides clear empirical evidence that impact investing does indeed provide attractive investment returns.

Positive Change is a listed equity impact fund, and it is pleasing to see a consistent level of long-term outperformance from such funds. However, we recognise that in order to effect real-world change, impact needs to be considered across multiple asset classes in both the public and private markets, so it is heartening to see strong performance across all impact asset classes.

The insights from consultants and pension funds within the research shine a light on not just the return potential of impact investing but also the diversification benefits. The thoughtful observations shared on the challenges and importance of impact measurement, monitoring and reporting also illustrate the evolving rigour of impact measurement, and the ambition that the industry has to continue progressing in this area.

Of course, it is encouraging there is real recognition that capital is a very powerful mechanism of change. All of us, from asset managers to asset owners and their advisers, have a role to play in directing capital to help solve some of the world's biggest challenges. This research helps to evidence that doing so is consistent with fiduciary duty and has the potential to generate attractive long-term returns.

Resonance

This research provides a great insight into how different impact sectors have historically performed, pulling it together in one place, which has been missing from the industry previously. We believe it will prove a useful ongoing tool for asset owners and their investment consultants, and it is important this research is kept up to date, to build on the historical picture.

Its findings illustrate that investors do not necessarily need to sacrifice financial returns to have a positive impact with their investments, whatever the sector.

It was also encouraging that the interviews with pension funds highlighted the increasing growth and interest in impact investing. There was a strong desire to have a positive impact with investments, which often could be achieved simultaneously by generating the best risk-adjusted returns.

At *Resonance*, our focus is on social impact property funds and the conclusion of this report, from a real estate viewpoint, reflects that impact investors concentrating on this market can execute risk-adjusted returns in line with the conventional market.

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Franklin Templeton

The report highlights compelling insights that resonate with our dual return objective on both financial and impact fronts. Having clear financial and impact objectives is an important step in evaluating opportunities in this asset class. By investing in assets that cater to social and environmental needs, we're not just aiming for financial returns; we're also targeting meaningful, positive changes in our communities and on the environment – both are equally important. This dual approach ensures our investments not only yield strong repeatable risk-adjusted financial returns, but also drive significant social and environmental impacts. The findings from the report support our strategy, and we are encouraged by the comments from asset owners and consultants, particularly around measurement of impact, SDG mapping and the long-term investment characteristics of private assets.

We aim to deliver competitive risk-adjusted returns to all clients including those looking for impact, and we believe this layering of broader goals and specific impact measurements draws from leading industry practices amid rapid developments in impact measurement across the asset management industry.

Franklin Templeton is well positioned to collaborate with clients to create portfolios with the explicit intention of generating financial returns alongside measurable and positive social or/ and environment impact objectives.

For instance, *Franklin Real Asset Advisors (FRAA)* has a dedicated social infrastructure strategy which has a dual-return objective of delivering social and environmental impact alongside financial return. With increasing investor demand for such strategies, we have continued to enhance impact measurement and reporting to align with evolving global standards such as the Five Dimensions of Impact framework that was developed by the *Impact Management Project (IMP)*, the SDGs and performance metrics from the *GIIN's* IRIS system.

On the wider topic of sustainability, *Franklin Templeton* recognises this as one of the deep waves transforming global capital markets. We frame our approach as 'Beyond ESG' because ESG is an acronym that references environmental, social and governance issues but does not include an 'F' for financial returns. By putting financial returns at the centre of our model, we reflect the fullest sense of our fiduciary duty to manage investment risks.

While our strength lies in the autonomous investment processes of our individual investment teams, we deploy our global scale and resources to work together on universal sustainability issues to create value for our clients. We have grounded our sustainable investment strategy on an economic model based on the effective management of risks to human and natural capital, as we believe this goes hand in hand with financial capital.

Aquila Capital

There can be no doubt that additional and incremental social or environmental impact arising from financial investments can only be a good thing. However, there is still a way to go to standardise the meaning of impact investment within the investor universe. *Aquila* utilises *The GIIN*'s definition, that impact investments are those made with the intention of generating positive, measurable, social and environmental impact alongside a financial return. That is a positive approach, although this remains a broad definition with room for multiple interpretations and expectations with regards to the final outcomes achieved.

Challenges remain when attempting to analyse the purely financial implications of adding such impact factors to an investment. This is most apparent within private markets, where performance data is less accessible and valuations tend to react more slowly to shifts in the economic landscape. Furthermore, sectors with the potential for impact investing tend to be sub-sectors of broader asset classes; an additional hurdle for gathering valid data. In many cases, the performance history is also short and less meaningful than when undertaking an analysis of longer track records.

Despite this, there is still a strong rationale for making impact investments. There is little evidence to support a view that impact investments do not provide competitive returns when compared with their non-impact equivalent. Indeed, the growing recognition of the importance of impact may even help boost future returns as investor demand for the sector grows.

Aquila's approach is to maintain our focus on assets which contribute to the energy transition and decarbonisation. We aim to deliver competitive market rate IRRs over the life of the investment for our investors. Furthermore, we provide meaningful metrics to enable investors to understand the social or environmental impact that such investments deliver. The imperative remains to attract further capital into these vital asset classes and *Aquila Capital* strives to provide the means through which asset owners can make positive impact.

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AXA Investment Managers

This piece of research is vital for the industry, especially now as more data is becoming available. We are pleased to see that the report findings also support our past research and key points:

- Asset owners can act now to drive change while meeting their fiduciary duty to their members and ensuring we have a world worth living in..
- Impact used to be confined to private markets, which is no longer the case. Investment and business dynamics have combined to give institutional investors the scope to deliver impact in public equity and bond markets.
- There are challenges in measuring and verifying data for credible impact investment. We think it is essential to use strict processes and frameworks to help overcome those challenges and seek to identify leaders within the impact universe.

We were delighted to see investment consultants note that climate as an impact investing theme goes beyond carbon emissions. We agree that climate and biodiversity are interlinked. What this report demonstrates is that asset owners can act now to drive change whilst also meeting their fiduciary duty to their members. It was great to see that consultants believe engagement is a crucial element for additionality in the listed market, alongside stewardship.

Impact leaders can form a key part of an asset owner's portfolio. We believe one of the ways to do this in a purist sense is to generate positive outcomes through a company's goods and services. They may be front-line businesses, producing renewable energy, for example, or embedded in a supply chain, delivering important technology or services. Leaders will not be perfect, and our engagement with them is designed to maintain and improve that leadership position.

Impact contributors, meanwhile, are companies that generate significant positive social or environmental impact but may be held back from leader status by a variety of factors – perhaps only a limited portion of revenue contributes to the SDGs while the rest of the business is largely neutral. Our assessment may also be affected by the relative severity of the issue being addressed, a lack of corroborating disclosures or negative externalities.

There is another potential challenge for investors in piecemeal harmonisation of the techniques used to collect and report impact data across asset classes. They may necessarily be very different for companies operating in different sectors but, while we focus on actively assessing each investment on its merits, we think it is also important for asset managers like *AXA Investment Managers* to work towards establishing a working consensus in markets. It is clear too that this would help address the greenwashing issue.

True harmonisation will require a wide acceptance of KPIs that are able to reach into the heart of impact delivery. We always look for granularity in data. If we can identify hard numbers like renewable power generation or the number of under-served consumers accessing socially beneficial services, then we can invest with confidence – particularly when this is repeatable over time and across sectors or issuance.

Our investment case on impact, whether in private-equity-style portfolios or in the liquid listed markets discussed here, is that we are tapping into some of the most important macro and corporate trends at play. In line with the report, we expect financial returns in impact portfolios to continue to reflect this as companies and issuers deliver potential solutions to some of the world's most pressing problems. In equity markets, we see the potential for financial returns from companies that support the transition to a new era in energy or that address social issues attracting attention from policymakers.

In truth, finance is only part of the solution but as an industry we clearly all have an important role to play in helping to build sustainable economies that will provide powerful investment opportunities over the years and decades to come.

7 Conclusion

What we have learned from the research

When we embarked upon this research, anecdotally we knew there were impact funds available to UK pension fund investors that were delivering strong risk-adjusted returns. However, sceptics wanted to know if that was true across all asset classes. The impact investment market is still developing rapidly and at this point, it is fair to say, the sample size of funds with a reasonable track record is still relatively small.

However, we hope the conclusions drawn from this research can reassure pension fund trustees, and other institutional investors, that there are investment opportunities which deliver both impact and a financial return at least as good as their market-rate equivalents.

In our interviews with pension funds, we were encouraged by the positive reaction from those who had been investing with impact for some time. Several funds indicated their investments had not only delivered competitive returns but, in some cases, had demonstrated considerable outperformance.

We often remind pension funds that impact investments can offer investors other attractive benefits, such as genuine diversification, inflation-linking and secure income. The contribution of an impact investment to the total fund's risk-adjusted returns, its ability to deliver payments to pensioners with confidence, its capability to help smooth the return stream from the whole portfolio, or its value in assisting with member engagement, should all be considered when reviewing an opportunity. Combined with the confidence we hope this research will convey, around the financial case for investing with purpose, these additional benefits lead us to conclude it is no surprise that impact investing is fast becoming a mainstream approach for UK pension funds.

Appendix

Appendix | Participants who gave permission for their name to be listed in our report

Pension funds / pools	Investment consultants	Data
Cushon	Isio	FTSE Russell
Clwyd Pension Fund	Mercer	
London CIV	Redington	
Merseyside Pension Fund		
Smart Pension		
Strathclyde Pension Fund		

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