Real estate impact investing: *Four key insights*

Understanding and defining impact investing can help investors succeed in this growing area.

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The concept of impact investing is still in its early stages, and despite its rapid growth, many institutional investors are only just starting to make impact strategies part of their permanent allocations. It is therefore not surprising that we are seeing an array of definitions of impact investing in the marketplace. Nevertheless, our research into the history and current state of impact investing finds evidence of rising standardization and sophistication, laying the groundwork for continued growth in institutional capital allocations.

Real estate is an important subset of the impact investing universe, accounting for between 10% and 15% of all capital invested in impact strategies, or between $27 billion and $40 billion by our estimates. It has many appealing attributes for impact investors, notably the ability to invest in physical, visible projects that can improve communities as well as the health and well-being of people who live in them.

We have identified four key insights that have helped us to better understand and define impact investing, and how real estate fits into this strategy:

1 Impact investing is a distinct strategy

Unlike other investment strategies, impact investing has a dual, rather than single, mandate to generate positive social change alongside market-rate returns. One element of this mandate cannot be sacrificed for the other, and in many instances the two reinforce each other. For example, upfront investment in energy efficiency improvements in an apartment building can create cost savings, as well as improve the health of its residents.

[1] U.S. Energy Information Administration, 2015 Residential Energy Consumption Survey.

Impact investing is not a "you know it when you see it" strategy investment because all investment outcomes must be specified *in advance* to ensure that every new investment is made to maximize impact. Measuring positive social change is more challenging than calculating financial returns, but it is possible with the right resources. Examples of metrics used to measure impact from real estate investment include the number of affordable housing units created, on-site jobs created, and results from tenant satisfaction surveys.

2 Real estate impact investing is not the same as sustainable or green investing

Sustainability principles are increasingly important to institutional real estate investors, with advantages ranging from enhanced returns via cost savings to explicit sustainability mandates. But impact investing is about more than environmental, social, and governance (ESG) investing and socially responsible investing (SRI). The key distinction is that impact investing has an explicit goal to produce measurable and *direct* social change.

A real estate impact strategy may incorporate many of the same sustainability principles that have been adopted by ESG and SRI investors. However, sustainability principles alone are often insufficient to meet impact investing goals such as improving the economic and physical health of tenants and users of real estate.

Consider two examples of how real estate impact investments can use sustainability principles to make measurable, positive social change:

> "In the U.S., there is widespread need for the preservation and creation of affordable housing. Nearly half of all renter households are "cost-burdened," meaning that they spend more than 30% of their income on housing."

- Housing affordability includes more than just rent. Energy use is a significant component of housing costs, so improving the energy efficiency of existing housing stock is a way to lower the cost burden on residents. This is particularly important for affordable housing, as data from the 2015 Residential Energy Consumption Survey found that multifamily rentals occupied by lower income households were less efficient than those occupied by moderate- and higher-income households.[1]
- Enhanced energy efficiency improvements have also been shown to reduce air and environmental contaminants linked to chronic illnesses and respiratory health conditions, which may ultimately reduce pressure on healthcare systems.

3 Housing unaffordability in the U.S. is an issue that impact investors can help solve

In the U.S., there is widespread need for the preservation and creation of affordable housing. Nearly half of all renter households are "cost-burdened," meaning that they spend more than 30% of their income on housing. Cost burdens are particularly high in cities with high housing costs such as New York and Los Angeles; however, even areas with housing costs that are at or below the national average, such as Orlando, Denver, and Phoenix, have large numbers of cost-burdened renters, due to lower incomes.

The need for affordable housing is not limited to urban areas. Between 2000 and 2015, the low-income population in the suburbs across the country grew from ten million to over 16 million, outnumbering the low-income population in cities by more than three million.

To increase affordable housing stock in the U.S., private investment is required. Over the past half-century, there has been a shift toward programs that incentivize private investment into affordable housing, as opposed to solely relying on direct government funding or subsidies. This shift has created an opportunity for impact investors to meet their dual mandate of generating positive social change alongside financial returns.

4 Affordable housing is just one aspect of real estate impact investing

The growing need for the preservation and creation of affordable housing in the U.S. is clear. However, in areas lacking other elements vital to a healthy community, affordable housing alone is not enough. "Transformative development" is also needed to revitalize communities.

The spectrum of transformative development is much wider than affordable housing. Broadly defined, transformative developments are larger, community-based projects that are catalytic — meaning they intend to have an impact beyond the real estate project itself. Transformative developments are often anchored by a housing component, which may or may not be affordable. Examples of transformative developments without housing include mixed-use projects such as job and service centers, manufacturing facilities and schools.

The role of transformative developments in an impact portfolio is less specifically prescribed than housing, and therefore must be evaluated on a case-by-case basis. Nevertheless, there are metrics that can be identified in advance to measure standard impact markers, such as for health, economic, and educational outcome improvements.

The future of real estate impact investing

To be successful in addressing the growing need for both affordable housing and transformative developments, more capital will be required to invest into larger projects. Private sector investment, including capital provided by impact investment vehicles, will be an essential part of the capital stack.

Green certifications and other sustainability initiatives have transitioned in less than a decade from a "nice to have" to a "must have" across parts of the real estate industry. If it follows a similar trajectory, impact investing will quickly transition from a small niche to a permanent part of many institutional investors' real estate portfolios. ◆

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