mallow street

Social Infrastructure Report 2024.

IN PARTNERSHIP WITH:

octopus investments

SOCIAL INFRASTRUCTURE – GETTING THE BALANCE RIGHT

Real assets are increasingly on the agenda for UK local government pension schemes (LGPS) given the recommendations of the Task Force on Social Factors and increased dialogue around social impact.

LGPS schemes remain focused on their primary goal: securing and improving member outcomes. Against this backdrop, the balance between central government ambition, local policy and investment priorities requires delicate work.

Social infrastructure broadly refers to the buildings, facilities, services and organisations that underpin everyday life and ensure its quality. While definitions may vary, social infrastructure investments often include community, health provision, education, play, youth, recreation, sports, faith, and emergency facilities.

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To understand the role that social infrastructure plays in long-term asset allocations and further break down the key obstacles in making such investments, **mallowstreet**, in partnership with **Octopus Investments**, surveyed 27 UK LGPS schemes in April 2024, gathering perspectives on more than £230bn in assets under management.

Our research uncovered that UK LGPS schemes are familiar with and investing in a range of social infrastructure themes, but they remain committed to investing for outstanding risk-reward characteristics rather than intentional impact alone. In fact, the impetus for impact sits with asset managers. The bar for social and climate credentials is set significantly higher for social infrastructure managers. They have two traps to avoid, those of of greenwashing and 'social washing', after the launch of the Financial Conduct Authority's anti-greenwashing rule and incoming Sustainability Disclosure Requirements.

This report presents our in-depth findings and key industry recommendations. We hope you find it insightful.

KEY STATISTICS

27
trustees, pension heads and investment decision-makers

100%
LGPS schemes and pools

10
LGPS schemes over £5bn

17
LGPS schemes under £5bn

£230bn+
of LGPS assets represented

10
questions

750+
primary data points

EXECUTIVE SUMMARY

SOCIAL INFRASTRUCTURE IS A KEY DRIVER OF RETURNS: LGPS schemes invest in social infrastructure to get higher returns, lower climate risks and achieve better diversification. Return expectations vary between 4% and 10%, but depend on the type of asset and portfolio bucket the investment would sit in. Against this backdrop, making an intentional impact does not feature as highly: only 15% name this as the main driver for social infrastructure investments, while those with a dual objective put returns and/or diversification on par with impact.

HOWEVER, LGPS INVESTORS ARE NOT INDIFFERENT TO SOCIAL IMPACT: the perceived clash with fiduciary duty is the main obstacle when investing in social infrastructure and explains the reluctance to invest explicitly for impact. Despite this, LGPS schemes already invest in social themes, including sustainable infrastructure, healthcare and affordable housing – with the last being the top area for social impact. This shows that many social infrastructure assets do not conflict with fiduciary duty after all, but such investments need more momentum. In other words, LGPS asset owners do not shy away from positive social impact even if they would not allow it to be the sole factor for decision-making.

THE IMPETUS FOR IMPACT FALLS ON ASSET MANAGERS: even if LGPS asset owners are reluctant to focus solely on social impact, they fully expect social infrastructure managers to back up their impact credentials. Additionally, managers must grapple with social and climate requirements spanning a long list of frameworks and standards. Impact may be second to returns, but LGPS asset owners put social infrastructure managers through more stringent 'hygiene checks', with SDGs and impact principles on par with net zero commitments. This means that ESG requirements for social infrastructure and real assets managers are higher, but they are uniquely positioned to help LGPS schemes with both climate and social goals.

KEY STATISTICS

74%

of LGPS schemes invest in social infrastructure due to its risk-return profile and diversification benefits

15%

invest explicitly to create intentional impact

48%

of LGPS schemes are worried about the clash with fiduciary duty to members when they invest in social infrastructure

60%

invest in affordable and social housing, healthcare, care homes and wellbeing services

70%

of LGPS asset owners would require social infrastructure managers to report on the AUM invested with an impact goal

[*] Throughout this report, figures may add up to 99% or 101% due to rounding of percentages. Additionally, some questions required multiple answers, so figures in some bar charts will add up to significantly more than 100%. In such charts, dark blue highlights may be used to emphasise key statistics and help the reader follow the analysis.

INDUSTRY RECOMMENDATIONS

FOR LGPS ASSET OWNERS:

- Invest in affordable and social housing – they offer good returns and diversification, as well as social impact in a high priority area
- There is no need to sacrifice returns in social infrastructure – if a manager is suggesting this, ask them to explain
- Discuss your concerns about fiduciary duty to members with larger LGPS investors, asset managers and regulators – there is increasing evidence that pension schemes can consider impact investments without fearing legal repercussions, so keep abreast of evolving best practices
- Check how social infrastructure managers are approaching climate risks and reporting – such assets can help towards your own net zero goals
- Discuss climate and social reporting needs with peers and managers as regulatory guidance and best practices evolve
- Work with a consultant and/or professional trustee that understands real assets – this can increase and improve your governance resources

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SOCIAL INFRASTRUCTURE IS A KEY DRIVER OF RETURNS

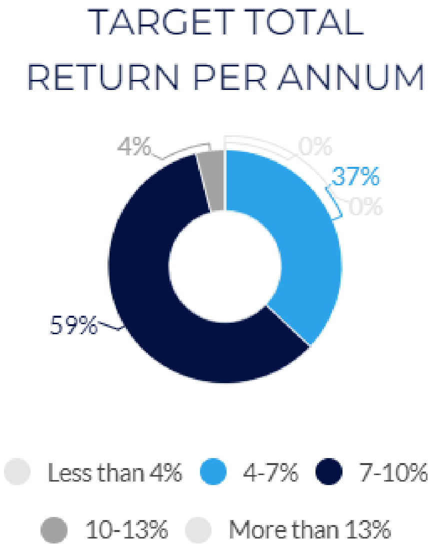
LGPS schemes invest in social infrastructure for higher returns and better diversification, but not solely for intentional impact.

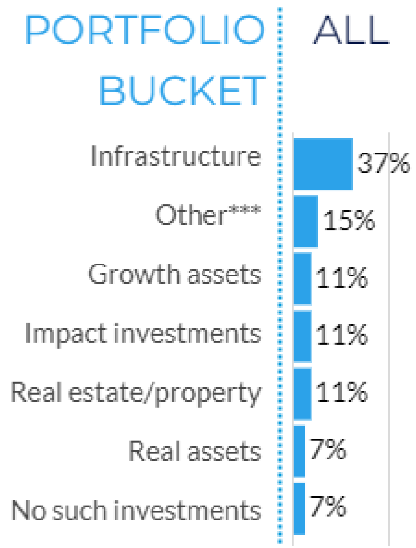
The main benefits attracting LGPS asset owners to social infrastructure are higher investment returns (22%) and lower climate-related risks (22%). Additionally, 15% recognise the diversification benefits of the asset class, especially of affordable housing. A similar proportion say they cannot pick only one reason to invest in this asset class: a dual objective typically combines return and diversification. Adding these together, 74% invest in social infrastructure due to its attractive risk-return profile.*

In contrast, making an intentional impact does not feature as highly: only 15% name this as the main driver for social infrastructure investments. Those with a dual objective put returns and/or diversification on par with impact, i.e. investing for impact without sacrificing returns. However, these investors are a minority.

Over half of LGPS investors would target a total return of 7% to 10% when investing in social infrastructure, but another 37% would be satisfied with a lower return, between 4% and 7%.

However, return expectations may vary somewhat, depending on the type of assets used to create a social infrastructure allocation. While 37% of LGPS schemes invest out of their infrastructure portfolio bucket, another 15% take a different approach, often spanning multiple illiquid portfolio buckets, such as private markets, real estate and other real assets. Additionally, 7% invest solely out of their real assets portfolio, while 11% do so via real estate.***





KEY STATISTICS

74%
of LGPS schemes invest in social infrastructure due to its risk-return profile and diversification benefits

15%
invest explicitly to create intentional positive impact

59%
target a total annual return of 7% to 10%

37%
would be satisfied with a return between 4% and 7% instead

37%
invest via their infrastructure portfolio

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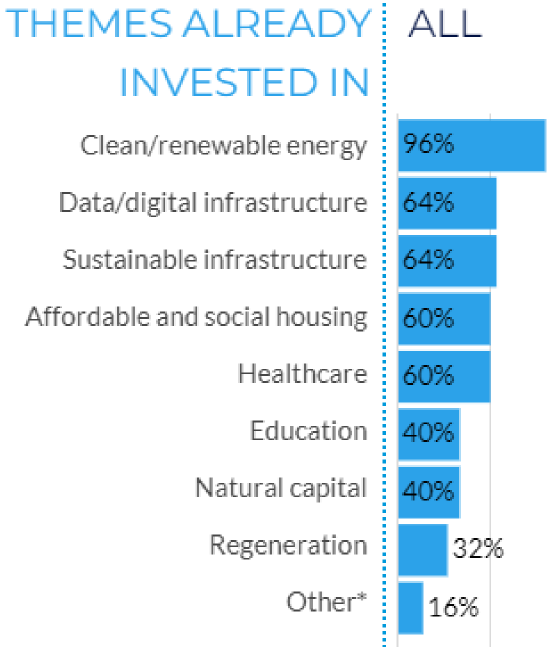
* Diversification was not an answer option provided in the survey, but many ticked ‘other’ and provided this explanation.
** Similarly, dual objective was not listed as an answer option, but some ticked it to explain they invest with a combination goal.
*** Those who ticked ‘other’ under their portfolio bucket broadly specified other or multiple buckets, e.g., a mix of real estate, private equity, private debt, and infrastructure.

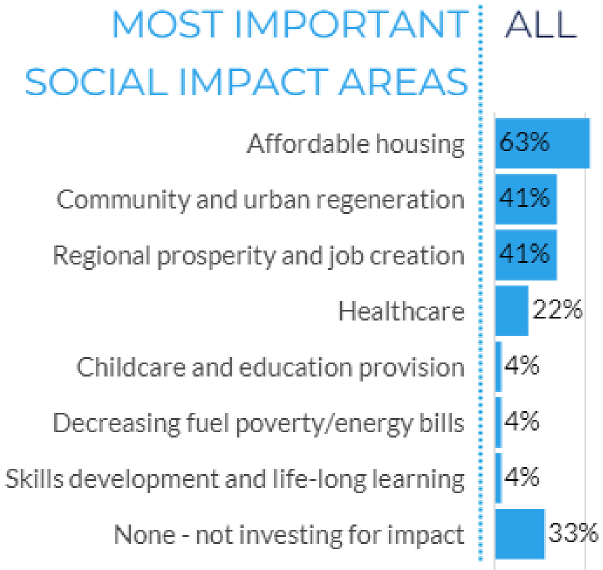
SOCIAL THEMES ARE FAMILIAR BUT NEED MORE MOMENTUM

Many LGPS schemes already invest in affordable housing, healthcare and education – however, not to the same extent as clean energy.

Almost all UK LGPS schemes invest in clean and renewable energy, and a third also have exposure to sustainable infrastructure (e.g., electric vehicle infrastructure, waste and water management, green transport). This shows momentum in mobilising capital to support the climate transition. Against this backdrop, themes associated with social impact are popular, but do not yet receive the same attention:

- 60% invest in affordable and social housing (e.g., affordable homes, shared ownership, social rent)
- 60% invest in healthcare (e.g., hospitals, care homes, life sciences, healthtech, health and wellbeing services)
- 40% invest in education (e.g., schools, edtech, upskilling, childcare)
- 32% invest in regeneration as a theme (e.g., urban regeneration, place-making, community services)





Indeed, 63% of LGPS schemes see affordable housing as the most important area for social impact (including mid-market rent, shared ownership and social housing). After all, there is a known shortage of adequate and affordable housing.

Additionally, 41% of local government schemes see a need for social impact via community and urban regeneration, and a similar proportion focus on regional prosperity, employment and job creation. Healthcare (including retirement communities, care homes and specialist care) is a top area for social impact for 22% of LGPS investors.

All this suggests that while one-third reiterate they do not invest for impact, LGPS asset owners are aware of investment themes associated with social impact and the potential for positive change.*

KEY STATISTICS

60%
invest in healthcare, including care homes and wellbeing services

60%
invest in affordable and social housing arrangements

63%
see affordable housing as the most important area for social impact

41%
prioritise community and urban regeneration, regional prosperity, employment and job creation

33%
have no opinion on areas for social impact because they do not invest with this in mind

* 'Other' themes span residential property/housing, including shared ownership in the private rental sector, which is not in the affordable housing bucket, but providing homes for those who would struggle to get a mortgage, as well as supported specialist living.

FIDUCIARY DUTY IS A KEY CONSIDERATION WHEN INVESTING

The perceived clash with fiduciary duty means that LGPS schemes often do not invest explicitly for impact – however, they are not indifferent to it.

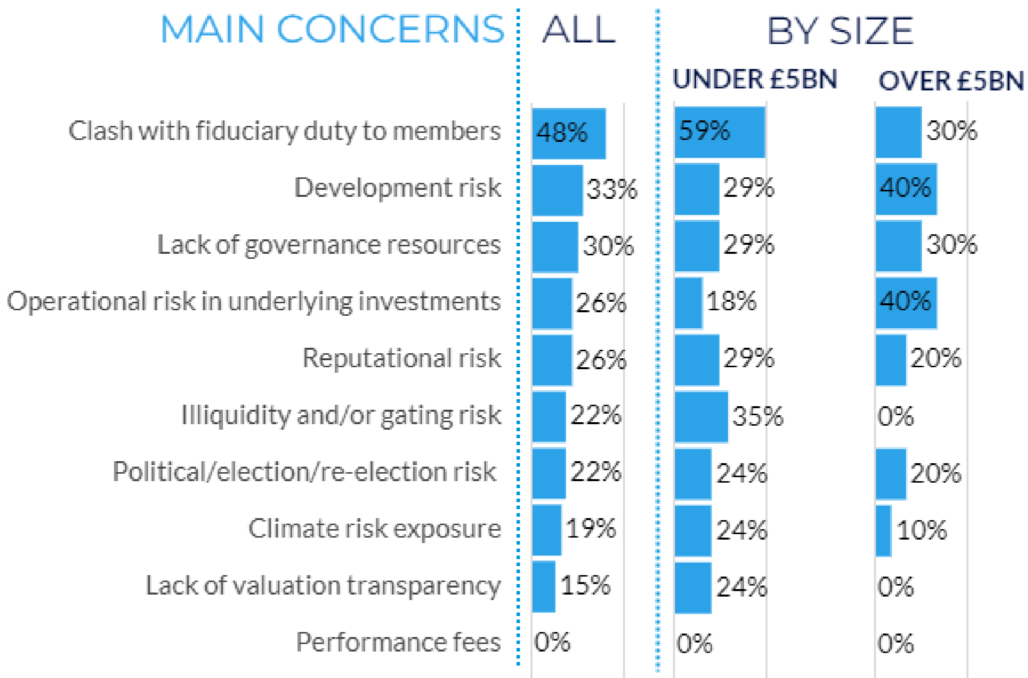
The top concern for LGPS schemes undertaking social infrastructure investments is the perceived clash with fiduciary duty – 48% of all schemes say they are worried about this, which includes 59% of smaller schemes with assets under £5bn. Given this opinion, it is not surprising that so few LGPS asset owners name intentional impact as their primary investment driver. In addition, over a quarter are worried about reputational risk. This signals that LGPS schemes are concerned about appearing to prioritise any other outcomes over those for members and explains the steadfast focus on risk-reward. However, this does not make them indifferent to investments which create social impact (see pages 5 and 6).

For example, the third biggest concern is the lack of governance resources to properly assess or monitor social infrastructure investments. Interestingly, this concern is shared by large and small LGPS schemes and reflects both the complexity of some social infrastructure assets, as well as the lower prevalence of LGPS professionals with an institutional investment background.

Larger LGPS pools and schemes with assets over £5bn are typically better resourced, with internal investment teams that can scrutinise individual assets. As a result, 40% say their top concern is development risk, and a similar proportion are concerned about the operational risk in underlying investments.

Encouragingly, just 22% of all LGPS schemes worry about illiquidity and/or gating risks when investing in social infrastructure – and this is mainly a concern for smaller schemes. Similarly low proportions worry about the lack of transparency around asset valuations, or political, election or re-election risk when dealing with local authorities.

Surprisingly, performance fees are not a major worry for LGPS schemes. This may reflect the fee structures prevalent in social infrastructure. As a result, funds with performance fees may not be well-received by LGPS asset owners.



KEY STATISTICS

48%

of LGPS schemes are worried about the clash with fiduciary duty to members when they invest in social infrastructure

40%

of schemes over £5bn are worried about development and/or operational risk

30%

of all LGPS asset owners are worried about the lack of governance resources to properly assess or monitor investments

26%

are concerned about reputational risk

22%

worry about illiquidity and/or gating risk

THE IMPETUS FOR IMPACT FALLS ON ASSET MANAGERS

While LGPS investors are reluctant to focus on social impact alone, they fully expect social infrastructure managers to back up their impact credentials.

Given the perceived clash with fiduciary duty to members, LGPS schemes do not invest in social infrastructure solely to create intentional social impact. Despite this, they fully expect social infrastructure managers to back their impact claims with detailed and appropriate metrics. For example, 70% would enquire about the assets under management (AUM) invested specifically with an impact goal, while about half would want to know about the volume and magnitude of the impact their investments create.

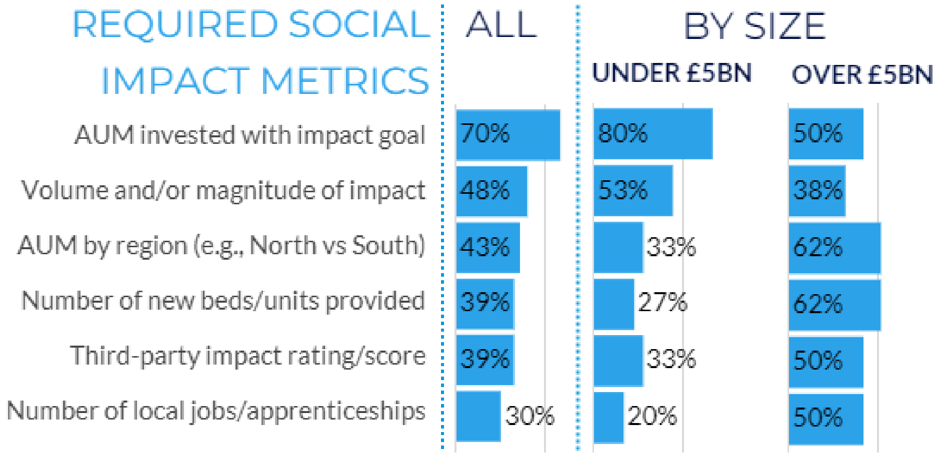
Larger LGPS pools and schemes over £5bn have even more detailed reporting requirements: 62% would ask for a breakdown of the AUM invested in each region (e.g., North vs South of England), likely reflecting a desire to create – and see – a real impact on local communities.

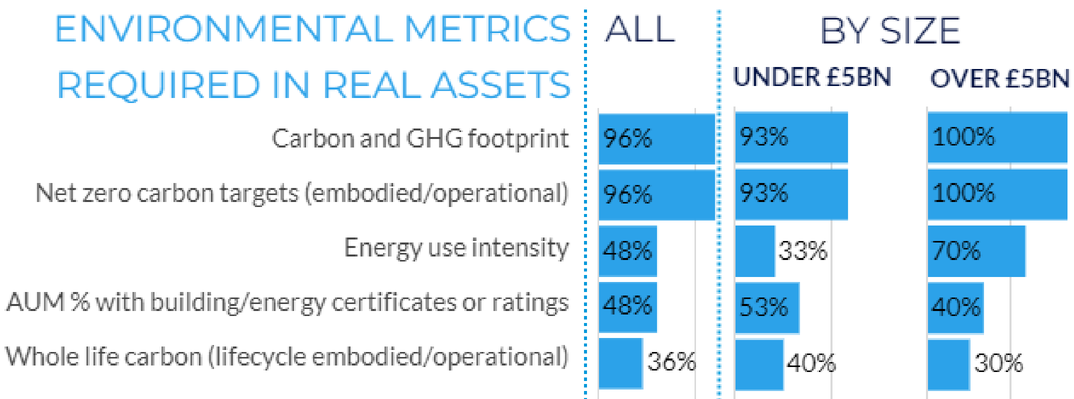
A similar proportion would want to know the number of new units or beds provided by their investments. Additionally, 50% of larger schemes would look for the number of local jobs and apprenticeships created, as well as third-party impact ratings or scores. All these offer ways to independently assess the manager's social impact claims.

And even though some LGPS investors prefer social impact to climate, the climate reporting requirements for real asset managers are not any lighter.

Carbon and GHG footprints are in demand for schemes of all sizes, as are net zero targets which factor in both embodied and operational carbon. However, whole life carbon metrics are not yet reliable and used more rarely.

Finally, larger schemes pay attention to energy use intensity, likely in cases where they have direct investments or closer scrutiny of individual assets.





KEY STATISTICS

70%
of LGPS asset owners would require social infrastructure managers to report on the AUM invested with an impact goal

48%
would additionally require details on the volume and magnitude of the impact created

96%
need carbon and GHG footprint reporting and net zero targets in real assets

62%
of schemes over £5bn would want metrics on the AUM invested in each region

62%
of them are further looking for reporting on the number of new units or beds provided

MANAGERS SHOULD PASS BOTH CLIMATE AND SOCIAL CHECKS

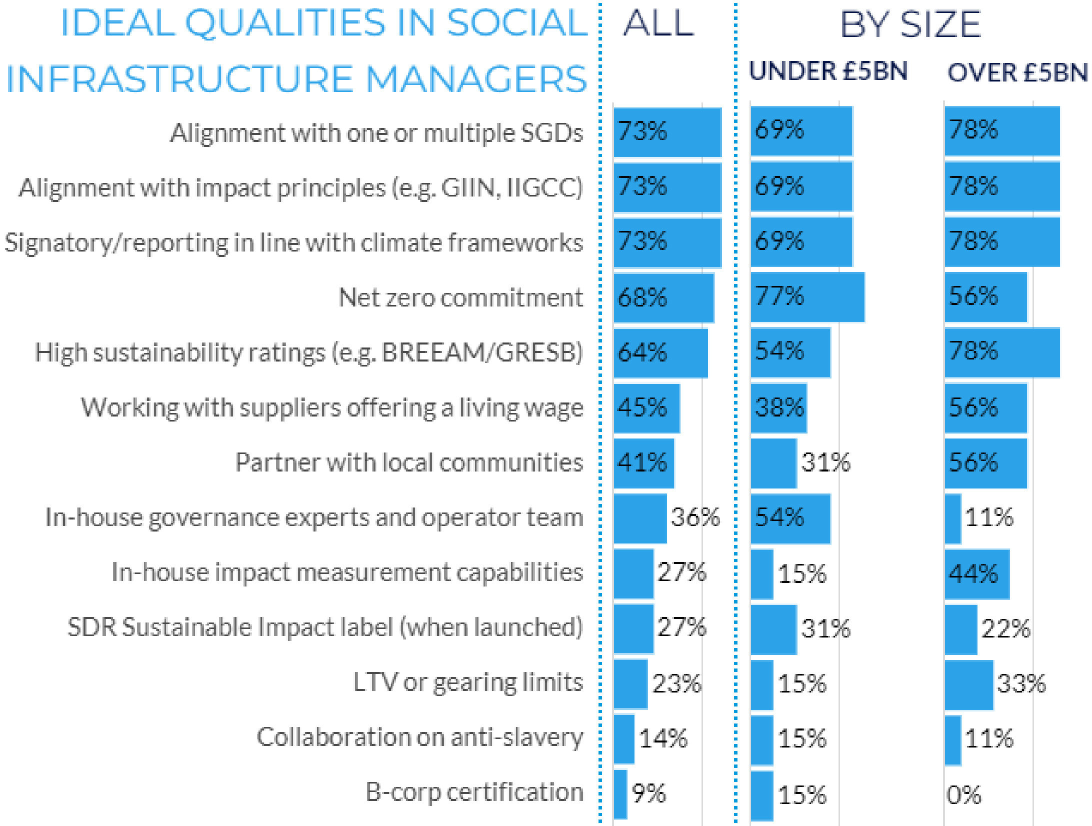
LGPS investors apply stricter 'hygiene checks' to social infrastructure managers, but with SDGs and impact principles on par with net zero commitments, they can combine positive social and climate impact.

Nearly three-quarters of LGPS schemes say their ideal social infrastructure manager should be aligned with one or multiple sustainable development goals (SDGs), as well as established impact principles, e.g., those provided by the Global Impact Investing Network (GIIN) or the Institutional Investors Group on Climate Change (IIGCC). Additionally, the ideal manager would be a signatory to and provide disclosures in line with established climate standards and frameworks, such as the EU Sustainable Finance Disclosure Regulation (SFDR), the FCA's upcoming Sustainability Disclosure Requirements (SDR), the UN Principles for Responsible Investment (UNPRI), and the Task Force for Climate-related Financial Disclosures (TCFD). This signals that SDGs and impact principles are the 'hygiene check' equivalent of net zero when it comes to social impact goals.

At the same time, social infrastructure managers can combine positive social and climate impact. It is not a coincidence that 64% of LGPS schemes would like to see independent verification via high sustainability ratings based on the Building Research Establishment Environmental Assessment Method (BREEAM) or the Global Real Estate Sustainability Benchmark (GRESB).

Beyond the 'hygiene checks', needs diverge with scheme size. Over half of LGPS schemes under £5bn value strong in-house governance and operational expertise. In contrast, 56% of larger schemes say offering a living wage and partnering with local communities is important.

One thing is certain: the ESG bar may be set higher for social infrastructure managers, but they can support LGPS schemes with their climate and social goals alike.



KEY STATISTICS

73%
of LGPS investors say their ideal social infrastructure manager should be aligned with at least one if not multiple SDGs

73%
want a manager which is aligned with established impact principles, as well as climate frameworks

54%
of schemes under £5bn are looking for a manager with in-house governance and operational expertise

56%
of schemes over £5bn prioritise managers which ensure living wages across their value chain, as well as partner with local communities

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