ALTERNATIVES

# Lifting the Lid on Social Infrastructure

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Raymond Jacobs, Managing Director, Franklin Real Asset Advisors, offers an introduction to social infrastructure investing and explains what it can do not just for investors' portfolios but for society as a whole.

Social infrastructure is a growing asset class, despite the budget limitations of its biggest investor: governments.

Since the 2008 financial crisis and subsequent global recession, government budgets have been squeezed and austerity measures have been imposed, leading to a reduction in spending on social infrastructure.

This, alongside the growing demand for more and improved social infrastructure in developed regions such as Europe, provides an opportunity for a wider pool of investors to participate in the sector.

## What Is Social Infrastructure?

At Franklin Templeton, we define social infrastructure as the physical assets that facilitate social services, helping build strong communities.

At the 2015 General Assembly, the United Nations adopted 17 "Sustainable Development Goals" designed to combat poverty and hunger as well as protect the environment, amongst other targets.

Social Infrastructure investing aims to align with six of these goals: good health and well-being; quality education; decent work and economic growth; sustainable cities and communities; climate action and life on land. At Franklin Templeton, we group these goals into two categories: community and environment.

An investment in social infrastructure offers the opportunity to pursue a dual objective: to generate financial returns and to provide a positive social and environmental impact in the wider community. Assets in the social infrastructure asset class include health care and education facilities; social and affordable housing; and buildings relating to justice, emergency and civic services.

While access to social services across Europe is essential for economic growth and prosperity, not enough is being done to build and adequately maintain the requisite facilities. Through investing in social infrastructure, investors can add much-needed private capital to boost and protect the social services being provided to communities.

Social Infrastructure investments tend to provide stable cash flows, with revenue arising from long-term indexed lease contracts, which protects against inflation while the tenant is in occupation.

## Challenges for Social Infrastructure Investing

Across Europe, the level of investment in communities is falling significantly short of the required level. The European Long-Term Investors Association recently published a report entitled, “Boosting Investment in Social Infrastructure in Europe,” suggesting that the total investment gap in social infrastructure is close to €142 billion.[1]

In the United Kingdom, the lack of public funding in social infrastructure has been identified as a critical issue that needs to be addressed through alternative financing schemes, to provide services such as affordable housing and health care. Governments do not have the economic resources to build sufficient new facilities or to maintain existing ones and are increasingly turning to private capital sources to make up the deficit.

The environment poses several challenges, with climate change, the declining biodiversity and water scarcity among the most pressing to address. According to the World Economic Forum, the real estate sector accounts for 40% of global energy use as well as 20% of global greenhouse emissions. Buildings use more energy than either industry or transportation and will contribute more to $CO^2$ emissions between now and 2030. Cities are contributing to the loss of biodiversity through economic pressures, waste production and physical presence.

## Five Ways to Contribute Positive Impacts

Once we have identified the social and environmental challenges that we seek to address, we look to the ways in which we align with our investors to contribute to solutions. There are five broad groupings that describe the ways we contribute to and create positive community and environmental impacts.

1. Aligning our long-term capital to be reliable stewards of the assets we hold. Our objective is to maintain strong-performing assets and enhance underperforming ones to improve the social services and the environmental footprint they render. In some arrangements, like a buy-and-lease-back, we can free up much-needed public capital and provide liquidity to municipalities.
2. Increased investment in social infrastructure can lead to functional enhancements through the direct and intentional enhancement of the facilities we purchase through renovation and upgrades. Examples include creating more usable space, improving the comfort and utility of the space for tenants and visitors and finding alternative uses that benefit the broader community.
3. We can create positive environmental impact through actions that reduce pollution, reduce net water and material use and support biodiversity and clean transportation. Examples of environmental upgrades include installing energy efficient systems, creating more green space, improving recycling and waste disposal policies and many others.
4. The fourth contribution we can make is through purpose-driven development. Select investments may arise with the opportunity to convert a non-social infrastructure building into social infrastructure. Or, the opportunity may arise to construct new buildings or to increase the building area used for social infrastructure.
5. Finally, tenant and community partnerships are critical to the success of impactful social infrastructure investments, in our view. In some instances, opportunities may arise to work with local partners to create new ways to serve the communities.

## Investment Implications

Our contributions play a critical role in grounding our efforts. By ensuring that investments include one or more of the five actions we’ve described, it is possible to track how investments lead to positive community and environmental outcomes.

By first identifying challenges and then directly addressing those challenges, we can create opportunities for communities. Access to quality health, housing, education and civic services can be improved through facilities with enhanced resource efficiency and conservation.

These positive potential outcomes require fully integrating impact management into our entire investment process. As such, we have developed an internal impact rating system which allows us to rate an investment’s current impact and assess the potential future impact performance alongside its projected financial performance.

Social infrastructure plays a critical role in the health and vibrancy of local communities. As physical assets, social infrastructure also has a large role in the health of our planet.

Without adequate resources to maintain and improve social infrastructure, communities are not well served and the environment suffers. In our view, bringing impact-focused private capital to the social infrastructure space can markedly improve the performance of these assets, which in turn can help better protect the environment and those that live in the community.

*This piece originally appeared on Responsible Investor.*

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## What Are the Risks?

**All investments involve risks, including possible loss of principal. The value of investments can go down as well as up, and investors may not get back the full amount invested.** Investments in infrastructure-related securities involve special risks, such as high interest costs, high leverage and increased susceptibility to adverse economic or regulatory developments affecting the sector. Special risks are associated with foreign investing, including currency rate fluctuations, economic instability and political developments.

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1. Source: European Commission: Boosting Investment in Social Infrastructure in Europe, January 2018