Rethinking impact investing in private markets: a cross-asset strategy

Which approach should investors take when allocating to impact investing – pragmatic or model-based? In conversation with Financial Investigator, Marsha Sinninghe from a.s.r. real estate reflects on her research into how investors determine their impact allocations, and discusses the suitability of private markets, real assets, and the importance of genuine intent.

By *our editorial team*

Are private markets suitable for impact investing?
'Absolutely! I have noticed a strong preference for making impact via private markets. Within these, real assets seem to be preferred over private equity and private debt. Real assets offer strong potential for impact investing as they easily combine its dual objective of striving for a social or ecological impact alongside a financial return[1]. Real assets are an investment category in which clear social or ecological impact can be made by contributing to themes like affordable housing, renewable energy and green buildings[2], in combination with healthy financial returns.'

What are the biggest challenges for impact investing in real assets?
'Greenwashing, claiming impact while it wasn't impact or the impact made was less than claimed, seems to be the biggest challenge. The multitude of impact definitions in place is not helping, as is the suspicion that some parties use impact investing as a marketing or equity raising tool. To mitigate this risk, it is important to check whether the correct definition is applied, verify and measure what the effect in the real world is (solely applying LED lighting and insulation is not enough to justify an impact claim), determine whether the impact measured is a direct consequence of the investment made, and assess the motive and motivation of the involved fund or investment manager to engage in impact investing.

Another challenge is measurability, especially for social themes. While measuring and reporting on financial risks and return is common practice and embedded in widely accepted standards, the measurement of social risks and returns still has a long way to go. There remains considerable uncertainty about how and in what units social risks and returns should be accounted for. Despite the lack of consensus on how to measure social impact consistently, more standards and measurement methods are being developed. There also lies a risk in this trend, since parties are developing their own reporting standards based on different KPIs. This even arises within a specific theme like affordable housing. The multitude of definitions of what 'affordable' means and how to measure it makes it hard to aggregate and report on the impact made, even within this single category.

Finally, as impact investing is quite a new market, it's hard to get a full view of the investment opportunities. Looking at the preferred market of real assets, it is noted that impact investing in this sector is still in its early stages. On the other hand, this challenge can also be an opportunity for real asset fund and investment managers.

It is important to emphasize that genuine intent and intrinsic motivation must underpin any impact investing strategy. Institutional investors will see through empty promises, and such superficial approaches are likely to do more harm than good.'

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You have recently researched impact investing. What were your key findings regarding the way investors determine their allocation to impact investing?
'Starting my research, I noticed a growing awareness among institutional investors that their investments can generate a positive impact on society. As a result,

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interest in and allocations to impact investing are increasing. However, how these allocations for impact investing are determined is often vague and seems to vary from one investor to another.

I found two explanations for these ambiguities and differences. First of all, traditional asset allocation models often leave little room for an investment category that considers not only financial risks and returns, but also social impact. And secondly, there is unclarity whether impact investing is a separate asset class or part of existing asset classes.

So, some investors use a pragmatic approach: they start with a certain allocation and often see impact investing as a separate asset class. Others use a more model-based approach and acknowledge that impact is not a separate asset class. This second group often uses traditional asset allocation models (ALM studies) to determine their asset allocation, and subsequently assess how much impact they are able and willing to make in specific (selected) asset classes.’

Which method is preferred in your opinion?

‘In my opinion the second method is more sustainable. Mainly because impact investing lacks sufficiently distinctive characteristics to qualify as a separate asset class. It does not have a unique risk-return profile, lacks a dedicated benchmark, is highly heterogeneous, and can be implemented across all asset classes. Moreover, the differences within impact investing are too diverse to position it as a distinct asset class.

Therefore, impact investing should not be considered a separate asset class, but rather a strategy implemented within existing asset classes. In line with this, the approach of adding an extra step to the traditional asset allocation process seems more logical than the pragmatic approach.’

How can you accommodate institutional investors with regard to impact investing in private markets?

‘Acknowledge that impact investing extends beyond private markets. Don’t get stuck in your private market bubble and align with the broader definition of impact investing. Modifying or bending definitions can create the appearance of greenwashing.

My research revealed that institutional investors find it important that fund and investment managers understand what they are looking for. Using a shared definition is a strong first step. Ultimately, the principle of ‘he who pays decides’ applies, it is the institutional investor who determines whether a fund or product truly qualifies as an impact investment.

Therefore, it is crucial to listen to the preferences and requirements of institutional investors when it comes to impact investing.

To accommodate institutional investors looking for impact investing in private markets, I would suggest to:
- listen carefully to their needs and requirements;
- ensure intrinsic motivation is embedded at all levels of your organization;
- remain cautious and avoid overestimating the impact achieved, rebranding existing funds as impact funds, or engaging in greenwashing;
- support institutional investors in addressing their challenges, such as complying with regulations, making impact claims measurable, and providing high-quality data.

Ultimately, it is about doing the right thing, with or without an impact label. In my view, scoring an impact label should not be seen as the holy grail.

As we face numerous social and environmental challenges, every contribution toward a better world matters.’ ■

1 Derived from the definition of impact investing of the Global Impact Investing Network, which reads a follows: ‘ Impact investments are investments made with the intention to generate positive, measurable social or environmental impact alongside a financial return’ (https://thegiin.org/publication/post/about-impact-investing)
2 As the build environment is a significant driver of climate change, accounting for 37% of global greenhouse gas emissions (https://www.unep.org/resources/report/building-materials-and-climate-constructing-new-future)

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SUMMARY

Private markets – especially real assets – hold strong potential for real-world impact.

Key challenges are greenwashing and the complexity of measuring social returns.

Institutional investors are supported through practical strategies that align with their expectations and help them to avoid superficial solutions, in order to invest with purpose, integrity and in a better world.

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