The Impact of Social Responsibility on Investment Outcomes

Forward thinking technology in London: the Thames Barrier was opened in 1984
We asked Linda J. Isaacson, Global Head of Innovation and Technology at Ferguson Partners, and Timothy McCarthy, Partner and Managing Principal at Hart Howerton, as like-minded thought leaders in the industry and colleagues to share their views on Environmental, Social, and Governance (ESG) and the growing importance in assessing investment and risk mitigation strategies in the investment management industry.

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Tim is Vice Chair of ULI’s Global Exchange Council and an inaugural ULI Health Leaders Network Fellow.
Environmental, Social, and Governance (ESG) concerns are increasingly important in assessing investment and risk mitigation strategies in the investment management industry. Throughout 2020, we saw how purposeful companies with better ESG profiles outperformed their peers. Drivers such as technology, data, and innovative business models are required to achieve net-zero demands of a carbon-neutral economy. Creating sustainable value for stakeholders and company shareholders requires clarity of purpose, aggressive capital management, a long-term strategy, and agile adaptability to climate change. All these elements will be necessary to generate enduring value for stakeholders and company shareholders. Further, this approach will elevate progressive companies in markets worldwide, set them on a path of global stewardship, and create a viable framework for the future of the built environment.

Climate Risk and Sustainability

While climate change poses significant risks, it also presents opportunities for investment that will transform the way we live—opportunities to “fund high-risk innovations related to ‘green premiums’”; enhance the reputation of businesses and the investment community, and increase corporate value. Climate risk is now a consideration in valuations in both public and private markets. The investment and ROI paradigms are shifting to reflect the increased value placed on sustainability and enterprise agility in minimizing climate risk. Measuring climate-related risk and a carbon footprint, with science-based targets (SBT) in an investment portfolio, are becoming an expectation for global investors. Rapid intensification of climate-change implications requires adaptation and mitigation in communities and cities of the future.

Energy transition is regarded as an essential component of long-term strategic planning. In some instances, leading investors are requiring disclosure of how business models will advance toward a net-zero economy. As the United States formally rejoins the Paris Climate Agreement, which came into effect on November 4, 2016, a global commitment to fight the climate crisis has accelerated. All United Nations members are signatories to the Accord and must adhere to a global framework for action. There is an intensified focus on sustainability, climate-related and other environmental risks, and opportunities in the real assets community. All are vital to institutional investors, pension funds, family offices, and real estate investment managers’ long-term strategy and investment stewardship.

Minimizing climate change risk has become a key consideration, leading to a shift toward greater valuations for forward-thinking companies addressing climate risk. For example, the Task Force on Climate-Related Financial Disclosures evaluates reporting of climate-related financial information, including risk assessment, capital allocation, corporate governance, and strategic planning.1

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1 See https://www.blackrock.com/us/individual/2021-larry-fink-ceo-letter
2 See https://hbr.org/2021/03/it-will-need-to-be-the-most-amazing-thing-humankind-has-ever-done
3 See https://www.blackrock.com/us/individual/2021-larry-fink-ceo-letter
4 See https:\/\slashwww.fsb-tcfd.org
By delivering value to its customers, its employees, and its communities, a company will compete more effectively and deliver long-term, durable profits for shareholders. Socially Responsible Investing (SRI), driven by purpose, partnership and accountability, and its subset Impact Investing (II), goes a step further than ESG. Impact Investing is a rapidly growing industry powered by investors determined to generate both a social and an environmental impact, plus competitive financial returns. The Impact Investing market and its AUM, estimated at $715 billion, had a greater than 42.4% growth rate in 2020. “From January through November 2020, investors in mutual funds and ETFs invested $288 billion globally in sustainable assets, a 96% increase over the whole of 2019.”

We have seen a significant change in the standard for corporate governance, purpose, and responsibility with the Business Roundtable’s new Statement on the Purpose of a Corporation. Signed by 181 CEOs, the statement shifts the focus from solely serving shareholders to broadly committing to serve all stakeholders—from shareholders to employees, customers and suppliers, and to even communities—as drivers for success. This change reflects the current view that creating long-term value for shareholders requires investing in employees and communities while meeting customers’ needs. Such leadership will create greater economic opportunity and a more robust, sustainable economy.

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5 See https://thegiin.org/impact-investing/
6 Ibid
Driving Outcomes

Global connectivity of younger generations and the awareness of environmental and social issues amongst younger heirs and investment managers are forcing the investment community to look beyond the traditional ESG framework in assessing investment risk and returns. Impact Investing is the critical lever for this cohort. Yet, despite the acceleration of Impact Investing across asset classes, there is a significant disparity between impact investors and institutional investment managers who have been slow to adopt a comprehensive impact management system in the real estate investment process. Further, a disconnect exists between ESG and Impact Investing as a long-term focus on value-creation. ESG, objectively defined to measure and assess the environmental, social, and governance performance of real assets globally, is a quantitative consideration. It includes real estate portfolios (public, private and debt) and infrastructure. Impact Investing is subjective. It requires a qualitative analysis that measures intentionality, financial returns, and the impact on the world. The outcome of this bifurcated ESG-Impact Investing framework yields a collision in the real assets industry. Yet evaluating investment decision outcomes based solely on defined ESG metrics is not a holistic way to measure an investment portfolio. Therefore, it is imperative that the relevancy and importance of investments in sustainable global cities and the world economy include social responsibility.

For designers, developers, builders and investors, a sustainability agenda will not suffice; it contradicts fact-based performance outcomes. Global citizens embrace outcome-based investing and demand transparency in this area. And while Covid-19 may have accelerated or “deepened” investors’ interest in a common purpose, greater visibility is required to measure social responsibility. The time has come to elasticize investment metrics, calculate what ESG includes, and factor in a host of nontraditional, socially responsible variables—with a focus on outcomes.

A data-driven Socially Responsible Investing (SRI) Index that identifies sustainable, socially conscious (ethical) investing metrics not previously measured is essential. The 4IR (Fourth Industrial Revolution) presents an enormous opportunity to address nonexposure to SRI and create an integrated approach to measure investment. Traditional ESG data has limitations absent the exploration of and correlation to other predictor variables. Consideration of nontraditional variables, such as dynamic job creation, carbon emission reductions, reduction of natural habitat destruction, diversification of investments to biodiversity assets, conservation efforts, alleviation of urbanization in rural areas, community investment in social determinants of health and equity, improvements in food systems, incorporation of natural capital as it affects ecosystems and livelihood, and many others resiliency factors is essential. A framework that includes ESG ratings attributed at the asset, portfolio, or fund level must extend to SRI at the investor level. For example, while the MSCI SRI Indexes are designed to represent the performance of companies with high ESG ratings, their approach is to target only the top 25th percentile of companies in each sector. It specifically excludes companies whose products have negative social or environmental impacts. There is little empirical evidence and a great deal of opacity when attempting to link the data to investors who do not fall within the various indexes. The challenge for the investment community is to engage in a far broader collection and analysis of data, one that goes beyond measuring ESG ratings of physical assets, to drive socially responsible outcomes. Additionally, investment managers must apply rigor in assessing how assets measure up against international social impact best practices.

Accelerating socially responsible investing is insufficient if we do not holistically embrace and measure outcome-based investing in averting systemic risk. The investor discourse must state and act on a vital need to transform. Data that reveals what is NOT being measured needs to be a focus as we advance. An active, more urgent expression, and a heightened interest in Impact Investing, extends beyond financial returns. It requires a worldwide lens focused on environmental sustainability to accelerate a livable, resilient built environment.

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New York City, with an angle that anticipates the future "Big U" resiliency plan around Lower Manhattan (post-Superstorm Sandy plan)
We recognise the need for an integrated approach to climate change.

The impacts of climate change on both human communities and natural systems are profound. The two are intrinsically linked. The depletion of natural resources, loss of species and ecosystem coping mechanisms, and the limitations this places on options for sustainable development combine to add further pressure on vulnerable terrestrial and marine habitats. Loss of land fertility and landscape productivity in turn impacts livelihoods and exacerbates poverty.

Our thinking is aligned to the 9 Planetary Boundaries as created by Professor Rockstrom of the Stockholm Institute and focuses on the intersection of human rights and environmental management.

This model informs our outcome-based approach to the interdependency between communities and ecosystems, and inspires us to consistently nurture resilience in the natural and human systems in which we work.

We focus on actively engaging the controllable variables that we can influence to manage and reduce damage to the planet, before crossing over the irreversible thresholds of CO2 emissions, habitat loss, biodiversity loss and so much more.

Source: Stockholm Resilience Centre – J. Lokrantz/Kebe based on Steffen et al. 2015
Climate change poses one of the greatest threats in history to the realization of sustainable development.

High Risk

Beyond zone of uncertainty

Climate change poses one of the greatest threats in history to the realization of sustainable development.

>85% wetlands lost

between 1700 and 2000 – rate of loss currently three times faster than forest loss (in percentage terms)

75% land impacts

terrestrial environment ‘severely altered’ to date by human actions

66% marine impacts

marine environment ‘severely altered’ to date by human actions

11 billion people

estimated global population by 2050

15% increase

in global per capita consumption of materials since 1980

47% reduction

of ecosystem extent and condition against estimated natural baselines, with many continuing to decline by at least 4% per decade

>85% wetlands lost

between 1700 and 2000 – rate of loss currently three times faster than forest loss (in percentage terms)

28% global land

area held and/or managed by Indigenous Peoples, which makes up >40% of formally protected areas and 37% of all remaining terrestrial areas with very low human impact

+/-60 billion tons

renewable and non-renewable resources extracted globally each year, up nearly 100% since 1980