APPENDIX 1

MJ HUDSON

London Borough of Bromley

Impact Investing and Social Housing

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Impact investing

As a rule, impact investors look for a double dividend of financial returns alongside social and environmental benefits. The desired impact that an investor wishes to achieve can vary but is usually set out in terms of the United Nations 17 Sustainable Development Goals (SDG'S).

There are guidelines designed to provide a solid foundation for impact investors. Further sources of information can be found via the Global Impact Investing Network (GIIN) https://thegiin.org/impact-investing/or the International Finance Corporation (IFC) – the World Bank's investment arm https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/development+impact/principles – both have established the following, largely overlapping principles.

1. Intentionality of the impact investment
   The investment process starts off by defining the impact objective(s) at the core of the intended positive social and environmental impacts aligned with some of the 17 UN SDGs or other widely accepted goals.

2. Aiming at financial returns
   Apart from achieving the desired effect, impact investors aim for a financial return on capital that ranges from at least a market rate to a risk-adjusted market rate. This is to distinguish impact investment from philanthropy, which solely focuses on social or environmental change and not on financial returns.

3. Investments across asset classes
   There are numerous opportunities across multiple types of asset classes, from private equity and private debt, to listed equities and "green bonds".

4. Managing and measuring impact
   Defining indicators according to the intentions, then measure each investment's achievement and report results.

Impact investing must be subordinate to the Committee's primary responsibility to ensure the Fund can pay current and future pensions. At its most damaging it can be used as an excuse to target a pet project irrespective of expected return. Because of this the four principles set out above are important. Whilst an existing committee may understand the issues around impact investing, I would strongly recommend that they produce an audit trail against the four principles to ensure that they can show their own duty of care and set a high bar for future committees.

I would recommend that the financial return should be equitable with other investment opportunities available in the market on a risk adjusted basis. At present the forecast return for the Strategic Benchmark, as recalculated in June 2021 using JPMorgan's updated 10 year return forecasts, is 4.2% per annum. This comprises assets targeting higher return forecasts for higher risk investments e.g. Private Equity (forecast return of 7.0% p.a. with an annualised volatility of 16.5%) and lower return/lower risk investments e.g. UK Government Gilts (forecast return of -0.2% p.a. with an annualised volatility of 6.7%).

The level of return targeted for an impact investment should be commensurate with that investment's particular risk and return profile as well as recognising any diversification benefits it may bring to the Fund. The Committee should justify an impact investment by targeting a return of at least 4.2% per annum and preferably higher whilst targeting the investment in such a way as to maximise the diversification benefits away from the predominant equity risk within the existing portfolio.

Social Housing

One area which has attracted interest from the LGPS sector is the provision of social housing, partly because this is a local government responsibility. This fits with a number of the UN SDG's, particularly No.11 - Sustainable Cities and Communities.

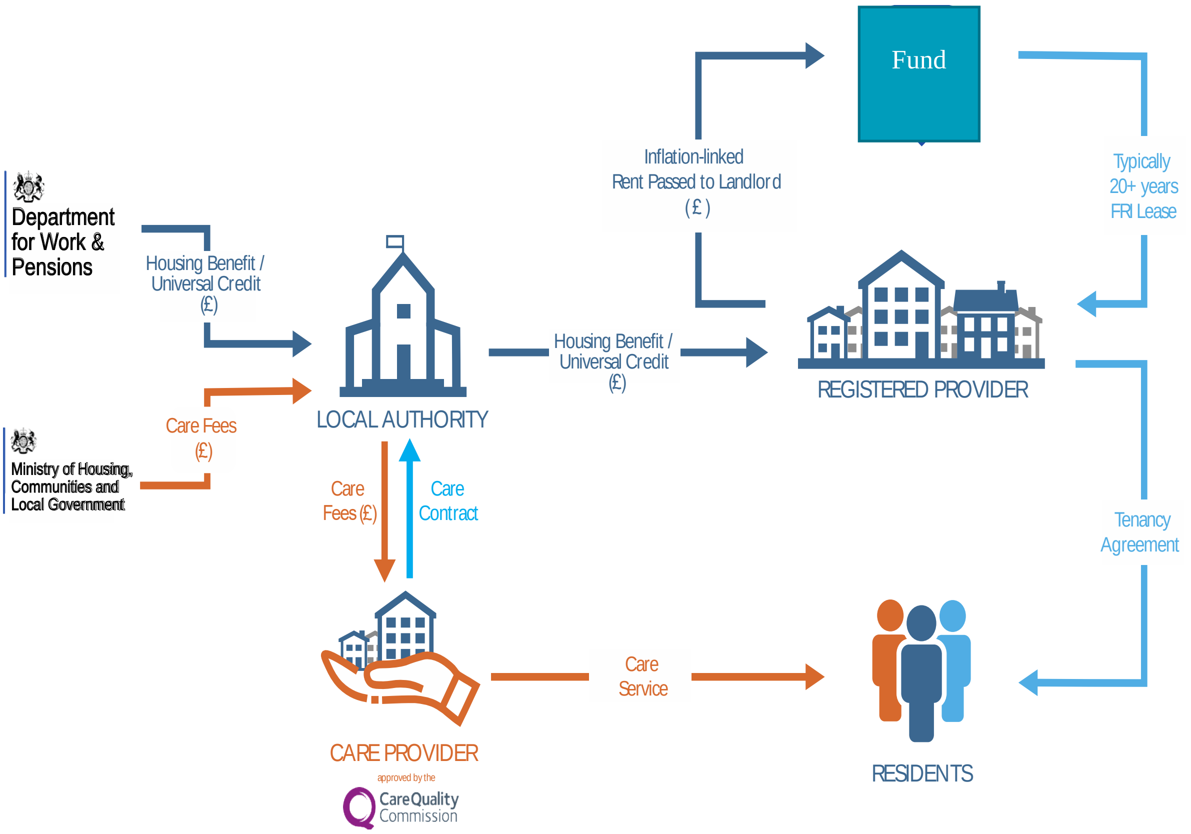
Social Housing covers a number of sub-sectors, each of which have their own specific structure around payment of rent to the landlord and payment of care costs where necessary. The greater the percentage of the rent covered by the Government through the MHCLG or DWP budget, the lower the perceived investment risk.

The table below is taken from a presentation by the Triple Point Impact House Fund.

Sector	Children's Services Housing	Specialised Supported Housing	Older Person Supported Housing	Social and Affordable Housing	Homelessness Housing	Private Affordable Housing	Asylum Housing
Residents	People under 18 years with care and support needs	Individuals of working age with care and support needs	Individuals and couples over 55 with care and support needs	Families and individuals	Families and individuals registered as homeless	Families and individuals	Families and individuals seeking asylum
Lessee	Care Provider	Registered Provider	Registered Provider	Local Authority / Registered Provider	Local Authority / Registered Provider / Charity	Individuals and Families	Private Provider
Income Source	Ministry of Housing Communities and Local Government	Department for Work & Pensions	Department for Work & Pensions	Department for Work & Pensions with private top up	Department for Work & Pensions	Private payments with contributions from the Department for Work and Pensions	Home Office
Lease Length	10 years +	10 years +	10 years +	10 years +	10 years +	Assured Shorthold Tenancy	10 years
Target Net Initial Yield	5.5 – 6.5%	5.5 – 6.0%	4.5 – 5.5%	4.0 – 5.0%	4.5 – 7.0%	4.0 – 6.0%	6.0 – 9.0%

The most advantageous position to be in as an asset owner in Social Housing is to have all rent paid directly by the local authority rather than via the tenant from housing benefit (see income source in the table above) and for the asset owner/landlord to have a contract with the lessee where the latter service provider covers all voids and maintenance. This reduces the investment risk but still leaves the asset owner at risk to a change in Government policy although the need for social care provision is highly unlikely to go away.

The flow chart below illustrates the older person supported housing sector



Investment would usually be via a closed-ended (time limited) fund which owns the properties being used to provide social housing. As can be seen from the previous table above, properties are usually owned on long leases although some funds are now looking to build new social housing in order to guarantee a better build quality and achieve environmental commitments such as low carbon emissions. Investors are often locked in for the early stages of the fund and liquidity may be quarterly or annually. Some funds allow gearing to boost investors returns but this obviously increases the risk.

Owning property directly does expose the investor to movement in house prices and a potential fall in value. I would look to minimise this exposure where possible and concentrate on stable income rather than higher return.

There are a number of fund managers operating in the social housing sector in the UK, including ones large enough for the Fund to invest up to 5% of its assets. The investment would be drawn down over a number of years as the underlying fund invests its capital with interest paid quarterly. Capital would be returned at the end of the funds life, often 10 years or so. Rents should be linked to inflation and as such social housing can provide a useful source of protection against a long-term uptick in inflation.

One of the supposed advantages of investing in social housing for LGPS Funds is the ability to support the aims of its administrating authority, this can be done by requiring any fund the Pension Fund invests in to targets social housing within the borough of Bromley. Many fund managers will acquiesce to this although it is likely to be a loose commitment rather than a pound for pound agreement. (In the case of Bromley this may be difficult given the relatively high house prices within the borough of Bromley and low social rent coverage.)

This raises an very obvious conflict of interest for the Councillors: If the intention is to achieve a social good alongside a financial return, why target your own borough over all others irrespective of its relative investment merits?. From an investment prospective I do believe a Pension Funds can target impact investing for a proportion of its assets. I am less sure of the justification for insisting that the impact investment must be in the locality of the administrating borough. This sounds more like politics!