

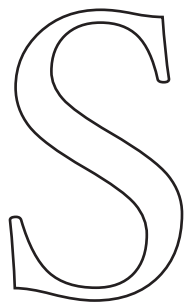
Social Infrastructure

*Measuring
and
Managing
Impact*

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Since the 2008 financial crisis and its aftermath, governments across Europe have been struggling to meet the growing demand for the building blocks of strong communities – affordable housing, schools and libraries, and hospitals and nursing homes. Between 2009 and 2016, private investment in social infrastructure grew to €247 billion, according to Preqin and McKinsey.

These assets are particularly attractive to long-term investors because they offer a dual return: an above-market rate financial return that typically comes from long-term lease contracts, and an impact return, which is the measurable improvement in the quality of life of communities resulting from investments that upgrade a school or a hospital, for example, or increase the supply of social housing.

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The tools available to measure financial performance are straightforward. But how should investors measure the social and environmental impact of investments in social infrastructure?

Towards a framework for measuring impact

Impact investing is a relatively new field, and like many frontier disciplines, it suffers from varying expectations of investors, a fragmentation of approaches and a lack of standardisation for measuring and managing the social

and environmental outcomes of investments.

Efforts are under way to define potential and actual impacts but we still lack the long-term data that would allow investors to compare the results of different approaches to impact investing.

At Franklin Templeton, our Real Assets team proposes a three-step theory of change for measuring and managing impact in social infrastructure investments: identifying the challenges, defining our potential contribution to solutions, and finally achieving impact which we measure and manage throughout the life of each asset.

Exhibit 1. Creating Social and Environmental Impact in Social Infrastructure.



Theory of change



Source: Franklin Templeton. For illustrative and discussion purposes only

The challenge

It is important to begin by identifying the challenges we seek to address and aligning them with the United Nations' Sustainable Development Goals. In the case of social infrastructure, we believe these challenges can be grouped into two categories – community and environment.

The community challenge is straightforward: there is an inadequate supply of quality social infrastructure in Europe. The environmental challenge has many dimensions – global warming, water scarcity, biodiversity, to name but a few.

Take climate action. By many measures, buildings use more energy than either industry or transport and account for 20 per cent of global greenhouse gas emissions, according to a January 2016 World Economic Forum report, which also calculates that buildings generate 30 per cent of all the waste in the EU. Our climate challenge, therefore, is to reduce the climate footprint of social infrastructure assets.

The Contribution of Investors and Managers

Once the challenges are set, investors need to define the ways in which they can make a difference. Here are five broad ways in which we believe we can do so.



ALIGNED LONG-TERM CAPITAL

It refers to how investors and managers of social infrastructure assets can align long-term capital in order to be reliable stewards of the assets they hold. In some arrangements, like a buy-and-lease-back, we can free up much-needed public capital and provide liquidity to municipalities.



FUNCTION ENHANCEMENTS

This contribution speaks about investors' ability to create a positive social impact by serving communities better – through investments that renovate or deliver new affordable housing, for example, or increase the space available for community living.



ENVIRONMENTAL UPGRADES

Third, building renovations can also create a positive environmental impact by reducing pollution (installing solar heating, for example), saving water, improving energy efficiency and encouraging the responsible recycling and disposal of waste.



PURPOSE-DRIVEN DEVELOPMENTS

Select investment opportunities may arise for purpose-driven developments, such as converting a warehouse or factory into buildings with a social purpose.



STAKEHOLDER PARTNERSHIPS

Stakeholder engagement is the fifth, crucial, way in which social infrastructure investors and managers can make a difference. Tenant and community partnerships, for example, can help investors identify the need for co-working spaces or childcare facilities.

By ensuring that investments include one or more of these five actions, it is possible to track how investments are better serving communities and nature.

Impact must be measured to be managed

We believe that measuring the impact is not just a matter of looking at the end result. Our goals must be met at a cost acceptable to investors, and this requires integrating impact management throughout the investment process: sourcing, due diligence, portfolio construction and monitoring & reporting.

At Franklin Templeton, we do this with tools that give us continuous feedback on our impact objectives, measuring our progress in a way that allows the roadmap to be corrected or reassessed as needed. We believe this is the best approach to align investment and impact considerations at every step.

It's clear that not all possible avenues of impact are economically viable. To this end, we have created an internal impact rating system that measures the current and projected state of each asset's community and environmental performance. This proprietary rating system is rooted in industry metrics such as IRIS impact standards. Progress can be quantified by tracking key performance metrics over time.

Social infrastructure plays a critical role in the health and vibrancy of local communities. As physical assets, they also have an impact on the health of our planet. By bringing impact-focused private capital to the social infrastructure space, the community and environmental performance of these assets can be markedly improved. But in order to achieve social infrastructure's full potential for dual returns, non-financial impacts must be measured as well as managed.

"Environmental Sustainability Principles for the Real Estate Industry" World Economic Forum, World Economic Forum Industry Agenda Council on the Future of Real Estate & Urbanization and World Bank January 2016