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INVESTING IN THE COMMUNITY AND THE ENVIRONMENT

Impact Investing in Social Infrastructure

Franklin Real Asset Advisors

This paper will discuss how investing in social infrastructure in Europe can lead to positive impact-based outcomes for communities and the environment. We will define social infrastructure, define impact investing and explain our mission and approach to bringing these two areas together. We will identify key challenges and strategic approaches to address these challenges. It will conclude with an overview of our innovative approach to impact management and measurement, which includes our alignment with the United Nations' Sustainable Development Goals and industry best practices and standards.

Social infrastructure is defined as the physical assets that facilitate social services. Examples include healthcare and education facilities, social and affordable housing, and buildings related to justice, emergency and civic services.

In a tacit acknowledgement of the importance of social infrastructure investments, the European Long-Term Investors Association (ELTI) formed a High-Level Task Force (HLTF) to analyse investment gaps in social infrastructure and make proposals to boost investment. The HLTF's report, "Boosting Investment in Social Infrastructure in Europe,"[1] was released in early 2018 and highlights the importance of social infrastructure, the challenges in adequately financing social infrastructure, and the many ways to address these challenges through both public and private investment. The report speaks to the importance of social infrastructure, stating that:

"High-quality social infrastructure provides benefits to individuals and communities and improves social cohesion. Appropriate access to social infrastructure generates more 'hired, housed, healthy and happy' people with positive spillovers on society…as well as on economic activities. Such access can also help to reduce transaction costs and enable knowledge and innovation to be disseminated. It can boost community resilience and regeneration while strengthening reputation and attracting trade/business and tourism."

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. **By investing in social infrastructure, institutional investors can add much-needed private capital to boost and protect the social services being provided to communities.** On behalf of investors, we can also be good stewards of the environment through eco-friendly management policies, maintenance and upgrades.

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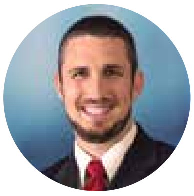

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IMPACT INVESTING DEFINED

Impact investing is investing with the explicit intention of generating financial returns alongside measurable and positive social and environmental impact. It can be thought of as investing with a dual-return approach that seeks "win-win" investment opportunities where a measurable impact return is targeted in addition to an at-least market-rate financial return.

It's important to note that not all impact investments seek market-rate returns, but for the sake of this paper we will only be referring to those that do. Impact investing is not typically defined as an asset class, but rather as an investment approach that can be applied across all asset classes, particularly in private markets. Major sectors which have received focus from impact investors include microfinance, clean energy, social infrastructure, green technology, health care, education and basic human services. It is also considered impactful to invest in sustainable real assets, small and medium-sized enterprises (SMEs) and enterprises run by women, minorities and the disabled or disadvantaged.

IMPACT IN SOCIAL INFRASTRUCTURE

Impact investing is a natural strategy to pursue within social infrastructure, as private capital, responsibly deployed, can create the "win-win" opportunities that we seek. In fact, in many instances, there is a natural alignment between impact return and financial return, as each can reinforce the other.

Renovations that directly improve the utility of the space for tenants and visitors can both improve the quality of services being provided and increase the value of the physical asset. We can also create local partnerships that enhance the experience of stakeholders. For example, working with a local school to have students volunteer time at an elderly care facility can create a more enjoyable experience for the elderly, thereby increasing the demand for that facility to the community. Another example of a win-win opportunity involves making energy efficiency upgrades. These improvements can reduce service costs while reducing greenhouse gas emissions. Investing in social infrastructure with a focus on impact can not only yield market-rate returns, it can also create financial resiliency that improves financial results.

OUR IMPACT COMMITMENT

We are committed to generating impact in social infrastructure on behalf of our investors and we base our entire approach and philosophy around three building blocks.

PURPOSE

We commit to clarity around Franklin Templeton's unique contribution to generating social and environmental impact on behalf of our investors. Our objectives always include clear articulation of the measurable impact sought through our approach and our economic investments.

DISCIPLINE

We commit to manage and measure impact through a robust system for gathering, benchmarking, and monitoring impact-relevant data and metrics.

LEADERSHIP

We seek a leadership position in the impact industry through a commitment to continual improvement. We will actively seek to contribute at the field level and share the lessons learned through our experiences.

THE OPPORTUNITY FOR IMPACT

The Franklin Real Assets team frames the impact opportunity into three main buckets: challenges, contributions and impact.

1. CHALLENGE

The core societal challenge we seek to address.

2. CONTRIBUTION

The value-add of investors & managers in addressing the challenge and achieving impact.

3. IMPACT

The social and environmental outcomes that result from investments.

By investing with a dual purpose of financial return and impact, we aim to positively contribute to communities, protect the environment, and provide attractive risk-adjusted returns to investors.

1. CHALLENGES

Our approach to impact in social infrastructure begins with identifying the challenges that we are seeking to address. We group these challenges into two categories – Community and Environment. All of the challenges we seek to address are aligned with the United Nations' Sustainable Development Goals.

SOCIAL INFRASTRUCTURE AND THE SUSTAINABLE DEVELOPMENT GOALS

At the 2015 General Assembly, the United Nations adopted 17 "Sustainable Development Goals" (SDGs) designed to combat global poverty & hunger, protect the planet & the environment, promote prosperity for all mankind through economic & technological development, and ensure peaceful co-existence amongst Earth's nations. Investing in social infrastructure seeks to specifically create an impact on six of the SDGs.

By creating an Impact management approach that is grounded in the SDGs, institutional investors can easily identify alignment with their own responsible investing goals and can more easily compare investments across their portfolio.

Good health and well-being
Ensure healthy lives and promote well-being for all at all ages

Affordable and Clean Energy
To ensure access to affordable, reliable, sustainable and modern energy for all.

Quality education
Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all

Sustainable cities and communities
Make cities and human settlements inclusive, safe, resilient and sustainable

Clean Water and Sanitation
To ensure access to safe water sources and sanitation for all.

Peace, Justice, and Strong Institutions
Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels.

Source: United Nations, Sustainable Development Goals (SDG). For illustrative purposes.

Community

Resource- and liquidity-constrained municipalities across Europe are seeking to provide the quantity and quality of infrastructure and services that are needed to serve their communities, but are falling significantly short of the necessary level of investment. Both the European Investment Bank and the European Long-Term Investors Association have estimated an investment gap in social infrastructure in the EU at around EUR142–EUR150bn. In the United Kingdom, lack of public funding in social infrastructure has been identified as a critical issue needing to be directly addressed through alternative funding schemes. 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 bridge the gap. If we accept that the provision of social services through quality social infrastructure assets helps communities, then our challenge is fairly straightforward – there is not adequate social infrastructure in Europe.

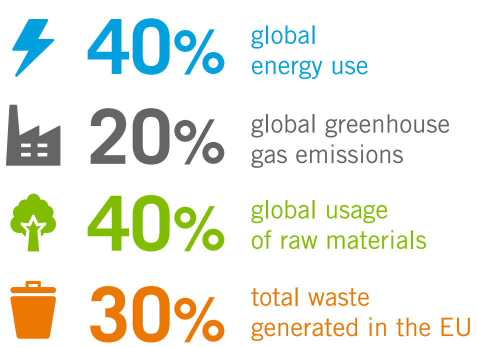
Environment

The challenges in environment include, among others, directly addressing climate change, loss of biodiversity and water scarcity.

Climate change:

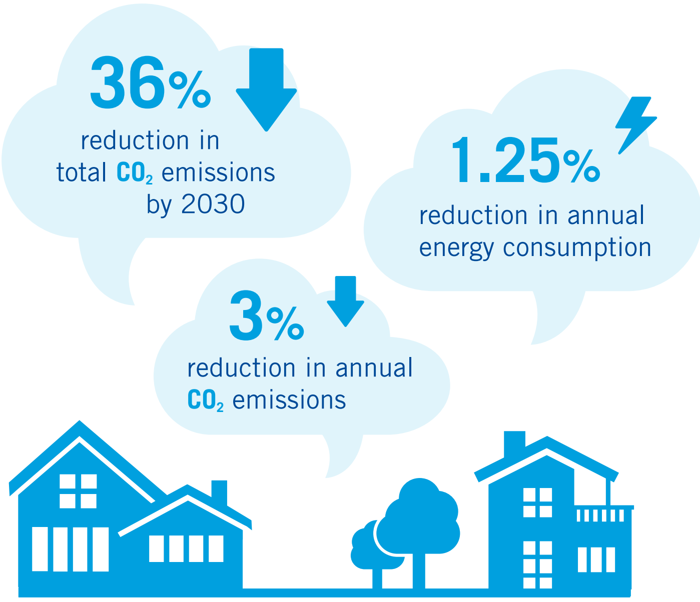
Parties to the United Nations Climate Change Conference in Paris in 2015 agreed to target keeping global average temperatures from rising 2°C from pre-industrial revolution levels by the end of the 21st century. Beyond 2 degrees, we risk dramatically higher seas, changes in weather patterns and food and water crises. The battle against climate change is being waged not only in the fields of manufacturing and transportation, but also in the real estate industry. In fact, by many measures, buildings use more energy than either industry or transportation and will contribute more to CO_2 emissions between now and 2030.

The Real Estate Sector (as a % of total)



Source: "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. For illustrative purposes.

CO_2 targets for the Real Estate Sector:



Source: "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. For illustrative purposes.

Our climate change challenge is that buildings today are contributing to a 2°C rise in global temperatures.

Biodiversity:

Our planet is becoming less biodiverse as species have been disappearing at up to 1,000 times the natural rate. Protecting biodiversity is in our self-interest. "Nature's products support such diverse industries as agriculture, cosmetics, pharmaceuticals, pulp and paper, horticulture, construction and waste treatment. Our personal health, and the health of our economy and human society, depends on the continuous supply of various ecological services that would be extremely costly or impossible to replace."[2] Cities play a large role in the global loss of biodiversity, but can also have meaningful positive contributions towards the retention of biodiversity through action. So, the challenge is that cities are contributing to loss of biodiversity, which is creating a more fragile environment with real costs to the global economy.

Water scarcity:

With the global population boom of the last century, demand for clean water has surged. In 2018, the World Economic Forum rated water crises in its top five risks in terms of global impact. Current water infrastructure in developed markets is outdated and leads to inefficient use. Our water scarcity challenge is that with inefficient infrastructure and outdated usage policies, we are using too much water.

2. FRANKLIN TEMPLETON'S CONTRIBUTIONS

Once we have identified the challenges we are seeking to address we look to the ways we can 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 | Aligned, Long-Term Capital

Both the EU and the United Kingdom have identified that private investors are needed to help bring more capital to social infrastructure. For instance, the United Kingdom, through its Private Finance 2 (PF2) model, introduced in 2013, identifies the benefit of integrating the "discipline, skills and expertise of the private sector," to better serve the public's interests. We align our long-term capital in order 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 | Function Enhancements

One of the primary ways we can contribute to impact is with the direct and intentional enhancement of the facilities we purchase through renovation and upgrades. Examples of function enhancement 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 | Environmental Upgrades

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 upgrades could include installing energy efficient systems, creating more green space, improving recycling and waste disposal policies and many others.

4 | Purpose-Driven Development

Select investments may arise with the opportunity to convert a non-social infrastructure building into social infrastructure. Other opportunities may arise to construct new buildings or to increase the building area used for social infrastructure.

5 | Tenant & Community Partnerships

Stakeholder engagement is critical to the success of social infrastructure investments, and in some instances, opportunities may arise to work with local partners to create new ways to serve the community. Examples could include working with local groups to install a business center with free wifi for underserved residents, or partnering with civil servant tenants or healthcare providers to hear ways we can work together to improve their connection with the community.

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.

3. IMPACT

By first identifying challenges and then directly addressing those challenges, we can create opportunities for communities to have increased access to quality health, housing, education and civic services through facilities with enhanced resource efficiency and conservation. These positive outcomes require fully integrating impact management into our entire investment process.

Impact management

We integrate impact into each stage of the investment process through tools and frameworks that ensure continued prioritization and reassessment of our impact objectives. By integrating impact we can form a more holistic process that aligns investment and impact considerations at every step. We also create efficiency in management by only considering proposed investments that meet the dual-return objectives of financial return and impact.

Throughout our Impact management process we stress the terms “authenticity” and “transparency”. To use these terms is an acknowledgement that with a dual-return objective, we will not be able to pursue all possible avenues of impact, since some may not be economically viable. To this end, **we created an internal impact rating system that measures the current and projected state of each asset’s community and environmental performance.** This system allows us to speak authentically to each investment’s impact thesis, whether it be to buy and lease-back already high performing assets, or to significantly improve the performance of old or underutilized buildings.

> *“Impact should not simply be measured, it should be managed.”*

The rating system serves to rate an investment’s current impact and assess the potential future impact performance. Progress towards impact objectives can be quantified in the community and environmental rating system and key performance metrics can be tracked over time. Also, reassessments of impact strategies can be made if and when opportunities to improve outcomes, in a financially viable manner, are uncovered.

SUMMARY

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 being well served and the environment is suffering.
By bringing impact-focused private capital to the social infrastructure space, the community and environmental performance of these assets can be markedly improved.

1. Source: Boosting Investment in Social Infrastructure in Europe. Report of the High-Level Task Force on Investing in Social Infrastructure in Europe. Lieve Fransen, Gino del Bufalo and Edoardo Reviglio. January 2018.
2. Source: Convention on Biological Diversity website – presentation – Biodiversity in Cities – A Biodiversity Exhibition Project Among Leader Cities.

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Please visit www.franklinresources.com to be directed to your local Franklin Templeton website.