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The Role of Impact Investing in a Portfolio

Sustainable investing consists of a variety of investment approaches one can apply across a multi-asset class portfolio, the primary ones being values alignment, environmental, social and governance (ESG) integration, and impact investing. Where values alignment and ESG integration have historically applied to the public markets, impact investing is most often applied to the private markets.

Impact investing focuses on providing capital to businesses where impact and financial outcomes are aligned and measurable. Impact strategies span across private market sub-asset classes, allowing investors to bring together their values with their investment goals. Through impact investing in alternatives, investors can allocate to sustainable themes in a way that drives market-rate returns.

Why incorporate impact investments in private market portfolios?

Impact investing provides the opportunity to both make meaningful environmental or social impact and generate market-rate performance within portfolios.

Meaningful Impact

As the alternatives industry continues to grow, impact investing can provide the capital required to tackle complex climate transition and social challenges across global communities. Reaching federal and corporate goals of net zero by 2050 may require an incremental $3.5 trillion per year in decarbonization capex, which represents one-third of current private markets AUM[1]. Heightened social tensions within communities are further fueled by the dispersion of socioeconomic status. This significant opportunity for deployment combined with limited dry powder (committed but unallocated capital) in the space allows private capital to drive impact goals.

Investors who allocate to impact investing have seen tangible results, with 99% of impact investors saying their investments meet or exceed their *impact* expectations[2].

Market-Rate Performance

Impact investing provides the potential for alpha generation versus the public markets, particularly as the number of offerings and managers in this space expands across sustainability themes. Impact private equity deal activity has grown rapidly, at 16% per annum from 2016 through March 2022 compared with 12% for private equity overall[1].

Research from the Global Impact Investing Network (GIIN) concluded that market-rate returns are achievable across private equity, private credit and real assets impact investing[3]. In addition, recent surveying showed approximately 90% of impact investors stated their portfolios meet or exceed their *return* expectations[2].

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Implementing Impact

How do I start investing with impact?

In line with traditional alternative investments, impact investments can be in each asset class in the private markets:

Private Equity	Private Credit	Private Real Estate	Infrastructure
• Strategies investing in companies through venture, growth equity and buyout, often skewed earlier given the maturity of sustainable solutions and technologies	• Strategies lending to companies specifically aligned to an impact theme or financing of renewable infrastructure	• Strategies investing in economic development, affordable housing, green buildings, sustainable land and forestry management	• Strategies investing in assets supporting energy transition, low carbon supply chains and digitization themes

Illustrative Examples			
Equity Investment in an Electric Vehicle Battery Manufacturer	Senior Loan to Solar and Storage Assets Developer	Investment in an Affordable Housing Complex	Acquisition of Utility-Scale Wind and Solar Platform

These asset classes should mirror the impact investor's broader portfolio targets, with impact being a thematic overlay at the strategy level. Investors can consider their desired risk-adjusted, market-rate return alongside climate transition (environmental) and / or inclusive growth (social) objectives.

Understanding that investors have varying investment and impact goals, there are options for implementing impact investing within a private asset allocation, each with a varying degree of diversification:

- ☑ Commingled – broad exposure to multiple managers in a single fund, often across multiple themes
- ☑ Single Manager – more selective exposure, often to a single theme or small subset of themes
- ☑ Direct Investments – single company exposure, providing opportunity to double down on high-conviction themes

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Climate Transition

A focus on environmental themes

Clean Energy

Assists in the global migration from natural resources to domestically available renewable powers

Investment opportunities include: renewable energy generation, such as solar and wind, energy efficiency solutions, including batteries, as well as grid services and maintenance

Example Impact Metrics

- Greenhouse gas (GHG) emissions avoided (metric tons)
- Water usage reduced (liters)

Sustainable Transport

Companies and infrastructure that enable more efficient and equitable transportation of people and goods to reduce emissions and mitigate climate change

Investment opportunities include: electric vehicles and corresponding infrastructure, shared-commute platforms, and autonomous and connected vehicle development

Example Impact Metrics

- GHG emissions avoided (metric tons)
- Cars off the road (#)

Sustainable Food & Agriculture

Seeks to increase food security while decreasing GHG emissions and water usage associated with food and agriculture production

Investment opportunities include: organic farmland transition, sustainable supply chain, water management, and alternative proteins

Example Impact Metrics

- Water conserved (metric tons)
- Sustainable food produced

Waste & Materials

Focuses on a circular economy through the production, transportation, use, and disposal of goods in a way that allows reuse

Investment opportunities include: waste management solutions, sustainable material development, and efficiency technology development

Example Impact Metrics

- Waste reduced (tons)
- Water conserved (liters)
- Increased recycling / reuse (%)

Ecosystem Services

Sustainable management of ecologically sensitive land to improve environmental, ecological and economic outcomes

Investment opportunities include: sustainable management of forests and agriculture, including those that generate carbon credits

Example Impact Metrics

- Climate regulation
- Carbon storage
- Decomposition

Objective

Reduce carbon emissions contributing to climate change

Investment

Invest in electric vehicle charging infrastructure to increase accessibility of electric vehicles

Dual Outcome

Reduce carbon emissions associated with transportation

Generate revenue as electric vehicle penetration increases

Investment opportunity examples and metrics provided are not inclusive of all investment opportunities and metrics in each particular theme. Dual outcome investment example is illustrative.

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Inclusive Growth

A focus on social themes

Accessible & Affordable Education

Focuses on increasing access to quality and affordable education to reduce economic, social, and financial inequalities at both individual and community levels

Investment opportunities include: online learning companies, college affordability solutions, school management systems, and workforce skills training

Example Impact Metrics

- Job placement rate (%)
- User reach (#)

Accessible & Innovative Healthcare

Seeks to improve efficiency and quality of care and reduce costs in current healthcare systems

Investment opportunities include: digital health platforms and tools, medical devices, certain life sciences, care coordination, and infrastructure

Example Impact Metrics

- Average patient savings ($)
- Reduction of in-patient time (hours)

Financial Inclusion

Addresses accessibility to affordable financial services for low- and moderate-income households and small businesses to provide financial stability and improve financial health

Investment opportunities include: FinTech products, financial services, and extension of affordable credit

Example Impact Metrics

- Jobs created (#)
- Average customer savings ($)

Housing & Communities

Investment into historically underserved communities, including low-income neighborhoods and majority-minority communities

Investment opportunities include: opportunity zone funds, strategies focused on affordable housing, and sustainable housing technologies

Example Impact Metrics

- Capital committed to underserved communities ($)
- Affordable & workforce housing developed (units)

Objective	Investment	Dual Outcome
Improve patient outcomes and reduce healthcare costs	*Invest in a prescription digital therapeutic for cancer patients*	*Treat more patients with cancer-related depression and anxiety at lower cost* *Generate return on growth capital by capitalizing on the adoption of digital medicine*

Investment opportunity examples and metrics provided are not inclusive of all investment opportunities and metrics in each particular theme. Dual outcome investment example is illustrative.

What's Next for Impact Investing

In line with the broader sustainable investing space, we believe impact investing momentum will persist as investor appetite grows and the breadth of offerings continue to evolve. We believe the following tailwinds will support innovation and investment opportunity among impact-oriented managers:

1. Governments and corporations continue to set and accelerate sustainability goals. In 2019, net-zero pledges covered just 16% of the global economy, and by 2021, nearly 70% of the global economy was committed to net-zero by 2050.[4]

2. Supportive regulatory policies and initiatives are in motion. The recent passage of the U.S. Inflation Reduction Act provides $369 billion in funding for climate-related initiatives, representing the U.S. government's commitment to global decarbonization.[5]

3. The public sector alone cannot meet the capital requirements proposed by global sustainability targets. The world needs $6 trillion per year of investment in the 2020s, up $2.8 trillion from the 2016-20 average capital expenditure to meet 2030 net-zero, infrastructure and clean water goals; Goldman Sachs Global Investment Research estimates the private sector will contribute $0.9 trillion of that "green capex" gap.[6]

4. In addition to the capital flowing into impact investing, the number of firms incorporating ESG into their private investment approach is also increasing. Integration strategies proactively evaluate ESG factors or themes as part of an investment process with the objective of outperforming a benchmark. In 2021, fundraising by GPs with formal, firm-level ESG policies increased to $630 billion, representing over half of total fundraising for the second year in a row[1], widening the scope of access for investors looking to incorporate ESG into their private markets portfolios.

If you would like to discuss impact investing further, please reach out to your Goldman Sachs team.

Endnotes

1: McKinsey & Company, Private Markets Rally to New Heights. March 2022.

2: Hand et al., 2020 Annual Impact Investor Survey

3. GIIN, Evidence on the Financial Performance of Impact Investments. November 2017.

4. Science Based Targets, The Net-Zero Standard. July 2021.

5. CNBC, Inflation Reduction Act could curb climate damages. August 2022.

6. GIR, Green Capex Report. October 2021.

Endnotes

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