

IMPACT INVESTING IN THE PRIVATE MARKETS: CONSIDERATIONS FROM AN LP PERSPECTIVE

Jackie Rantanen, Head of Product Management

For the private markets, 2018 was marked by some record highs in terms of fundraising and deal flow, some worrisome trends in the way of compressed outperformance versus the public markets, as well as some welcome developments – such as LPs increasingly investing in their own infrastructure. (High fives all around on that front!) Generally, the markets performed well once again, and investors remain positive on the industry overall, with most planning to maintain or increase their allocations as shown in our [2018/2019 Private Markets Survey](#).

A logical question, then, becomes where specifically do LPs plan to direct their increased allocations – to new strategies, managers, geographies? While there's no one single answer to that question, we are seeing pockets of interest that we believe are worth discussion and examination – and one such area is impact investing. It is a rare conversation with an LP today that does not touch on impact investing at some level, ranging from “What is impact?” to “What impact strategies are best positioned for success?” Undeniably, impact as a strategy has gained a significant amount of traction over the past several years as preferences and priorities have evolved, and investors increasingly are seeking to identify investments capable of delivering social benefits in addition to expected financial returns.

The Draw

Over the last few years, the notion of “making an impact” has grown in favor not just in the investment world, but also among consumers. According to a recent CONE Communications study¹, 87% of Americans would purchase a brand/product because that company advocates for social or environmental issues. Another study from Morgan Stanley² found that 86 percent of millennials (who comprise a large and increasingly influential demographic of consumers and business decision makers) indicated an interest in socially responsible investing. And in turn, changing consumer preferences have sparked the establishment

of ranking systems such as “Just Companies³” that allow consumers and investors to make decisions based on corporate behavior and governance. The unique value proposition of using capital to make a positive difference in the world has sparked interest from all corners.

In private markets investing, the value proposition of impact is particularly well positioned given the control nature of the investment coupled with the longer time horizon, which can allow managers to drive and influence change in their portfolio company investments. We've observed that the level of interest in impact investing varies from LP to LP – some already have a well-developed impact or ESG portfolio and are looking to add to their exposure, while others are new to the space and are seeking guidance on how best to build a program. In either case, these LPs are taking action – a 2018 Global Impact Investing Network survey⁴ reported there is now \$228.1 billion in impact assets under management, up from \$114 billion the year before. A report last year from The Forum for Sustainable and Responsible Investment⁵ found that investors in the U.S. had nearly \$12 trillion in sustainable, responsible and impact investments. That figure grew at a 38% compound annualized rate between 2016 and 2018, which is more than twice the rate of U.S. investments overall. And the opportunities for deploying impact capital are vast and numerous, with the aim of addressing some of the world's largest societal and environmental challenges.

Metrics and Measurement

For many investors, broad-based guidelines are setting the framework (and a bit of a standard for the industry) for their portfolio development. The most significant, and oft-quoted of these guidelines is the United Nations Sustainable Development Goals (“UN SDGs” or “Global Goals”), the 17 interconnected goals set as part of the UN SDG’s 2030 Agenda⁶ for a better, more sustainable world. Beyond these, many other sets of guidelines exist that may appeal to investors with specific religious, ethical or moral agendas. Some examples are the Bishop’s Socially Responsible Investment Guidelines⁷, which some faith-based organizations have adopted, an organization called the Principles for Responsible Investment⁸ (of which Hamilton Lane is a long-time member) and The Forum for Sustainable and Responsible Investment⁹ (US SIF).

These sets of guidelines often share common goals that help define the target “impact”:

- Protecting the environment;
- Supporting clean energy and water;
- Fostering economic justice; and
- Providing education and healthcare in order to promote human dignity.

Additionally, there are, of course, core missions and objectives that drive individual organizations’ impact strategies. It is not uncommon to see a company focus specifically on areas such as healthcare, education or financial inclusion. This is evidenced by the rise of “Place-Based” investment strategies wherein organizations combine both their highest-priority sustainability goals with investment into targeted geographies.

Much like the SDGs, which provide the framework for investors, the Sustainability Accounting Standards Board (“SASB”) developed a “Materiality Map¹⁰” to guide investors’ assessment of the financial impacts of sustainability as a way to add further structure for investment decision-making.

Expanding Options; Increasing Complexity

As the interest and sophistication in impact has grown, so too has the opportunity set available to investors, which continues to become more diverse and expansive. In turn, the bar for measuring outputs and outcomes has been raised, and the sector is growing more complex.

For LPs, that means making choices between specialists versus generalists, where within the investment cycle to focus their exposure, as well as how to diversify across geographies and regions.

Regardless of the strategy, sector or geography, a resounding theme we hear from investors is the need for greater transparency. And while that theme is by no means new to the private markets generally, in the realm of impact investing, transparency can mean quite specific deliverables. LPs want to understand the process that GPs are undertaking to underwrite both the investment thesis, as well as the impact thesis. Further, they want to be assured of the ongoing monitoring and reporting of the impact thesis with identifiable metrics and regular measurement.

Yet, measurability is still very much a work in progress. In fact, we hear from LPs that this is one of the most challenging aspects of impact investing, because the impact being generated isn’t always clear or quantifiable depending upon the types of investments being made and into what businesses and industries. As the market continues to mature, we expect that managers will improve upon transparency and be able to deliver more quantifiable metrics and results. The important strides being made in this area will add greatly to the overall approachability and, ultimately, adoption of impact investing more broadly. We continue to believe that data – and the use of technology to analyze, understand and utilize that data – will transform the private markets broadly, and impact investing specifically.

Opportunity and Momentum

Within the private markets, the dollars being dedicated to impact represent a meaningful amount of capital invested into a significant number of companies: over \$35B into 11,000 companies in 2017 alone.

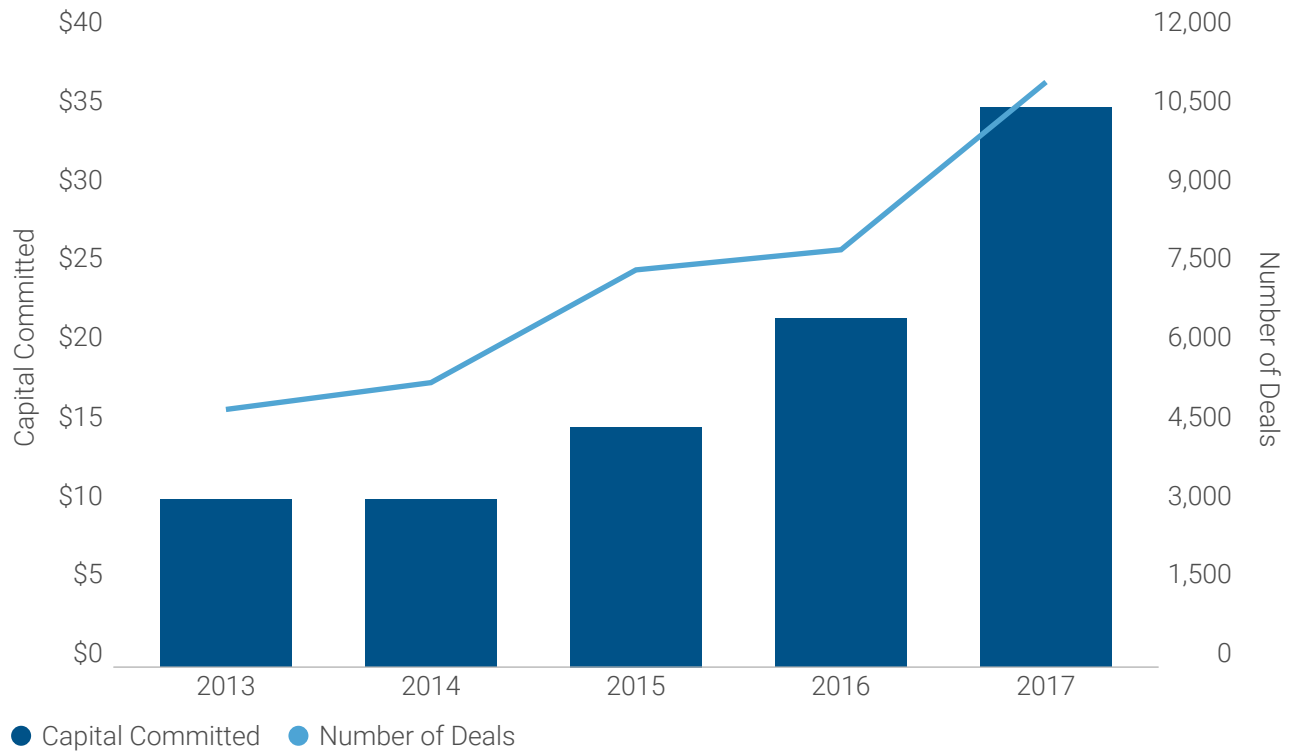
We’re often asked for specific examples of what qualifies as an impact investment. While the range of investment types and strategies is quite broad, here are a few examples we’ve seen:

An irrigation company that brings much-needed water to arid land that creates an increased crop yield to feed a growing population and does so through the efficient use of water;

A mobile healthcare practice that brings quality healthcare to previously underserved populations;

Capital Invested and Number of Deals in the Private Markets is Growing

USD in Billions



Source: GIIN Annual Investor Survey, 2014-2018

A geothermal electricity producer that provides an important alternative to high emission fossil fuels. Through its geothermal resources and energy-generation technologies, in addition to generating millions of MWh of electricity, this company has prevented the emission of millions of tons of carbon dioxide.

These are just a sampling, but of course there are many, many others. Our review of direct investments and fund managers suggests that there is no lack of attractive impact investment opportunities to match with institutional missions and values going forward.

As the universe of opportunities grows, we predict that the spectrum of how we look at and define impact will also increase in sophistication. In the (not too distant) future, we can envision LPs' questions shifting from "What is impact?" to "How much of my portfolio should I allocate to impact strategies?" or "What types of impact strategies are best for my organization?" And, as the outcomes of these strategies become more measurable, private markets capital will stand to represent an even larger piece of the impact investment pie.

Endnotes

¹ Source: <http://www.conecomm.com/research-blog/2017-csr-story>

² Source: <https://www.morganstanley.com/ideas/sustainable-socially-responsible-investing-millennials-drive-growth>

³ Source: <https://www.forbes.com/just-companies/#3c0f9c5d2bf0>

⁴ Source: <https://thegiin.org/research/publication/annualsurvey2018>

⁵ Source: <https://www.ussif.org/trends>

⁶ Source: <https://sustainabledevelopment.un.org/post2015/transformingourworld>

⁷ Source: <https://www.catholicinvestments.com/catholic-investing/usccb-socially-responsible-guidelines/>

⁸ Source: <https://www.unpri.org/>

⁹ Source: <https://www.ussif.org/>

¹⁰ Source: <https://www.sasb.org/standards-overview/materiality-map/>

Disclosures

This presentation has been prepared solely for informational purposes and contains confidential and proprietary information, the disclosure of which could be harmful to Hamilton Lane. Accordingly, the recipients of this presentation are requested to maintain the confidentiality of the information contained herein. This presentation may not be copied or distributed, in whole or in part, without the prior written consent of Hamilton Lane.

The information contained in this presentation may include forward-looking statements regarding returns, performance, opinions, the fund presented or its portfolio companies, or other events contained herein. Forward-looking statements include a number of risks, uncertainties and other factors beyond our control, or the control of the fund or the portfolio companies, which may result in material differences in actual results, performance or other expectations. The opinions, estimates and analyses reflect our current judgment, which may change in the future.

All opinions, estimates and forecasts of future performance or other events contained herein are based on information available to Hamilton Lane as of the date of this presentation and are subject to change. Past performance of the investments described herein is not indicative of future results. In addition, nothing contained herein shall be deemed to be a prediction of future performance. The information included in this presentation has not been reviewed or audited by independent public accountants. Certain information included herein has been obtained from sources that Hamilton Lane believes to be reliable but the accuracy of such information cannot be guaranteed.

This presentation is not an offer to sell, or a solicitation of any offer to buy, any security or to enter into any agreement with Hamilton Lane or any of its affiliates. Any such offering will be made only at your request. We do not intend that any public offering will be made by us at any time with respect to any potential transaction discussed in this presentation. Any offering or potential transaction will be made pursuant to separate documentation negotiated between us, which will supersede entirely the information contained herein.

Certain of the performance results included herein do not reflect the deduction of any applicable advisory or management fees, since it is not possible to allocate such fees accurately in a vintage year presentation or in a composite measured at different points in time. A client's rate of return will be reduced by any applicable advisory or management fees, carried interest and any expenses incurred. Hamilton Lane's fees are described in Part 2 of our Form ADV, a copy of which is available upon request.

The following hypothetical example illustrates the effect of fees on earned returns for both separate accounts and fund of funds investment vehicles. The example is solely for illustration purposes and is not intended as a guarantee or prediction of the actual returns that would be earned by similar investment vehicles having comparable features. The example is as follows: The hypothetical separate account or fund of funds consisted of \$100 million in commitments with a fee structure of 1.0% on committed capital during the first four years of the term of the investment and then declining by 10% per year thereafter for the 12-year life of the account. The commitments were made during the first three years in relatively equal increments and the assumption of returns was based on cash flow assumptions derived from a historical database of actual private equity cash flows. Hamilton Lane modeled the impact of fees on four different return streams over a 12-year time period. In these examples, the effect of the fees reduced returns by approximately 2%. This does not include performance fees, since the performance of the account would determine the effect such fees would have on returns. Expenses also vary based on the particular investment vehicle and, therefore, were not included in this hypothetical example. Both performance fees and expenses would further decrease the return.

Hamilton Lane (UK) Limited is a wholly-owned subsidiary of Hamilton Lane Advisors, L.L.C. Hamilton Lane (UK) Limited is authorized and regulated by the Financial Conducts Authority. In the UK this communication is directed solely at persons who would be classified as a professional client or eligible counterparty under the FCA Handbook of Rules and Guidance. Its contents are not directed at, may not be suitable for and should not be relied upon by retail clients.

Hamilton Lane Advisors, L.L.C. is exempt from the requirement to hold an Australian financial services licence under the Corporations Act 2001 in respect of the financial services by operation of ASIC Class Order 03/1100: US SEC regulated financial service providers. Hamilton Lane Advisors, L.L.C. is regulated by the SEC under US laws, which differ from Australian laws.

Any tables, graphs or charts relating to past performance included in this presentation are intended only to illustrate the performance of the indices, composites, specific accounts or funds referred to for the historical periods shown. Such tables, graphs and charts are not intended to predict future performance and should not be used as the basis for an investment decision.

The information herein is not intended to provide, and should not be relied upon for, accounting, legal or tax advice, or investment recommendations. You should consult your accounting, legal, tax or other advisors about the matters discussed herein.

The calculations contained in this document are made by Hamilton Lane based on information provided by the general partner (e.g. cash flows and valuations), and have not been prepared, reviewed or approved by the general partners.

As of February 4, 2019