LGPS consultation: Better Society Capital and Impact Investing Institute response

About the organisations

Better Society Capital (BSC) is the UK's leading social impact investor, set up by the UK Government in 2012 as an independent investment organisation. To date BSC has directly committed more than £1bn to local investments throughout the UK. These investments support thousands of people with affordable and safe homes, access to good healthcare, and enable thousands of SMEs to become more financially resilient whilst generating sustainable returns for institutional investors, including Local Government Pension Scheme funds (LGPS). The £10bn directed into social impact investment in the UK forms part of the broader £76.8bn UK-managed impact investment market.[1]

The Impact Investing Institute (The Institute) is an independent, non-profit organisation working to transform capital markets, so they support a fairer, greener, more resilient future. The Institute seesimpact investing as an effective way to achieve that transformation and so we work to accelerate the field, both in the UK and globally. We come up with innovative solutions that help private finance address societal challenges, and we grow the field of impact investing by building expertise across financial markets. We work with investors and their advisors to move more effective capital for the benefit of people and the planet, and we advocate for regulatory and policy environments that allow the impact investing market to thrive. The Institute is a trusted partner in working with LGPS and the wider investment community to support the growth of place-based impact investing (or "PBII").

Consultation response

Introduction

Interest in impact investment is already established and growing rapidly; we were delighted to see strong support for the approach from the new government, with the Chief Secretary to the Treasury's roundtable with major impact investors and the announcement of over £550mn of impact investments for social and affordable housing at the International Investment Summit,[2] as well as notice in the Autumn Budget of the Government's intention to start designing a social impact investment vehicle to support the delivery of its missions, for example through social outcomes partnerships.[3]

To deliver local investment, **place-based impact investing (PBII) is a powerful tool for driving positive change in communities across the UK, which can provide a compelling investment opportunity for pension funds.** The Institute's 2021 white paper, "*Scaling up institutional investment for place-based impact",* delivered in partnership with The Good Economy and Pensions for Purpose, highlighted that if 5% of LGPS funds were allocated to local investment, this could

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[1] See BSC 2023 market sizing data release and the Impact Investing Institute's 2024 market sizing

[2] https://www.gov.uk/government/news/hundreds-of-millions-of-new-investment-secured-to-get-britain-building-again

[3] NB: As an example, this aligns to the mention in the LGPS Advisory Board's response to this consultation, which notes that "the Board has long recommended that the Government create and market a selection of social impact bonds [also known as social outcomes partnerships]. Currently these tend to be at too small a scale to interest LGPS investors, but the aggregation of appropriate opportunities would allow all funds to invest at a scale that is appropriate for them.

unlock £16bn, generating substantial social and environmental impact and savings for the state.[4] There are growing opportunities to invest in areas such as social housing, SME finance and renewable energy as well as emerging areas such as social infrastructure, natural capital and preventative health. Alignment with government policy priorities is also crucial, as central and local government play a vital role in creating the enabling environment for local investments, supporting the shaping and directing of where capital can meet local needs.

LGPS funds are already investing locally; the Mansion House reforms would accelerate this, creating additional positive outcomes. The LGPS is one of the largest pools of institutional capital with connections to communities across the UK, with key features including its decentralised geography, local investment decision-making powers and a legacy of local investing. The LGPS funds are already allocating to the key PBII sectors, demonstrating that commercial investment opportunities delivering meaningful local impacts are available within risk-adjusted parameters suitable for institutional portfolios, while satisfying fiduciary requirements. 64% of LGPS funds intend to increase commitments to local investments, signalling a significant shift in the sector.[5] The Mansion House reforms could accelerate the delivery of local investment through PBII, with examples of how this investment is already being directed towards tackling social and environmental issues:

- Several of the LGPS pools have already demonstrated that they can assist their client funds to create local investment allocations. In 2022 for example, Brunel Pension Partnership Limited worked with Cornwall Pension Fund to create their Cornwall Local Impact portfolio to channel investment into affordable housing and renewable energy;
- Key institutional investors, such as Schroders and Legal and General, recognise the alignment between pension fund capital and PBII, where financial returns and positive environmental and societal outcomes drive together.
- The market is simultaneously experiencing a growth in investment products targeting positive local outcomes, such as Schroders' Real Estate Impact Fund and Octopus' Affordable Housing Fund. LGPS funds are providing significant capital for these types of funds; for example, Gresham House's Sustainable Infrastructure Fund secured £450mn investment from eight LGPS funds.

Our joint response focuses on **Chapter 3: Local investment** from the consultation and communicates the position of two organisations working to strengthen the role LGPS funds play in contributing to local growth. Our experience has taught us valuable lessons about creating, assessing, and managing local investments which are highly relevant to the LGPS community as they develop their local investment delivery plans, and we provide an overview of these lessons in this response.

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[4] The Impact Investing Institute, The Good Economy and Pensions for Purpose (2021) Place-based Impact Investing White Paper [online]

[5] https://www.room151.co.uk/partner-content/using-place-based-impact-investing-as-an-approach-to-attract-external-investment/

Question 13: What are your views on the appropriate definition of 'local investment' for reporting purposes? *The term 'local investment' is used to include investments local to any of a pool's partner AAs, or investments in their region (or in Wales, for Welsh AAs).*

- **It is important to align local investment by LGPS with local needs, which includes tackling issues such as affordable housing, transition to net zero and driving inclusive growth;**
- **This presents a range of suitable and scalable investment opportunities for LGPS through taking a PBII approach, such as through investing in housing, clean energy, SME finance, infrastructure and natural capital;**
- **For reporting purposes, "local investment" activity should be defined as local to any of a pool's partner AAs, or investments in their region;**
- **LGPS investments across the UK using a PBII approach will also make a positive contribution to UK growth.**

PBII is an effective approach to delivering local investment. PBII is an approach to investing which mobilises institutional investors, such as pension funds, to invest in a way that engages with local stakeholders in a specific place to address localised needs. This delivers appropriate risk-adjusted financial returns and positive local impact, whilst providing an opportunity to amplify community voice through sustained engagement between investors, local stakeholders and communities.[6]

For reporting purposes "local investment" activity should be local to any of a pool's partner AAs, or investments in their region. A mission-driven government intending to deliver its missions in places needs mission-aligned actors with local expertise. LGPS should be not only investing locally but investing for local positive impact; defining 'local investment' at this level enables LGPS to report on impacts that directly benefit their members who may also live locally, alongside receiving the financial benefit in retirement through their pension.

However, **LGPS investments within the UK should not be limited to these defined geographic areas** and can contribute to UK growth by investing in PBII sectors across the country. By adopting a PBII approach, aligning investments with local need and engaging local communities through the investment process, LGPS can make a significant contribution to investing in PBII sectors across the UK.

Question 14: Do you agree that administering authorities should work with their Combined Authority, Mayoral Combined Authority, Combined County Authority, Corporate Joint Committee or with local authorities in areas where these do not exist, to identify suitable local investment opportunities, and to have regard to local growth plans and local growth priorities in setting their investment strategy? How would you envisage your pool would seek to achieve this?

- **A partnership approach between LGPS and combined and local authorities is vital to effective local investment;**

[6] See Impact Investing Institute (2023) *Fostering Impact: An investor guide for engaging communities in place-based impact investing* [online] for more detail on the spectrum of public participation.

- **There is a need to build capacity within and upskill local government on impact investment and bringing forward projects which could be investible;**
- **Central government also has a key role to play, in particular around creating an enabling environment for delivering local investment.**

We would agree that a partnership approach is vital to effective local investment. It is vital that any reforms do not solely promote investment into large-scale commercial projects but reach into communities across the UK to achieve deep and lasting impact. However, that does not mean that private sector investors have to compromise; a local lens can help to identify overlooked investment opportunities. This is where partnerships with local experts, including local government, can help shape compelling impact investment solutions. PBII must be informed and driven by the needs of places and a range of local stakeholders (such as local government, investors, civil society organisations and others) who can shape investment solutions that are right for them. Local government is increasingly proactive in seeking partnerships with investors, in particular where new devolved powers and funding enable more flexibility. Examples include:

- The Institute's 'place pilots' in Wakefield and Southampton contribute to this growing field by supporting local authorities to build the capability to engage more effectively with investors seeking aligned societal outcomes.
- Greater Manchester provides a strong example of where a combined authority has worked effectively with its local pension fund to deliver local impact.
- The West of England Combined Authority (WECA) launched a £10mn Green Growth Fund to leverage £90mn of private investment to drive renewable energy supply and tackle high energy bill spend across the city region. This will be delivered in partnership with BBRC who have invested over £70mn across the region in the last decade, building on locally-led initiatives such as Bristol One City Fund and also Bristol City Leap.

Beyond local government, there are examples of investments bringing together other regional stakeholders which are critical to the local growth agenda. BSC has invested in local, non-profit financial organisations known as Community Development Finance Institutions (CDFIs) which provide much-needed finance for small businesses, particularly in underserved areas.[7] Following an initial pioneer investment by BSC, which helped over 1,000 small businesses, the Community Investment Enterprise Fund (CIEF) was launched in 2024. This unlocked £62mn from Lloyds Banking Group and BSC to support small businesses through investing in four CDFIs in Nottingham, Wolverhampton, Doncaster, and Bradford; this was also the first investment by a commercial bank in CDFIs. The Institute alongside the CDFI trade body Responsible Finance also played a key role in bringing this second phase to fruition.

Case study: Greater Manchester Pension Fund (GMPF)

[7] See Responsible Finance (2024) Impact Report

GMPF is the largest LGPS fund in the UK, with over 414,000 members and a total AUM of c.£30bn.[8] It makes a 5% allocation of its main fund value (with 4.5% committed, or £1.36bn, as of end-2022[9]) to local investments that positively benefit Greater Manchester and the North West, by generating employment and supporting SMEs as well as providing housing, renewable energy, infrastructure and social investment. GMPF was also the first UK pension fund to publish on the impact performance of its local investment portfolios. This includes a £20mn investment in the National Homelessness Property Fund, managed by Resonance, which acquires properties and leases them to the social housing sector and homelessness charities to provide safe, high-quality and energy-efficient homes to those at risk of housing insecurity or rough sleeping. Independent research has shown that these property funds have housed over 3,300 people in 10 years, with £140mn saved by local and central government in spend on temporary accommodation.[10]

Local authorities have great insight into the needs of their communities but often lack the capacity and capability to work effectively with institutional investors. A priority should be to upskill officials on impact investment and enhance the capability of local authorities to bring forward investable propositions. There is a recognition that officials within local authorities and/or LGPS may need to be upskilled on local impact investment practices and business models, in particular where they may lack clarity and confidence to bring forward investible propositions.[11] Local authorities may also design projects that are not investible for institutional capital, so early-stage engagement with investors can help bring forward more viable propositions. This is particularly relevant given the proposal in the Government's Devolution White Paper for the new Strategic Authorities to work with LGPS Administering Authorities and "their asset pools to develop investment opportunities that are appropriate for pensions investment", with regard for the Local Growth Plans priorities.

Challenges or perceptions of PBII as an investment approach could include the following:

- A lack of knowledge on impact investment approach and products within local government, in particular the existing breadth of investment opportunities and solutions;
- Similarly, LGPS are small teams working across big portfolios, without the resource or time to get up the impact investment learning curve.
- Perceived concerns by LGPS around a lack of investable opportunities.

Capacity building and upskilling is therefore vital. To tackle this, BSC and the Institute are keen to work in partnership with LGPS funds, pools and central and local government to support this agenda. With over a decade of hands-on experience, our organisations have insight into finding, making, and managing local investments without geographical or political bias. For example, the Institute has experience of convening within places, bringing investors and local government together to explore opportunities, and recently produced an "Emerging Impact and Insights" overview on PBII in partnership with the Department for Culture, Media and Sport. BSC is in the process of drafting a

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[8] GMPF 2023 Annual Report [online]

[9] GMPF Local Investment Portfolios overview [online]

[10] Resonance Impact Report on Homelessness Property Funds [online]

[11] For example, see insights from the aforementioned PBII white paper co-authored by the Institute, The Good Economy and Pensions for Purpose (page 42)

place-based investing toolkit to showcase examples of how a multi-asset approach to impact investing can work locally.

In addition to the local actors, central government also needs to be a key partner in this ambition. The following present examples of how central government could work with local actors to ensure an enabling policy environment for LGPS to tackle social challenges through local investing:

1. **Building capacity for pension funds to make place-based impact investments**

Central and local government can work with the private sector to ensure there are suitable investment opportunities and to build capacity across sectors to deliver these projects. It will also take time to build capacity and expertise for pension funds to allocate locally, which is why LGPS need to harness existing expertise. BSC already plays a role in supporting LGPS and others to understand how to allocate, as well as seeding and scaling impact investments with our own investment capital which enable pension funds to identify investments delivering on their PBII goals and addressing their fiduciary responsibilities. Suitably scalable vehicles will be required to enable pension funds and other institutional investors to access these investments.

2. **Clarifying the fiduciary position**

In the first instance, LGPS funds have a responsibility (fiduciary duty) to act in the best interests of their scheme members and employers. As outlined, PBII can support the creation of strong returns and local multiplier effects to improve member outcomes through local investment. Stronger local economies would also mean increased financial stability for members. To support and incentivise LGPS funds to invest in local communities with the aim of contributing to local and regional growth, policy clarity is required: LGPS funds need explicit reassurance that they can take account of how their investments affect the economy, community, environment, and members' standards of living in the context of acting in the best interests of members. This would create a more enabling policy framework for LGPS to have the confidence to invest for local impact.

3. **Reduce risk and create incentives**

Government can provide first loss or guaranteed minimum investment returns to encourage the crowding in of pension fund capital in local areas, e.g. through blended finance or outcomes-based approaches. BSC has worked to build blended capital structures and support the provision of blended finance products, including committing over £140mn in 33 blended finance funds, making over £270mn available to social purpose organisations focused on tackling local issues.

Question 15: Do you agree that administering authorities should set out their objectives on local investment, including a target range in their investment strategy statement?

- **AAs should set out their objectives which should include positive local impact, and consider the benefits of a multi-asset approach to deliver these objectives.**

AAs should set out their objectives, and achieving positive local impact should form a key pillar. Although we do not have views on the target range for AAs' investment strategy statements, we would urge funds to consider the benefits of including PBII as part of their toolkit for local investment. There are benefits to this, including benefits of this enabling clarity around what "success" is, where the investment needs and opportunities are and the measure of impact of these investments. It is important that this is co-developed with input from investors, so that it is informed by what is genuinely investible. It can also play a vital role in the "market creation" to grow local investment ecosystems. The existing US place prospectuses can serve as an example of best practice.

AAs and LGPS should think broadly across asset classes as to how they can meet those objectives. PBII as an approach involves a multi-asset approach which works for places and investors alike, whilst satisfying fiduciary duty obligations. Places are not homogeneous and local issues are addressed by a variety of different business models. This means they need a toolkit of investment solutions. A multi-asset approach to local investment has dual benefits, as it can address the diverse needs of different areas at the same time as enabling investors to meet their needs across their portfolio allocation, across financial, risk, social and impact metrics. For example, if an AA's objective were to focus on increasing renewable energy generation and green jobs creation within that area, it might pursue an investment in community-owned renewable energy assets. A case study of this type of investment made in practice is CORE Partners.

Case study: CORE Partners
As well as private credit and real estate, we see community owned renewable energy as an important part of the asset mix and supporting a just transition to net zero. CORE was designed by Finance Earth, Power to Change (PtC) and BSC to help create revenue streams into more disadvantaged communities, by providing capital to fund the purchase and development of solar farms. CORE holds the solar farms in trust and supports the local community to buy back the assets under community share schemes. Asset ownership allows communities to generate their own energy and reinvest profits to benefit local people. In the refinancing of CORE, abrdn invested £31mn on behalf of its strategic partner Phoenix Group. In 2024, the biggest transfer of community energy assets ever in the UK was completed when CORE facilitated five community businesses to take ownership of eight solar farms with a collective capacity of 36MWp, increasing England and Wales' community solar capacity by one fifth. The initiative has delivered significant community benefits, including £48mn in community benefit funds, showcasing the effectiveness of combining different types of capital to achieve a greater impact.

Question 16: Do you agree that pools should be required to develop the capability to carry out due diligence on local investment opportunities and to manage such investments?

- **There are advantages to developing pools' capability to carry out and manage local investment;**
- **Any consolidation should safeguard the ability of larger pools to invest in smaller funds;**
- **Capacity-building at the local level is key, as the development of expertise and knowledge will enable LGPS to truly live up to the objectives of local investments.**

There are some clear potential benefits in developing pools' capability to carry out and manage local investment. These benefits include allowing close relationships between the pools and AAs and not undermining the cost saving of pooling. In addition, if PBII is used as a key mechanism to deliver local investment, this will give a broader group of people within the investment ecosystem knowledge about local impact investing; an approach which creates robust financial returns, is not correlated to traditional markets and drives positive change for local communities. Better outcomes can be delivered for people in local areas, with private investment responding to the needs of places.

Any consolidation needs to be done well and must safeguard the ability of larger pools to invest in smaller funds. Investing in smaller funds offers benefits to LGPS such as portfolio diversification and risk mitigation, higher impact through community-based projects, complementing larger fund strategies and closer engagement enabled through smaller fund managers. Any consolidation should include better governance to build the appropriate capability and resource within pools to be able to invest in smaller funds (as well as larger ones), and clear guidance and expectations to enable the development of teams and expertise to enable that investment into smaller funds across the UK.

Several LGPS concerns on local investment can be mitigated or there may be misperceptions around PBII, but there are also capacity and capability gaps in local government to bring forward investible opportunities at the scale required. This will take time, and those with experience in this field will need to respond appropriately to support pools. It is worth bearing in mind that if this due diligence work is outsourced to non-experts at relative arm's length, it will likely be costly and undermine the cost-saving benefits of pooling, as well as creating additional barriers and impeding the partnership working between local authorities, combined authorities and the pools. Consultants should be used to support the pools' transition, rather than as a permanent solution.

We would also reiterate that local investment does not always preclude scale. For example, investing in social and affordable housing can have a transformative effect on the people in a local area, and scaling in substantial private capital will be essential. The social and affordable housing impact market is already worth £5.1bn, with many affordable housing funds working in partnership with LGPS to make local investments. £280mn was co-invested alongside BSC in affordable housing during 2024, when we saw several LGPS funds commit to investments such as the Octopus Affordable Housing Fund.

Case study: Octopus Affordable Housing Fund
Octopus Investments (part of the Octopus Group) established an Affordable Housing Fund which targets long-term strategic equity partnerships with housing associations to deliver affordable housing for low-income households. Through its sister-company Octopus Energy, the fund will also target high standards of energy efficiency and strategies to address fuel poverty. Having raised £50mn in 2023 from London CIV and a further £10mn from BSC, in July this year it was announced that a further £150mn was invested in the fund by various LGPS, including Avon and Gloucestershire. This capital will enable more than 500 affordable homes for families and older people to be built across the UK and is the first step in meeting an overall target of funding 5,000 homes to be built in coming years. Octopus' links to its sister company, Octopus Energy, will enable more energy-efficient homes to be built to reduce resident outgoings and provide an example of how LGPS funds are meeting their environmental targets and delivering social impact. All the homes are expected to be ready by April 2025.

Question 17: Do you agree that administering authorities should report on their local investments and their impact in their annual reports? What should be included in this reporting?

We agree that reporting on the impact of any local investment approach is critical, as it shows the impact is considered and measurable. The focus should shift away from reporting "for reporting's sake" and towards the active management of impact. This allows AAs and LGPS to learn from their existing approaches as well as encouraging continuous improvement and minimising unintended consequences, whilst also ensuring full transparency for scheme members. There are existing IMM frameworks which could be aligned to and replicated, whilst recognising that AAs and LGPS will require support to implement these processes. A helpful starting point is the Good Economy's overview of the three principles of Impact Management and Measurement, namely intentionality, integration and integrity, and The Good Economy-BSC Equity Investor Impact Reporting Project which developed a common reporting framework for impact for equity investors in social and affordable housing. The key pillars of BSC's impact and systems practice also serves as a helpful reference, which are built out through regular, fund-specific impact reporting, annual impact conversations and performance committees.

Question 30: Do you consider that there are any particular groups with protected characteristics who would either benefit or be disadvantaged by any of the proposals? If so please provide relevant data or evidence.

- **Rather than identifying specific cohorts at this stage, we would highlight examples of best practice around identifying which groups may stand to benefit or be disadvantaged by the PBII approach, in addition to the role of investments in supporting vulnerable or underserved groups.**

We would flag the importance of including user voice within the investment process to ensure that investments are designed with local people's needs understood and are accountable to end-users and the public. There are examples of best practice of fund managers including user voice across BSC's investments, for example the social impact property fund manager Resonance establishing a tenants forum as part of their engagement on homelessness funds to measure tenant satisfaction and positive move-on rates.[12]

Data collection is also important, with regards to identifying the extent to which fund managers are diverse-led, the diversity of the leadership of their portfolio companies, pay gap reporting, and barriers and resources to implementing EDI practices, but we also recognise this is a complex process. The annual BSC EDI Fund Manager survey seeks to gather this data from across the BSC portfolio, with findings published online to ensure transparency. We would also highlight the success of the Investment Committees of the Future e-learning programme, established by Good Finance to support greater diversity and lived experience in investment decision making.

There is also a role for impact investment to play in supporting vulnerable or underserved groups, for example those housed in temporary accommodation or children in social care. We would suggest the strategy from each AA identifies particular priority needs in their area, and this should be considered as investments are designed and made. While not all needs can be met through

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[12] See more in Resonance's Impact Report (2023) [online]

enterprises and investment, considering how these needs can be met can help identify overlooked people and places. For example, within BSC's portfolio, the aim is for at least 50% of the organisations that take on social lending are from, or are working with, under-represented communities. BSC also aims to invest at least 60% of its portfolio in the areas of the UK that have been overlooked, as represented by the top two quintiles in the IMD.