

## EXECUTIVE SUMMARY

### *Research Question*

5 Stone Green Capital (“5 Stone”) seeks to fund green real estate investments by attracting capital from both traditional and “impact” investors. The impact investing space is relatively new to capital markets, and traditional investors are skeptical of the risks on investments accounting for anything other than financial returns. 5 Stone wishes to explore how to draw traditional investors into the impact investing space.

Given its emphasis on generating optimal sustainability in energy, housing, food and employment markets, while generating consistent economic returns, and the constraints of an evolving impact investment market, how can 5 Stone draw traditional investors into the impact investing space?

### *Recommendation*

With the underlying goal of bringing traditional investors into the impact space to fund its green real estate investments, 5 Stone should pursue Generation Investment Management’s model of “sustainable capitalism” that incorporates profitability and sustainability into its long term strategic planning. 5 Stone’s target investors from traditional financial markets will accept few tradeoffs for maximum financial returns. While both the patient and sustainable capital models provide examples of profitability and long term visions for impact, only Generation seeks above-market-rate risk returns on investment.

### *Defining of Impact Investing*

Impact investing is broadly defined as a set of investment strategies that generate financial return while intentionally improving social and environmental conditions within a defined context. Many view impact investing as a response to the shortcomings of existing efforts – i.e. government, philanthropy, and private markets – to effect positive, large-scale social change. Governments have fallen short due to inefficient use of resources and, in some cases, corruption. Traditional philanthropy has failed to establish scalable means of addressing many global issues. Private markets are structured for strictly financial returns, without a historically accepted method for considering non-financial returns.

### *Sources of Capital for Impact Investors*

For impact investing to grow beyond its current state, it must attract and incorporate new sources of capital into the market. The Acumen Fund has outlined seven sources of capital for impact investors, noting that commercial capital is virtually absent

from the sector due to a perceived risk return tradeoff. These sources of capital, from most commercial to most philanthropic, include financial institutions, pension funds, high net worth individuals, single limited partnerships, governments, foundations, and individual philanthropists.

### *What Is Not Working*

The financial industry has developed a vast infrastructure for managing investments that traditionally “puts profits ahead of people” – or emphasizes risk-adjusted financial returns over social and environmental outcomes. To sustain any capital market, a certain threshold of investment is required to allow an enterprise to scale its initiative and overcome transactional costs. Underinvestment in social capital markets, signaling a lack of recognition among financial managers, hampers the growth of impact investing. This underinvestment is shaped by multiple factors, among them: the failure of the current model to account for social returns on investment (SROIs), a lack of industry-wide performance metrics, uncertainty related to impact investments’ ability to achieve sustainable returns on both social and financial ROIs, and conflicting regulations within the financial market.

### *What Is Working*

Jonathan Greenblatt, Director of the White House Office of Social Innovation and Civic Participation, views the success of impact investing as a gradual process that “doesn’t happen over night.” To date, the impact investing sector has four factors working in its favor as it moves toward broader recognition and acceptance as a viable investment strategy: above-market-rate returns during the recent financial crisis, the emergence of a common language and infrastructure for impact investors, influential market actors affirming the space, and a growing body of evidence linking financial success and commitment to impact.

### *Key Considerations*

Any proposed solution to attract traditional investors into 5 Stone’s impact-oriented projects must be weighed according to its ability to:

- Maximize risk-adjusted financial returns
- Align short term financial targets with long term impact goals
- Appeal to traditional investors within their comfort zone
- Contribute social and environmental impact to target markets

## *Two Models of Success*

Acumen Fund and Generation Investment Management present two divergent models for raising capital for impact investing. Acumen, funded predominantly by smaller investments from individual philanthropists, employs a model they refer to as “patient capital,” targeting disciplined investments – loans or equity in lieu of grants. Generation, on the other hand, focuses its model on more traditional investments, under the principle that an investment’s measurements of sustainability will drive the company’s returns. Both models emphasize an investment approach that prioritizes long term returns over short term performance measures.