Date: 31 August 2023

Case study: Asset Owner of the Year

This award is for asset owners and investors including pension funds, corporations, banks, governments and development finance institutions that deploy their capital to impact investments.

Old Mutual

Founding date	17 May 1845
Geography	Southern Africa
Sector	Financial services
SDGs	1 [no poverty], 3 [good health and wellbeing], 4 [quality education], 8 [decent work and economic growth], 10 [reduced inequalities] & 11[sustainable cities and communities]
Web	https://www.oldmutual.co.za

Background

Old Mutual's core objective is pursuing long-term risk-adjusted returns for clients while aligning with the broader interests of society and addressing long-term system risk. This includes driving real-world outcomes in the form of impact.

The financial services group's responsible investment practices aim to ensure that its smoothed bonus range of products aligns to the broader interests of society, addressing long-term system risk alongside long-term risk-adjusted returns for its clients. As part of its smoothed bonus products, Old Mutual proactively seeks investment opportunities that create value through positive sustainability outcomes. These include:

- Infrastructure investments – renewable energy, toll roads and utilities
- Impact funds – affordable housing and schools, as well as companies that provide end-user finance to low- to middle-income earners
- Agricultural investments – South African agricultural land and associated infrastructure

Old Mutual invests in impact initiatives via Old Mutual Alternative Investments and Futuregrowth.

Originality of design

Old Mutual is a well-known and highly reputable insurance company that has a strong footprint in Southern Africa. It has integrated impact investing in its portfolio, which demonstrates to other asset owners how traditional investment practices can be adjusted to intentionally include impact considerations. Old Mutual's impact investments not only support worthy initiatives but also drive strong inflation-beating returns for its smoothed bonus investors. As a result, the group is strategically repositioning impact investments with a shift towards preferred asset classes that ensure reliable future target returns for investors. Furthermore, Old Mutual has an impact investing fund that has been generating positive social and environment impact alongside positive financial returns since 2007, making it one of the most experienced providers in the market.

Meeting unfilled needs

Old Mutual's impact investments are housed within their smoothed bonus products, which invest debt and equity in two strategic focus areas: social infrastructure (including rental and student housing and education assets) and financial inclusion. South Africa is the most unequal society in the world and investments in these two critical areas can help narrow this gap by making basic social infrastructure more accessible and by enhancing the underserved population's access to markets through investments in initiatives targeting financial inclusion. It is divesting from legacy assets (develop-for-sale housing, retirement accommodation and financial inclusion equity) to ensure reliable delivery of future target returns.

The debt and equity investments generate a return for investors from the cash flows generated by the underlying assets and impact is driven primarily by a focus on the affordable and middle-income market segments.

Impact thesis

Aligning the interests of its clients – the investors in Old Mutual's smooth projects range of funds – with those of wider society will be beneficial to both and result in the scaling up of investments in areas that address South Africa's socioeconomic needs.

By strategically repositioning impact investments, Old Mutual aims to increase its positive impact on the above-mentioned fund. This approach seeks to optimise returns for investors while simultaneously driving meaningful social and environmental change. Through the integration of these improvements, the impact investments aspire to generate both financial growth and measurable positive outcomes that contribute to a more sustainable and equitable future.

SDG linkages

Old Mutual contributes to the achievement of several SDGs through its various investments across different impact focus areas. Direct contributions to specific SDGs are made by investing in schools, linking to SDG 4 (quality education), while its Housing Impact Fund helps make cities and human settlements more inclusive, safe, resilient and sustainable, which links to SDG 11 (sustainable cities and communities).

Through investments in specific socioeconomic initiatives, Old Mutual contributes to a wide range of SDGs. One of Old Mutual's investments is in the Kruisvallei Hydroelectric Power Generation Scheme, the third hydropower project procured under South Africa's Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) to come online. The hydro project is situated along the Ash River between Clarens and Bethlehem in the Free State and it is linked to numerous impact developments.

Unemployment, access to education and housing shortages are some of the biggest social and economic challenges experienced by the Clarens and Bethlehem communities. A portion of the Kruisvallei hydro project's annual operating revenues are used to support initiatives in early childhood development, including nutrition programmes; youth and adolescent education, motivation and behaviour; employment and skills development opportunities; and substance abuse mitigation. We highlight some individual projects below.

Affordable Brickmaking Initiative

The Dihlabeng Municipality faces a housing crisis with a shortage of affordable rental units. The Kruisvallei socioeconomic development strategy supports local small and medium blacked-owned businesses. This includes a capital injection to improve their service offering and ability to seek growth opportunities. The Ntlafatsa Bophelo Cooperative, founded by Thabo Mosia in Kgubetswana Township near Clarens in 2005, manufactured 50 block bricks a day using one machine. Support for this initiative has enabled it to purchase another brickmaking machine and perimeter meter fencing, which has increased daily production and created 10 permanent jobs. The cooperative is able to sell one block for R5 compared with R7.60 charged in Clarens, making it the preferred brick maker in the area.

Fitness Plus Community Gym Initiative

Low-income households that are unable to afford access to exercise equipment and gym facilities find themselves struggling to maintain a healthy lifestyle. A community needs assessment conducted by ED Advisory Services in the Dihlabeng Municipality in the Free State revealed that lifestyle diseases are a growing concern.

Founded in 2018 by Thabiso Mokebe, a beneficiary of the Kruisvallei socioeconomic development project, Fitness Plus is an affordable community fitness facility situated in the Kgubetswana township near Clarens. The gym appeals to community members who are seeking to become active, while also promoting a healthy lifestyle among the members of the community. The Fitness Plus gym has become a social enterprise because of the additional income generated through establishing a kiosk at the gym, hosting fitness classes and other activities that promote good health and wellbeing. The fitness centre has since employed five permanent workers through this support, a first of its kind in the community.

Atlehang Day Care Safe Playground Initiative

A lack of safe spaces can be a hinderance to children in fulfilling their potential. In South Africa, one in three children is a victim of sexual and physical abuse. This shocking figure was revealed in the SA Child Gauge 2017 survey. Safe playgrounds provide safe spaces for children in which to play and participate in a wide range of activities while under adult supervision. According to UNICEF, South Africa has about 400 Safe Parks across all nine provinces and more than 6,500 child and youth care workers who support more than 400,000 children. Government's objectives are to expand the cadre of care workers to more than 10,000 to support children and adolescents through home visits and Safe Parks. Kruisvallei is committed to engaging in such initiatives to promote community-led action and create sustainable circles of care and protection for children and has seen this as an opportunity to contribute towards child-friendly safe zones in Kgubetswana. The Atlehang Day Care Centre, established in 2016 by Anna Mofokeng, lacked capacity, resulting in the exclusion of several children from the services provided. A contribution by Kruisvallei to this initiative will enable the facility to purchase and install playground equipment and perimeter fencing. Child trauma training will also be provided, which will have a direct impact on more than 60 children in the area.

Impact

Through its various investments Old Mutual focuses on job creation, economic empowerment of previously disadvantaged individuals, diversity, percentage of women in leadership roles, transformation, climate change and governance.

Schools Fund

To date the Schools Fund has about 25,800 learners enrolled across 47 schools with 1,700 staff employed. The schools perform annual numeracy and literacy tests against set targets to continuously improve education outcomes. The matric pass rate of 92% in 2021 for these schools exceeded the national average of 76% and the university exemption of 59% outperformed the national average of 36.

The schools gave many children the opportunity to receive quality education and also created jobs for teachers. In this particular investment they also built their own system to provide the school with green energy by installing solar rooftop panels to allow the school to be 100% off the grid. They also installed rainwater tanks to enable the school to be 50% off the grid, therefore saving on water costs.

Housing Impact Fund

To address the housing shortage in SA the Housing Impact Fund assisted in building 323 two- and three-bedroomed green homes, of which 125 are rental properties. To date across the Housing Impact Fund there are 24 projects on the go and 24,000 transfers, with 80% of these in the affordable market segment.

The houses built are eco-friendly with significant energy saving through practical solutions, such as heat pumps for hot water, low-flow taps (which reduce hot water consumption through aeration) and water-efficient fittings, such as low-flow showerheads and dual-flush toilets. Adjusted window-to-wall ratios and good roof insulation also ensure optimal energy efficiency, all of which contribute towards environmental outcomes. It also created a number of jobs.

Hydropower plant

The hydropower plant in Kruisvallei generates around 24GWh per annum, supplying enough clean energy to provide power to approximately 1,916 South African homes.

The hydropower plants aim to supply much needed power to the community ensuring that there is little to no negative impact on the environment. The plant is split into two run-of-river hydropower plants that combine to supply 4MW of hydroelectric power through two turbines.

The hydropower plant provides power to the community. A portion of the Kruisvallei hydro project's annual operating revenues will be used to support initiatives in early childhood development (ECD) – including nutrition programmes; youth and adolescent education; motivation and behaviour; employment and skills development opportunities; and substance abuse mitigation, for the life cycle of the project.

Financial performance

The debt and equity investments generate a return of 5.2% on average for investors from the cash flows generated by the underlying assets and impact is driven primarily from a focus on the affordable and middle-income market segments.

The impact investment unit is currently refocusing and repositioning its portfolios into three preferred assets (rental and student housing, education assets, and financial inclusion debt) and divesting from legacy assets (develop-for-sale housing, retirement accommodation, and financial inclusion equity) to ensure reliable delivery of future target returns.

The preferred asset classes represent a materially improved risk profile, underpinned by cash generative assets, relative to the legacy asset classes which represent a higher risk profile and less certain cash flow profiles.

Potential for replicability

Impact investing (ie commercial investment into positively impactful strategies for a competitive risk adjusted return) is an immensely challenging undertaking, with a unique set of nuances, challenges and opportunities, but it is replicable with the right investment strategy in the hands of the right asset owner and the right asset manager.

It requires an intentional and carefully constructed impact strategy, a committed asset owner and an asset manager with deep focus, specialisation and track record in both impact investing and the relevant sectors and/or strategies that are being invested in (eg housing, education, financial inclusion, renewable energy, infrastructure, agriculture etc).

Impact investing is undoubtedly building momentum (across stakeholders, markets and sectors) but asset owners should be mindful of the following:

1) Some sectors, strategies and markets lend themselves better to targeting both positive impact and competitive risk adjusted returns in a risk appropriate manner; and

2) It is not a journey to be taken on lightly, with a short-term view or in partnership with an asset manager lacking in deep impact investing credentials.

Ultimately, one can expect to see increasing institutional investment into impactful strategies but, unfortunately, potentially with mixed results in the short to medium term as the industry matures and develops. In the long term, however, there is a place for viable growth in impact investing across a reasonable cohort of stakeholders, sectors and markets.

Old Mutual, through its smoothed bonus product range, currently targets positive impact with investment strategies in the following focus areas:

1) Infrastructure investments (eg renewable energy, toll roads, utilities)

2) Social Infrastructure (eg housing and schools in the affordable and middle-income market segments)

3) Financial inclusion (SMME and consumer finance in the low income, affordable and middle-income market segments)

4) Agricultural investments (South African agricultural land and associated infrastructure).

These are targeted, sector specific interventions which seek to align:

1) Sectors and market segments in need of targeted investments which are beneficial to society;

2) A number of the United Nations SDGs;

3) Sectors/strategies with favourable fundamentals/investment characteristics which allow investors to earn competitive, long term, risk adjusted returns in a risk appropriate manner; and

4) The expertise of selected asset managers able to access and successfully invest in these sectors, in a positively impactful manner.

Impact investing, in general, is also practiced in a broader subset of sectors and impact themes (eg employment, transformation, gender inclusion etc) and Old Mutual proactively seeks such additional investment opportunities which could viably form part of its smoothed bonus products.

It is also worth noting, however, that Old Mutual's asset managers generally seek to embed positive thematic outcomes within their sector specific mandates, targeting job creation, transformation, environmental sustainability, gender inclusion etc, by the way in which they invest in (for instance) housing, schools, renewable energy, agriculture and so on.

Old Mutual does, as a general principle, seek to scale its investment into viable interventions as 1) it seeks to scale its positive impact on society; and 2) experience has shown that there is a positive correlation between scale and the financial outcomes for the investor.

The extent to which a specific intervention can be scaled is, however, a function of multiple factors. For investment strategies which, for example, seek to invest in the low income to affordable market segments (housing, schools, financial inclusion etc) effective consumer demand is often curtailed by affordability constraints. In response, asset managers would typically seek to improve affordability and/or scale of impact by, in that case, also investing in tech enabled enhancements to their investment strategy, alongside infrastructure such as education technology, blended learning models etc.

The availability of viable operators in a specific sector who can absorb capital at sufficient scale is another factor that could constrain scalability. Housing and school investments have, for instance, in the past been limited by this constraint, in which case the asset manager would typically seek to proactively build capacity in the sector by working closely with operators to help them grow in a sustainable manner, over an extended time horizon, which ultimately results in increased capacity in the sector and ability to absorb scaled capital.

Scalability is, however, sometimes constrained in a manner that would cause an asset owner or asset manager to discontinue investment into a certain sector or subsector if that sector does not, for instance, have fundamentals or investment characteristics which are supportive of long-term institutional investment, in a risk appropriate manner, for competitive risk adjusted returns. This has been seen in certain areas of the housing sector, as well as by Old Mutual. In these cases, it has refocused its investment into other areas of the housing sector which do lend themselves to viable, long-term, institutional investment.

Risks

Assessing and mitigating risk is a significant part of the investment process across a broad spectrum of potential risks: sector, market segment, financial, developmental, operational, counterparty, macroeconomic, legal, compliance, tax, regulatory, environmental, social, governance and reputational risks.

In terms of impact risks specifically, there is a recognition that the impact of an investment can be both positive and negative, and asset managers are specifically assessed by Old Mutual for the robustness and capacity of their ESG systems and processes to ensure that they have an effective capability in place to identify, mitigate, manage and report on any potentially significant risks or events of an environmental, social or governance nature throughout the investment process.

A strong ESG capability, and focus on both ESG risks and opportunities, significantly reduces the risk of the investment thesis being undermined by a negative impact outcome.

In the case of social infrastructure investments, the most significant negative developments have tended to be regulatory in nature or constraints in the ability of local authorities to reliably provide the necessary support for the development of social infrastructure.

In the past, regulatory constraints have included changes in tax legislation which negatively affected institutional investors' existing social infrastructure investments. Uncertainty of how future changes in tax legislation may affect new or existing investments remains one of the challenges for institutional investors to invest in impactful strategies.

Similarly, the ability of local authorities to reliably provide bulk infrastructure for the development of new neighbourhoods has materially constrained investment into certain areas of the housing sector. Uncertainty of the availability of bulk infrastructure remains a meaningful constraint for institutional investors to continue investing in certain areas of the housing sector, to the extent that Old Mutual has refocused its investment into areas of the housing sector which are less prone to this specific challenge.

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