

Socially Responsible Investment Comes Of Age

Historically associated with low-income housing tax credits, socially responsible commercial real estate investment now includes a variety of increasingly popular and profitable vehicles.

BY NEIL BO

While socially responsible investing (SRI) has become popular in the general investment community, it continues to be a relatively overlooked sector of the commercial mortgage market. According to the Social Investment Forum, a Washington D.C.-based nonprofit organization, there is currently an estimated \$2.3 trillion in investments in the U.S. that are deemed socially responsible, but almost none of that sum is going to real estate.

That contrasts sharply with the typical portfolio asset allocation, which would designate approximately 10% to real estate. This difference indicates the enormous potential for the socially responsible real estate sector: \$230 billion.

Up to now, part of the challenge for many investors, like insurance companies and pension funds, has been the need to put a meaningful amount of money to work in a targeted area with an understanding of exactly what they are going to get.

Options meeting these needs have been limited, but things are beginning to change - with the advent of an increasing number of commercial real estate (CRE) firms and funds dedicated to community development and SRI, as well as a growing awareness that social responsibility as it relates to CRE investing does not mean sacrificing returns or quality.

There has long been one segment of the CRE markets considered a socially responsible sector in which to invest, namely low-income housing tax credits (LIHTCs), which are usually funded with private debt and equity and generate a stream of tax benefits that investors use to offset their tax liabilities.

Born with the Tax Reform Act of 1986, LIHTCs created a successful early marriage between private and public sectors, encouraging increased development of affordable housing and resulting in direct community impact.

Community improvement was

spurred further through the Community Reinvestment Act (CRA), passed in 1977, under which banks are encouraged to reinvest in the communities in which they take deposits. Affordable housing became an important way to satisfy that requirement.

Banks consequently began taking an increasing leadership role within the community development arena - able, through affordable housing, to both satisfy their CRA requirements and earn reasonable after-tax fixed rates of return due to the tax benefits.

However, LIHTC investment vehicles are generally illiquid, have a holding period of 15 years, include cumbersome accounting practices and produce negative pre-tax impact.

SRI progresses

Affordable housing tax credits nonetheless laid the early foundation for SRI in CRE and have been an outstanding success. Over time, the program has also helped alter the perspective of the banks themselves



The Plaza at PPL Center, a trademark building built for the Pennsylvania Power & Light (PPL) Corp. The building is located in a Keystone Opportunity Zone, a zone targeted for public-private partnerships to spur economic development and revitalization.

Photo courtesy of Pembroke Capital Management.

when it came to socially responsible CRA investing.

Thirty years ago, most people would agree that corporate expectations for the first portfolios were generally low, while today, most institutions expect their CRA investments to be

a profit center.

At the same time, insurance companies in many states are also feeling the pressure toward socially responsible investments.

Unlike banks, insurance companies have state-level regulators - resulting in somewhat fragmented investment rules for a company that writes premiums on a national marketplace. But perhaps an insurance industry mandate is no longer altogether necessary, as many CRE investors are now seeking out SRI on their own, especially with the proliferation of new investment vehicles.

Moving into 2008, socially responsible CRE is facing a huge fork in the road. Yes, affordable housing tax credits remain a bastion of the SRI industry, but now there are major debt and equity funds being raised to invest in community development, urban retail, green building and more.

These funds represent a new era for socially responsible real estate investing, and what's more important, collectively, they offer much greater liquidity and diversification for socially responsible CRE investors than options previously available.

Our socially responsible investment portfolio, for example, includes debt on a newly redeveloped shopping center in New Orleans that had been severely damaged during Hurricane Katrina, American Indian bonds that helped finance infrastructure on tribal lands, and a mortgage on a green Class A office building in an empowerment zone, such zones being areas targeted for community revitalization.

Another firm has facilitated more than \$3 billion of urban revitalization through equity fund investments in the development of retail, mixed-use, industrial properties and more in urban



Sweetwater Cove Apartments, a newly renovated multifamily property in greater Atlanta. Pembroke Capital provided a \$10 million bridge loan for the Class B property, which is situated in a low- to moderate-income neighborhood.

Photo courtesy of Pembroke Capital Management.

centers around the country. A third is raising a fund to invest in green properties that are energy efficient, reduce waste and improve indoor air quality. Additional firms are embracing the concept as demand increases.

Why, at long last, the growing acceptance of SRI in CRE? Perhaps it is partly connected to the overall green movement in the U.S., which has seen people become increasingly concerned with the state of the environment and the plight of their fellow citizens.

Many organizations have set up socially responsible platforms. Institutions ranging from Harvard and Stanford to Memorial Sloan-Kettering, the Teamsters and New York City Employees' Retirement System have developed specific socially responsible investment programs, often via mutual funds dedicated to SRI.

On the buy lists of qualifying investments, according to Social Investment Forum, might be investments in companies with strong environmental prac-

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