VIRTUS
REAL ESTATE CAPITAL

Social Impact and ESG Considerations in Commercial Real Estate

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Executive Summary

Recent years have seen a dramatic rise in the prominence of "Social Impact" as a valued component of an investment paradigm's success among major investors. As one would expect, these value judgements are inherently nuanced, giving way to multiple frameworks as well as different organizations that provide guidance and attempt to define the problem set. These concerns have been slower to permeate the commercial real estate community, but they have become increasingly prevalent, especially for managers with institutional investors or as younger generations gain greater influence in investment decision making. Discussions around basic considerations, such as carbon footprints and inclusionary hiring practices are commonplace in recent news cycles. With so many views to consider and without yet any established broadly accepted framework, it can be easy to confuse even informed investors considering Social Impact and related principles.

Our goal with this paper is to create a shared understanding of social impact frameworks and apply their concepts across both real estate investing broadly and the alternative property types that Virtus invests in more specifically. We are learning as we go, and we feel it's appropriate to approach the challenge with curiosity, humility, and an open mind. As follows are a few high-level thoughts on the subject.

- The Environmental, Social, Governance ("ESG") framework is gaining popularity over the older Socially Responsible Investing ("SRI") framework. The ESG lens makes more nuanced and value-specific judgments on a sector or business, versus SRI's more binary "to invest or not" rubric. For more detail on how Virtus approaches social impact and ESG in its own portfolio, you can read the Firm's 2018 ESG Report.

- Analysis of conventional commercial real estate via the ESG framework generally gravitates toward environmental aspects, specifically around energy efficiency, since they tend to be the most quantifiable. The social impact dimension of *most* real estate tends to be either more qualitative or difficult to measure at the individual site level.

- Within alternative property types, the social dimension of real estate often becomes more obvious, especially for categories like healthcare, education, and workforce housing in which Virtus is active. Such properties provide core services to their communities and take on the risks and responsibilities of providing care to sensitive population groups.

We believe this application of ESG concepts to the unique challenges and opportunities of real estate will help investors of all interest levels deepen their understanding of the interplay between social impact and built space.

Introduction and Overview

For as long as social implications related to investments have been an area of focus, managers have struggled with the friction between generating the best risk-adjusted returns, versus generating at least a neutral, but preferably a positive social impact from their investment activities. It is a truism that these concerns are not always antagonistic, but the investment community is developing clearer and more holistic vocabularies for how to assess their interplay. The concept of the triple bottom line, where investors want to analyze the social and environmental traits of an investment in addition to the financial characteristics, has become more relevant than ever. Indeed, these interests do not have to be mutually exclusive, nor even be in competition. In the best cases, they can be interrelated and perhaps even complementary to one another.

As real estate investors, it is sometimes difficult to know where to begin or end this analysis, as investment merits are primarily focused around "built space." As a manager active in alternative property types focused around education, healthcare, and affordable workforce housing, which have crucial and sensitive social functions for users and communities, Virtus requires itself to take this topic especially seriously. This paper will attempt to assess and formulate the interplay between social, environmental, and financial impacts in real estate in general, the alternative property segments in which Virtus focuses, as well as the framework the firm uses to assess ESG.

First, it is helpful to provide an overview of the most common terms and value systems a manager encounters when engaging in ESG and social impact.

Defining the Question: SRI, ESG, etc.

Socially Responsible Investing

Socially Responsible Investing ("SRI") historically referred to a negative screening approach to investment, ensuring investor gains do not come from socially destructive sources, so it tends to "redline" certain sectors. The concept originated among faith-based organizations like the Methodists and then the Quakers some 200 years ago. Others argue that Shariah-compliant investing started well before that with a similar redline approach. Regardless of the origin, SRI took off during the 1960s and 1970s, during times when social activists pushed for institutions to avoid investing with military contractors or major polluters. Of course, it is worth acknowledging that there is an inherent subjectivity to this goal. Thus, some managers or funds are careful to avoid "sin" sectors (tobacco, alcohol, firearms, and adult services) that drive away investors with faith requirements, but they may not concentrate on social concerns outside of those parameters. Others, by contrast, may care more specifically about either environmental or social impacts (neither of which are always in perfect harmony) and avoid investing with fossil fuel companies or "predatory" lenders. In either case, when an investor historically asked about an SRI policy, it generally meant they wanted to know what an investment manager would avoid.

In recent years, so-called SRI options have expanded in number and how they assess impact considerably. According to The Forum for Sustainable and Responsible Investment, total SRI assets grew by 38% in only two years, surging from $8.7 trillion in 2016 to $12.0 trillion in 2018. That figure was less than $4.0 trillion in 2012, underscoring the rapid and continued rise in investor appetite. Given the current scale of the space, overgeneralizing the landscape is unwise. There are SRI managers who purport to offer higher returns not despite, but because of, the SRI screening in their portfolio. Of course, others note that any limiting factor should theoretically reduce returns, while others criticize using SRI as a justification for higher fees while not making meaningful judgments in what companies or sectors should not be included in such a portfolio.

Environmental, Social, and Governance

In contrast, an Environmental, Social, and Governance ("ESG") rubric is a more recent terminology (originating along with the United Nation's Principles for Responsible Investment efforts) and a more positively oriented rubric. Instead of laying out guardrails of sectors to avoid, the ESG rubric focuses on the value and sustainability of investments in a holistic sense. This means asking how a prospective investment will weather future changes in environmental impact (and the corresponding regulatory changes), how it will either serve or respond to changing social needs, and how its management serves the interests of an expanded spectrum of stakeholders through proper corporate governance. Thus, instead of directing investors to avoid oil companies, an ESG framework might ask, "Which energy companies are best poised to thrive in a more diverse energy economy with significant support for renewables?" Or perhaps, "Which companies provide the best working environment to attract and retain top talent?" Finally, ESG policies place a much greater focus on the "governance" aspect of responsible investing, ensuring that firms offer a greater degree of transparency and stakeholder input. This is intended both as a safeguard against poor management incentives and a general tenet that investors should have knowledge about the inner workings of the securities or businesses they support and how they generate returns. Unlike environmental and social concerns, good corporate governance is always aligned with better long-term financial performance. Of course, the ESG framework has its detractors as well. Much like with SRI funds that do not offer meaningful differences, many have noted that some ESG funds seem more marketing than substance, for instance, including tobacco companies and other unexpected entities. Others have noted the difficulty of benchmarking such funds for the value of their social dimensions and suggest they are chiefly marketing differentiators—and, in addition, inconsistencies in ESG benchmarking and reporting among asset managers may make it hard to accurately compare ESG investments.

Social Impact Investing from a Manager's View

In addition to varying standards for assessing social impact, managers also face a variety of client interest levels on the topic. There are clients who (1) have no interest; (2) have a modest interest (and perhaps a small compliance checklist); (3) have a material interest and will consider social impact or ESG as one of many factors when considering investment opportunities; and finally (4) have a specific mandate and target allocation to investments that satisfy their requirements around social impact and ESG. This continuum is manageable for strategies with either inherently low social impact (though that list shrinks in perception each year), as well as those whose social mandate supersedes their financial performance. However, the majority of investment managers fall somewhere in the middle, and thus must contend with the difficult question of assessing their value system, both as a stated philosophy and action in principle. In addition to the diverse ways in which the problem is defined for managers, there is the additional concern of not being "pigeonholed" as a "Social Impact" firm with the perception of inferior risk-adjusted returns or the other tangential concerns the connotation entails for some investors. Indeed, there are some for whom the only ethical requirements of an investment manager are to avoid legal risk, uphold fiduciary duties, and maximize returns. Under this rubric, anything beyond those directives is *contrary* to the interests of stakeholders and the purpose of investment management. As such, it is quite challenging for an investment manager today to know how transparent they should be about their efforts related to social impact. For example, our firm has always embraced social impact and ESG standards as part of its strategy and investment process, but in the past, we were cautious about mentioning such to a prospective investor in case they fell into one of the first two categories above described. They might erroneously conclude that because social impact is important to us, perhaps maximizing returns or mitigating risk is not. Today we are more open about our views partly because investor interest has grown, and partly because even skeptical investors are less apt to view the subject in a stark zero-sum framework.

Social Impact and Traditional Real Estate Categories

How, then, does a responsible investment manager navigate a landscape with such diverse and competing frameworks for utilizing capital in a beneficially impactful manner? There are a plethora of operating businesses, like TOMS Shoes, that generate a financial profit while also having an obvious ongoing positive social impact. It is less obvious how to have a

positive social impact or prioritize ESG standards when an investment manager is simply investing in an office building or an industrial warehouse. However, there are a number of ways to emphasize ESG in the "basic food groups" of commercial real estate investment: office, retail, industrial, and multifamily.

Beginning with the "E" in ESG, any property can have a negative, neutral, or positive impact on the environment. A prudent investment manager will typically assure their properties mitigate any negative environmental impact in operating their buildings because it is in their own self-interest and typically mandated by governmental bodies or their lenders. Some managers have gone further in trying to assure a neutral environmental footprint through certain building and operations requirements, while others have gone as far as focusing on the highest standards in environmental factors, such as LEED certification. For ground-up construction, the public sector has become more mindful of environmental impact when approving zoning changes and construction permits for new projects. Without a doubt, the emphasis on such varies widely based on location.

Further, it is simply good business when building a new property to include a high degree of focus on energy renewability related to the materials selected and the building systems installed. For existing properties, an entire industry has emerged around installing new building systems that decrease energy consumption. This goes way beyond just installing solar panels to minimize external electricity use or gathering systems to use rainwater and reclaimed bathroom water for landscape watering. Unfortunately, some of the same improvements when done to existing properties are not economically viable in the short-term, such as a three or five year holding periods that the typical closed-end fund manager targets. In other words, the cost of the capex is higher than the reduction in operating costs or even the increased value of the asset when applying a cap rate to the net operating income enhancement. As such, most managers typically do not replace existing systems with more environmentally friendly systems unless there is a requisite economic benefit during their intended holding period. For shorter holding periods, some managers may choose to install systems where there is a governmental incentive or subsidy in order to reduce out-of-pocket costs sufficiently to make the new system more economically viable. Without governmental subsidies, often the payback for retrofitting such systems is ten plus years, which is usually only applicable to open-ended real estate funds or perhaps direct ownership and separate accounts that have a long-term hold strategy for their underlying assets. No doubt, this should be an obvious opportunity for those managers.

When it comes to supporting environmental concerns, if a building owner is going to market its efforts in that regard to prospective and current tenants, the owner must actually deliver on those ideals. A number of active multifamily operators have found value in marketing their "green" efforts in their value proposition to prospective tenants. They recognize that most of their target market is likely Millennials, and Millennials demonstrate more concern over social impact and the environment than other demographics. While it is clearly beneficial to market as such, it is vitally important that the manager actually delivers on the marketing fodder. It would be quite destructive if their consumer were to determine that the manager or owner might be "greenwashing," that is marketing an environmental conscience, but not actually delivering on it. That idea started in the hotel industry decades ago when hotel chains began inserting signs in bathrooms asking guests to reuse their towels to save the environment, when the motivation may have been to reduce laundry costs. It all comes down to the intent of the owner. If an owner has genuinely taken steps to reduce its environmental footprint, they should be proud to market such, and ideally, they will be rewarded with higher demand from their targeted audience.

In the case of an investment manager who might be mindful of social benefits (the "S" in ESG) when operating their buildings, some owners of office buildings, for example, may choose to maintain more open space or common area for the well-being of the tenants and their workers, even though that may be considered wasted space from a direct economic benefit. Perhaps the motivation is purely noble in considering the well-being of the inhabitants, or perhaps the manager believes they can attract more tenants at a higher rate for offering a more attractive workspace for the tenant's employees. Indeed, the amenities and services in large tech company campuses, which include not only eateries but also amenities like laundry services, are frequently noted as being simultaneously lavish, while also encouraging employees to maximize office time by minimizing the time spent doing mundane tasks. In short, the primary social value of an individual building

may largely depend on the intended use, but the spatial decisions a developer or investor makes still have significant effects on both the financial and social value of real estate.

In summary, it is possible to have at least a moderate level of social impact in traditional property types, and certainly, quality governance is good business for any real estate investment manager. However, it is admittedly challenging to see how traditional property segments can have as meaningful of a social impact or ESG standards compliance as an operating business. Nevertheless, real property investment and management is a massive space, and being thoughtful about environmental concerns in how an owner builds, operates, and maintains its asset is important for the well-being of all, well beyond just their tenants or underlying investors.

Social Impact and Alternative Real Estate Categories

Real estate touches the lives of all its users and the surrounding communities in at least some minimal way, given that built space supports most human activity. Most conventional forms of real estate do not have an outsized impact on their users beyond this universal truth. However, there are certain "alternative" property types chosen for their serving persistent demographic demands and inuring social needs, which can effectively make them cornerstones of communities. At Virtus, we tend to focus exclusively on "alternative" property types that benefit from pervasive demand, even during periods of economic distress, such as properties that facilitate the delivery of healthcare, education and affordable housing. This focus has helped craft an investment paradigm with the potential to thrive in all phases of an economic cycle (given that demand for them is more persistent than discretionary). It also necessitates consideration of the social ramifications and impact of investment decisions given the sensitive nature of the stakeholders our property types involve. It goes without saying that the numerous ways to have social impact and align with ESG principles in traditional real estate categories are equally prevalent and arguably more opportune in these alternative categories. Below we discuss each sector of real estate in which the firm is active and its unique social impact dimensions.

Medical Office Buildings

Medical Office Buildings ("MOBs") are specialized suites fitted out for the delivery of healthcare. Already a massive real estate sector in the U.S., demand for MOBs continues to grow significantly due to the "Silver Tsunami" of Baby Boomers who need expanded healthcare as they age. Combined with this is the broader prioritization in the U.S. to make healthcare accessible to all Americans, regardless of financial means. MOBs frequently function as "outpatient infrastructure" for hospital networks, a subsection that has proliferated and eclipsed traditional inpatient care over the last several decades. In addition to the complex regulatory burdens such spaces have beyond those governing conventional office buildings, MOB investment requires knowledge of the kinds of healthcare practices best positioned for a specific site, whether due to the types of consumer demand in the area or for harmony with other tenants and hospital referral networks in the building.

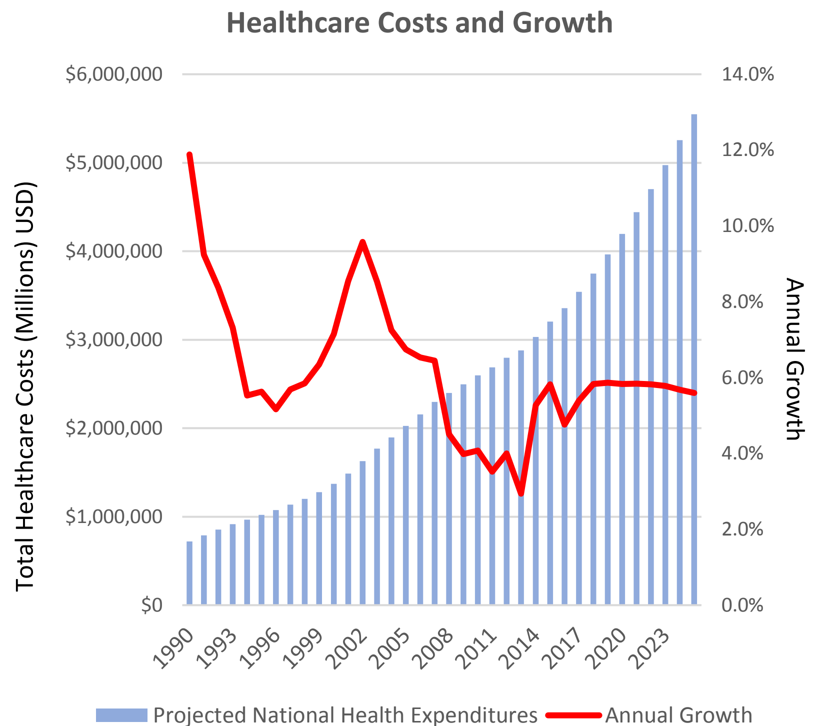

Figure 1 - Source: Centers for Medicare and Medicaid Studies

Private enterprises like Virtus and others are responsible for optimizing the mix of healthcare services a submarket will benefit from best. Therefore, the value of a medical office portfolio depends on how well a manager understands the nuances of the space. In practice, this has manifested in divergent ways across the Virtus portfolio. The firm recently acquired a hospital-affiliated MOB asset that constitutes one of the only outpatient centers in a low income area of Miami. Understanding the submarket and keeping the building occupied is instrumental in avoiding a "healthcare desert" for area residents without the ability to travel across town easily for care. Oppositely, the firm recently acquired a heavy value-add asset in an area of Houston that is otherwise both affluent and highly occupied. The anchor tenant will be a truly disruptive cancer therapy provider with a unique business model that the firm had to get comfortable with quickly. Both assets positively impact their local healthcare markets in highly specific ways requiring both local knowledge and sector expertise.

In this sense, it is impossible to invest thoughtfully in MOB without educating oneself on healthcare consumer costs, the impacts of legislation, and the trajectory of the industry. For example, the healthcare sector has been in transition from a fee for service model to an outcomes-based model for years. As part of this transition, real estate needs have changed materially, such as designing buildings to support a more collaborative ecosystem between the various healthcare providers, to locating MOBs away from hospitals to bring healthcare services to the communities where patients and healthcare professionals live. If an investor does not stay at least aware of the trends in this ever-evolving space, investment outcomes will likely be challenged, let alone the social outcomes. Ironically, this "expertise barrier" is one factor that can contribute toward the sustainability of cash flows in medical properties. The fact that these assets have a significant social aspect to them, combined with the regulatory and reputational risks that make it difficult for a passive real estate investor to perform, is one leading factor to the MOB sector's historical outperformance compared to traditional office investment.

Senior Living

Much like MOB, Senior Living assets provide crucial healthcare for elderly residents across a wide variety of acuity levels, with the added consideration of housing. The Senior Living industry has evolved in response to the need from consumers, especially given the massive wave of demand to come from Baby Boomers as they age and start to enter Senior Living in the coming decades. That is occurring at the same time that caregiver ratios for seniors continue to fall in a dramatic fashion. Simply put, there will be fewer people, paid professionals or family members, who are capable of caring for our aging population in the U.S. This has led to an explosion in the home healthcare space, as well as to greater acceptance of Senior Living as a viable alternative for elderly family members. Fortunately, most Senior Living developers and operators have dramatically improved the quality of the built space and the quality of hospitality, programming, and the daily care provided to their residents. This has enhanced the quality of life for the residents. In fact, studies indicate an enhanced quantum of life for residents due to a mix of factors including better industry training for professional caregivers; wider adoption of technology for collaborating about a resident via secure sharing of medical records; allowing residents to "age in place" by offering multiple levels of care in a community; and providing advanced programs such as "Rementia" care, which can

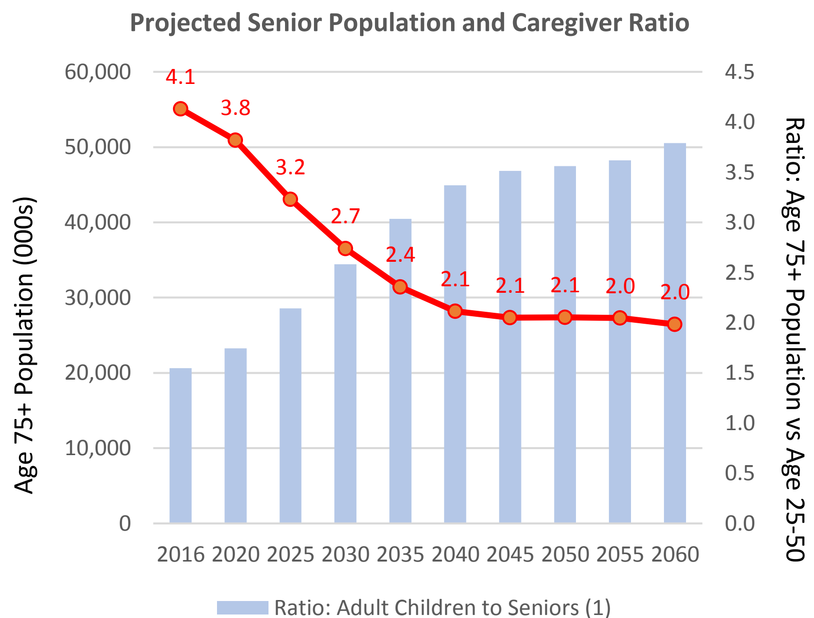

Figure 2 - Source: Census Department

help slow, stop, and in some cases reverse the advancement of dementia, Alzheimer's, and related conditions.

Despite Senior Living being one of the most resilient, it is also one of the most operationally intensive sectors of all commercial real estate categories, best exemplifying the observation that some alternative sectors require every bit, if not more, attention to operations than the built space aspect of the investment. Senior patients have sensitive immune systems and a diversity of specialized needs, and a good operator needs to provide both an exceptionally maintained space and an efficient but customized care delivery process. In addition, the duty operators have toward tenants is paramount, with extreme reputation risk and loss of state licensing possible for single-minded corner-cutters or negligent landlords. It is impossible to navigate terrain like this without a holistic sense of both economic reality and social responsibility. Again, these requirements form a barrier to entry that generalist real estate investors are not typically equipped to shoulder. This factor, along with the inuring nature of demographic demand for the sector, has historically weathered recessionary periods with greater resilience than the basic food groups of real estate. Not only do Senior Living residents, and their families, benefit, so do investors that work with experienced and proven investment managers in the space.

Early Education / Charter Schools

Just as Virtus' efforts in Senior Living address the social need of providing quality elder care, the firm's efforts in charter schools and early education (a term functionally synonymous with daycares, often with additional learning and enrichment) takes on another crucial social function for another population with sensitive needs. Expanding access to quality education is arguably one of the most important things a society can do. Furthermore, early education services allow both parents in a family unit crucial flexibility to maintain their careers.

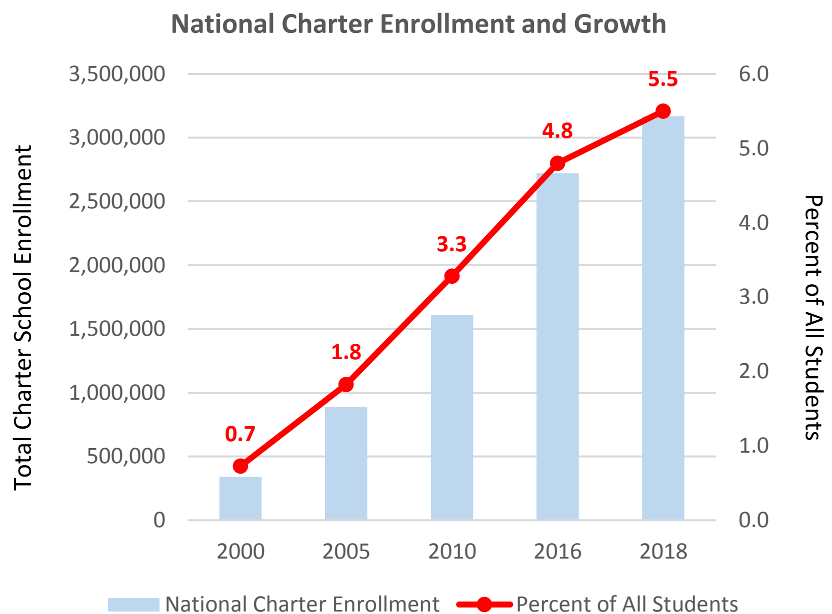

Figure 3 - Source: National Alliance Public Charter Schools

Despite having a reputation for the highest quality post-secondary education offering in the world, the U.S. is well down the list in the quality of its primary education offering when compared to other developed economies. Traditional primary education via public schools has been inconsistent at best in providing quality outcomes. Many schools have failed to advance their offering with modern curricula, more advanced learning tools, and a holistic focus on improving not just intellectual capacity, but the emotional and social capacities in our children. As the public sector struggled to provide quality primary education, it also has relatively no offering for early education, despite numerous studies showing the immense capacity (and innate human need) to learn at an early age. Where the public sector has fallen short, the private sector has entered to be part of the solution. Not every charter or early education operator has been successful. However, there is a clear trend that we have seen in other sectors that have undergone a public to private transition where the private sector can typically generate better outcomes at a lower cost.

With the rise of privately operated yet publicly funded charter schools, as well as the expansion of early education, the seriousness of child safety and quality of care delivered under an operator's supervision is clearly commensurate with the social responsibility of senior care. These issues are further complexified in charter schools, in which investment managers are also responsible for evaluating the strength and quality of the education curriculum and compare it to peer institutions to determine whether it offers advantages over the existing public school system. The point is that although these

categories can offer a superior risk-adjusted return all while delivering education in a more effective manner, there is a high degree of responsibility for an investor in such built space, well beyond that of other categories of real estate.

University Housing and Infrastructure

The immense growth in both university enrollment and cost to attend over the past decades has placed a greater burden on state universities, which list "educating students" as only one directive among a host of other bureaucratic and financial concerns. In recent years, most universities have determined that education and research are core competencies, whereas real estate development, operations, and maintenance are not. This acknowledgment, combined with decreased support from public sector funding has led public universities to outsource much of their non-core competencies to those with expertise and capital to provide much of the required infrastructure in a university ecosystem. For example, in recent years, providing clean, affordable housing for growing student bodies has largely been ceded to the private sector, as private developers and operators are often better positioned to take on the executional risks of development and property operations Indeed, most housing at an average flagship state university is increasingly provided by third parties like Virtus and their operating partners rather than dormitories or similar facilities offered by the university. Private student housing is instrumental in making sure college is an accessible option for anyone who enrolls.

The outsourcing of university housing has also paved the way for financing other categories of university infrastructure through alternative means. Again, the lack of capital amongst other resources in short supply has spurred universities to create public-private partnerships or enter into long-term leases for parking garages, power plants, and in some cases, research and laboratory facilities. It is still the early days of this transition, especially compared to the outsourcing of housing, but the trend to find more cost-effective and perhaps more informed capital is not likely to abate any time soon.

In summary, the private sector plays an indispensable part in making a college education accessible to the nearly 20 million students enrolled in post-secondary education across the U.S. Universities working in partnership with real estate investors, developers, and operators is a key ingredient for both minimizing the total cost of education and allowing American universities to maintain their global edge.

Workforce Housing

Workforce Housing has numerous connotations, but as a general category, it usually refers to quality affordable housing for the average U.S. renter. For decades now, inflation-adjusted median incomes have experienced minimal growth while the costs of new development have experienced explosive growth, thus making it nearly impossible to deliver new housing stock that is affordable by this cohort. This is especially the case in urban areas that suffer from outdated zoning laws, which constrain unit count, combined with migratory trends towards urbanization. The result has been that rents have increased to over half a typical renter's income in many metros in order to justify new construction costs and even more so in gateway markets with antagonistic development policy. This has created an expanding cohort of households that are too affluent for the small percentage of federally subsidized housing, but also too poor for the product that has been delivered during the recent multifamily boom. Therefore, Workforce Housing provides more appealing options for these households often through careful renovation of assets that are not yet obsolescent but require a revamp to meet today's market demands. Meanwhile, decades of zoning policy have prioritized neighborhood home values, aesthetic character, and issues like traffic over the availability of affordable housing. It has been private firms that have filled in the gap for consumers who would otherwise have scant housing options in the massive gap between public housing and Class "A" luxury apartments.

This lack of affordable housing for the vast majority of Americans is a major social issue that will have implications for years to come. Providing housing for the massive blue collar cohort will always be an issue, and it's essential we continue to seek out ways to address the affordable housing shortage. The fact that the backbone of the economy, the grey collar comprised of teachers, firefighters, and police officers (among others), must either live in sub-par conditions or spend more than one-third of their gross income on rent has economic and social repercussions that go well beyond housing. For example, one out of every eight Bay Area, California teachers has left the profession or has moved from the area,

primarily due to a lack of quality affordable housing, despite earning nearly $70,000 per year on average. Although the Bay Area is the epicenter of the affordable housing crisis, similar trends across numerous high-need professions are pervasive throughout the U.S. What will happen when crucial professions, like teachers, firefighters, police officers, and other government workers are pushed out of urban areas for lack of affordable housing?

For this reason and others, our firm has been conducting research over many years on the different ways to address the housing affordability crisis. In addition to retrofitting older properties, there are several ways to develop new multifamily housing that are affordable to the average consumer. Of the numerous techniques that can be employed, they generally fall into three categories. First, build a higher density product to reduce the nominal cost of each unit. This has been widely adopted in markets throughout the globe, such as in Tokyo, Hong Kong, and London. However, most American cities have been slow to approve zoning changes that would permit such action. Second, partner with the public sector either through soft-dollar support or public-private partnerships to reduce the total build cost and/or ongoing operating cost of a multifamily community in order for rents to be more affordable. Third, new construction techniques that reduce costs, reduce delivery time, or improve quality will be key moving forward. There is no one silver bullet technique for solving the affordability crisis. A compilation of these tools, combined with the public and private sectors prioritizing this more than they have historically, should lead to improved outcomes for society as a whole while also providing attractive risk-adjusted returns to savvy investors.

Affordability More Broadly

Providing quality affordable space, especially for residential tenants, is our firm's No.1 goal over the coming years. This goes way beyond just traditional Workforce Housing focused on middle-income apartment residents. Virtus has also been researching ways to deliver quality, affordable Senior Living for some time now. The wave of Boomers needing Senior Living in the coming decades is immense, yet it is predicted that about 54% of middle-income seniors will not be able to afford it even after using the proceeds from their existing homes. This will be a pervasive issue that will pile on to the already burdensome increases in healthcare expenditure as a percentage of GDP in the U.S. Unfortunately, solving the high cost of built space is not the only challenge in Senior Living. The rising cost of providing care is a significant part of the problem. This conversation needs to be brought to the forefront of political, technological, and investment considerations. Otherwise, the negative impact to seniors and society at large will be immense when we have millions of seniors who can't afford housing and care, while at the same time the number of caregivers becomes even more limited.

In addition to affordability challenges for Millennials today and seniors tomorrow, university students struggle to access quality education at an affordable price. As the cost of post-secondary education has risen at roughly double the rate of the broader CPI index for several decades now, the cost of college has become untenable for many. These factors have resulted in 44 million borrowers owing a combined $1.5 trillion in student loan debt. Couple that with reduced support from the public sector, and no end in sight for rapid increases in education inflation, the problem is daunting. For that reason, Virtus and others have been studying ways to make at least room and board more affordable without negatively impacting the college experience. The need is considerable: total cost for a public four-year college education has more than doubled in the last ten years as education demand has surged, and room and board comprise over half that cost.

The lack of affordability is a universal issue across all categories of real estate, but especially those with individual tenants, such as Workforce Housing, Senior Living, and Student Housing. All three of these are essential to society. By addressing affordability issues around these cohorts, no doubt a positive social impact can be made. In addition, there is an attractive risk-adjusted return to be had, due to the inuring demand from these cohorts in good times and bad. Arguably, outsized returns can be generated for those forward-looking real estate investment managers who can be early movers in solving the affordability crisis in the U.S.

ESG and the Triple Bottom Line Framework in Real Estate

The above gives a sense for how Virtus considers each sector holistically. However, in the context of formal social impact policy, the Firm uses an ESG framework to account for separate dimensions of an investment. As mentioned above, for

more detail on how Virtus approaches social impact and ESG in its own portfolio, see the Firm's [2018 Social Impact and ESG Report](). All aspects of ESG are highly relevant for each property type we focus upon, though in different contexts. The environmental impact of a building refers to its performance in both energy consumption and its waste interactions with its natural setting. The social dimension of a building is how well it serves its stakeholders, including investors, users, the surrounding community, and the investment management team. Lastly, the governance aspect refers to how well the incentive structures and management frameworks of an investment vehicle fulfill fiduciary duty and realize their financial goals for stakeholders.

Conclusion

When executed correctly, the result of ESG and social impact investing approaches in real estate is replicable financial returns originating from socially beneficial uses—returns that go toward supporting key institutions that create significant value in their communities. Assessing the environmental, social, and financial dimensions of an investment is an important component of thorough due diligence, especially in our day and age. Attention to social needs helps a manager locate sectors that have all-weather appeal to consumers. It also acts as an impetus for finding areas for improvement that may impact the financial bottom line, or assessing risks that could erode value or have negative community impacts and reflect poorly on the business. In addition, operating in a mindset where managers have responsibility to their investors and stakeholders contributes toward a more holistic sense of "investment return"—not one in which financial ROI is less important or subordinated toward other metrics, but rather one in which financial results are bound up inextricably with other dimensions of investment impact. Ultimately, this view amounts to an acknowledgement that the financial sector is not just a passive reflection of market truths, but an equally active force in shaping the values that drive society. When viewed in this light, ESG and other rubrics are not optional "extra" considerations, but rather fundamental aspects of successful investment management today, and for years to come.

About Virtus

Virtus Real Estate Capital, founded in 2003, brings thoughtful stewardship to the practice of real estate investment, delivering non-correlated alpha via cycle-resilient real estate. Over the last 16 years, Virtus has acquired 229 properties for a combined acquisition value of over $3.7 billion and has fully realized 172 property investments. With a strong and established track record, Virtus has proven to be successful in all phases of the market cycle. For more information, please visit www.virtusre.com.

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