Turning to natural capital

Claire Glennon explores the strong institutional demand for natural capital investments

Investors are turning their attention to natural capital as the depletion and damage to global natural resources are fast translating into financial risks. Nature has subsidised our growth to its serious detriment, creating another existential threat, inextricably linked with climate change.

Furthermore, as a result of new regulation and the introduction of voluntary frameworks that place a value on nature, it is becoming apparent that it is possible to deliver a financial return by investing in nature.

Natural capital markets

The WWF (WFF) estimates that, globally, nature provides services worth around US$125 trillion a year.[1] Yet, nature markets today are valued at only $9.8 trillion, 11% of global GDP, which is mostly derived from commodity production including agriculture and timber.[2] The difference between these two values shows we are far from understanding the true value of nature.

Investors are also recognising that existing nature markets are not always good for nature. Currently close to $7 trillion is invested globally in activities that have a direct negative impact on nature, compared with approximately $200 billion in flows into nature-based solutions.[3]

New nature markets are establishing themselves and growing, for example carbon credits and sustainability linked bonds. Looking forward, it is expected that future nature markets will vary significantly from where they are today. Climate change commitments will be a key driver of these changes. These new nature markets will either be based in regulatory requirements or through voluntary ambitions from businesses to do better for nature, both with differing underlying risk profiles for investors.

Recent research

We recently teamed up with mallowstreet, a community for the institutional investment industry, to look at investor appetite for natural capital investments in institutional portfolios. mallowstreet spoke to 22 UK asset owners representing more than £360 billion in assets; half said they already invest in natural capital or will do so within the next 18 months.

Key findings include:

- 50% of UK asset owners are either already investing in natural capital or will do so within the next 18 months
- 73% of UK asset owners would invest in natural capital to support climate adaptation
- 59% would allocate up to 3% of assets to natural capital

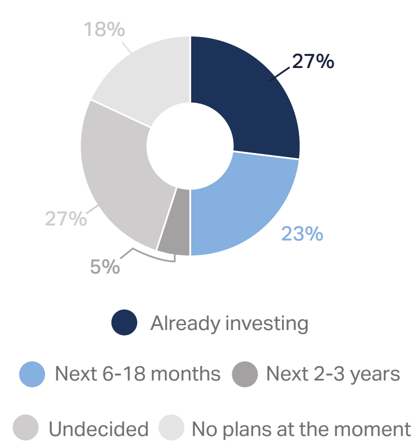
The research shows strong backing for the asset class, as investors become increasingly aware of natural capital's potential to deliver resilient, impactful returns.

Alongside financial performance, the report found that supporting climate adaptation and mitigation was the biggest driver of investment in natural capital, followed by the good stewardship of members' assets and reducing nature-related investment risk. Allocations to natural capital are likely to comprise 3% to 5% of total assets, with 59% of the surveyed asset owners saying they would invest up to 3% and an additional third potentially investing up to 5%.

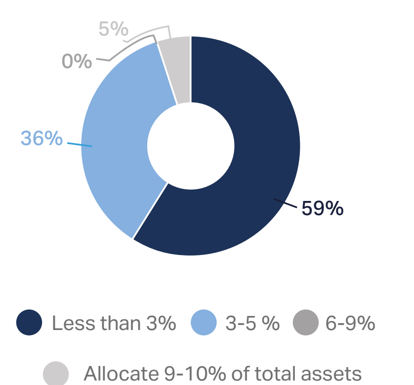
The survey revealed a range of approaches to investing in natural capital among institutional investors. Local government pension schemes would typically invest in natural capital via illiquid assets, with 33% putting an allocation in real assets and a further 25% would put an allocation in the private markets bucket.

23% of UK investors would allocate to the asset class via growth assets, while 18% would align it to an impact

Investment plans



Allocation size



allocation, highlighting the need for a wide range of liquid and illiquid strategies to cater to different investors' requirements.

The study also explored institutional investors' attitudes to carbon and biodiversity credits, finding overwhelmingly that investors prefer to generate their own credits from their investments, rather than buying them. 52% of investors said they would primarily generate credits to offset nature loss or emissions in their portfolio, while 48% would sell the credits they generate to deliver a return. However, investors remain keen to see a more formal international market and consistent global standards to increase confidence in trading these assets.

Conclusion

Society cannot continue to extract from nature at its current pace and prosper. The loss of nature globally is rapidly becoming a financial risk that investors are starting to take note of and therefore, want to find ways to allocate to assets that create positive outcomes for nature, and also meet their return ambitions.

As we better understand how to place a value on nature, the opportunities for investors to allocate to natural capital assets are increasing. This is not just a trend, but we believe to be a crucial aspect of a modern investment strategy. The ability of institutional investors to invest for the long term at scale uniquely positions them to allocate capital to make a difference to nature.

Gresham House is the world's ninth largest natural capital manager by value, offering clients a platform of varied return-generating natural capital assets with established track records, including sustainable forestry, sustainable agriculture, carbon forestry and biodiversity creation.

Written by Gresham House head of UK institutional sales, Claire Glennon

[1] WWF Living Planet Index, October 2018
[2] Taskforce on Nature Markets, Global Nature Markets Landscaping, December 2022
[3] Study UNEP State of Finance for Nature 2023 report

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