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# NATURAL CAPITAL WILL BECOME A FUNDAMENTAL COMPONENT OF INVESTORS' PORTFOLIOS

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# Introduction

Climate Asset Management welcomes Environmental Finance's call for investment in natural capital solutions, and supports the recognition of natural capital as an independent investable asset class:

## ► COMMENT: CAN NATURAL CAPITAL BECOME ITS OWN ASSET CLASS?

Whether natural capital should form part of its own allocation, or be a sleeve of a larger allocation into infrastructure or real estate, is a very nuanced question involving allocation decisions within institutional investment platforms.

At its very core, natural capital is finite real estate that plays a critical, infrastructure-like role in providing essential services and commodities to support healthy communities, economic prosperity and planetary wellbeing.

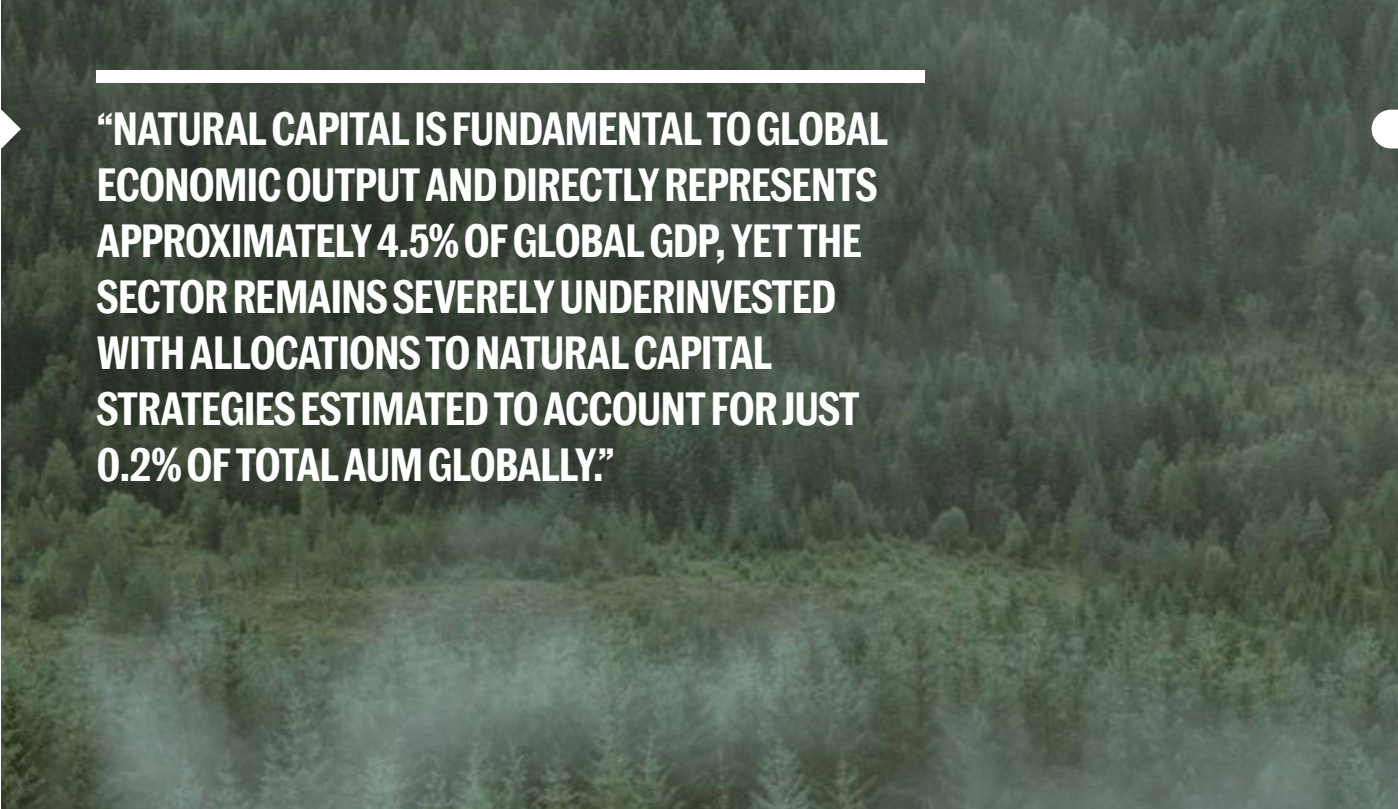
On this basis, natural capital could well fit into a sleeve of a diversified allocation into infrastructure

or real estate, or alternatively stand alone as its own separate allocation within a well-diversified institutional investment portfolio.

What is clear is that natural capital is significantly underinvested across institutional investment portfolios, with a material mismatch between its contribution to global GDP at 4 - 5% and its composition of institutional capital allocations at around 0.2%.

The sector's unique ability to contribute to portfolio diversification, long-term wealth creation and positive climate and environmental outcomes make it an essential piece of a diversified investment portfolio in an increasingly environmentally conscious world.

Climate Asset Management has been formed to allow for a dedicated pathway for exposure to this asset class, with the aim to provide investors with a diversified portfolio of natural capital exposure, accompanied by measurable and verifiable impact outcomes at scale.



**“NATURAL CAPITAL IS FUNDAMENTAL TO GLOBAL ECONOMIC OUTPUT AND DIRECTLY REPRESENTS APPROXIMATELY 4.5% OF GLOBAL GDP, YET THE SECTOR REMAINS SEVERELY UNDERINVESTED WITH ALLOCATIONS TO NATURAL CAPITAL STRATEGIES ESTIMATED TO ACCOUNT FOR JUST 0.2% OF TOTAL AUM GLOBALLY.”**

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## What is natural capital?

Natural Capital refers to the earth's air, land, water and biodiversity. It is defined as the “stock of renewable and non-renewable natural resources that combine to yield a flow of benefits to people”<sup>1</sup>, in effect, the earth's planetary infrastructure. These assets provide services that help sustain life, livelihoods and well-being.

Natural capital services provide valuable goods and services to humanity, such as clean air and water, fertile soil, biodiversity and climate regulation.

The most common asset types found in natural capital investment strategies include:

- farmland and farm operating platforms;
- timberland including existing forests or new plantations for commercial timber or forest carbon; and
- other environmental assets, such as peatlands and mangroves, which generate carbon credit income.

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## Why natural capital now?

It is estimated that agriculture, forestry and other land use changes (AFOLU) are responsible for 21% of global GHG emissions.<sup>2</sup>

Agriculture, in particular, is a significant contributor to anthropogenic global warming and reducing agricultural emissions will play a significant role in climate change mitigation.

Investing in natural capital solutions and AFOLU measures remains key to retaining the potential for alignment with the target of limiting warming to 1.5°C above pre-industrial levels. Additionally,



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1. Natural Capital Coalition (2016). Available at: <http://www.naturalcapitalcoalition.org/protocol>

2. IPCC (2023). Available at: <https://www.ipcc.ch/report/ar6/wg3/chapter/chapter-7/>



nature-based solutions are uniquely positioned to deliver climate change mitigation as well as co-benefits which can help overcome wider challenges, such as biodiversity loss.

Natural capital is fundamental to global economic output<sup>3</sup> and directly represents approximately 4.5% of global GDP, yet the sector remains severely underinvested with allocations to natural capital strategies estimated to account for just 0.2% of total AUM globally.<sup>4</sup>

As policy-makers worldwide implement stricter environmental regulations to address issues such as climate change and biodiversity loss, we see a growing number of investment opportunities in the

space. Accelerating commitments toward net zero emissions from governments and organisations represent structural tailwinds which are increasingly driving investment into nature-based solutions, particularly in compliance markets.

Similarly, the emergence of new markets and payments for ecosystems service (PES), such as biodiversity and peatland restoration, is providing additional revenue streams for investors.

Natural capital offers investors the opportunity not only to generate long-term value from the finite and essential resources that support life on our planet, but also to manage them in a way that ensures the prosperity of those assets for future generations.

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## Natural capital as an independent asset class

Investors tend to group disparate parts of capital markets together, creating an asset class framework, typically for analysis and allocation purposes. Bundling investments with similar attributes leads to a form of assetisation, enabling ease of allocation to groups of investable securities.

Further stratification of varying investable opportunities has created the segmented asset classes we have become used to, for example, private equity, private credit, infrastructure, real estate and hedge funds are all examples of individual asset classes commonly referred to as 'alternatives'.

While natural capital investing is not a new phenomenon, it has evolved from the more typical investments such as farmland and forestry, which historically focus on income and capital appreciation, to a more balanced approach to achieving positive economic and environmental outcomes, while also including more nascent opportunities such as those that derive income from the provision of carbon credits, biodiversity credits, conservation easements and other ecosystem services.

Investor enthusiasm and demand for natural capital solutions are being driven by solid market

fundamentals and climate impact potential. A recent report published by financial consultancy bfinance on natural capital investing, noted a shift in investor appetite for real assets, whereby natural capital manager searches on behalf of bfinance clients surpassed real estate manager searches for the first time.<sup>5</sup>

Investors, from high net-worth individuals to institutional LPs, increasingly view natural capital as a standalone asset class, taking its place alongside more conventional alternatives at a portfolio level.

Those investors that are new to natural capital investing, without a dedicated natural capital allocation, often cite the similarities of natural capital strategies to those of infrastructure and real estate. As well as sharing the attributes of a real asset, natural capital assets are characterised by long duration, stable and predictable cashflows while

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3. World Economic Forum (2022). Available at: <https://www.weforum.org/agenda/2022/05/nature-positive-net-zero-global-financial-system/>

4. JP Morgan and Schroders

5. Bfinance (2024). Available at: <https://www.bfinance.com/insights/natural-capital-investing#:~:text=While%20natural%20capital%20investing%20is,resource%20management%20and%20for%20extraction.>

delivering potentially attractive risk-adjusted returns that are uncorrelated with the broader economic cycle.

From a portfolio perspective, natural capital strategies also demonstrate inflation hedging capabilities while delivering superior environmental upside when compared to more conventional real asset strategies.

Unsurprisingly, infrastructure strategies seeking investments beyond the realm of conventional core and core-plus type assets have begun to emerge, as managers see opportunity in long-term contracted offtakes with fixed price and volume components from corporate buyers seeking to fulfil net zero commitments. The climate-focused energy transition sector is the most obvious avenue to which this capital has been channelled.

Increasingly, investors are overcoming the allocation and portfolio-fit hurdle by viewing natural capital strategies through an infrastructure and, more broadly, a real assets lens, but with recognition of the additional ESG upside and associated reporting benefits.

It is becoming apparent that investors engaged in the space, either through direct conversations with GPs or via other intermediaries, are seeking innovative investment solutions to obtain exposure to the natural capital space in a diversified and scalable strategy.

This can be delivered by co-mingled funds, or for the largest managers more tailored solutions, such as separately managed accounts, to provide more bespoke exposure to the asset class that delivers more specific portfolio diversification. These types of vehicles tend to be specialised and often employ a regional focus, or may have specific sub-asset class investment requirements.

Overall, Climate Asset Management shares the perspective that nature is now firmly on the agenda, with soft reporting regulations supporting the shifting investor awareness of how natural capital investment can benefit institutional portfolio outcomes.

As economies rebound and investors acknowledge the need for nature-based solutions, we anticipate that natural capital will become a fundamental component of investors' portfolios.

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**“INCREASINGLY, INVESTORS ARE OVERCOMING THE ALLOCATION AND PORTFOLIO-FIT HURDLE BY VIEWING NATURAL CAPITAL STRATEGIES THROUGH AN INFRASTRUCTURE AND, MORE BROADLY, A REAL ASSETS LENS, BUT WITH RECOGNITION OF THE ADDITIONAL ESG UPSIDE AND ASSOCIATED REPORTING BENEFITS”**





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## About the Author



*Ben O'Donnell is Chief Investment Officer: Natural Capital Strategy at Climate Asset Management.*

Ben joined Climate Asset Management in 2020 and is CIO of the Natural Capital Strategy, which is an Article 9 aligned investment product deploying across agriculture, forestry and environmental assets in developed markets.

He has more than 20 years' experience in funds management and investment banking, with extensive experience across a range of natural capital industries.

Previously, Ben worked in agriculture funds management at Macquarie Infrastructure & Real Assets, playing a key role in doubling the AUM to A\$2.7 billion, and led food and agriculture coverage within Macquarie Capital, advising on more than A\$4 billion of transactions.

**Further reading: Read Ben's interview with Environmental Finance first published in their Biodiversity Insight feature January 2024 [here](#).**



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