RESPONSIBLE INVESTMENT IN **INFRASTRUCTURE**

DECEMBER 2014

Between **ESG due diligence** and **green infrastructure** financing

With public investment on the decline, **the financing need for infrastructure** has never been higher, both for replacing existing installations in OECD countries and for developing new facilities in emerging countries. The annual gap between worldwide financing needs and available public funds is estimated at some **$500 billion** by Standard & Poor's. But quantity is not the only problem. New infrastructures have a minimum lifespan of 20 years. Taking account of **environmental, social and governance (ESG) criteria** is decisive in ensuring that the installations built today are compatible with future expectations. Although managers are gradually making more systematic use of ESG analyses in due diligences, their practices are still far from being consistent with the **transition towards a green economy**.

Types of infrastructure investment

Infrastructure projects correspond to facilities providing services to the community, such as transportation networks, energy supply and distribution systems, water distribution and treatment systems, waste management facilities and communication networks, as well as social facilities such as hospitals, prisons and schools. "Greenfield" projects refer to new developments whereas "brownfield" projects refer to the operation of existing facilities. Investment in infrastructure can be made directly in projects or indirectly through equity or debt funds.

A rising asset class

A total of $38 billion was collected worldwide by infrastructure funds in 2013, up 58% on 2011. Although the infrastructure asset class accounts for just over 1% of the total assets of asset owners, it is gaining momentum. Preqin, a data provider, estimates that infrastructure allocation could triple over the next few years.

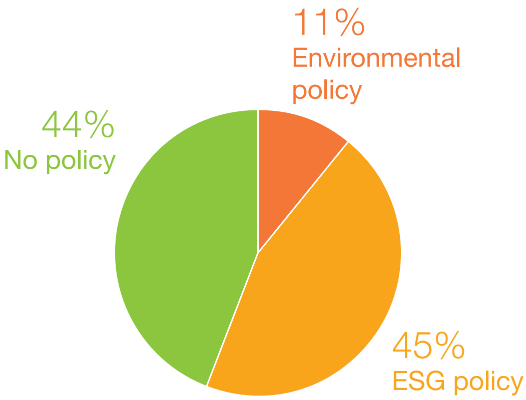
Risk management as the main driver of ESG policies

Integrating ESG criteria in infrastructure investment is currently mainly motivated by risk management. The main objectives are to ensure the social acceptability of projects, anticipate regulatory changes and reduce the running costs of existing facilities. As such, the key ESG themes examined include environmental issues, labour conditions, safety, local job creation and consultation with stakeholders.

However, a number of factors call for further action. The ecological and energy transition requires a reallocation of existing financing flows as well as over $1 trillion a year in new financing according to the International Energy Agency. Yet most investments are still going in the wrong direction. In addition, private infrastructure investment could also contribute to meet the needs of local communities through what may be called "impact investing". Overall, meeting social challenges such as the 1.2 billion people without electricity or the 748 million people without access to safe drinking water would require over $1.5 trillion a year of new financing in emerging countries according to the Centre for Climate Change Economics and Policy.

Novethic surveyed 185 asset owners from 13 European countries on their ESG integration practices. Some 106 of the investors – mainly French, British, Dutch and Spanish institutions – said they held infrastructure assets.

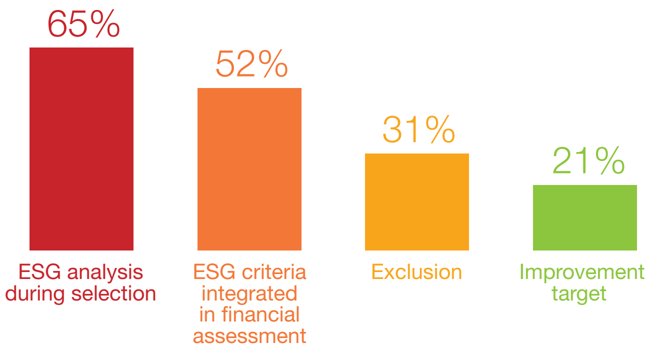
Number of investors implementing an ESG policy in infrastructure



Forty-five percent of the respondents investing in infrastructure have implemented an ESG policy in their infrastructure asset class. This share jumps to 65% for respondents having signed the Principles for Responsible Investment (PRI).
But large discrepancies exist between countries. While the share rises to 71% in Nordic countries, it fails to exceed 30% in France.

Details for the 76 investors implementing an ESG policy

Among the participants having implemented a policy, 65% systematically conduct an ESG analysis when selecting assets. This analysis is frequently incorporated in the financial appraisal and may lead investors to ask for modifications or to even completely abandon the projects if the risks thus identified are too high.



During the selection process, asset owners investing with ethical motives make exclusions mainly on the basis of the countries in which projects are located. Dutch pension fund PDN and Germany's BVK have such policies in place. During the operation phase, improvement targets are usually set on an asset-by-asset basis according to the risks identified. PGGM in the Netherlands, Caisse des Dépôts in France and Aviva in the UK communicate on this type of strategy. Last, investors indirectly investing through funds, such as APG in the Netherlands, usually use ESG questionnaires to select their fund managers and monitor the actions they have implemented.

Increase in collaborative initiatives

- In late September 2014, a group of investors representing $1.3 trillion of assets signed a joint statement to the UN on climate-resilient infrastructure in which they committed to better integrating climate change in their infrastructure investment to the extent that the public sector paves the way.
- In early October, the World Bank launched its Global Infrastructure Facility to promote collaboration with private investors.
- In mid-October, the Long-Term Infrastructure Investors Association (LTIIA) held its first general meeting. ESG integration was one of its three work streams.
- Other initiatives should be launched in 2015.

Various ESG practices are implemented in infrastructure according to investment type (debt or equity, through funds or direct investment), project type (roads, hospitals, energy facilities) and geographical area. Asset managers highlight the complexity in finding common standardised indicators.

INSIGHT ON THE FRENCH MARKET

Among the 19 main asset managers active in the French infrastructure market, representing some €34 billion under management (infrastructure debt funds excluded):

- 14 report globally on their responsible investment policy,
- 12 are signatories to the Principles for Responsible Investment (PRI),
- 5 communicate on the type of ESG criteria they consider.

ESG analysis of the projects

When investing in greenfield projects, asset managers conduct ESG analyses as part of their due diligence process, relying on project documentation and in-depth dialogue with the project officers. Experts may also be appointed to examine the ESG characteristics of the project in more detail and identify improvements. When investing in brownfield projects, asset managers take account of ESG factors in their risk analysis with a view to identifying potential improvements and the associated drivers. During the annual asset review, managers monitor the targets set for each asset and engage dialogue with project officers.

Best practices

Mirova Environment and Infrastructure uses a single ESG framework comprising more than 80 criteria with different weightings according to the type of infrastructure considered. Projects are assessed from basic compliance with applicable regulations to the implementation of existing best practices.

In the asset selection phase, **Meridiam** establishes a specific set of objectives and associated metrics for each project. These targets are monitored throughout the holding period of the asset. In an example of social policy, a tunnel construction project in the US led to the creation of the “BUiLD 305”partnership initiative resulting in a full 85% of the workers on the project coming from the local community.

CDC Infrastructure has developed a tool covering 15 themes, including water, biodiversity and greenhouse gas emissions. The tool is used for the initial environmental assessment of the projects, the definition of improvement plans and the monitoring of the commitments set during the tendering stage of construction companies. In addition, the company monitors the carbon footprint of its portfolio and has committed to reduce its footprint by 14% by 2020 compared with 2010.

ESG reporting

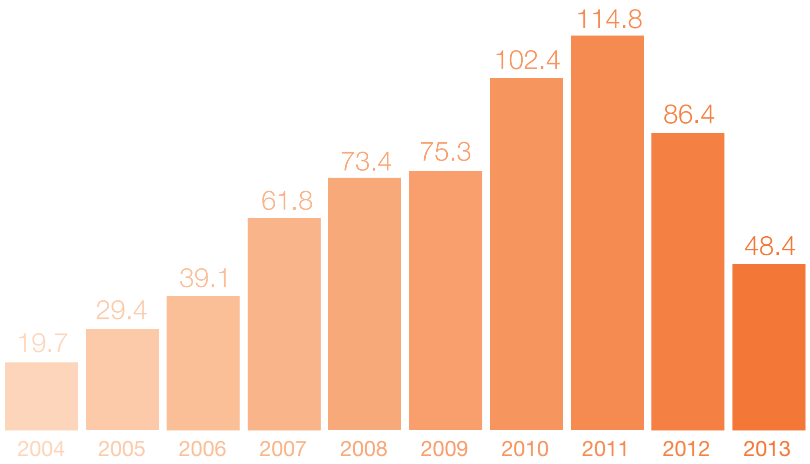
Analysis completed at the project level is seldom consolidated into aggregated indicators for ESG reporting at the fund level. Yet investors are increasingly requesting information on the impact assessment of their investments.

Best practices

For its multi-management activity, **OFI AM** has created an online platform to analyse the ESG practices of the asset managers in unlisted infrastructure. In 2013, 69% of the 43 asset managers surveyed responded to the questionnaire. The answers collected enable the multi-management team to aggregate its own reporting for its institutional clients through a dozen key indicators such as the number of local jobs created or the share of the projects where a carbon footprint assessment was performed.

The European Union has committed to raise its share of renewable energy in final energy consumption to 20% by 2020, and to 27% by 2030. However, investment in renewable energy has decreased since 2011 both in Europe and worldwide. Despite a slight increase in allocation on the part of asset owners, financing needs remain considerable.

A marked decline in new investment in renewable energy in Europe ($ billion)



Source: Bloomberg New Energy Finance & UNEP

Some $48 billion was invested in renewable energy in Europe in 2013, all investment types combined. This sum is far below the €270 billion a year required for the energy transition according to the European Commission.
The amount is also a full 137% lower than the 2011 record. Regulatory uncertainties, project complexity and technological evolutions are the main barriers highlighted, with business model sometimes still unclear.

An increasing but still insufficient contribution from asset owners

In Europe, asset owners account for less than 10% of the total investment in renewable energy. But the share is increasing. Over the first nine months of 2013, some $3.3 billion was invested in renewable energy, compared with $1 billion in the whole of 2008. And figures should continue to rise. For instance, the Dutch investor APG has recently committed to doubling its allocation in renewable energy to reach €2 billion by 2017, and the Danish pension fund PKA is to invest an additional €1.5 billion in wind farms by 2015.

An expanding supply of renewable-energy funds

In addition to direct investment, the supply of unlisted funds dedicated to renewable energy is expanding, among them Triodos Renewables Europe Fund, Allianz Renewable Energy Fund and the Eurofideme 2 and 3 funds by Mirova. According to Bloomberg New Energy Finance, total assets under management for unlisted renewable-energy funds increased by 17.1% between 2012 and 2013. In France, Novethic counts 20 or so unlisted funds dedicated to renewable energy, corresponding to 7% of the total assets under management of equity funds in infrastructure, or roughly $2.5 billion of assets.

A study of Novethic's research center
conducted by Yona Kamelgarn
under the supervision of Dominique Blanc.

Novethic, a part of the Caisse des Dépôts Group, is a French research centre on Responsible Investment. Founded in 2001, Novethic analyses the major trends and conducts studies on specific ESG topics. Novethic's SRI and green fund Labels provide a reliable reference point for responsible investment funds available on the European market. **www.novethic.com**