Infrastructure Investor

Impact Investing

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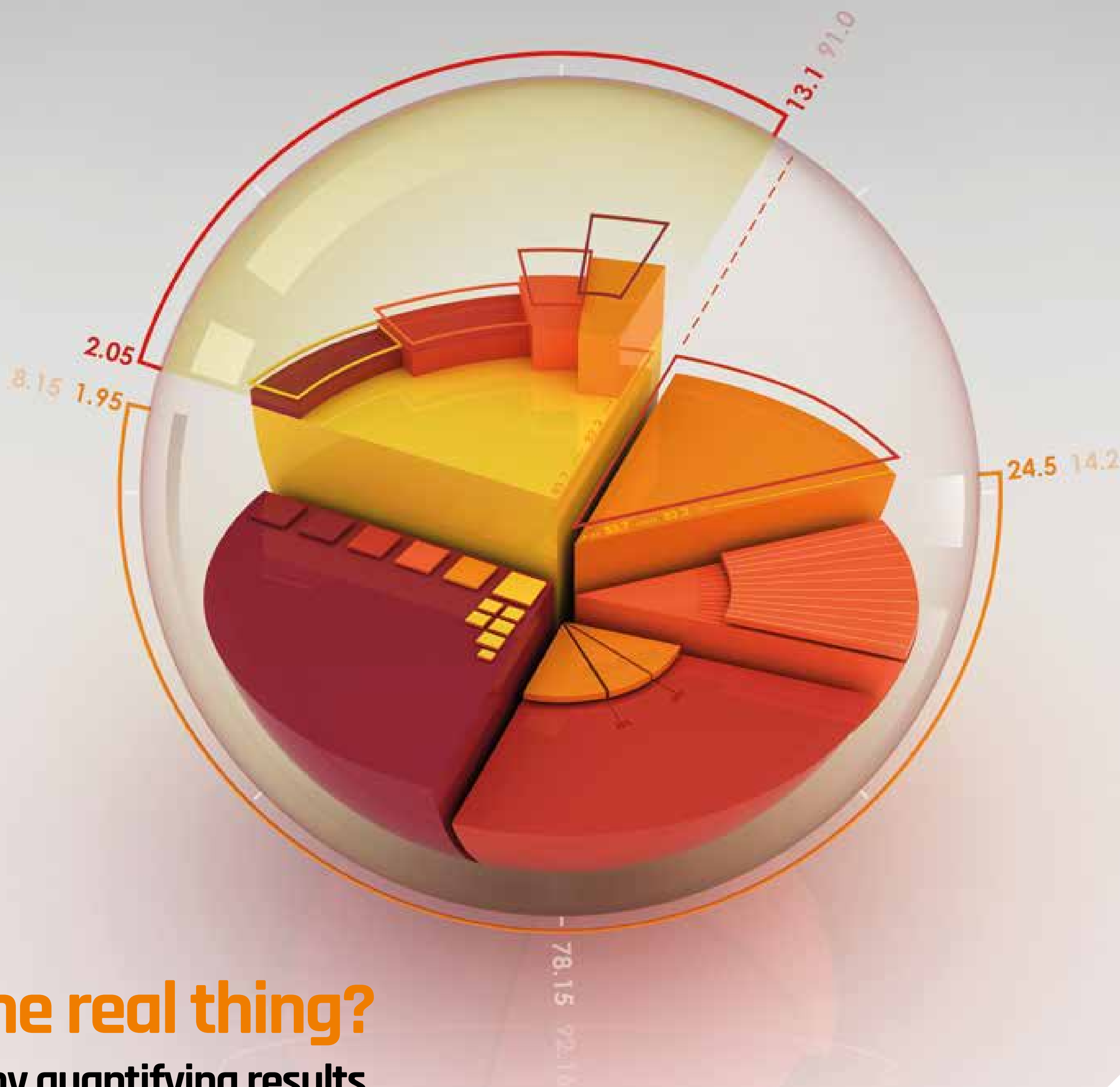

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Impact Investing

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Editor's letter

Impact must be about more than intentions

James Linacre
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Deontological ethics posits that an action is right or wrong, positive or negative, in and of itself. Infrastructure investors are increasingly showing themselves to be utilitarians by nature, however; it is not the intent of an action which counts so much as its outcome.

How else to explain the increasing focus on measuring impact? It is no longer enough to want to make a difference – that difference must be confirmed and quantified.

The UN Sustainable Development Goals are frequently serving as a starting point for managers keen for a standard against which to measure their funds. The Global Impact Investing Network reported that over half of impact fund managers were benchmarking against the SDGs or similar agendas as of 2020 and, as the voices in this report testify, investor commitment is only growing.

> **" It is no longer enough to want to make a difference "**

Measuring the impact that such funds have is fundamental to gauging their utility. While impact funds seek a profit – and how to balance profit with positive impact is another ethical conundrum with which the industry is wrestling – they also have a higher purpose than pure profit.

How to do that measuring remains the challenge. There are several ideas in this report and frameworks such as GIIN's IRIS+ have proved popular. But, as with all great philosophical arguments, the debate rages on.

At least one argument can be laid to rest. With apologies to the deontologists, intent is not enough – true impact has to be measured.

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Insight

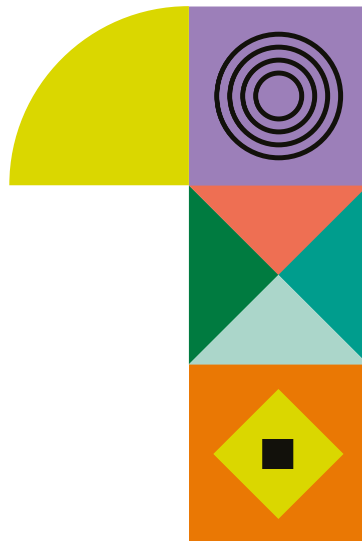
The big picture **Impact continues to grow as investors prioritise different solutions**

It'll come as no surprise that impact is the buzzword on most investors' lips. And with worries surrounding sustainability and climate change becoming more prevalent, the interest in impact is only set to grow, ***writes Evie Rusman***.

According to 2022 GIIN data, the impact investing market currently has $1.2 trillion in assets under management, which is significant considering impact is a relatively new sector that is still maturing and developing.

GIIN chief executive Amit Bouri says: "While this figure serves as a very positive sign for the industry, it is also a call for further action. Vast allocations of capital and an intentional focus towards generating positive impact are required right now if we are to achieve the UN Sustainable Development Goals by 2030 and to reach net-zero emissions by 2050."

So, as the sector advances, how can infrastructure investors unlock opportunities? Here are four key trends to watch.



Tracking and measuring performance

Impact can still be a grey area for investors and measuring its success can be a challenge. Without proper frameworks outlining how to track impact, it becomes difficult to know whether investments result in positive lasting change.

"Measuring impact is critical to what we are all trying to achieve," says Jon Collinge, sustainability director at alternative asset manager Morrison & Co. "Infrastructure investing is about providing services that enhance the environment and society, aiming to make the world a better place. Improving how we measure impact gives us greater licence to discuss the positive contributions we are making to society."

Managers can measure impact by setting targets most relevant to their portfolios and funds then by agreeing a method to measure progress towards those goals.

"KPIs need to focus on social and environmental objectives, carefully tailored to each investment and business," argues Adrien-Paul Lambillon, ESG and sustainability specialist at Partners Group. "When setting impact metrics, thinking about measurability or aligning to specific SDGs, it is crucial to consider how they affect the core business."

Kristina Kloberdanz, chief sustainability officer at Macquarie Asset Management, adds: "Managers need to ensure data collection is reasonable, regular, and built on efficient systems and processes to ensure that even the

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$1.2trn Size of the impact investing market

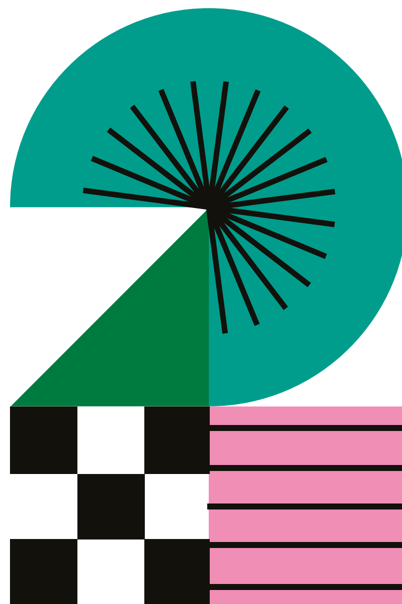
20% Increase in the cost of installing minigrids in 2022

smallest of portfolio companies and their teams are resourced appropriately."

However, even if managers put that data collection process in place, there can be issues when it comes to the availability, quality and granularity of the data. This is because it either doesn't exist yet or the resources needed to capture the data are too costly or time-consuming.

Frameworks such as the GIIN IRIS+ framework, which allows managers to compare data, are key to solving data collection issues. "Being able to standardise and point to an established framework is important as it gives greater credibility to what we are trying to achieve," says Lisa Shaw, managing director of infrastructure debt at Vantage Infrastructure.

"It also helps trying to access data from borrowers or portfolio companies as we can point to a metric in the framework and explain why it is needed."



Investing in nature-based solutions

Nature-based solutions are a significant area of interest for investors. They combine a positive environmental impact with efficient infrastructure services. Indeed, nature-based solutions can be more effective than alternative options.

"Designing nature-based solutions into infrastructure can both help with climate change adaptation, as well as climate change mitigation," says Dima Zogheib, associate director at Arup, a company that designs and plans infrastructure and other building projects.

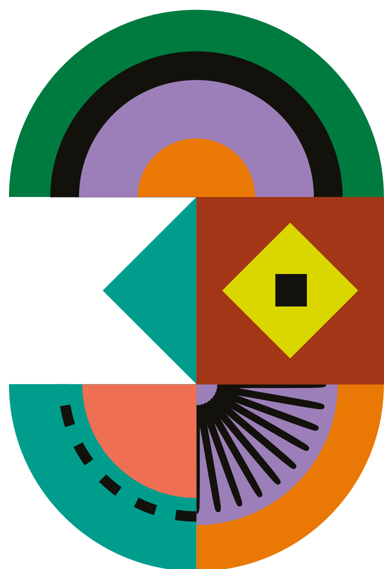
Zogheib argues that nature-based solutions are particularly effective in cities as they provide outdoor space and also offer relief when it comes to extreme weather such as flooding.

"We think about infrastructure and natural ecosystems as both man-made and natural assets," she says. "We see them as assets that really protect us, provide new things, but also connect us as human beings – and we see those as the support systems for our everyday life in cities."

Loss of biodiversity is another reason why interest in natural assets has increased. For instance, research shows that well-managed solar power sites can lead to an increase in biodiversity, giving hope that what has been lost can be regained. A report by Solar Energy UK cited an increase in bird and insect species at solar farms where there was ecological monitoring.

Ross Grier, UK managing director at NextEnergy Capital, which manages a fund that invests in solar assets in the UK, says: "What we realised was we could tailor measures around the solar operation that would foster ecosystem services for that surrounding community.

"We end up providing a much better outcome for society than just the green power. What we are doing is actually creating these hubs that protect biodiversity."



Rise of place-based impact

As with putting nature at the heart of projects, place-based impact investing is a concept gaining ground in the industry. Place-based impact investing covers those investments that are made specifically to yield appropriate risk-adjusted financial returns as well as, crucually, positive local impact.

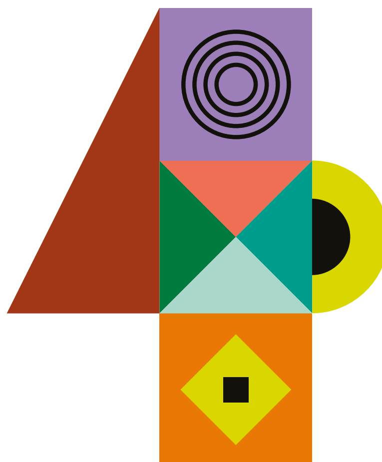
According to many industry specialists, infrastructure is a vital element of place-based impact investing. For instance, transport can be a tool to solve regional inequalities, as more investment will go into an area that has good transport links. An example is the HS2 project in the UK, which looks to improve the railway connections of northern cities with London.

Mark Hall, programme manager in place-based impact investing at the Impact Investing Institute, adds: "Infrastructure investments have a really powerful multiplier effect and play a critical role in supporting local communities and local economies."

He argues that there is "a huge need and demand for this kind of investment", which is why he sees it as being particularly primed for growth.

Place-based investing requires intentionality to not only achieve strong financial returns but also benefit the region being invested in. However, Peter Bachmann, managing director for sustainable infrastructure at Gresham House, argues this ideal can cause issues for infrastructure investors.

"If you try to invest solely into a region for a particular reason, and you ignore other places that perhaps might be better for various other reasons, that may create difficulties," he says. "Where we have seen this get unstuck is in the past where you have had very locally driven investments, that may ultimately create the situation where you invest into something that is sub-optimal."



Using microgrids to power developing countries

Providing power to less developed countries can be a challenge due to costs and resources, but increasingly microgrids – small-scale power grids, which can function independently of national grid networks – are being seen as a solution.

"Connecting rural populations in Africa is expensive," says Ash Sharma, head of the Beyond the Grid Fund for Africa, a financing vehicle managed by the Nordic Environment Finance Corporation with funding from various development financing institutions and donor agencies. "Microgrids can offer a faster and more cost-effective route to electrification – up to half the cost of grid connection."

Microgrids can also be efficient in providing power to remote areas as they often rely on solar energy. Speaking on regions in Asia, Wymen Chan, head of Asia at SUSI Partners, notes: "The reality is that the grid is not available everywhere for people to connect to in Asia. There are 6,000 inhabited islands in Indonesia, and 2,000 inhabited islands in the Philippines that don't have grid access. These communities currently rely heavily on diesel gensets which do not make sense today, neither from a cost or a climate change perspective."

Despite significant advantages, there are also major setbacks for microgrids. The International Energy Agency says that minigrids became at least 20 percent more expensive in 2022, due to increasing component costs. Sarvesh Suri, director for infrastructure and natural resources in Africa at the International Finance Corporation, adds: "It is not only the cost of commodities, but also the cost of financing has gone up, and that is also going to slow down electrification."

Regulation is another concern for the rollout of microgrids, as a result of different rules in different jurisdictions. "Uncertainty as [to] the roles of different government departments and applicable licensing procedures are also risk factors to consider," says Alberto Galhardo Simões, partner and head of Lusophone Africa at CMS Law. "Clarity on these matters should be a priority and the granting of relevant licenses and permits should be swifter to enable accelerated rural electrification." ■

Putting impact to the test

Investment is flowing into projects that promise environmental and social benefits alongside financial returns, but how can managers demonstrate genuine impact? Charles Waine investigates

Impact investing has proved irrepressible in recent years. The Global Impact Investing Network (GIIN) estimates that the worldwide market across assets topped $1 trillion for the first time in 2022, doubling in size over the past three years while almost tripling the number of organisations actively managing assets over that time, from 1,340 to 3,349.

Even the pandemic and war in Ukraine have failed to curb appetite from investors. Economic uncertainty, precarious energy security and global hunger have all been exacerbated in recent years and shone a spotlight on the importance of the UN's Sustainable Development Goals. The funding gap alone has widened upwards of $4 trillion across infrastructure and other assets.

Increasingly, capital is being funnelled into funds that promise a combination of financial returns with positive social and environmental change.

But the rapid emergence of the sector has also caused many to be sceptical and question the reliability of claims. Talk is cheap and without proper frameworks for measuring and tracking, impact investing risks becoming a mere sideshow to real lasting change.

"Measuring impact is critical to what we are all trying to achieve," says Jon Collinge, sustainability director at alternative asset manager Morrison & Co. "Infrastructure investing is about providing services that enhance the environment and society, aiming to make the world a better place. Improving how we measure impact gives us greater licence to discuss the positive contributions we are making to society."

Laying the groundwork

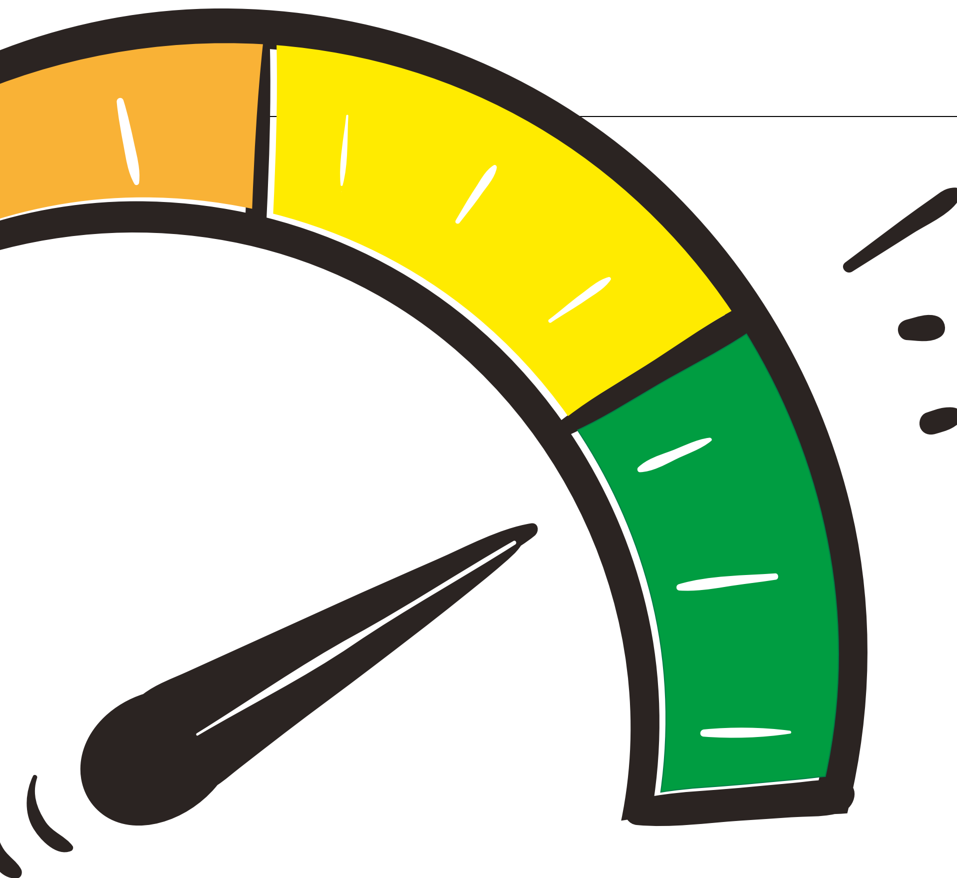
Defining the strategic objectives and goals of an impact investment is the first port of call for managers, serving as an important reference point for tracking and measuring performance. Often, this means selecting targets most relevant to portfolios and funds, and agreeing the mechanisms in place to measure progress.

"KPIs need to focus on social and environmental objectives, carefully tailored to each investment and business," stresses Adrien-Paul Lambillon, ESG and sustainability specialist at Partners Group. "When setting impact metrics, thinking about measurability or aligning to specific SDGs, it is crucial to consider how they affect the core business."

Investors often also confuse the goals of ESG with impact investing. While diversity might be an important topic, tracking the number of female board members should be considered an operational ESG issue rather than impact, explains Lambillon. "That is an example of how businesses are run rather than what a business does or how it can contribute towards environmental and social objectives."

Collinge agrees. "ESG is quite passive, factoring in environmental, social and governance concerns into investment activities, whereas impact is much more active as you are purposefully investing in assets with an intention to deliver a significant contribution to society or the environment."

Impact funds often start by mapping KPIs and metrics to the UN's SDGs. In a 2020 survey for GIIN, 52 percent of respondents said that they develop goals in line with global development agendas like the SDGs or the Paris Climate Accord. The same percentage explained they examine the social and environmental problems that they want to address



and set targets to measure progress against these challenges. Forty-five percent of respondents added that they set targets depending on investor objectives.

Capital flows to the SDGs are also constantly shifting. Research from Dutch impact investment consultant Phenix Capital shows that the number-one SDG for capital raised across all impact funds last year was access to clean energy (SDG 7). Just over half of capital raised was by managers focused on access to information and communication technologies (SDG 9). Access to health care (SDG 3) was in the third spot.

Vital statistics

This trend is perhaps not too surprising considering the pandemic and increased focus on energy security since March 2022. In contrast, the top three SDGs for impact funds in 2021 were climate mitigation (SDG 13), SDG 7 and SDG 9. Last year, SDG 13 dropped into seventh place as climate concerns fell in precedence, again likely due to the war in Ukraine and changing priorities. $259 billion was raised against climate goals in 2021, against just $99 billion last year.

"Being able to standardise and point to an established framework is important as it gives greater credibility to what we are trying to achieve"

LISA SHAW
Vantage Infrastructure

Once metrics and targets have been set, sourcing and collecting impact data is the next important step for accurately measuring progress. "Managers need to ensure data collection is reasonable, regular, and built on efficient systems and processes to ensure that even the smallest of portfolio companies and their teams are resourced appropriately," says Kristina Kloberdanz, chief sustainability officer at Macquarie Asset Management.

Marcel Metzner, senior impact associate at growth equity firm Planet First Partners, adds that "impact data should be collected as much as possible from direct sources and accompanied by the methodology utilised for its calculations and evidence of the source of that underlying data". Often, managers also look to improve the quality of the data by verifying their data measurement and methodologies via a third-party, either under a full peer-review process or audit.

Partly due to the nascent nature of impact investing, one of the main challenges is the availability, quality and granularity of the data, either because it does not exist yet or because of a heavy financial burden and the time needed to collate and capture data.

Lisa Shaw, managing director of infrastructure debt at Vantage Infrastructure, points to the debt space, where "based on our experience, there is still hesitation from the borrowers to provide data – and even when it is provided, it is very rare for it to be certified or validated in any way". She says: "We have seen huge year-on-year fluctuations driven by companies still refining how they calculate their data points."

The GIIN found just 8 percent of the 278 impact investors it surveyed thought that collecting quality data presented no challenge, versus 35 percent claiming a significant challenge and 57 percent a moderate challenge.

The survey also showed that only 26 percent of respondents believed aggregating, analysing and interpreting data presented no real challenge.

Given that impact investing is still an evolving strategy, flagging the maturity of the data can be useful for managers and investors, showcasing the limitations of the existing data and being transparent about how the process could still be improved. "Commitments to transparent reporting by managers must incorporate challenges and lessons learned," adds Kloberdanz.

Two sides of one coin

Beyond simply measuring positive impact, weighing potential negative outcomes and adverse impact are also gaining more attention. A 2022 survey from advisory Cambridge Associates found that one third of respondents engaged in negative screenings across their portfolios to some extent, with fossil fuels, weapons and tobacco the main considerations. Screening fossil fuels also grew by 10 percentage points over the past two years as investors raised more climate concerns about the long-term risk of stranded assets.

Adverse impact indicators vary across subsectors, but factors often considered by managers include disruption of ecosystems and deforestation that directly impact biodiversity and climate concerns.

Similarly, exposure to carbon-intensive fossil fuels might be a relevant factor. Failing to conduct due diligence on the unintended negative outcomes of investments, and focusing only on positive results, risks producing a skewed view of social and environmental impact.

"We need to have a balanced scorecard when talking about the positive impact that our investments are having," says Collinge. "We need to be honest with ourselves and disclose where there are carbon emissions or other negative metrics. Without the complete picture, we have not earned the right to tell the full impact story."

Meeting in the middle

Blending quantitative data points with qualitative targets is also a challenge, particularly with the subjective nature of social impact goals. Asset managers want to be able to translate targets into measurable KPIs backed by performance data, or at least be able to provide evidence that there was tangible change.

"If we want to unlock enhanced performance across our assets, we have to be able to produce quantitative analysis," explains Collinge. "For all the engagement we have with portfolio companies, it is often not until they actually see their performance on a scale of one to 100 or against their peer group that we actually start to see change."

This is where the emergence of greater standardisation and industry benchmarks should make it easier for infrastructure firms to compare and contrast investments. The GIIN's IRIS+ framework is one benchmark that has gained traction across the infrastructure space in recent years, allowing managers to compare data. It is used by more than 7,000 organisations.

Each core metric aims to ask five key questions: What is the goal? Who is affected? How much change has happened? What is the contribution? And what is the impact risk?

The rules of engagement

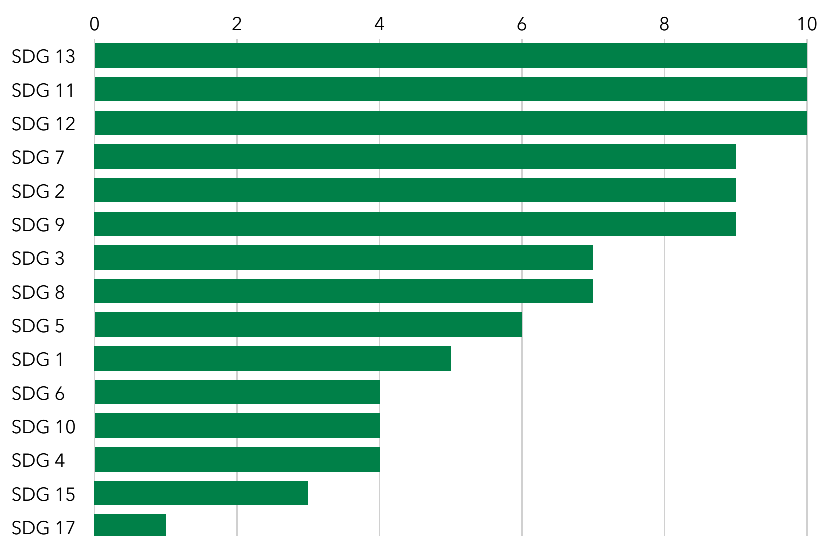
Mandatory sustainability regulations are poised to shape the asset class dramatically

"Regulations are positive in that they increase standardisation, but we have seen a lot of confusion and cautiousness, particularly with the Sustainable Finance Disclosure Regulation," says Adrien-Paul Lambillon, ESG and sustainability specialist at Partners Group. "All this focus on reporting and administrative burden favours the largest companies because impact funds do not always have ESG data availability, or the coverage like in the public market space."

Ahead of the mandatory raft of SFDR changes in the EU that came into force in early January, many impact funds opted to downgrade their sustainability status. Data from services firm Morningstar at the end of Q3 2022 showed more than a tenth of all Article 9 funds were planning to downgrade to Article 8 status because of the pending regulations. "The SFDR has had a dramatic impact," adds Jon Collinge, sustainability director at Morrison & Co.

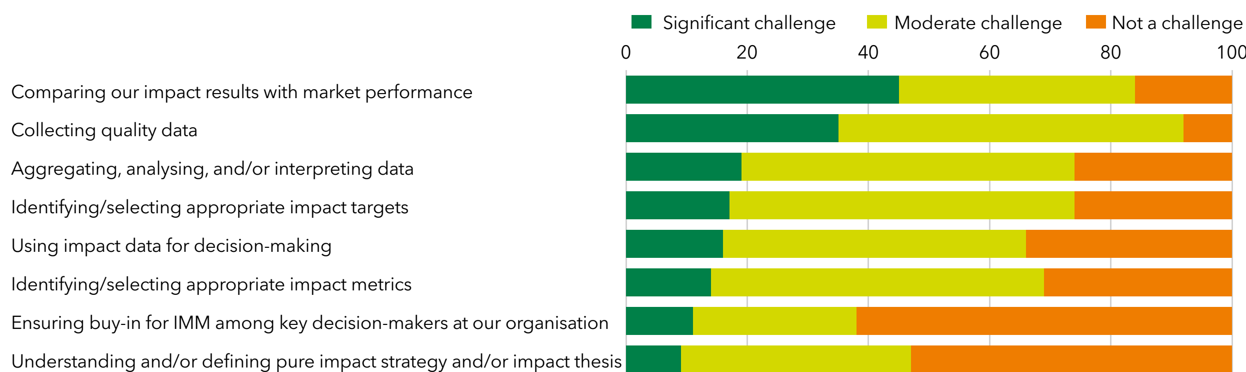
But the regulations might also reveal a difference between managers' ability to gather data, argues Dan Watson, head of sustainability at Amber Infrastructure. "Whilst regulations provide guidance on what to measure, it is down to the manager to determine how they collect the relevant data. It is important that managers can access good quality data and not have to rely on estimation, which can introduce reporting risks."

Lisa Shaw, managing director of infrastructure debt at Vantage Infrastructure, adds that it can also be very difficult for debt providers to access all the data and therefore accurately classify a fund as Article 9. "Regulations are great from an impact-washing perspective, and can move the industry in the right direction, but I think it would be helpful if there was recognition that it is particularly challenging to meet the data requirements across the private space."



Source: Phenix Capital Group

> *"Managers need to ensure data collection is reasonable, regular, and built on efficient systems and processes"*
>
> **KRISTINA KLOBERDANZ**
> **Macquarie Asset Management**



Source: GIIN

"Being able to standardise and point to an established framework is important as it gives greater credibility to what we are trying to achieve," says Shaw. "It also helps trying to access data from borrowers or portfolio companies as we can point to a metric in the framework and explain why it is needed."

The IRIS+ framework organises impact investments into social and environmental themes, with a collection of standardised goals and metrics selected within each category. For example, one goal might be providing all individuals with consistent access to sufficient, safe and reliable energy. Metrics in the IRIS+ framework include measuring consumption of renewable energy and amount of money spent on connectivity over a given time period.

"Measurable, repeatable and comparable metrics are key if we are to make collective progress," adds Kloberdanz. "While we seek to use industry metrics sets for tracking and reporting on performance, a challenge we have found is that they can often be limited for new sectors, especially when investing for targeted social outcomes. There is still a need for developing custom metrics occasionally."

For Dan Watson, head of sustainability at Amber Infrastructure, "benchmarking can be a useful tool, but it is important that it does not detract from taking real-world action". He also warns that it can "create a reporting burden when time could perhaps be better spent on improving the sustainable performance of investments".

As impact investing evolves, a balance needs to be taken to ensure progress is accurately benchmarked, but disclosures are not so punitive that managers struggle to find the time and resources to actually make a tangible environmental and social difference.

"It is essential that we collaborate, learn from each other and share our experiences for the betterment of everyone in the industry," says Collinge. "Infrastructure has enormous potential to deliver positive environmental and social impact." ■

KEYNOTE INTERVIEW

Impact today, impact tomorrow

Infrastructure investing is changing, says Eurazeo's Laurent Chatelin, as sustainability and impact are becoming integral to generating financial returns

The energy transition and moves to decarbonise the economy are transforming the infrastructure investment landscape, presenting new risks, opportunities and capital pools.

All this will require infrastructure fund managers not just to embrace sustainability as an investment trend, but also to apply a high level of rigour to processes, measurement and reporting of data as well as to incorporate genuinely long-term considerations that stretch far beyond a fund's typical holding period.

Laurent Chatelin, partner and head of the infrastructure team at Eurazeo, explains why he believes that the asset class is entering a new phase, what that looks like, and what it takes to achieve Article 9 status.

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Q What are today's trends in the infrastructure impact space?

Infrastructure fund asset management is moving into a new era. ESG and impact are becoming ever more important when building and managing infrastructure assets and that is absolutely correct because, by definition, large infrastructure has an impact on its environment and its different stakeholders, especially its end users.

We must consider the long term, which can be counter-intuitive to private equity, where investment horizons are relatively short. In infrastructure, you are building for the future; if you build a rail or energy system or a bridge, that will likely be there for 50 years and possibly more.

This is why we established our infrastructure platform. We want to set the new standards of what it takes to manage infrastructure in the context of sustainability and impact. Being part of the Eurazeo group allows us to focus on investment and asset management, and, at the same time, allows us to benefit from Eurazeo's corporate functions, and in particular its ESG team.

For example, Eurazeo launched its O+ strategy before we launched our platform. O+ sets out two pillars – the first is net zero for all portfolio companies by 2040, and the second is social responsibility across all portfolio

companies, including gender parity and diversity. The firm also adopted the science-based targets on carbon emissions to plot the path to net zero.

Q How does that inform your investment strategy and approach?

We have adopted the Eurazeo approach and adapted it for an infrastructure context – it is a solid foundation and framework that we have tailored to infrastructure and to comply with and support Article 9 fund requirements. Our aim is to deliver sustainability, which encompasses reduction of the carbon footprint of the essential services delivered by infrastructure. We have a holistic investment strategy focusing on energy transition, digital transition and other transition areas, such as clean transport, waste and water management, industrial decarbonisation and circular economy.

We have excluded all fossil fuels from our strategy, even though the EU taxonomy allows gas. That is because the chemistry doesn't change just because gas falls within the taxonomy – burning gas will always emit CO2. If we want to reduce carbon emissions, we can't be investing in assets that add more to the environment.

This also informs our due diligence, as we use frameworks for assessing investments according to environmental impact – what externalities are generated by the investment, for example – as well as according to what climate risks the infrastructure might be subject to, such as damage from wind or water. And finally, we look to the impact of operating assets to assess whether they may impact other businesses and ecosystems such as water, air or earth, and we

Q How have you found the process of meeting Article 9 compliance?

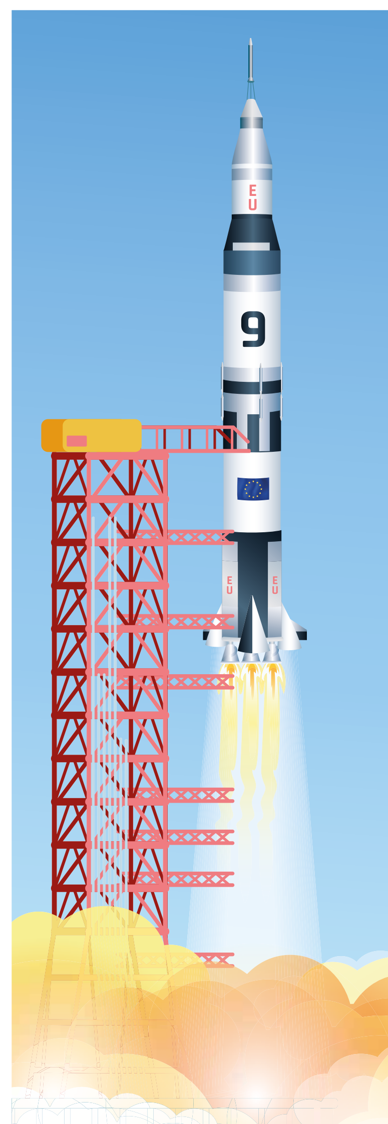
It is not straightforward, but our investment strategy makes a natural fit for Article 9 and it is a strong foundation for what we want to achieve. You need discipline to generate impact and complying with Article 9 enforces that discipline.

We are new kids on the block, so we don't have a legacy and that means we are effectively starting with a blank sheet of paper to determine and put in place the standards that will prevail 20 years from now. It is like going to the moon – the journey is not easy, but it will deliver value to our investors, to our portfolio companies, and ultimately to the wider community.

It is as President John F Kennedy said: "We set sail on this new sea because there is new knowledge to be gained, and new rights to be won, and they must be won and used for the progress of all people… We choose to go to the Moon in this decade and do the other things, not because they are easy, but because they are hard; because that goal will serve to organise and measure the best of our energies and skills, because that challenge is one that we are willing to accept, one we are unwilling to postpone, and one we intend to win."

The issue of carbon will determine how companies, governments and broader society operate. Given that infrastructure is all about carbon – using energy to transform it into something else and deliver essential services – we believe it makes financial as well as environmental and societal sense to find ways of making infrastructure sustainable. Operating within the broader Eurazeo group has provided us with a head start and made the implementation of Article 9 easier as the group manages other Article 9 funds and has a dedicated corporate ESG team providing knowledge, data and tools for reporting on carbon and other sustainability measures. And, when you take a scientific approach to carbon – as Eurazeo has with implementing the science-based targets on carbon emissions – it is a robust approach that fits squarely with Article 9.

That approach informs how we collect, manage and analyse data and all our portfolio companies support this. We made an investment in a plastic sorting facility in Denmark, Resource, and the management team was clear that one of the reasons it wanted to work with us was because we are an Article 9 fund.



monitor the social impact of our investments, including, for example, measuring progress towards gender parity.

Q Linking carried interest to impact outcomes is notoriously difficult. Why have you opted to do this?

This is a clear marker of commitment to impact. If you link a portion of carried interest to meeting extra-financial KPIs, you are more likely to achieve your targets because it ensures you build a robust business plan around those targets.

Ours are mostly linked to carbon – to Scope 4, avoided carbon emissions – in part because that is a scientific and straightforward measurement. It is vital that this is also independently audited, just as with financial reports, because you want to be dealing with your investors in a transparent and accountable way.

We are not just looking at environmental KPIs. We also monitor social KPIs, such as female board representation, the health and social coverage of the people working in the companies we invest in and how we share the value created over time.

Q When you say you share the value created over time, does that mean employees receive payments if the investment does well?

As fund managers, if we deliver financial performance, we gain through carried interest. We believe that managers and employees of the companies we back should also gain. We say to portfolio companies that if we achieve a financial return above a certain threshold, employees will receive a pay-out – and this is ratcheted, so the higher the return, the more they receive.

Given few of these employees will be equity holders, these sums can change people's lives because it could be equivalent to years or even decades of their salary. We think this is a fair thing to do, but it also benefits the businesses as it aligns interest with investors and it is great for attracting and retaining people.

> *"Impact investing is all about delivering financial performance as well as positive outcomes"*

It is worth adding, though, that financial rewards are only part of the story. For younger generations in particular, working for a business with a purpose is also very attractive. We have an electric vehicle charging station company in our portfolio where many of its employees are motivated by the desire to bring about change – providing purpose can be very powerful.

Q How can the fund meet the needs of both impact and traditional institutional investors?

It is interesting because the landscape has changed a lot over recent years. Just five years ago, if you talked about impact in infrastructure, it often meant investing in projects such as building wells to provide drinking water for remote communities, which is great but may not deliver financial performance. Today, impact investing is all about delivering financial performance as well as positive outcomes for the environment, society and communities.

So, the more energy you can generate from solar, for example, the more carbon you can avoid, plus the greater the revenues and therefore financial return. Energy transition and decarbonisation are helping to shift the narrative, and there are also moves by investors with financial objectives to diversify into impact strategies.

The two types of investor – impact and financial – are no longer separate and distinct. Indeed, many European institutional investors are starting to become de facto impact investors because of their portfolio compositions and their commitments to net zero.

Q What developments will we see in infrastructure impact over the coming years?

There is currently quite a high level of regulatory uncertainty. The EU's impact framework and taxonomy are in their infancy today and they have yet to fully stabilise. This will happen over time. That said, the current situation where the US and Europe compete on frameworks is not especially helpful.

In the US, for example, the standard test is single materiality, which is accounting for the way sustainability affects financial value, while in Europe it is double materiality, which is the effect on financial value as well as on the environment and society. We need a single global standard and framework, just as we have with IFRS – if that were to happen all managers would have to adopt it. Again, I think this is a matter of time.

I also believe that the quality of information around impact will improve because it is only when you start asking questions that the data gets collected and refined. For example, when trying to assess the embedded carbon emissions from manufacturing the solar panels you are trying to buy, it can be difficult to get reliable data – but again, this will change.

I am optimistic because so much has changed over a short space of time. The pandemic and the war in Ukraine have accelerated the move towards impact and climate strategies. The financial community is starting to act.

In infrastructure, we are seeing a much greater recognition that there is a duty to manage assets over the long term for the benefit of all stakeholders. That is so important because, as I said earlier, infrastructure built today will be used for perhaps centuries to come and so we need to think very carefully about what we are doing today to deliver resilient and sustainable essential services to communities, and financial performance to investors. ■

Positive about nature

Infrastructure funds are under growing pressure to deliver 'nature-positive' investments, writes Ben Payton

Nature is in crisis. As human societies have industrialised over the past few centuries, plants and animals have disappeared at an alarming rate. Just since 1970, the World Wide Fund for Nature says that the populations of animal species it monitors have suffered an average decline of 69 percent.

On the positive side, the world has finally begun to pay attention to the biodiversity crisis. The COP15 biodiversity conference, held in Montreal last December, produced a historic deal to stem the tide towards mass extinctions. The agreement saw governments commit to ambitious targets, including a goal for protected areas to cover 30 percent of the Earth's land and oceans by 2030.

Across the alternative asset classes, fund managers have increasingly identified nature as a priority area within their ESG strategies. Meanwhile, an architecture of measurement and reporting frameworks have begun to take shape. The Taskforce on Nature-related Financial Disclosures (TNFD) is developing a framework along the same lines as the more established Taskforce on Climate-related Financial Disclosures (TCFD).

It could well be argued that the infrastructure sector has a special responsibility towards nature. After all, infrastructure projects have historically been a major cause of biodiversity loss.

Roads and railways have sliced through habitats, power stations have belched greenhouse gases into the atmosphere, and water treatment plants have polluted rivers and oceans. Even wind farms face significant scrutiny over their effects on birds.

There is growing interest in designing infrastructure that breaks this pattern and provides benefits for nature. But, with time running out to protect what is left of the Earth's biodiversity, can the asset class deliver before it is too late?

Working with nature

Of course, new infrastructure projects – notably in Europe – have had to comply with stringent regulations to minimise harm to biodiversity for decades.

More recently, however, the idea that 'no net loss' should be the main goal for developers has started to be seen as inadequate.

Instead, the ambition that developments should be 'nature-positive' – producing overall gains for nature – has come to the fore. Under legislation that will come into force from November, planning permission in England, for example, will require developments to produce a 'net gain' in biodiversity of at least 10 percent.

At the same time, infrastructure planners have realised that wildlife and natural ecosystems can produce benefits – sometimes labelled 'ecosystem services' or 'nature-based solutions' – for human populations.

"The value of nature for providing certain infrastructure services is seriously underestimated," says Liesbeth Casier, co-ordinator of the International Institute for Sustainable Development's Nature-Based Infrastructure Global Resource Centre.

Casier notes the example of how green spaces in cities, which offer a habitat for wildlife, can also "operate like sponges" and help prevent flooding following periods of heavy rainfall. "It is actually much more effective than built stormwater solutions," she says.

It is worth bearing in mind that the biodiversity crisis and the climate crisis are closely interconnected. The loss of rainforests, for example, has accelerated the rise in temperatures, while a hotter climate and more erratic weather patterns are significant drivers of biodiversity loss.

"Designing nature-based solutions into infrastructure can both help with climate change adaptation, as well as climate change mitigation," says Dima Zogheib, associate director at Arup, a company that designs and plans infrastructure and other building projects.

"We think about infrastructure and natural ecosystems as both manmade and natural assets. We see them as assets that really protect us, provide new things, but also connect us as human beings – and we see those as the support systems for our everyday life in cities."

Particularly in urban areas, nature-based solutions tied to infrastructure can also deliver positive social benefits – providing outdoor spaces that promote connectivity and exercise, for example. Zogheib cites the example of New York's High Line, a disused railway that was converted into a linear green space in 2019. The project provides a habitat for 33 species of bees, among other wildlife, and boasts 150,000 plants, trees and shrubs.

"The High Line has had a ripple effect all over the world. Everybody wants a High Line," says Zogheib. "Now, everybody is thinking about their infrastructure that they are not using, or that is under-utilised, to actually think about nature-based solutions to bring nature back to the city."

It is not only disused infrastructure that can provide comparable benefits to wildlife. Working railway lines can also be designed to provide green corridors for wildlife. Zogheib notes that the Eurostar rail link was designed to provide a wildlife corridor. "Because of the railway corridor, we had an immense increase in tree planting and an immense increase in biodiversity," she says.

Solar strives for biodiversity gain

Solar power is rapidly emerging as one of the cornerstones of the modern energy system. Huge areas will be carpeted with photovoltaic panels in the coming years; the International Energy Agency says a sevenfold increase in solar generation is needed by 2030 to keep the world on track for net-zero goals.

Ross Grier is the UK managing director at NextEnergy Capital, which manages a fund that invests in solar assets in the UK. He believes the industry has a "unique opportunity" to develop sites that bring benefits for biodiversity.

"What we realised was we could tailor measures around the solar

> *"Designing nature-based solutions into infrastructure can both help with climate change adaptation, as well as climate change mitigation"*
>
> **DIMA ZOGHEIB**
> **Arup**

operation that would foster ecosystem services for that surrounding community," he says. "We end up providing a much better outcome for society than just the green power. What we are doing is actually creating these hubs that protect biodiversity."

A report published last year by Solar Energy UK, an industry association, found that well-managed solar sites can lead to a "dramatic" increase in biodiversity. It cited several examples showing an increase in bird and insect species at solar farms where ecological monitoring took place. The report also noted that techniques such as planting wildflowers among solar panels can boost pollinator species, which then in turn pollinate crops on surrounding farmland.

Achieving biodiversity benefits on solar farms is not cheap or simple, however. "It is very delicate – it requires a lot of joined-up thinking," says Grier. He notes that NextEnergy uses specialist ecology consultants to design solutions that are highly tailored to specific locations. "You can trip over yourself trying to do the right thing here by implementing measures in the wrong place that stop you from managing your asset effectively."

Indeed, the fact that such specialised and asset-specific solutions are required creates a challenge for measurement and reporting. There is no simple way of comparing how biodiversity is faring in different locations.

"One of the real issues you have got in this space is it is very difficult to get consistent data on how measures are being effective," says Grier. "You have to have really robust baselining across all of your assets in order to see how things progress out into the future."

Habitat banks

The difficulty of measuring how infrastructure affects biodiversity – and in comparing impacts across different types of projects – will be a major hurdle to scaling-up investment in nature-based solutions.

Promising to create 'nature-positive' infrastructure is much easier than actually delivering measurable improvements to biodiversity. For example, simply carving out a green space alongside an infrastructure scheme, without making any effort to create functioning ecosystems on the space, is unlikely to create significant benefits for biodiversity.

"I think the danger is greenwashing," says Zogheib. "This is where we need to be very careful of not providing green space for the sake of green space."

Indeed, achieving a 10 percent 'net gain' in biodiversity is easier said than done. It certainly remains to be seen how this will work in practice when new planning rules take effect in England. If a project causes the loss of 100 hedgehogs, can this be compensated for with the gain of 110 squirrels?

In practice, many developers will rely on offsets to comply with England's net gain requirement. This will involve funding 'habitat banks' at a different location to the site of the infrastructure project. Multiple investors are exploring how this requirement will lead to a market for 'biodiversity credits' developing.

A spokesperson for the UK Infrastructure Bank says: "UKIB is carefully monitoring where we can most effectively play a role to enhance and crowd-in investment. There is still uncertainty about the demand for offsite habitat creation and the price of biodiversity units.

"It may be appropriate for the bank to step in and take additional risk to bring forward necessary supply. We could do this by investing in habitat banks when private capital is unable to price the risks."

There is clearly much work to be done before nature-positive infrastructure becomes the norm, rather than the exception. For centuries, infrastructure has been designed to conquer nature; the idea that developers should work with nature, rather than against it, is only just beginning to gain traction. ■

On the minds of the managers

Impact remains a priority, despite turbulent times, says our panel of experts

Q What is the appetite for impact investing?

JP: Infrastructure, by its nature, provides critical services to communities, but the accelerated transition to net zero and urgency for energy security means that it is a natural home for impact investment. We expect the asset class to remain robust in terms of underlying performance, coupled with an increase in equity investment opportunities amid higher cost of borrowing.

AW: Some projects that have yet to be financed may find it challenging to raise capital in a higher interest rate margin environment, rendering those investments uneconomic. Secondly, for infrastructure projects under construction, there is a risk of failure if contractors and suppliers cease operating or cannot access materials on account of supply chain issues and higher costs. But despite the headwinds, we still see strong appetite for infrastructure investing in emerging and frontier markets.

MJ: GIIN's announcement last year estimating the size of the global impact investing market at more than $1 trillion is an indicator of the continued appetite in impact, despite near-term headwinds and greenwashing concerns. The demand for impact investing cuts across geographies and generations, so when considered alongside an increasingly supportive regulatory environment and broader industry co-operation, this investment sector is set to observe continued growth.

Q How are LP attitudes towards impact investing evolving?

AW: We see a continued focus from LPs on the impact theme. There is a particularly strong interest in strategies that centre on climate risk mitigation and adaptation. In our view, investments in sustainable energy and infrastructure assets are well suited to that interest.

JP: Many LPs no longer hold the view that you must choose between impact or financial returns. This view also reflects the heightened level of ESG sophistication we are seeing among LPs, marked by the level of engagement and questioning over impact claims and ESG disclosure more generally.

JM: In the last seven or eight years, impact investing has transformed from a niche, philanthropic activity into a mainstream investment strategy. This was initially catalysed by funds offering commercial returns and social impact. Increasingly, decarbonisation and the energy transition are viewed as a critical, high-impact and mainstream investment strategy that has significant potential for further growth.

James Magor, director, sustainability, Actis

Marina Johnson, head of impact, Actis

Joanne Patrick, head of sustainable energy, Amber Infrastructure

Ashwin West, head of sustainable infrastructure investments, BlueOrchard

Q Are decarbonisation initiatives the most important element of impact investing?

JM: Potentially, yes. Because climate change is an environmental issue with profound social consequences. Impact investing strategies focused on affordable healthcare and education, universal access to banking and the digital economy are all important impact themes, but the negative impacts of climate change will compound these social problems if we cannot decarbonise society and decouple economic growth from carbon emissions.

AW: Decarbonisation is a critical element when it comes to impact objectives. The outcome of decarbonisation, whether through the modernisation of energy production, or the construction of new and more sustainable transportation networks, is a tangible and quantifiable impact metric that we are actively pursuing.

MJ: We have seen net-zero commitments exploding in recent years, galvanised by Mark Carney's 'GFANZ', the umbrella group of over 550 financial institutions with net-zero commitments (covering $130 trillion of AUM). The doubling down on decarbonisation initiatives aligns naturally with impact investing, given both the environmental and social outcomes at stake.

Q What will the next round of regulatory changes in 2023 mean for the impact investing market?

JP: The EU's Sustainable Finance Disclosure Regulation (SFDR) and EU Taxonomy will distinguish managers with experience in ESG investing and are likely to increase flows of capital to the right managers, positively affecting the EU's sustainability objectives. It has been interesting to see the number of funds that had to downgrade from Article 9, perhaps highlighting the challenge of delivering on sustainability commitments and the need to have adequate resourcing and ESG experience in-house.

AW: The current regulatory environment is presenting both opportunities and challenges in the impact investment market. The bottom line is that a lot of funds with an Article 9 label in 2022 will not be able to claim that distinction going forward, or simply do not want to manage the increasingly comprehensive disclosure requirements.

JM: The EU Taxonomy and SFDR have fundamentally changed the landscape for sustainable investors, in terms of the reporting, disclosure and data capture requirements. However, in some respects, impact investors were slightly ahead of the curve, as there has been a requirement and expectation for several years that any credible impact investing strategy includes intentionality, measurement and disclosure.

Q Which areas and subsectors do you expect will offer the best opportunities to accelerate positive change?

JP: We believe one of the biggest – and perhaps most straightforward – opportunities for accelerating positive change is to focus on increasing energy security through the rollout of infrastructure that supports a low-carbon future. Local, low-carbon generation is critical – particularly in Central and Eastern Europe.

AW: We see the definition of infrastructure investment evolving and expanding to keep up with the changing needs. Investments in core infrastructure such as renewable energy, transportation and digital infrastructure will continue to deliver positive change. And newer subsectors such as green hydrogen, clean fuels and energy efficiency investments are starting to have a greater impact.

MJ: In addition to investments aligned with the energy transition, there is a growing expectation to factor in nature or ecological considerations into investment decisions. Reporting requirements are mirroring this trend, with the recent Task Force on Nature-related Financial Disclosure providing a steer on how private sector investment should factor in nature-based risks and opportunities. ■

KEYNOTE INTERVIEW

Address inequalities through investment

Impact has to be at the core of targeting environmental and social outcomes, says AIIM's Dean Alborough

African Infrastructure Investment Managers (AIIM) is one of the largest African infrastructure managers, with $2.4 billion in assets under management, and is part of the Old Mutual Alternative Investments group. Dean Alborough is the firm's head of ESG, responsible for ensuring the implementation of its ESG practices, including impact investing activities throughout the investment lifecycle, and managing ESG systems and performance of AIIM's assets.

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AIIM

Q What makes a successful impact strategy?

Any impact investment strategy needs to include the fundamental elements of upfront intent for an environmental or social positive impact, measurement of the impact achieved and the financial return. When we consider impact, we start by considering the major global challenges humanity is facing, particularly those relevant in Africa. Once we know the critical needs to be addressed, we consider our own expertise and where we can make the most significant difference. By thinking in this way, we have decided to prioritise four impact themes: fighting climate change; being a champion for better governance; increasing diversity; and what is known as 'decent work'.

These four themes play out through our investment strategy as seen in our latest pan-Africa fund, African Infrastructure Investment Fund 4. AIIF4 strategically targets impact in the digital, energy transition and mobility and logistics sectors.

We particularly look at the UN Sustainable Development Goals (SDGs), and seek to tie every investment we

make to specific goals through our theory of change methodology, ensuring it has an impact pathway and end goal of positive impact.

Finally, in terms of measuring impact, we collect quantitative and qualitative data. This is perhaps one crucial difference between private and public markets. ESG practices in the public markets are far more reliant on third-party data providers, whereas we collect data ourselves. That said, there is a role for specialist advisers who can help us with modelling and benchmarks.

Q How do you seek better governance?

We think of it in two different ways: structural governance and functional governance. Structural governance is the legalistic framework – the boards, the charter, and so on. All of that must be the starting point, especially where we are creating a special purpose vehicle from scratch.

When we move on to functional governance, we are really seeking to drive a performance mindset. While everything may look right on paper, we ask ourselves whether a framework is actually working in a company and whether it is being implemented properly.

As an investor in private markets and in growth platforms, this has to be a focus. Strong governance is fundamental to the smooth operation of any business. If processes and governance fail, as an investor you will never fully achieve the positive impact you seek.

Q Is your focus on diversity and decent work also driven by your African perspective?

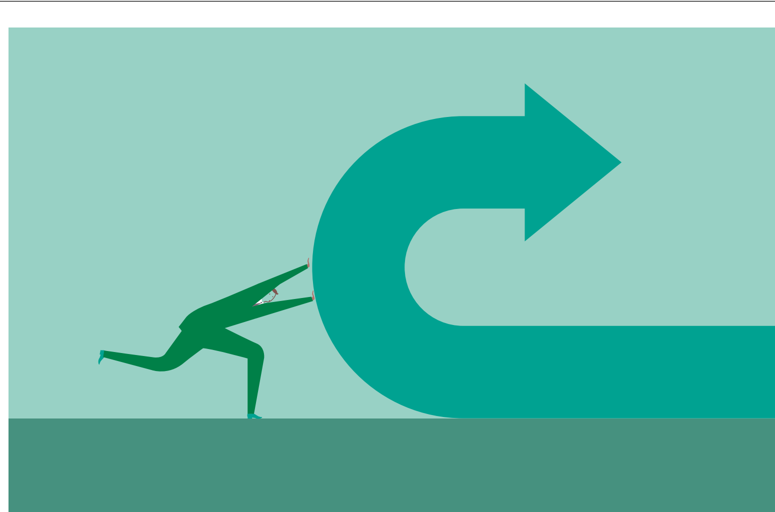
Yes. For example, gender is a particular focus for us and our clients, in part because there have been specific challenges historically in the infrastructure sector, especially in Africa. Likewise, as a South African manager, we have a specific focus on addressing historical inequalities in our South African investments.

Our concept of decent work is similar. We do not simply want to create jobs; we want to create jobs that are dignified, safe and meaningful. All our investment impact pathways include gender, decent work and climate action.

Q With your impact philosophy, what investment themes do you see in energy?

Our key focus is being part of the solution for the energy transition to lower carbon energy mixes. Inevitably, we lead with an emphasis on investment in renewables. Historically, this has been in large-scale wind or solar utility projects.

Given the current imperative to enhance the power generation capacity and decarbonise the power mix, we are seeing a massive acceleration in off-grid private power in South Africa, including the commercial and industrial sector as businesses look for alternative solutions to ensure long term sustainability of their energy supply. In this area we have made a significant investment in Net Zero Africa (NOA), who



Q Will the push-back against ESG in the US spill over into Africa?

I think much of the push-back against ESG is because many people do not properly understand what it is about in the first place, resulting in unaligned expectations of ESG outputs. This is partly the fault of the ESG community itself, in that we have often had a lack of clarity around definitions and requirements for ESG. Perhaps if we can be clearer, then this would reduce some of the current friction in the financial system.

In Africa, however, the alignment between robust ESG systems and strong financial outcomes is something that has been well-demonstrated over a number of vintages. The involvement of development finance institutions in the sector for more than two decades has meant that the ESG systems are generally embedded in the investment processes that managers apply.

There is a potential that global investors try to separate the ESG considerations based on what is being seen in the US. But we believe that rather than being a stand-alone hurdle to pass, ESG consideration is an integral part of the process of making good investment decisions.

"Africa has long been the most underserved region for infrastructure investment globally and we continue to operate in markets where there is significant demand for high-quality infrastructure"

are targeting the creation of a gigawatt of off-grid commercial and industrial power.

We very much believe an accelerated energy transition is crucial to fighting climate change. At the same time, we try to keep economic, technical and social perspective for what is practical and realistic in an African context.

As part of a feasible energy transition, it is important that we recognise the need for 'base load' power supply in certain energy grids. This means gas and liquid natural gas will still likely play a key role in the mix of energy going forward. Likewise, liquid petroleum gas remains a key fuel source for cooking across Africa, where it can replace deforestation for charcoal production.

Q Can investment in digitalisation also be 'green'?

Certainly 'greener'. A good example would be Eastcastle Infrastructure, a telecommunication business, rolling out telecom towers across the Democratic Republic of Congo and Nigeria. Tower sites historically powered by diesel generators are installing solar energy and battery power supply with a material reduction in carbon emissions across the portfolio.

Data centres are power hungry, often resulting in a relatively high carbon footprint. We are driving green building certification and the use of renewable power for data centres, such as Onix DC in Ghana, which has built a solar power plant adjacent to the data centre providing cheaper and cleaner power than traditional sources.

Of course, in digitalisation, the inclusion of underserved communities in the digital economy is also an important aspect of the impact. This is true of investments in towers, in data centres and fibre, such as MetroFibre South Africa which is providing fibre to the home and business in lower economic areas at affordable rates.

Q What about sustainability in mobility and logistics?

In logistics we have invested in The Logistics Group (TLG), a private logistics operator, which handles a range of different commodities through multiple ports and corridors. Here again we are able to look for energy efficiencies, climate resilience and adaptation, such as using technology to reduce the empty back-haul of trucks.

As we head into a world of uncertainty, strong logistics will prove increasingly important in avoiding the kind of disruption we saw during the covid pandemic. We have also identified key export corridors for investment that are critical to the supply of battery metals, a key input in supporting the ramp-up of global battery production and, ultimately, the decarbonisation of transport and energy systems through improved storage solutions.

Saving emissions by transporting goods more efficiently will always be a focus in our mobility strategy. But there are also opportunities for climate adaptation, such as in Kenya through an investment called Infraconnect, through which c.80 kilometres of previously dirt roads that have very high traffic volumes are being re-engineered and upgraded, allowing the roads to better withstand increased precipitation and flood risks and ensuring long-term climate resilience.

Q What is the outlook for infrastructure impact investment in Africa?

Africa has long been the most underserved region for infrastructure investment globally and we continue to operate in markets where there is significant demand for high-quality infrastructure to expand and replace the existing infrastructure which is no longer adequate or efficient to meet the needs of the societies it serves. That demand is rising rather than falling.

Africa also has a high proportion of vulnerable communities, particularly to climate change. This presents huge opportunities for positive impact through replacing this inefficient infrastructure with sustainable long-term solutions.

From an impact investing perspective, climate will remain the number-one priority. However, I think this will increasingly be joined by the biodiversity loss crisis.

Again, Africa has some of the highest natural capital in biodiversity desperately requiring protection. The challenge, however, is establishing investable cases. Some of the most promising cases I have seen are based on a mixed land use model, including sustainable agriculture and community enfranchisement. ■

Getting investment in place

Infrastructure projects are key to place-based impact investing fulfilling its potential, writes Ben Payton

Impact investors like to talk about their global ambitions – ending hunger, fighting climate change, curing diseases, saving the rainforests. But investors can also make an impact closer to home. Indeed, the need to address regional inequalities through investing in local infrastructure is beginning to pique the interest of impact-focused investors.

Regional inequality, while not a new phenomenon, has attracted growing concern in many developed market countries over the past decade. In Japan, for example, rural areas are shrinking rapidly as young people abandon villages for jobs in Tokyo and other major cities. More than half the country's municipalities are now classified by the Japanese government as 'depopulated'.

In the US, meanwhile, wealth has become increasingly concentrated in the cities of the northeast and the west coast. The proportion of Americans living in metro areas with incomes 20 percent higher or lower than the national average grew from just 12 percent in 1980, to more than 30 percent in 2013, according to one Harvard University study.

Political pressure to combat these regional disparities has become harder for governments to ignore. The Trump administration introduced tax breaks for 'opportunity zones' in 2017, in an effort to spur investment in deprived areas of the US. In the UK, where the wealth divide between London and the rest of the country has widened as traditional industries have declined, 'levelling-up' has become a key priority for the government.

But there is a limit to the public funding available for new infrastructure that can stimulate regional economies. Private sector investment is needed to bridge the gap.

Multiplier effect

Advocates seeking to mobilise institutional capital to support 'left-behind' communities have developed the concept of 'place-based impact investing'. This term was defined in an influential

2021 white paper produced by advisory firm The Good Economy alongside non-profit groups the Impact Investing Institute and Pensions for Purpose, as: "Investments made with the intention to yield appropriate risk-adjusted financial returns as well as positive local impact, with a focus on addressing the needs of specific places to enhance local economic resilience, prosperity and sustainable development."

The white paper identified infrastructure as one of the five 'pillars' of place-based impact investing (alongside housing, SME finance, clean energy and regeneration). "Infrastructure is pretty crucial," says Mark Hepworth, co-founder of The Good Economy and one of the authors of the white paper. "Because infrastructure generally defines in real terms what the 'place' in 'place-based impact investing' looks like."

Infrastructure – particularly transport infrastructure – has long been recognised as having a crucial role in narrowing geographic disparities in wealth. Businesses are more likely to invest in deprived areas if they can easily reach their key markets; housing developments are made viable by better commuter connections.

"Infrastructure investments have a really powerful multiplier effect and play a critical role in supporting local communities and local economies," says Mark Hall, programme manager in place-based impact investing at the Impact Investing Institute.

Many of the projects included in the US Infrastructure Act passed by the Biden administration in 2021 are specifically designed to combat regional inequality. And in the UK, the HS2 high-speed railway, which will cut journey times between London, Birmingham and Manchester, is the government's flagship levelling-up project.

Within London itself – a city characterised by massive inequalities – improved transport links have been crucial to the regeneration of several districts over the past 20 years. Jon Tabbush, senior researcher at think tank Centre for London, says that investment in light rail infrastructure around the site of the 2012 Olympic Park "facilitated the enormous regeneration of the area".

"Infrastructure investments have a really powerful multiplier effect and play a critical role in supporting local communities and local economies"

MARK HALL
Impact Investing Institute

Infrastructure requirements go beyond transport, however. Digital infrastructure is also at the forefront of place-based impact investing. Peter Bachmann, managing director for sustainable infrastructure at Gresham House, cites his firm's investment in Wildanet, a company providing rural broadband in southwest England. Gresham House commissioned a study to quantify the impact, which Bachmann says found that the £50 million ($60 million; €56 million) investment had produced £600 million in local economic benefits.

These kinds of place-based investments can also be a good fit for a traditional infrastructure investment strategy. "Ultimately, what we are trying to create are large, long-term, enduring assets that derive quite a lot of their value from their location in some respect," says Bachmann.

Local money, local investment?

If place-based impact investing is to truly gain traction, one of the vital ingredients will involve directing a greater share of institutional capital – notably from public pension funds – towards the regions where it originated.

However, public pension funds appear to be generally moving in the opposite direction. The OECD reports that the proportion of pension assets invested abroad has increased in 32 out of its 38 member jurisdictions over the past 10 years. Although public pension funds have also increased their exposure to infrastructure over this time, this trend does not necessarily translate into investing in local infrastructure.

The place-based impact investing white paper found that very few of the UK's 98 Local Government Pension Schemes have indicated an intention to make place-based investments. Only around 1 percent of total LGPS assets are invested within the UK in sectors relevant to place-based investing, The Good Economy found.

The white paper noted that if every LGPS allocated 5 percent of its assets to place-based impact investing, £16 billion would be available for local areas – far exceeding the capital available from the government's £4.8 billion Levelling Up Fund. The logic of requiring LGPS to allocate at least a small share of their AUM to their local

areas is hard to dispute in principle. As Hepworth asks: "How are you going to level-up Britain, if you are not going to somehow mobilise at least some of the institutional capital in the country?"

But LGPS managers have not been in a rush to change course. So far, only the Greater Manchester Pension Fund has adopted the 5 percent place-based investing commitment.

Geographic focus

By definition, one of the key aspects of place-based impact investing is that investors must set out to generate social and environmental benefits within a specific place. "There has to be intentionality," insists Hepworth. "We have got to have evidence that this is intentional and not some side effect of your normal business operations."

But the focus of bringing tangible benefits to specific, pre-defined areas does not necessarily fit in seamlessly with the preferred strategies of infrastructure fund managers. "If you try to invest solely into a region for a particular reason, and you ignore other places that perhaps might be better for various other reasons, that may create difficulties," says Bachmann. He warns that investors need to focus on finding the optimal locations to establish particular assets, rather than the other way around.

"Where we have seen this get unstuck is in the past where you have had very locally driven investments, that may ultimately create the situation where you invest into something that is suboptimal," he says.

Scaling-up?

Gresham House manages a sustainable infrastructure fund with a mandate to invest in assets across Britain. Having a relatively broad geographical mandate makes it easier for fund managers to find assets with appropriate characteristics to deliver both impact and returns.

> *"What we are trying to create are large, long-term, enduring assets that derive quite a lot of their value from their location"*
>
> **PETER BACHMANN**
> **Gresham House**

However, small-scale infrastructure projects designed to benefit specific areas are less likely to be attractive to fund managers with a broader mandate. Investing time and effort in striking deals with small ticket sizes is unlikely to make financial sense.

This issue of scale "definitely is a challenge", says Hall. LGPS managers will mostly need to rely on direct investments if they want to boost infrastructure in their specific localities. But, as Hall notes, only the larger public pension funds are likely to have the resources and expertise to make direct investments in local infrastructure.

Pooling is also a tool that can facilitate LGPS investment into larger, regional infrastructure schemes. As Tabbush notes, pooling pension fund assets "reduces the risk of each individual fund and allows for much larger projects".

The London Pensions Fund Authority and the Greater Manchester Pension Fund joined forces in 2016 to create GLIL Infrastructure, a fund mandated to invest in UK infrastructure. GLIL has since invested in 14 assets. Few of these investments, which include stakes in offshore wind farms and a railway operating company, could be described as 'place-based', however.

Another challenge is that investors in place-based projects will need to work closely with local governments. Yet capacity at the local government level in the UK is widely acknowledged to be seriously constrained. "Half the battle is getting the elephants to dance," says Hepworth. "Local government itself is a bottleneck… their ability to innovate, their ability to take on new things is seriously restricted."

Nevertheless, in spite of the major obstacles that lie in the way, advocates of place-based impact investing remain cautiously optimistic about the future. Indeed, few would deny that infrastructure has a key role to play in revitalising left-behind areas. "There is a huge need and demand for this kind of investment," says Hall. "It is a market that has got a lot of potential for growth." ■

KEYNOTE INTERVIEW

Data drives impact delivery

Creating and measuring economic inclusion are of utmost importance, believes Thierry Déau

Thierry Déau began his career as an engineer, building infrastructure. He then spent 12 years at French development bank Caisse des dépôts et consignations before founding Meridiam in 2005, with a focus on long-term infrastructure investment.

Meridiam has made the UN Sustainable Development Goals (SDGs) a blueprint for its ESG efforts, developing digital tools to measure the environmental and social impact of its investments. Déau discusses the evolution of investing for impact as well as returns, and how firms can hold themselves accountable for their results.

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Q How has your approach to impact investing changed over time?

From the creation of Meridiam, we have always focused on sustainability. Over time we have professionalised and adapted our approach as we have a long-term strategy of holding investments for 25 years, managing and transforming them. The whole sustainability set of criteria for selecting but also managing investments has been key in our DNA from the outset.

Gradually, since adoption of the 2030 Agenda, we have engaged with the UN SDGs. At the time of COP 21, we have also embraced the climate goals and decided to wrap our strategy around those goals. We created the first transition fund back in 2015, to invest in the energy transition and an umbrella of infrastructure technologies that were delivering low-carbon solutions. Now everyone is joining this trend.

We have grown around that framework to set clear strategic goals – on sustainable cities, access to clean energy, economic inclusion, biodiversity enhancement and of course climate. And we have developed concrete tools to measure our impact.

When the investor world got into impact investment, it was done by foundations and charities, very much focused on social goals. What we brought to that world was to say that you can achieve financial goals at the same time as non-financial ones. It is not an arbitrage, it is both.

With our track record of being able to set goals, measure and meet them, we were certified as a B corp last year. There is also an equivalent certification in French law, which we reached the status of in 2019. We are very proud of this certification, which recognises our business philosophy, our

corporate mission and our long-term vision.

We believe infrastructure that delivers the highest ethical and sustainability standards brings more value to communities and economies, and to our partner investors. For the long term, we strive to professionalise this further, to remain credible, creating real impact, measuring, implementing and reporting transparently.

Q How can social and environmental impact be tracked and quantified?

For climate, we have a specific tool called CIARA developed with Carbone 4 and other institutions to measure the alignment with the Paris Agreement. CIARA is able to measure the carbon footprint on Scope 1, 2 and 3 emissions and tells us whether we are aligned with the targets of the Paris Agreement. We therefore have a temperature projection for our portfolio.

On the other hand, our tool Simpl., for Sustainability Impact Measurement Platform, collects every year more than 250 data points for each of our 110 assets and provides an outcome in terms of SDG contribution on a scale of zero to five. Specific focus is given to the strategic pillars including sustainable infrastructure and cities, as well as access to clean energy. The other targets based on SDGs fall under inclusion, which has several aspects. One is access to decent work (SDG8), and another is gender equality (SDG5).

Q How do frameworks such as the Sustainable Finance Disclosure Regulation (SFDR) or the UN SDGs guide your investment activity?

In terms of impact, UN SDGs are really the guiding principles. Everything else, from SFDR to the commitments that we have made as part of the Net Zero Asset Managers Initiative, is really supporting our trajectory.

The SFDR is purely a regulation, which is first about compliance rather than outcome and output, so that is why our frame of measurement is additional to those regulations. They are quite compatible.

> *"Infrastructure that delivers the highest ethical and sustainability standards brings more value to communities and economies, and to our partner investors"*

Eventually, on the climate side, our climate policy wraps the entire endeavour including the regulation.

Implementation is, however, key: we have actions plans in place, to invest in accordance within this framework but also to transform our existing portfolios to bring them closer to target. We are now transforming our very first fund (2006 vintage) along those lines.

Q Could your methodologies for concretely measuring impact be used more broadly and by others?

Definitely. And it is already being used by a few partnering banks. In the beginning, our tool was very much focused on infrastructure, including a survey specific to each asset class – hospitals, highways, etc – and a performance visualisation space based on the operational data of each asset. We have now broadened it to apply to other

Q How can impact be balanced with the need to achieve a financial return?

When you want to make an investment, you have a minimum threshold to reach in terms of impact, otherwise we will not proceed with the investment. One of our pillars on the environmental side is to respect the principle of "do no significant harm" as a minimum. After that, it is an equal footing in terms of financial returns and impact. You have to put in a bit of work to get this impact and you do need to set targets from the outset.

The way we see it, a lot of the social impact or biodiversity or sustainability issues are basically contributing to the risk management of our assets in the long term. We invest in essential public infrastructure in 30 countries; the main long-term risk for us is political and social risk, in all sorts of shapes.

That does not just apply to emerging countries, there is more political risk in many developed countries, meaning the possibility of political institutions using a level of dissatisfaction from either the users or the neighbours of our infrastructure to try to breach the contract.

And in fact, we share the benefits of the impact that we create with those communities. That solidifies the relationship and also contributes to our overall risk reduction. People who are not financial investors but are stakeholders around the investment also need to have a benefit, so by creating impact we are also trying to address that.

"Impact investing is not just about charity: it is about creating economic inclusion; it is about climate and biodiversity; it is about any of the key themes under the UN SDGs"

small and mid-size enterprises and as we are talking together, we are working to make it a more universal tool for measuring impact.

Q In which markets or sectors do you see the greatest opportunity to have a positive impact?

We see impact investing becoming a lot more mainstream. For us, it is not about investing in a certain niche market, but rather investing in a different way in the classic markets. There is obviously a lot more pressure, and a very high level of responsible behaviour by investors, where regulation like SFDR is in effect.

In Europe, investors need to create a social licence to operate, if you will, so there is very good growth of impact investing there. In the US, those who feel responsible for these type of things are typically public pension funds. But at the same time, they are torn by their fiduciary duty, which today only includes financial returns.

The big ones with boards of trustees that are fairly engaged with society, such as CalSTRS, tend to want to promote responsible behaviours, but others are quite blocked. For reasons such as this, I would say that this market probably will become more mainstream in Europe before it does in the US.

In terms of sectors, it depends on what kind of impact you want to have. If you focus on social impact, the healthcare and education sectors are where you will find a lot of opportunity. But you can also find yourself focusing on low-carbon mobility and transportation.

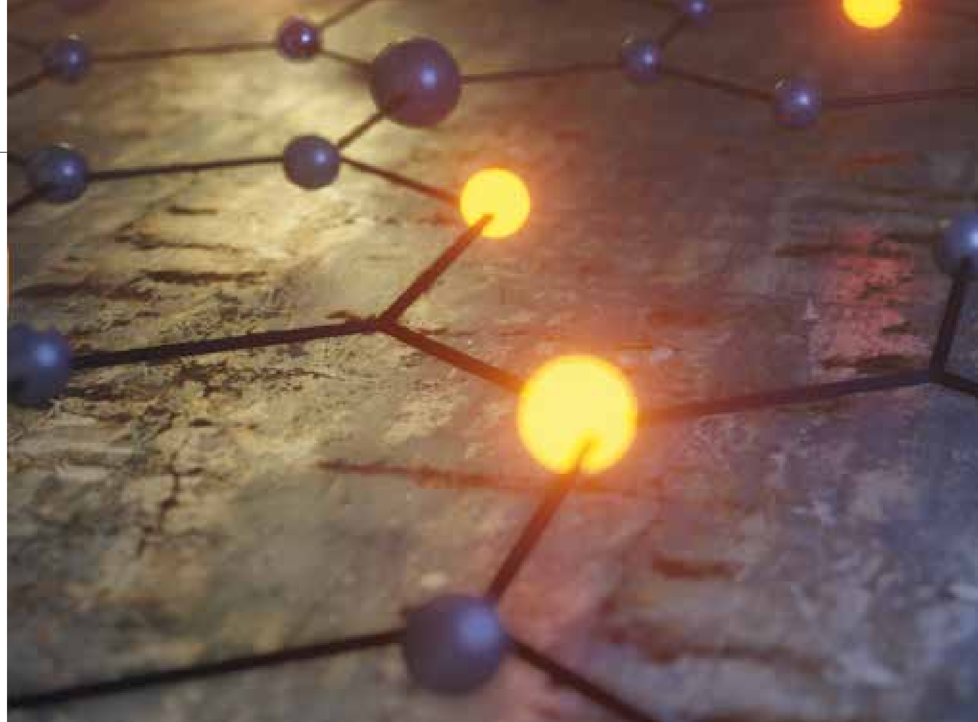
Take the example of California, with its goal for all public transport to be zero-carbon by 2030. If you decide that this is the kind of impact you want to have, you can invest heavily in that.

Q Is there a particular investment you would point to as a case study to underline these themes?

We do case studies for the impact investing class at Harvard Business School, and our very first one was the airport in the capital city of Madagascar. This was a major project in a country that is probably one of the poorest in the world. It involved resurfacing the runway and constructing a new international terminal at Ivato Airport in Antananarivo, more than doubling the passenger handling capacity.

Improvements were also made to Fascene Airport at Nosy Bé, the main tourist island. The impact of this is significant because it enables the major share of the export throughput of the country. And there are a number of other social issues related to this economic effect.

The bottom line is that impact investing is not just about charity: it is about creating economic inclusion; it is about climate and biodiversity; it is about any of the key themes under the UN SDGs that you find appropriate for your own business, and that you can focus on to actually deliver results. I think we are coming out of the time when people thought that impact was all about just social concerns. ■



Microgrids are key for electricity access

Ben Payton looks at the role of microgrids in bringing power to developing countries

The number of people living without electricity reached 775 million last year – almost 10 percent of the world's population – according to the International Energy Agency. More than a billion more have to rely on low-quality connections, often using expensive and dirty diesel generators as a back-up option. Progress on increasing electricity access has ground to a halt, as rising costs make the financial case for connecting rural communities in developing countries harder to justify.

Traditionally, providing electricity access has involved connecting homes and businesses to national electricity transmission and distribution networks. However, particularly in rural or remote areas where incomes are low, the cost of extending grid connections can be prohibitive.

"Connecting rural populations in Africa is expensive," says Ash Sharma, head of Beyond the Grid Fund for Africa, a financing vehicle managed by the Nordic Environment Finance Corporation with funding from various development financing institutions and donor agencies. He believes that 'microgrids' – small-scale power grids that can function independently of national grid networks – are a more viable alternative in many areas.

"Microgrids can offer a faster and more cost-effective route to electrification – up to half the cost of grid connection," says Sharma.

Microgrids often rely on electricity generated from solar sources, so can also be a good option for bringing clean and reliable power to remote islands. "The reality is that the grid is not available everywhere for people to connect to in Asia," says Wymen Chan, head of Asia at SUSI Partners.

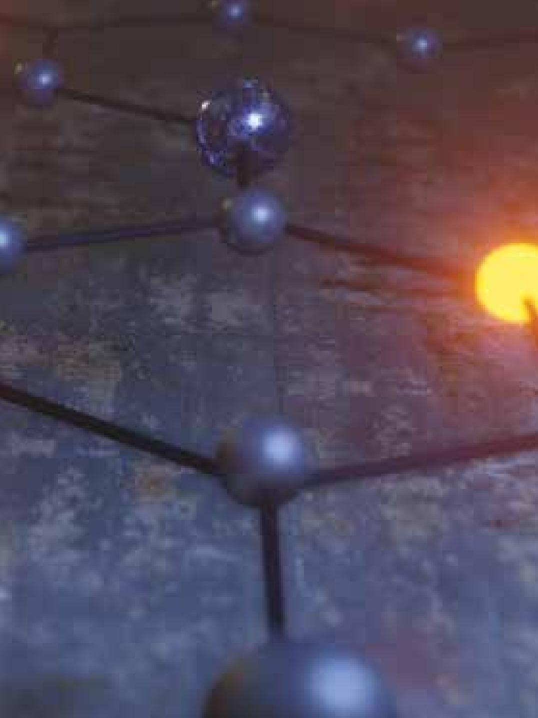
"There are 6,000 inhabited islands in Indonesia, and 2,000 inhabited islands in the Philippines that don't have grid access," says Chan. "These communities currently rely heavily on diesel gensets, which do not make sense today, neither from a cost nor a climate change perspective."

Shaky economics

Deploying microgrids – or 'minigrids', which operate in a similar way to microgrids but typically serve a larger number of customers – may be more viable than extending grid access in many areas. According to the UN Development Programme (UNDP), minigrids will be the lowest-cost approach to bring energy to 265 million people by 2030.

But this does not mean that the financial case is straightforward. On the contrary, the IEA warns that installing minigrids became at least 20 percent more expensive in 2022, owing largely to the increased costs of components.

Increased costs are "definitely slowing the pace of deployment, at least in the short term", says Sarvesh Suri, director for infrastructure and natural resources in Africa at the International Finance Corporation. "It is not only the cost of commodities, but also the cost of financing has gone up, and that



> *"All electrification – grid or distributed – needs public subsidy to some extent"*
>
> **ASH SHARMA**
> **Nordic Environment Finance Corporation**

is also going to slow down electrification."

Even at the best of times, the economics of most electrification projects in Africa are "shaky at best", warns Sharma. "All electrification – grid or distributed – needs public subsidy to some extent." He adds that Beyond the Grid's Fund for Africa, which provides funding to enable developers to scale up electricity access projects, "offers a cost-effective and competitive option for an efficient, transparent and fair approach to allocate that subsidy".

Regulatory roadblocks

On the other hand, investors seeking to achieve a strong financial return may need to have a different focus, Chan says, noting that SUSI Partners is prioritising commercial offtakers over residential customers. "The impact of improving the sustainability and economic feasibility of commercial enterprises in these communities could result in better credit quality offtake and perhaps make residential microgrids a possibility in the future.

"If we take a step back even further, we can try to achieve scale by first building larger minigrids in industrial parks and leverage the economies of scale to build microgrid systems in nearby communities with no grid access."

Investors in microgrids will also have to navigate a complex range of regulatory and operational risks, depending on the jurisdiction. And they "would greatly benefit from more clarity" on the legal regime for minigrids and microgrids in Angola, for example, says Alberto Galhardo Simões, partner at law firm CMS Portugal, which last year advised sustainable energy developer Sun Africa on a $1.95 billion investment in minigrids and other projects in that country.

"Uncertainty as [to] the roles of different government departments and applicable licensing procedures are also risk factors to consider," Galhardo Simões continues. "Clarity on these matters should be a priority and the granting of relevant licences and permits should be swifter to enable accelerated rural electrification."

In spite of the challenges, Galhardo Simões says that following the Sun Africa investment, other developers are expressing interest in similar projects in Angola. Much greater levels of investment will certainly be needed in the coming years if the world is to have any hope of meeting electricity access targets.

Indeed, one of the UN's Sustainable Development Goals is to ensure universal access to affordable and reliable electricity by 2030. On current trends, however, there is little chance of this goal being achieved. The IEA projects that there will still be 660 million people without electricity at the end of the decade, of whom 85 percent will be in sub-Saharan Africa.

Inflection point?

Chan says that more work is needed to make microgrids a financially attractive option for investors. "Economic feasibility is key, and the main factor for that is scale," he says. "Scale in microgrid systems is almost a paradox in and of itself – but we need scale to achieve economies of scale especially in a period of continued inflationary pressure."

On this point, Suri is optimistic. "Once a certain scale is achieved, once certain technological sophistication is achieved, it will help to drive the costs down to a point where the commercial investors will start to invest in this space in a much bigger way," he says. "That is when we will see really an inflection point in terms of the amount of money that can flow into this space.

"With aggregation, and as companies start to scale up, these companies will start to step towards financial sustainability, and this will become a mainstream investment area."

If the project economics for minigrids and microgrids can be improved, the potential gains for impact-orientated investors are considerable. The UNDP's goal of connecting 265 million people in Africa with minigrids equates to a $65 billion investment opportunity, it says.

Realising the opportunity will require incentivising different types of investors, ranging from providers of concessional finance through to investors that are purely guided by returns, to support the deployment of minigrids and microgrids. "I can foresee significant growth," says Sharma, "but falling well short of need unless financing and local development barriers can be overcome." ■

They said it

Expert insight on the state of play in infrastructure impact investing

"The pandemic and the war in Ukraine have accelerated the move towards impact"

LAURENT CHATELIN
Eurazeo

"An accelerated energy transition is crucial to fighting climate change"

DEAN ALBOROUGH
African Infrastructure Investment Managers

"Benchmarking can be a useful tool, but it is important that it does not detract from taking real-world action"

DAN WATSON
Amber Infrastructure

"In terms of impact, UN SDGs are really the guiding principles"

THIERRY DÉAU
Meridiam

"There is a particularly strong interest in strategies that centre on climate risk mitigation and adaptation"

ASHWIN WEST
BlueOrchard

"Without the complete picture, we have not earned the right to tell the full impact story"

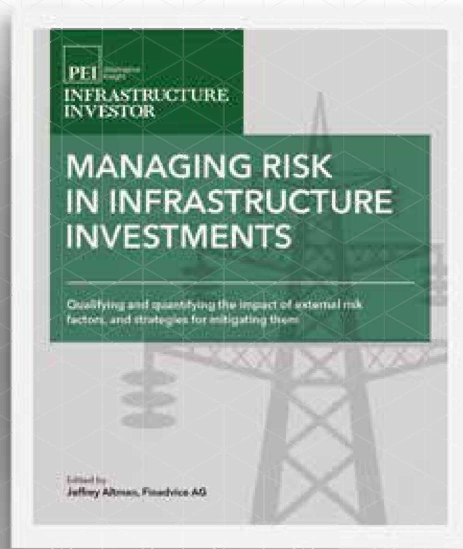
JON COLLINGE
Morrison & Co

"There is still hesitation from the borrowers to provide data – and even when it is provided, it is very rare for it to be certified or validated in any way"

LISA SHAW
Vantage Infrastructure

Infrastructure Investor

PEI



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