

# CROSSING THE BRIDGE TO SUSTAINABLE INFRASTRUCTURE INVESTING

EXPLORING WAYS TO MAKE IT ACROSS



# EXECUTIVE SUMMARY

The world needs more infrastructure, particularly in developing countries. But not just any infrastructure. To achieve the economic, social and environmental objectives embodied by the Paris Agreement and the Sustainable Development Goals (SDGs), this infrastructure must be sustainable, low-carbon and climate resilient. At the same time, investors' interest in and allocations to infrastructure are gradually increasing,<sup>1,2</sup> driven by a combination of factors (such as low yields in traditional asset classes and inflation protection). Together, these should be positively reinforcing developments. However, current allocations and volumes of investments still fall short of the estimated \$6 trillion per year required to support economic development<sup>3</sup> (see Box 1).

Although a variety of stakeholders — from governments to multilateral development banks (MDBs) to institutional investors — have articulated support for Sustainable Infrastructure (SI)

investment, progress to date has been patchy. To better understand what is happening on the ground, review the barriers and identify tangible next steps to address the funding gap for SI, the Inter-American Development Bank (IDB) commissioned Mercer to undertake a multiphase project beginning in mid-2016. This document is a companion to the Mercer-IDB November 2016 paper *Building a Bridge to Sustainable Infrastructure*,<sup>5</sup> which is discussed later in the report.

This current paper is structured in five parts: Chapter 1 provides an overview of the SI imperative and the financing gap; Chapter 2 reviews the state of play regarding SI in the investment process, including feedback received from investor interviews; Chapter 3 discusses approaches to more fully embed SI within investment decision-making; Chapter 4 presents our call to action to governments, MDBs, investors and supporting initiatives; and Chapter 5 is a short conclusion.

## BOX 1: THE TRILLION DOLLAR CHALLENGE

Investment in infrastructure is widely recognized as crucial to promoting economic and social growth through the development of essential services and assets. As the global population grows and urbanizes, the demand for infrastructure grows with it. The New Climate Economy<sup>4</sup> estimates that from 2015 to 2030,

the global requirement for new infrastructure assets is US\$90 trillion, more than the value of the world's existing infrastructure stock. To meet these needs, annual investment in infrastructure would need to increase from about \$3 trillion currently to \$6 trillion.

<sup>1</sup> Organisation for Economic Co-operation and Development. *Annual Survey of Large Pension Funds and Public Pension Reserve Funds* (2015).

<sup>2</sup> Prequin. "Global Infrastructure Projects Attract an All-Time High of \$413bn of Investment in 2016." (2017).

<sup>3</sup> New Climate Economy. *The Sustainable Infrastructure Imperative: Financing for Better Growth and Development* (2016).

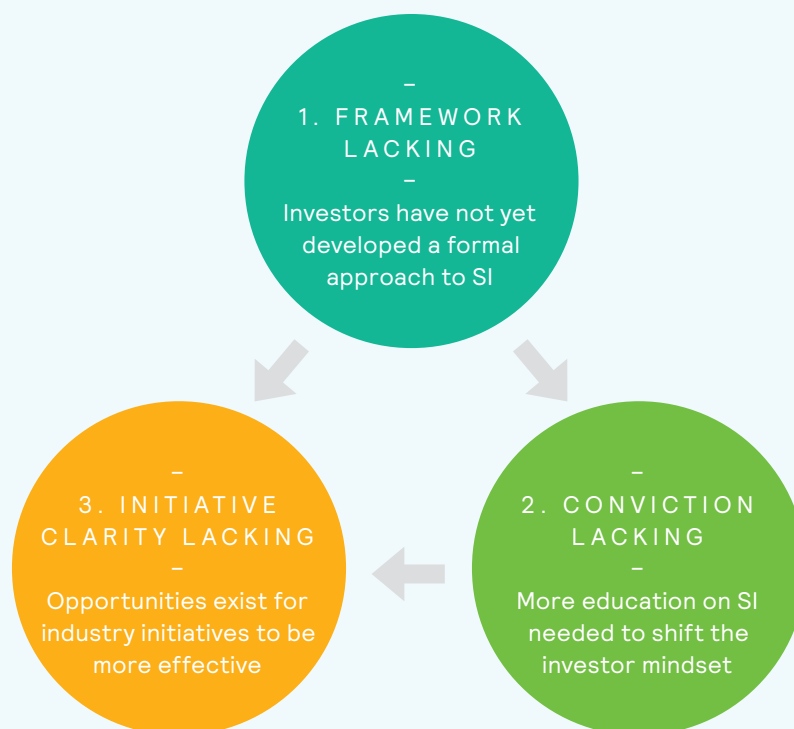
<sup>4</sup> New Climate Economy. *Better Growth, Better Climate*. (2014).

<sup>5</sup> Mercer and IDB. *Building a Bridge to Sustainable Infrastructure*. (2016).

## KEY FINDING – INVESTOR PERSPECTIVES

Despite emerging interest and attention to ESG<sup>6</sup> practices, investors lack a formal approach to SI, which relates to their lack of knowledge about – and conviction in – the merits of an SI approach.

To date, industry initiatives have not been successful in closing this gap and would benefit from greater clarity of what constitutes SI and its business case.



Although we do see some development underway to incorporate Environmental, Social and Government (ESG) and climate considerations at the deal level, there is little “top-down” thinking about the transformational change and the investment pathways that must accompany successful implementation of the Paris Agreement and the SDGs, and the opportunities that they offer to investors. When considering the reasons for the lack of progress so far, we identify the following factors:

- **Lack of familiarity** with SI business case and related lack of experience in considering what might qualify as SI
- **Limited standardization of tools and approaches**, with significant barriers to entry for investors
- **Lack of coordinated policy** signal and commitment across regions and sectors consistent with the Paris Agreement and the SDGs, which dampens investors’ focus on energy transition (that is, mitigation) risk
- **Lack of tools and focus on climate resilience** (that is, adaptation), which has seen little prioritization to date

<sup>6</sup> ESG practices are the integration of environmental, social and corporate governance (ESG) factors into investment management processes and ownership practices in the belief that these factors can have material impact on financial performance.

## EVOLVING THE MARKET FOR SUSTAINABLE INFRASTRUCTURE

The investors interviewed outlined a number of suggestions to address the challenges they are facing. These fall in two categories and are addressed in Chapter 3.

- There is a need to influence the investor mindset to understand and embrace the SI imperative, and to accelerate the development and standardization of frameworks and tools.
- There are a number of areas where MDBs could assist in addressing risk–return investment barriers (for example, project pipeline preparation, assistance on greenfield assets and being a cornerstone investor to “crowd in” private investments).

## RECOMMENDATIONS: GETTING TO THE OTHER SIDE

Given the high-level commitments to sustainable development made by policymakers, and the significant efforts underway to leverage private sector finance, there is still a lack of engagement by many infrastructure investors. Thus, **a call to action is essential**. The actions required need to influence the professional investor making individual allocation decisions, the development banker for whom it may be easier to proceed with status quo, and the national government ministries that have not yet aligned their vision for future development. We call for three key actions:

### Action 1: Convene the

**Conveners:** The various initiatives should harmonize SI frameworks toward a coordinated and convergent approach to support best practices and leverage their efforts and results.

### Action 2: Internal Alignment for

**Success:** This needs to take place across the key stakeholder groups, focused on the following four themes:

- Break down barriers internally
- Align organizational strategy with global agreements
- Align incentives and support
- Demonstrate commitment

### Action 3: External Collaboration

**for Success:** There are key collaborative interactions that must take place between the stakeholder groups namely, MDBs, governments, investors and initiatives to enable all to cross the bridge toward SI.

## IN CLOSING

We know that there is an active group of industry initiatives, MDBs and other organizations committed to fostering progress on this critical topic. We hope this frank assessment of what needs to happen to cross the bridge is a useful contribution to those discussions. We also hope that this document can provide a perspective of the roles that key stakeholders play and the challenges that they encounter.

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# INTRODUCTION: THE SUSTAINABLE INFRASTRUCTURE IMPERATIVE

There is abundant literature about the need for infrastructure development, particularly in developing countries. The adoption of the Paris Agreement and the Sustainable Development Goals (SDGs) have highlighted how this infrastructure must be sustainable, low-carbon and resilient to achieve our economic, social and environmental goals. At the same time investors' interest in and allocations to infrastructure are gradually increasing.<sup>1,2</sup> This

interest is driven by a combination of factors (for example, low yields in traditional asset classes, the potential for low correlations to other asset classes, stable cash yield, inflation protection and investment performance through the entire economic cycle). Together, these should be positively reinforcing developments building even a stronger case for Sustainable Infrastructure (SI) investments.

## BOX 2: THE SI IMPERATIVE<sup>3</sup>

“Investing in sustainable infrastructure is the growth story of the future.”  
“The next 2–3 years will be crucial in bringing about a fundamental change of direction.”

THE GLOBAL COMMISSION ON THE ECONOMY AND CLIMATE, 2016

- Investing in SI is key to tackling the three central challenges facing the global community: reigniting growth, delivering on the Sustainable Development Goals and reducing climate risk in line with the Paris Agreement.
- Significant investment is needed over the next 15 years – around US\$90 trillion, which is more than the entire current stock. This investment need is about \$6 trillion per year, compared to current annual investment estimated at \$3.4 trillion.
- The global south will account for roughly two-thirds of global infrastructure investment (or about \$4 trillion per year).
- Transformative change is needed in how we build cities, produce and use energy, transport people and goods, and manage landscapes.
- The challenge is urgent. The window for making the right choices is uncomfortably narrow because of lock-in of capital and technology and because of a shrinking carbon budget.<sup>4</sup>

<sup>1</sup> Organisation for Economic Co-operation and Development. [Annual Survey of Large Pension Funds and Public Pension Reserve Funds](#) (2015).

<sup>2</sup> Preqin. [“Global Infrastructure Projects Attract an All-Time High of \\$413bn of Investment in 2016.”](#) (2017).

<sup>3</sup> New Climate Economy. [The Sustainable Infrastructure Imperative: Financing for Better Growth and Development](#) (2016).

<sup>4</sup> A “carbon budget” is the maximum amount of carbon that can be released into the atmosphere while keeping a reasonable chance of staying below a given temperature rise. Source: <https://www.carbonbrief.org/analysis-only-five-years-left-before-one-point-five-c-budget-is-blown>.



Yet the challenge that lies ahead is daunting. We need not only to increase the annual investment in infrastructure by \$2 trillion to \$3 trillion a year,<sup>5</sup> but — to develop SI — we must also shift the composition of investment with an estimated reduction of 30% into traditional energy infrastructure, with similar increases into energy efficiency and low-carbon core infrastructure.<sup>6</sup>

Further, more than half of this investment demand is coming from emerging and developing countries, where investment capital is more constrained and sustainability competes with other development priorities on policymaker agendas.

Despite the urgent need for a significant increase in infrastructure funding and the desire for investors to increase their allocations, a funding gap remains. Current annual investment in infrastructure by institutional investors is in the range of \$500 billion.<sup>7</sup> Assuming the right conditions could be in place to attract and enable higher infrastructure allocations, it is plausible that infrastructure investments from institutional investors could increase to \$1 trillion to \$1.5 trillion per year over next 15 years.<sup>8</sup>

### BOX 3: WHAT IS SUSTAINABLE INFRASTRUCTURE?

In a broad sense, SI is infrastructure that is socially, economically and environmentally sustainable.<sup>9</sup> The specific application of this concept will depend on the relevant geographical and sector context. But ultimately, SI is that which will enable the world collectively to meet the SDGs and the Paris Agreement.

Some investors have the misconception that SI means simply more renewable energy infrastructure. Indeed, investment flows into renewable energy have been increasing; for example, in 2016, over 40% of new infrastructure investment went into renewables.<sup>10</sup> Although this is positive, SI needs are broader. The New Climate Economy’s 2014 report *Better Growth Better Climate*<sup>11</sup> outlines in detail the change that is required across three critical economic systems: cities, land use and energy.



In addition, infrastructure needs to be resilient in the face of changing climate. A 2016 study on public-private partnerships (PPPs) by Acclimatise found that “Among the sample of 16 national PPP policy frameworks examined, not a single one was found to mention a changing climate, climate resilience or adaptation.”<sup>12</sup>

<sup>5</sup> Ibid New Climate Economy (2016).

<sup>6</sup> Ibid New Climate Economy (2016).

<sup>7</sup> Brookings. [Driving Sustainable Development Through Better Infrastructure: Key Elements of a Transformation Program](#) (2015).

<sup>8</sup> Ibid Brookings (2015).

<sup>9</sup> Ibid Brookings (2015).

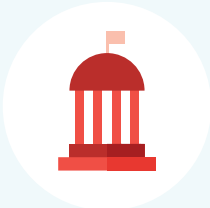
<sup>10</sup> Ibid Prequin (2017).

<sup>11</sup> New Climate Economy. [Better Growth Better Climate](#) (2014).

<sup>12</sup> International Bank for Reconstruction and Development/The World Bank. [Emerging Trends in Mainstreaming Climate Resilience in Large Scale, Multi-sector Infrastructure PPPs](#) (2016).

Recognizing the significant need for funding of infrastructure in line with low-carbon, resilient and inclusive development, various commitments have been made by key stakeholders, as outlined in Figure 1.

FIGURE 1: KEY STAKEHOLDER COMMITMENTS RELATED TO SI



GOVERNMENTS

- The 2015 SDGs and the Paris Agreement signaled far-reaching goals,<sup>13</sup> such as eliminating poverty and achieving zero-carbon, resilient development.
- The Addis Ababa Action Agenda (AAAA)<sup>14</sup> provides a new global framework for financing sustainable development, and among other commitments, the AAAA establishes the Global Infrastructure Forum.<sup>15</sup>



INSTITUTIONAL INVESTORS

- More than 400 investors with over \$24 trillion in assets under management issued a global statement<sup>16</sup> in 2015 in advance of COP21, calling for strong policy action on climate.
- FSB Task Force for Climate Related Financial Disclosure will issue its final recommendations in July 2017.<sup>17</sup>



MULTILATERAL DEVELOPMENT BANKS (MDBs)

- In October 2016, the six major MDBs issued a joint statement,<sup>18</sup> which includes a commitment to align financial flows with countries’ pathways to low-carbon and climate-resilient development and leverage private finance for climate investments.

<sup>13</sup> United Nations. [2030 Agenda, Paris Climate Accord “Twin Plans for Transformative Progress”](#) (2016).  
<sup>14</sup> United Nations. Department of Economic and Social Affairs. [Addis Ababa Action Agenda of the 3rd International Conference on Financing for Development](#) (2015).  
<sup>15</sup> United Nations Department of Economic and Social Affairs. [Financing for Development](#). See also: [Chairman’s Outcome Statement – Global Infrastructure Forum 2016](#)  
<sup>16</sup> Institutional Investors Group on Climate Change. [2014/2015 Global Investor Statement on Climate Change](#) (2014).  
<sup>17</sup> Task Force on Climate-related Financial Disclosures (TCFD). Available at <https://www.fsb-tcfd.org>.  
<sup>18</sup> The World Bank. [Statement by Multilateral Development Banks: Delivering on the 2030 Agenda](#) (2016).

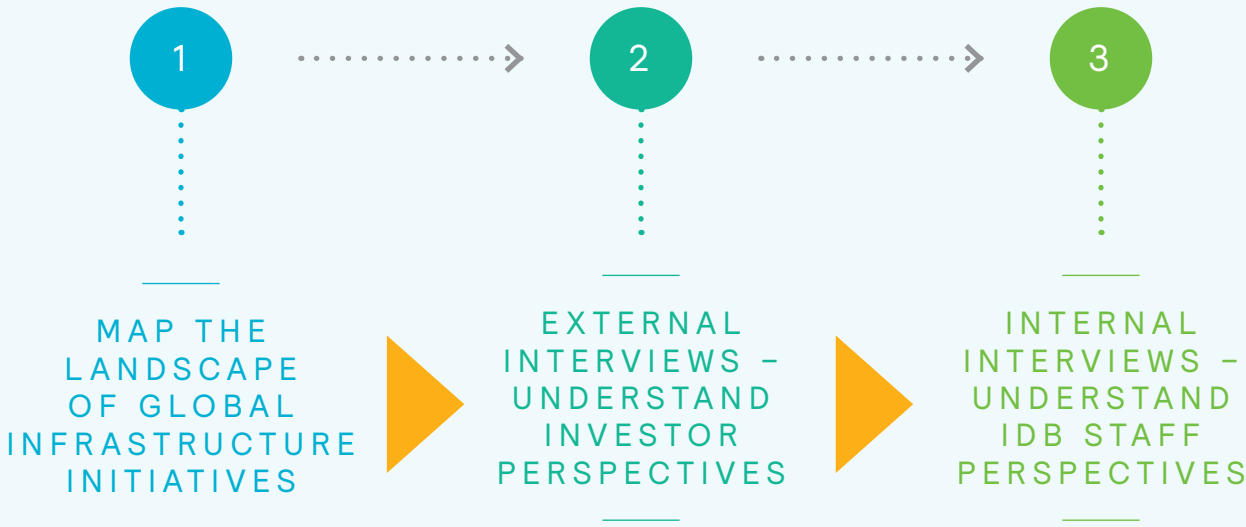


COMMITMENTS IN ACTION: WHAT IS HAPPENING ON THE GROUND?

To better understand what is happening on the ground, the Inter-American Development Bank (IDB) commissioned Mercer on a multi-phased project with the aim to understand the industry state of play regarding SI, review the barriers preventing deeper adoption of best practices, and identify tangible next steps to address the funding gap for SI. We sought to answer the following:

- In the context of high-level commitments to sustainable development from policymakers and increasing evidence of the business case for SI, how are professional investors including sustainability concerns in the investment process and their capital allocations?
- How can multi-lateral development banks (MDBs) leverage private dollars to close the SI investment gap?
- What are priority action items for key stakeholders to accelerate and scale efforts?

FIGURE 2: THREE-STEP APPROACH TO MERCER/IDB RESEARCH

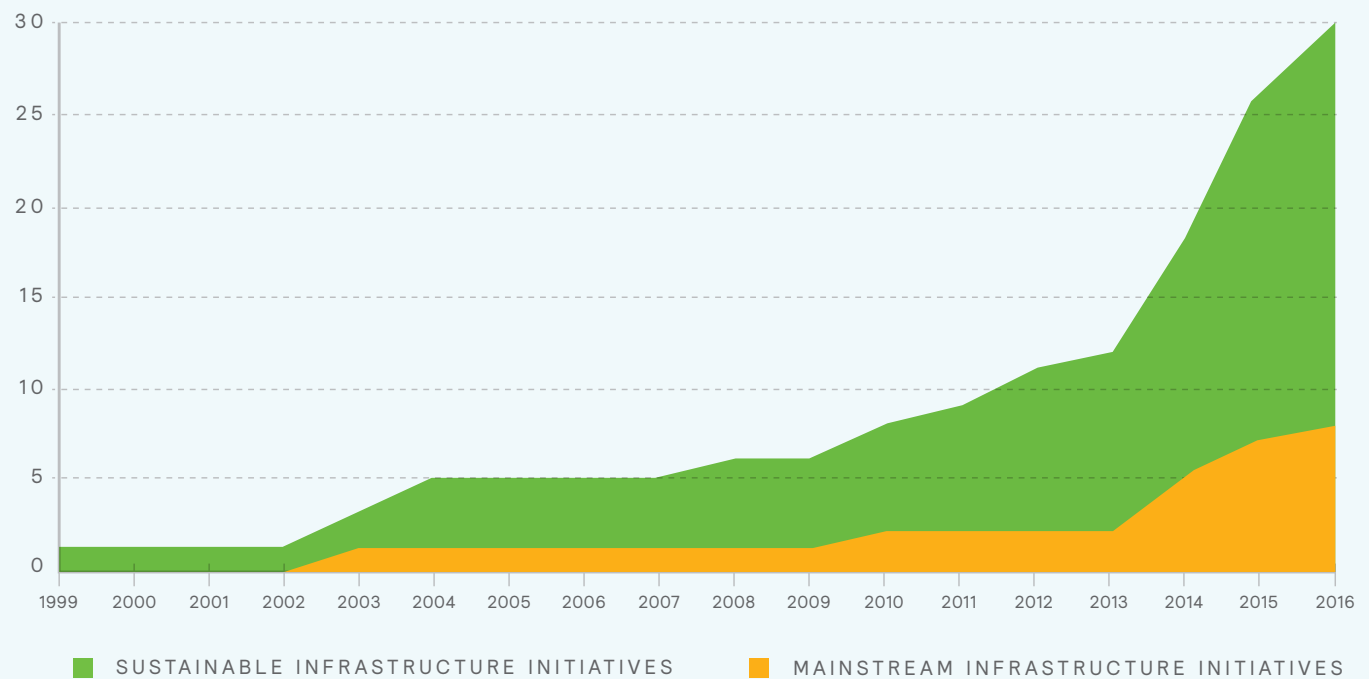


# STATE OF PLAY: SUSTAINABLE INFRASTRUCTURE IN THE INVESTMENT PROCESS

We undertook this through a three-step approach beginning in mid-2016. The key outcomes of our work are captured in this paper.

In response to the sizable infrastructure funding gap, in recent years there has been a significant increase in the number of initiatives that operate at scale with a mission to support investment in infrastructure and SI in particular. To better understand this evolving landscape, Mercer and IDB identified and reviewed 30 initiatives that have a core focus on supporting investment in infrastructure and have scale (or strong potential for scale). The results of this review are presented in our first paper as part of this multi-phase project, *Building a Bridge to Sustainable Infrastructure*.<sup>19</sup>

FIGURE 3: GROWTH IN INFRASTRUCTURE INITIATIVES



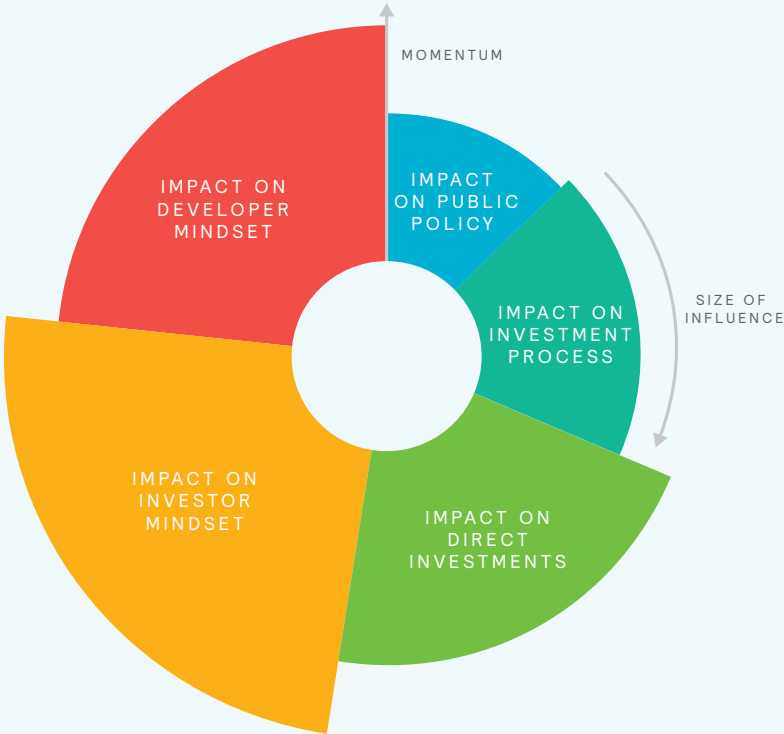
Source: Mercer

A key finding of this review is that there has been a significant rise in the number of industry initiatives focused on fostering growth in SI in particular and on *shifting the investor mindset* in relation to SI.

<sup>19</sup> Mercer and IDB. [Building a Bridge to Sustainable Infrastructure](#). 2016.

When considering the range of levers that initiatives focus on to mobilize more SI development, we see a broad distribution across those identified, as illustrated in Figure 4. Since 2013, we have seen activities targeted at influencing the investor mindset gain significant momentum – a critical item given that investor allocations must sharply rise to close the funding gap.

FIGURE 4: INITIATIVE INFLUENCE ACROSS KEY FOCUS AREAS (INITIATIVES ESTABLISHED SINCE 2013)



Source: Mercer

The initiatives assessed were organized into one of the three categories outlined below, based on the key role they each seek to play.



### INFLUENCERS

Those that provide **thought leadership and research** relating to sustainable infrastructure or those working to **influence public or industry policy** and/or the financial system to align infrastructure investment plans with INDCs and other environmental/social outcomes.

5 initiatives



### MOBILIZERS

Those seeking to i) work with governments to **develop “bankable” projects** and/or ii) **convene investors** to channel more funds into sustainable infrastructure projects. In most cases, mobilizers are working with and convening multiple stakeholders.

13 initiatives



### TOOL PROVIDERS

Those seeking to **enable integrated environmental or social analysis** of infrastructure projects into the investment and monitoring process, resulting in increased risk-adjusted returns and environmental/social outcomes.

12 initiatives

## ASSESSING THE STATE OF PLAY: INVESTOR INTERVIEWS

Mercer and IDB conducted a series of 10 interviews with large institutional investors (both asset managers and pension funds) actively allocating to infrastructure to understand how they are approaching sustainability concepts and whether they are actively allocating resources to SI in particular.

None of the investors interviewed had a formal approach to SI per se. Although most are implicitly taking into account sustainability considerations in a number of investments (for example, by appreciating that strong due diligence inclusive of environmental, social and governance [ESG] factors tends to reduce risk), there is no formal consideration of whether an investment is aligned with the Paris Agreement, and more specifically with a country’s NDC,<sup>20</sup> or whether it will be resilient in the face of current climate change projections.

<sup>20</sup>A country’s Nationally Determined Contribution (NDC) spells out the actions that country intends to take to address climate change (adaptation and mitigation). See also: <http://climateactiontracker.org/global.html>.

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“Personally, I have seen little impact on the ground of the Paris Agreement or country NDCs specifically”

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INVESTOR INTERVIEWED

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“We have an internal team focused on climate related research and strategy development, but their work does not seem to be utilized by our infrastructure team.”

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INVESTOR INTERVIEWED

Interestingly, there is increasing recognition that the energy transition is underway, and this is affecting investment decisions, such as the desire to avoid “stranded asset” risk because of the potential for future policy changes (for example, some investors indicate that they have no new investments in thermal coal). Investors cited a time lag between regulatory commitments, developments and their potential impact on the projects, while also indicating that policy signals are not always consistent across different geographies and sectors, with the resulting uncertainty hindering investments in allocation and resources.

In effect, we see evidence of awareness of changes that would be required to implement the Paris Agreement, yet many investors do not have a conviction of or commitment to the need to significantly alter their approach to investing. Instead, we see marginal changes that take place at the deal level but little “top down” thinking about the transformational change that must accompany successful implementation of the Paris Agreement and the SDGs, and what this means for investment strategy. Barriers for investors in embracing SI are similar to those that impede adoption of sustainable investing more broadly at the portfolio

level, such as the following outlined in World Resources Institute’s *Navigating the Sustainable Investment Landscape*<sup>21</sup>:

- *Inertia in the status quo* – It is difficult to disrupt the entrenched beliefs, knowledge and processes associated with traditional investment decision-making.
- *Limited frameworks for action* – Investors that are responding to market signals from new policy initiatives like the Paris Agreement and the SDGs still lack clear frameworks to fit their entire investment portfolios into the future world envisioned by these aspirations.
- *Inadequate data and disclosure* – Most available ESG (and climate) data focus on publicly listed equities, and although data are sometimes available for unlisted companies, it is more limited and less standardized.
- *Gaps in the investment chain* – This can range from limited high-quality funds that integrate ESG criteria to structural disincentives that often limit interest in considering new long-term factors or proactively offering sustainable investment products to clients.

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<sup>21</sup> World Resources Institute. [Navigating the Sustainable Investment Landscape](#) (2017).

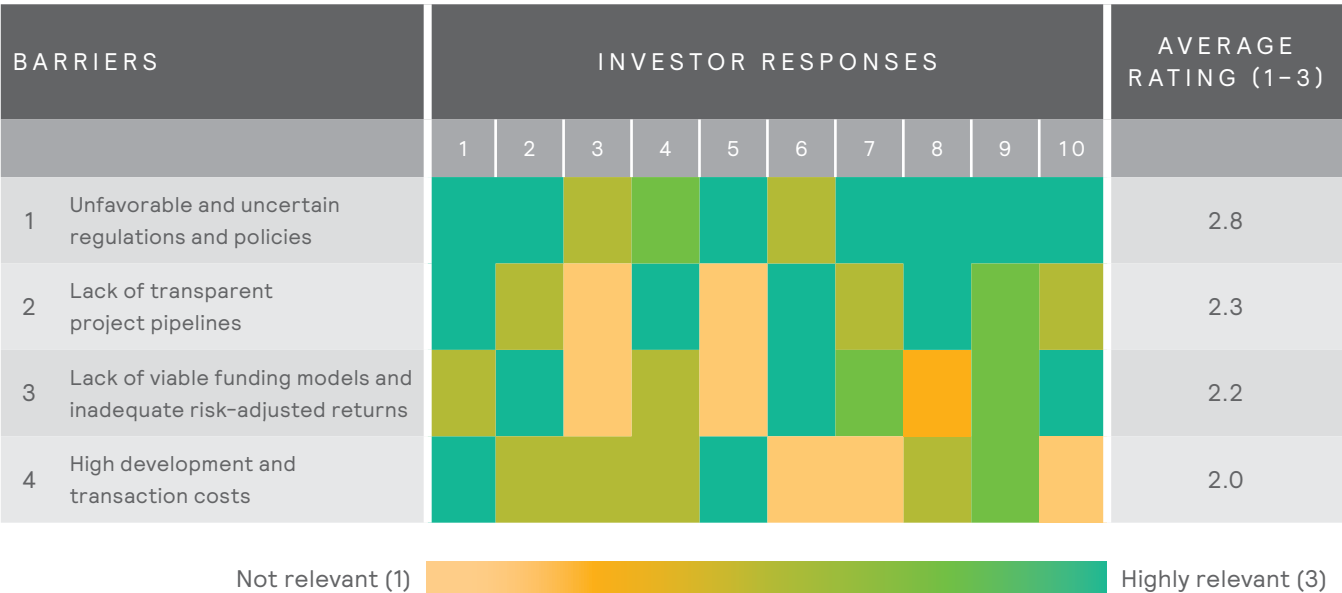
Climate resilience (that is, adaptation) is less well factored in than energy transition risk considerations. There was a sense that investment research has not kept up with climate science, and one investor found that some of its consultants are not prepared for questions on climate change and/or resilience. One investor referred to the use of stress tests (for example, considering bad-weather scenarios), but its assessments typically rely on historical, not prospective, data.

Investors generally are seeing a greater interest in climate change among their stakeholders (for example, clients/plan members). One investor commented that “climate alignment” could be something that they are asked to report on over time in light of growing interest and demand from governments for this type of information<sup>22</sup>; however, stakeholder concerns are still largely driven by financial considerations (that is, risk-adjusted rate of returns).

The more advanced investors (that is, those who have taken the time to understand the drivers and business case for SI) are in the process of developing sustainability definitions, evaluation metrics, tools (such as forward-looking environmental risk assessments), reporting and so on, and related industry initiatives can support efforts in this regard. This type of activity includes the development of investor-specific climate scenario and energy-transition pathways; tools to measure future climate future physical risks to existing infrastructure and real estate assets; and the growing focus on impact-investment reporting metrics.

The heat map in Figure 5 outlines how the 10 investors ranked commonly cited barriers<sup>23</sup> to their infrastructure investing experience. As evidenced, investors cited uncertain regulations as the top barrier, followed by the lack of bankable projects with adequate risk-adjusted returns. Scant project pipelines and uncertain policy frameworks result in inadequate deal flow that can prove insufficient in drawing investors and reducing transaction costs to mobilize financial resources at scale.

**FIGURE 5: CHARACTERISTICS OF SECURED FINANCE SECTORS**



Source: Mercer

<sup>22</sup>For example, Article 173 of the French Energy Transition Law requires investors to report on how their investment policies align with national and international decarbonization goals. See United Nations Principles for Responsible Investment. [French Energy Transition Law – Global Investor Briefing](#) (2016).

<sup>23</sup>McKinsey. [Financing Change: How to Mobilize Private-Sector Financing for Sustainable Infrastructure](#) (2016).



# EVOLVING THE MARKET FOR SUSTAINABLE INFRASTRUCTURE

The investors interviewed outlined a number of suggestions to address the challenges that they are facing. These are outlined below in two categories.

- There is a need to influence the investor mindset to understand and embrace the SI imperative, and to accelerate the development and standardization of frameworks and tools. Industry initiatives are well placed to do this, and for many of them, this is their mission.
- There are a number of areas where MDBs could assist in addressing risk-return investment barriers.

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“SI initiatives will become more important in the future given the increasing focus on sustainability considerations. However, up to now, our infrastructure team has not had much, if any, interaction with these industry initiatives.”

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INVESTOR INTERVIEWED

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“There is still a big role to play in educating investors that incorporating sustainability principles does not mean that higher returns will be foregone, and that instead they should realize that the chances are higher that the project will be compensated in the long term. A lot of investors still have the idea that SI would be ‘nice to have,’ but it is going to cost them extra money and invariably reduce returns, which they are unwilling to accept.”

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INVESTOR INTERVIEWED

## INDUSTRY INITIATIVES: CHANGING THE INVESTOR MINDSET AND EQUIPPING INVESTORS

A number of the initiatives are investor-led (or at least have investor participants), yet the investors that we spoke with about how the global initiatives are impacting infrastructure investor decisions in their area indicated that for them, there is little impact so far.

Suggestions for tangible progress that industry initiatives could focus on include the following:

- **Investor education** — Many investors noted that a key opportunity is to “influence” the investor mindset to encourage more investors to focus on sustainability within the infrastructure asset class and/or specific sectors. As one investor said, “Unless there is this change in investor mindset, it will be hard to move massive amounts of capital to finance SI.” A few investors acknowledged that there is likely not enough discussion on the topic of SI among mainstream infrastructure investors, and agreed that the industry could benefit from more education opportunities. The concept of SI is still new to some — not out of skepticism but lack of information. Investors could benefit from a greater understanding about the economics of SI (that is, investors will benefit from higher returns over the long term). Progress by data providers, credit-rating agencies and investment consultants to more formally monitor and assess SI-related metrics can also support investor education.
- **Convergence of SI frameworks** — Investors noted that a lack of common definitions in this area is contributing to the slow progress, and that the industry should consolidate the various frameworks promoting a convergence of approaches and best practices around a standard set of principles or building blocks, which would make it less confusing for both companies and investors.
- **Increase effectiveness of mobilizers** — Investors cited the lack of bankable SI projects as a key barrier to further infrastructure funding, resulting in too much money chasing too few projects, and look to governments and local partners (like development banks) to help develop such project pipelines. The mobilizers need to support supply-side SI initiatives to bring more bankable projects to the private sector. There is a lot of research and discussion, but more implementable action is needed.
- **Improve pricing of sustainability risks in investment tools** — Sustainability needs to be incorporated into risk assessments at the time of analyzing an investment (for example, assessment of climate risk, carbon footprint, mitigation/adaptation strategies). It is important that tools used to assess infrastructure risk incorporate consideration of how and where sustainability features (or the threat from unsustainable features) impact the quality and life of any particular asset. Addressing these items should demonstrate more competitive risk-adjusted returns in the long term for SI projects.. Effective tools need to be available for greenfield as well as brownfield assets.
- **Support region-specific approaches** — Many of the initiatives try to be global in their approach and have overarching frameworks, but they tend to overlook the fact that each country and its jurisdiction have different issues. More specificity in this area would be more useful (for example, through providing best-practice case studies of what has worked in different sectors/countries).

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“Private banks and investors have little experience with these sectors in emerging markets and are hesitant to take the lead. MDBs, on the other hand offer decades of experience in planning and executing complex infrastructure projects. They also have the credibility to serve as trusted brokers between governments, investors and civil society.”

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MORENO, STERN<sup>24</sup>

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“Better pipeline development is the most relevant solution for our investing needs, and likely for others too. There is plenty of financing capacity in their markets.”

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INVESTOR INTERVIEWED

## MDBS: PROVIDING SOLUTIONS TO OVERCOME BARRIERS

Given the size of the funding gap, the public sector cannot be relied on to make all necessary investments to close the infrastructure gap and MDBs have already recognized that the role of private-sector funding is key.<sup>25</sup> Two related areas of opportunity on delivering on this commitment arose during staff interviews on this topic:

- **Local investors** — Local pension funds and insurance companies investing in local infrastructure could enhance the financial sustainability of projects (for example, increasing availability of long-term financing, reducing currency mismatch and exchange rates risks). However, for this to be practical, countries need sizable pension/financial institution assets, and governing investment regulations that are supportive of infrastructure investment. MDBs can leverage its relationships with both governments and investors to engage in discussion regarding more supportive investment frameworks.

- **International investors** — As noted earlier, many investors have not yet had an opportunity to work with a development bank and may not appreciate how these can support infrastructure investment (whether being a local partner, providing co-financing, etc.). Cultivating closer relationship with key investors and/or investor groups could enhance MDB’s development impact.

A number of investors have limited or no experience in working with MDBs. This represents both a challenge and an opportunity for MDBs. Investors were asked for their perspective on potential solutions that could catalyze such investments and, within this, what role the development finance community could/should play. Specifically, they were asked how to prioritize the following solutions offered by development banks help to improve conditions for SI investment.

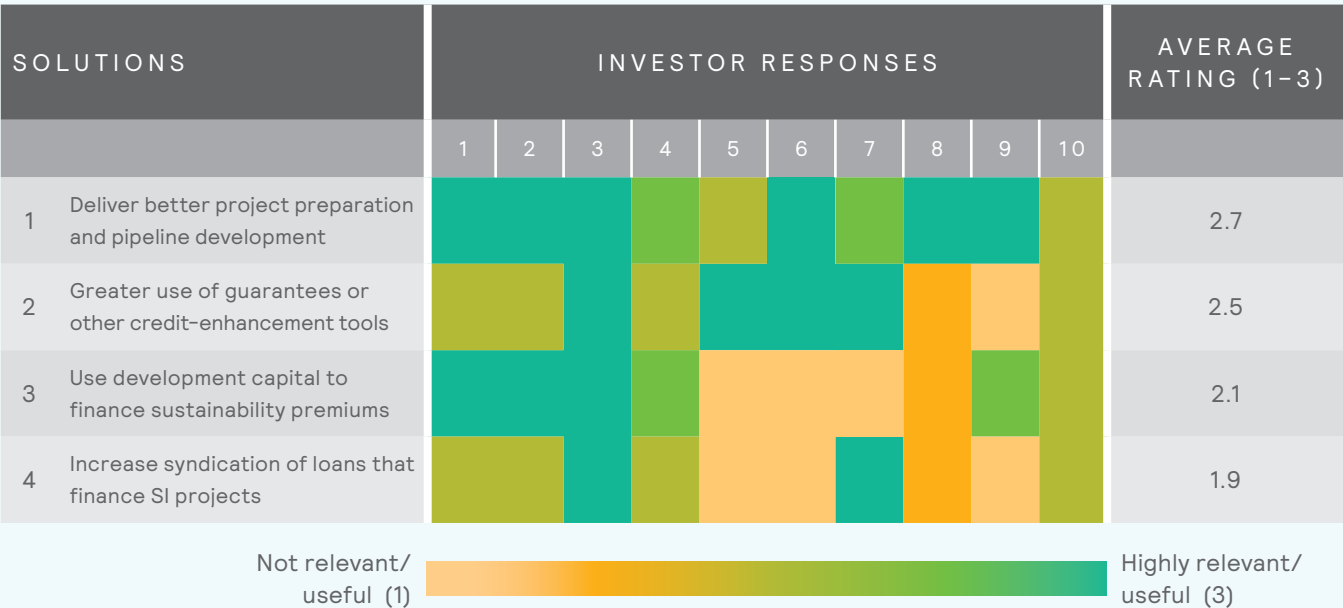
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<sup>24</sup> Moreno LA, Stern N. “[Smart Infrastructure Is the Key to Sustainable Development](#).” *The Guardian* (May 10, 2016).

<sup>25</sup> [Joint MDBs statement on Delivering Climate Change Action at Scale](#) (2015).

Figure 6 shows the resulting heat map, with the development of bankable project pipelines as the top priority.

**FIGURE 6: INVESTOR RANKING OF SOLUTIONS TO SUPPORT SI INVESTMENT**



Source: Mercer

The most important opportunity cited by investors for MDBs is for them to help deliver better project preparation and pipeline development. This would help deliver much-needed bankable projects. Better project preparation and early intervention can help increase certainty of returns to investors and would encourage investments in SI.

Although the above solutions are already available, MDBs are looking for ways to scale efforts. For example, in fall 2016, IDB rolled out the new NDC Invest platform.<sup>26</sup> The platform includes four components – Programmer, Pipeline Accelerator, Market Booster and Finance Mobilizer – that will support countries, from setting up the implementation strategy of their NDC, to the planning and preparation of pipelines of projects, to the financing of the projects, as needed to meet their NDCs.

<sup>26</sup> <https://www.ndcinvest.org>

To help guide MDBs on priorities (in addition to the ranking of solutions in Figure 6), investors cited the following two key areas as important opportunities for support by MDBs to increase private sector finance of infrastructure:

- **Support for greenfield investments** – Some active infrastructure investors have had limited experience working with MDBs, likely because they generally invest in operating (brownfield) investments, but indicated that they could see there may be value in partnering with MDBs on greenfield investments. MDBs can offer expertise with early stage development and can support SI design from the start of the project cycle, and even before, in helping the public sector in planning infrastructure pipelines.
- **Cornerstone investors** – Investors indicated that development banks could increase their role in attracting major “first movers” into infrastructure in emerging markets, in order to generate wider momentum with other investors.<sup>27</sup> Participation of development banks in new emerging market funds – both as equity or debt providers – has had a positive signaling effect for other investors and has helped attract capital in the past, including through the use of credit enhancement instruments to improve expected risk-adjusted returns for investors.

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<sup>27</sup> An example: Allianz. [“Allianz and IFC Sign Partnership to Invest in Emerging Markets Infrastructure Projects”](#) (2016).

# BRIDGING THE DIVIDE: A CALL TO ACTION

Given the high-level commitments already made, the significant efforts underway to leverage private-sector finance, yet the lack of engagement of many infrastructure investors, a call to action is essential. The actions required need to influence the investment staff making individual investment decisions, the MDB staffer for whom it may be easier to proceed with the status quo and the national government ministries who have not yet aligned their vision for future development with sustainability goals. We outline below three sets of complementary actions:

- Convene the Conveners
- Internal Alignment for Success
- External Collaboration for Success

## ACTION 1: CONVENE THE CONVENERS

Investors identified a number of opportunities for the industry initiatives to influence the investor mindset, and to accelerate the development and standardization of frameworks and tools. Our earlier paper outlined key steps to align, support and leverage the identified initiatives, which are still critical. Action 1 is about delivering on these five Cs:

1. **CLARIFY the principles for SI investment** – Although it is unrealistic to develop shared definitions for SI, we can develop a harmonized framework and principles focused around common building blocks of sustainability. This will drive clarity and urgency across the industry, provide a more compelling alternative to “traditional infrastructure” framing and enable comparability for investors.

2. **COMMIT to SI** – Those infrastructure initiatives that do not formally include a consideration of SI should consider why this has not been incorporated and review their mission and objectives accordingly. SI-focused initiatives should adopt and reinforce the harmonized framework in their materials and the support they offer to the industry.
3. **COORDINATE the conveners** – Planning, developing and financing global infrastructure is a major undertaking, and it is certainly reasonable to assume that a range of complementary initiatives will be involved. However, the joint impact would be optimized if the key groups were working toward a shared “grand plan,” enabling thoughtful division of labor and the cross-pollination of ideas.
4. **COLLABORATE** – Many of the mobilizers share common missions and are working in parallel. By bringing these organizations together or through having international finance institutions or other groups acting more directly as a liaison between them (to facilitate co-investments, for instance), activity could be more effectively scaled.
5. **COMMUNICATE for systemic change** – Although a number of thoughtful and compelling reports have been published on this topic, there is very little awareness of or discussion about SI topics among mainstream infrastructure investors or related industry media (journals, magazines and conferences). A proactive communications strategy can help to shift this.

Behind the scenes, work has begun to implement in the “5Cs,” with Mercer having held three industry dialogues on SI in 2016 and IDB/GIZ/Mercer having convened a major session in Berlin on March 23, 2017.



## ACTION 2: INTERNAL ALIGNMENT FOR SUCCESS

Within each organization type across the key stakeholder groups, we identify key steps for success aimed at addressing internal barriers preventing prioritization of SI and implementation of required changes, alignment of organizational strategies to international agreements and commitments, and structuring of incentives to deliver on those commitments (Figure 7).

FIGURE 7: INTERNAL ALIGNMENT FOR SUCCESS: FOUR STEPS FOR EACH STAKEHOLDER GROUP

	1. BREAK DOWN BARRIERS INTERNALLY	2. ALIGN ORGANIZATIONAL STRATEGY WITH GLOBAL AGREEMENTS	3. ALIGN INCENTIVES AND SUPPORT	4. DEMONSTRATE COMMITMENT
MDBs	Include sustainability concerns in all sectors and prioritize programmatic approaches toward SI (e.g., infrastructure, cities )	Embed SI vision into organizational planning and staff incentives	Cascade goals down the organization that, when rolled up, will support achievement of global goals	Place sustainability concerns at the core of financing evaluation and allocate resources to support government SI planning and PPPs
GOVERNMENTS	Ministries of finance, environment and development need to work together around a national sustainable development plan	Develop SI finance strategy and implementation investment plan for NDCs	Align financial market incentives to support investment in SI (e.g., carbon pricing, procurement policies, etc.), as well as related disclosure (e.g., TCFD recommendations)	Translate G7 and G20 commitments into finance plans aligned with SDGs and Paris Agreement (e.g., timeline to phase out fossil fuel subsidies)
INVESTORS	Sustainability (ESG) teams need to work with infrastructure teams	Adopt disclosure and transparency practices (i.e., TCFD recommendations) to empower SI approach	Incorporate SI considerations into investment and measurement processes (from portfolio alignment with energy transition, to bottom up risk assessment);  Provide training/support	Update the Global Investor Statement <sup>28</sup> to include comment to consider NDC alignment and resilience in infrastructure portfolios
INITIATIVES	Broader (core) infrastructure initiatives must sharpen their thinking on SI	Develop a clear and consistent approach to SI (definitions, risk tools, etc.)	Prioritize partners, members, projects, initiatives and funding, toward those that have SI in the mandate or on the radar	Review and revise mission statements to explicitly commit to SI in line with the SDGs and/or the Paris Agreement

<sup>28</sup> Ibid Institutional Investors Group on Climate Change.

### ACTION 3: EXTERNAL COLLABORATION FOR SUCCESS

There are key collaborative interactions, as outlined below, that must take place between the stakeholder groups to enable crossing the bridge toward SI. These leverage key links across the infrastructure development and financing process, from project planning, to investment due diligence, and reporting. To evolve the ecosystem towards effective SI outcomes, each group has a role to play. A key focus is on building new relationships and shifting the nature of the discussion towards one where infrastructure investment and development naturally considers alignment with evolving NDC commitments, aimed at achieving the 2°C (or lower) target.

FIGURE 8: EXTERNAL COLLABORATION FOR SUCCESS

#### MDBs – GOVERNMENTS

MDBs facilitate inter-ministry dialogue and strengthen relationships with finance ministers to reflect budget allocations to SI.

MDBs provide broader upstream planning support (sector and/or national level), including development of NDC financing plans.

#### MDBs – INVESTORS

MDBs engage with investors on role and value-add of MDBs on SI, regional opportunities/challenges, specific ask of investors (e.g., develop “road show” material; appoint MDB relationship managers for key investors).

#### MDBs – INITIATIVES

MDBs can support supply-side SI initiatives that develop bankable projects.

Leverage the convening power of the MDBs to execute the 5 Cs (Action 1 outlined earlier).

#### GOVERNMENTS – INVESTORS

Support alignment of NDC financing plans with investment portfolios by developing clear infrastructure development and climate investment plans.

Support adoption of TCFD recommendations on mandatory or voluntary portfolio disclosure.

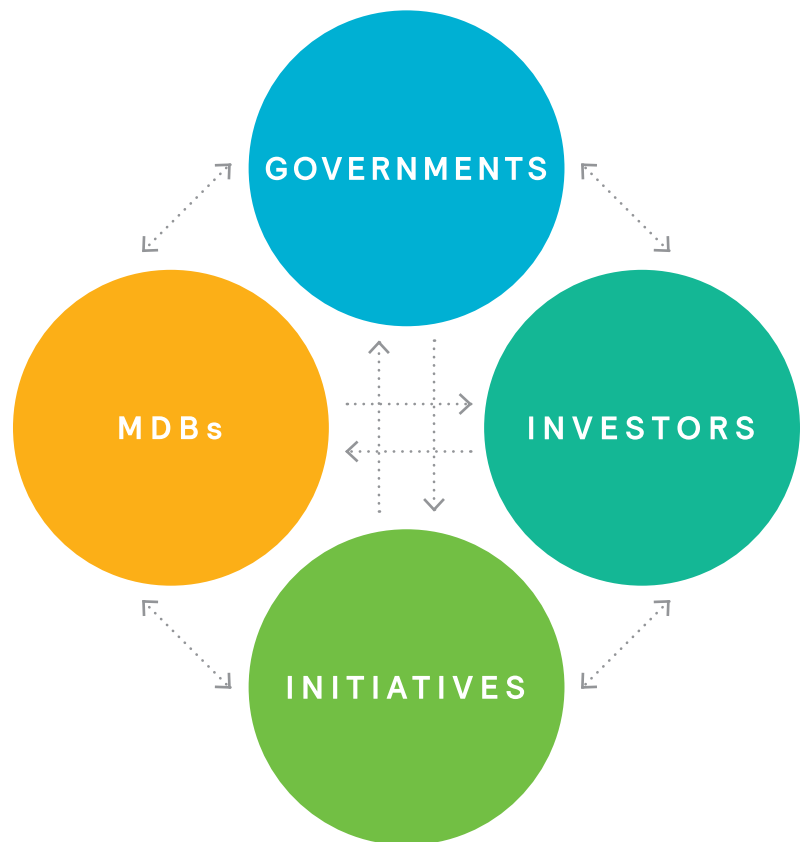
#### GOVERNMENTS – INITIATIVES

Align definition of SI with NDCs; encourage initiatives to adopt similar language and focus.

#### INVESTORS – INITIATIVES

Industry initiatives should: i) scale up education and awareness regarding SI and ii) develop metrics, tools and capabilities regarding SI portfolio assessment.

In addition, data providers, credit-rating agencies and investment consultants should more formally monitor and assess SI-related metrics (regarding the energy transition and climate resilience).



# CONCLUSION

The SI challenge is crucial to the world's future, particularly in light of rapid global urbanization. This is why SI has been an increased focus of so many industry initiatives, think tanks and development banks. As highlighted in this paper, there is both good news and bad news.

The good news is that there is significant action being taken to catalyze more SI development going forward. For example MDBs have committed to enhance their support mechanisms to SI delivery, scale up climate finance, and also to deepen collaboration among the development banks – in recognition of the need to exploit synergies to achieve greater impact.

In this sense, MDBs are working toward a shared approach to blended finance, including risk-sharing and credit enhancement tools; consistent climate risks disclosure standards and analytics; and strategies to crowd-in private sector finance. MDBs have also made strategic commitments to increase climate finance (See Box 4) and support mechanisms to enable the translation of country-specific NDCs and SDG agendas into infrastructure investment plans.<sup>29</sup> Numerous investors have also committed new allocations to sustainability-themed investments.<sup>30</sup>

## BOX 4: SAMPLE CLIMATE FINANCE COMMITMENTS<sup>31</sup>

- Inter-American Development Bank Group to double climate finance to 30% of the volume of approvals of loans, guarantees, investment grants, technical cooperation and equity operations by year-end 2020
- African Development Bank to scale up climate finance to \$5 billion per year by 2020, representing ~40% of total investments
- Asian Development Bank to double annual climate financing to \$6 billion by 2020
- European Bank for Reconstruction and Development aims to raise environmental investment to 40% of total by 2020
- European Investment Bank to increase its lending for climate action in developing countries to 35% of total by 2020
- The World Bank Group will increase the climate-related share of its lending to 28% by 2020

<sup>29</sup> For example, in 2016 the IDB Group launched NDC Invest, a platform to align resources from the IDB Group to support national climate change actions as articulated in country NDCs. Additionally, the IDB Group started to integrate NDCs within Bank country strategies, and initiated a process to scan the project pipeline for potential opportunities for climate investments.

<sup>30</sup> For example, Dutch healthcare pension fund PFZW has committed to invest €20 billion in climate, water, food and health solutions, and wants to half its carbon emissions by 2020. Source: [Sustainable Investment in the Dutch Pension Sector](#) (2016).

<sup>31</sup> [Joint Statement by Multilateral Development Banks at Paris, COP21](#) (2015).

The bad news is that the action so far seems only partially effective and not yet impactful enough to significantly change the behavior of mainstream infrastructure investors. To do so is not a “quick fix”; it requires a complex evolution of the architecture of the system. In Section 4 of this paper, we outlined three actions to achieve this:

1. **Convene the conveners** – There are numerous initiatives globally working to address the funding gap for SI. Coordination and collaboration among these global initiatives will be critical to ensuring that private investment strategies are aligned with the global commitments to the SDGs and the Paris Agreement. We have outlined the five steps (clarify, commit, coordinate, collaborate and communicate) to help to ensure that a) everyone has a clearer understanding of what SI is and b) that efforts are more aligned toward achieving it.
2. **Internal alignment for success** – We have outlined key steps that each of the key stakeholder groups (MDBs, governments, investors and initiatives) can take to address internal barriers preventing the prioritization of SI. Namely, to align organizational strategies to international agreements and commitments, and structure incentives to deliver on those commitments.
3. **External collaboration for success** – There are key collaborative interactions that must take place between the stakeholder groups to enable crossing the bridge toward SI. These interactions can leverage key steps in the infrastructure financing cycle, from a more coordinated project planning process between governments and MDBs, to more clear due-diligence processes which support investors in considering the sustainability characteristics of prospective investments, including their alignment with country NDCs.

We hope this frank assessment of what needs to happen will help inspire action required to cross the bridge to sustainable infrastructure and unlock the investment required to reignite growth, deliver on the Sustainable Development Goals and reduce climate risk in line with the Paris Agreement.

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The **Inter-American Development Bank** is a leading source of long-term financing for economic, social and institutional projects in Latin America and the Caribbean. Besides loans, grants and guarantees, the IDB conducts cutting-edge research to offer innovative and sustainable solutions to our region's most pressing challenges. Founded in 1959 to help accelerate progress in its developing member countries, the IDB continues to work every day to improve lives.

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Mercer's sustainable infrastructure credentials include research, advice and implementation solutions. Mercer has worked for many years to address the challenges and opportunities investors can face when seeking to access a diversified range of high-quality managers focused on sustainability themed investment opportunities.

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