

Infrastructure investing in a post-Covid world



Benjamin Kelly
Senior Analyst,
Global Research



Ingrid Edmund
Senior Portfolio Manager,
European Sustainable
Infrastructure Fund

The nature of sustainable infrastructure investment is one of many areas that was changed in 2020 by Covid-19. The economic impact of the pandemic, as governments around the world restricted movement and business activity in an attempt to slow the spread of the coronavirus, prompted unprecedented levels of state spending in areas of infrastructure ranging from healthcare and education to employment programmes.

The headline figures in response are impressive. Capital markets have seen a record level of issuance of social bonds to raise funds for such projects. Morningstar estimates that European sustainable funds have reached more than \$1 trillion of assets for the first time on record – with the third quarter alone seeing more than €50 billion, representing 40% of the total European fund flows. The trend is also highly noticeable in private markets (Figure 1).

Heading into the pandemic, sustainable investment was typically more likely to focus on the environment and climate change mitigation strategies – indeed, when companies and other organisations talked about their ESG (environment, social and governance) performance, the emphasis in recent years has been very much on the first of those three factors.

But investing to produce more beneficial or equitable social outcomes is now firmly in the spotlight, consolidating the concept of social license to operate which



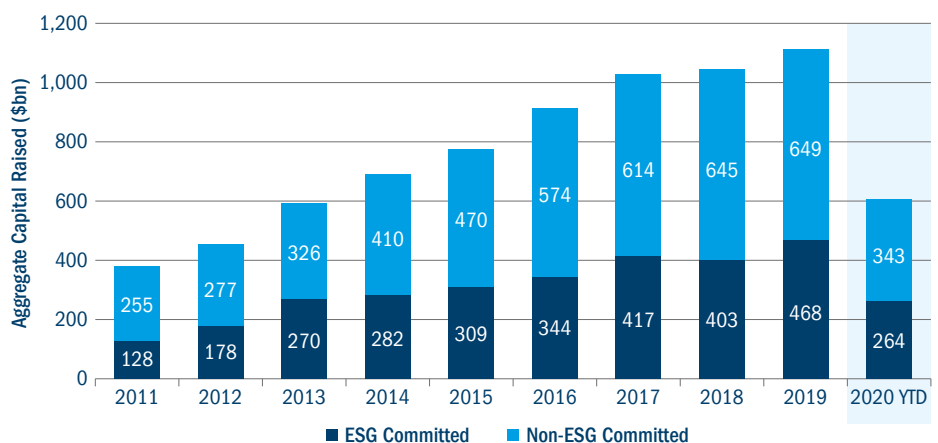
Investing to produce more beneficial and equitable social outcomes is now in the spotlight. Source: iStock

has been gathering momentum over the past few years. This is unlikely to fade once again into the background as the world emerges from the pandemic. There is growing realisation by investors that infrastructure investments have long-term consequences on communities, and ultimately integrating ESG is not just a risk mitigation tool but a return generator

and an opportunity to create further value by shaping positive outcomes.

Historically, investments deemed and themed as social were often associated with an emerging markets geographic focus, and coupled with a specific impact thematic – for example healthcare, water, poverty alleviation and education. →

Figure 1: Aggregate capital raised by ESG-committed vs. non-ESG-committed general partners



Source: Preqin Pro, October 2020.

The United Nations' Sustainable Development Goals (SDGs), which were published in 2015, have a very significant social element. Relevant to infrastructure investments are health and safety, supply chain issues, anti-corruption, diversity, labour conditions and human rights; meanwhile, job creation and social and technological improvements can address issues such as inequality – both between the rich and poor, and between men and women. The increasing importance of the social element of ESG criteria has created a heightened focus on social benefits among organisations and individuals looking to invest responsibly.

Climate change investment and Covid-19

The idea that investing in infrastructure can benefit the environment and/or mitigate the impact of climate change is not new and is certainly here to stay. What is different is that the pandemic has changed some of the dynamics in this area, in both positive and negative ways.

Reduced travel, industrial activity and electricity generation during Covid-19 saw global emissions fall by up to 7% in 2020, according to the UN Environment Programme.¹ The impact of the coronavirus on emissions is, of course, likely to extend well into 2021. Further lockdowns have already been imposed across the world, and it may take several years for demand in sectors such as air travel to return to pre-pandemic levels.

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Despite this, atmospheric CO₂ is continuing to rise rapidly. This shows that while the dramatic measures imposed during the pandemic are helpful in terms of reducing global emissions, they remain far from what scientists estimate is needed to avoid the worst impacts of the climate emergency.

Meanwhile, the downturn in business activity in 2020 also led to a sharp fall in fossil fuel prices, and as economies return to growth in the months and years ahead there is a chance that expansion in some parts of the world could be underpinned by cheaper oil and gas, with a concomitant increase in emissions. Furthermore, while the share of renewable energy production has been increasing exponentially, it has only translated into 18% of the EU's gross final consumption in 2018, with results in transport and heating/cooling particularly below expectations, as well as the incidence of “dirty” electricity also finding its way into Europe.²

This highlights that a lot more needs to be done to prevent the post-pandemic economic recovery leading to a rebound in emissions. At the same time, Europe is facing an estimated 7%-10% downturn – the health and social impacts will be felt across the economy.³

The post-pandemic period is likely to provide opportunities to increase investment linked to climate-change mitigation: the European Union, for example, has indicated it will put the environment at the centre of its Covid-19 economic recovery plans,⁴ while the UK has also recently announced more ambitious proposals to meet its emissions targets.⁵ There seems to be more consistency of policy than ever before promoting a cost-effective, secure and “just” transition underpinned by industrial transformation, technology and innovation. The green stimulus does not only achieve a reduction in emissions but also fosters investment which can boost job creation in critical manufacturing, construction and small and medium-sized businesses, as well as save consumers money.

In the US, president-elect Joe Biden has said the US will rejoin the Paris Agreement at the first opportunity,⁶ and several US states already have goals in place to hit at least 50% renewable energy by the end of the decade.⁷

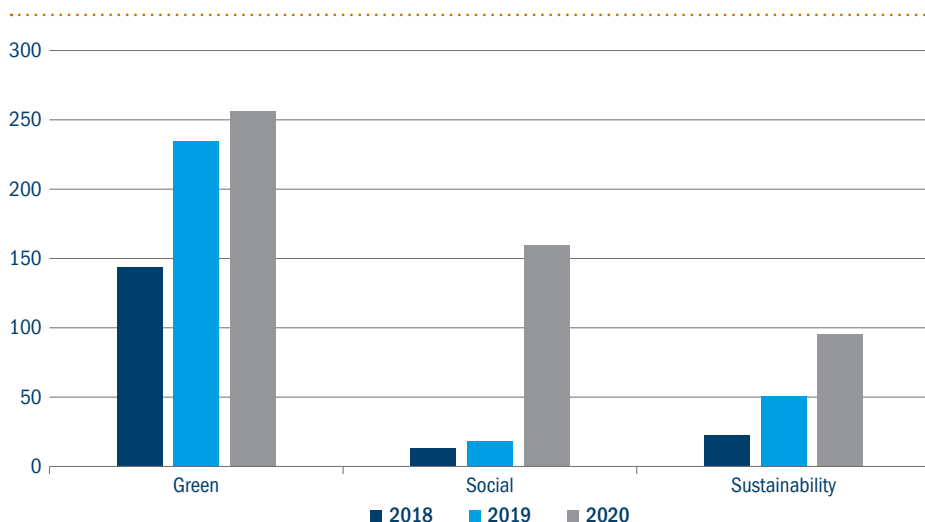
INCREASING THE SHARE OF RENEWABLE ENERGY IN THE MIX IS ABSOLUTELY CRITICAL, BUT IT IS NOT ENOUGH

How will energy transition achieve decarbonisation?

1. Switch from emitting fossil fuels to low/neutral carbon renewable electricity
2. Reduce energy demand by improving energy efficiency, eg electric vehicles consume only around 25% of the energy consumed by conventional vehicles; heat pumps have a higher performance coefficient than typical gas boilers
3. Electric production of alternative fuels such as hydrogen and P2X for industries in heavy need of decarbonisation, where direct electrification is not a solution, such as shipping and certain industrial processes

There are no signs that the tough climate targets put in place by governments around the world prior to the Covid-19 crisis will be watered down in any way, which bodes well for the future of sustainable investment. A salient example of this is the pervasive endorsement of green hydrogen by governments. Hydrogen is positioned as the clean technology solution to decarbonise many areas of the economy, such as transportation, which has until now proved challenging with electrification alone. Europe's €180 billion investment to scale up and deploy clean hydrogen⁸ has completely changed the outlook for a sharp reduction in costs which should promote the scaling up of production and use of renewable hydrogen.

This will provide additional opportunity in creating a smarter, reinforced distribution grid and new balancing solutions that will enable the integration of more decentralised renewable resources, including smart metering and storage. The European Commission estimates that €350 billion in additional annual investment will need to be made between 2021 and 2030, compared with the previous decade. Most of the extra money is to finance interconnections to link up countries' grids and new capacity, including replacing old power and industrial plants.⁹

Figure 2: social, green and sustainability bond issuance, 2018-2020 (\$bn)

Source: Bloomberg/World Bank.

A boom in social bond issuance

As a barometer for identifying trends within environmental and social investing then look no further than the public bond markets and the issuance of specific use of proceeds bonds, especially green, social and sustainability (Figure 2). Issuance in 2020 was underpinned by a sharp increase in the issuance of social bonds (more than 700% year-on-year)¹⁰ – with debt financing channelled to specific projects which have an agreed socially beneficial outcomes. This could be the creation of jobs, the setting up of healthcare programmes or facilities, or the provision of education or training services.

The pandemic has had a devastating impact in all of these areas: the reduction of business activity, whether enforced or not, has led to a rise in unemployment all over the world, with sectors such as tourism and hospitality particularly hard hit; the coronavirus has, of course, put national health systems under unprecedented pressure; while the temporary closure of education facilities in many countries, both at school and university levels, has created new challenges in terms of remote learning and digital connectivity.

By the end of November a total of \$155 billion were issued,¹¹ an increase of 869% on the same period in the previous year. Around \$100 billion was raised by issuing dedicated Covid-19 bonds covering either social and/or sustainability projects.¹² This has clearly been a record year for social issuance but that has not been at the expense of green. This whole segment of issuance – ie green, social and

sustainability – was on the cusp of issuing \$0.5 trillion in debt this year, another record. As such the rise in social has not been a zero-sum game, and with issuers still raising finance for environmental and social projects, an increased examination of social factors is not expected to be a transitory trend, rather the new normal for sustainability investing.

Viewing sustainability investment through a new lens

The wide range of social bonds issued this year, and the likelihood of this trend continuing for the foreseeable future, means investors and institutions now have a much wider choice of socially beneficial investments – alongside those with green and/or sustainability credentials.

The pursuit of both social and environmental outcomes has been a central tenet of the Columbia Threadneedle European Sustainable Infrastructure strategy's approach to sustainable investment, which earlier this year invested in Lefdal, a data centre based in Norway. Lefdal has excellent environmental credentials, in particular its industry-leading levels of energy efficiency, which are based in part on its use of seawater from a nearby fjord for cooling.¹³

But Lefdal also has a significant social impact: the role it plays in supporting Norway's digital infrastructure is vital in terms of providing connectivity to previously underserved communities – for example those in remote and rural areas. This can improve access to digital training and help create new employment opportunities.

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Improved connectivity also has a role to play in enabling businesses such as those in the agriculture sector to invest in or take advantage of new technology, which can have a positive knock-on effect in terms of food security and sustainability.

The European Sustainable Infrastructure strategy has also recently acquired Condor Ferries, a transport firm that is the primary facilitator of freight and passengers between the Channel Islands, the UK and France. While the shipping industry as a whole often attracts questions in terms of its suitability within sustainable investment portfolios due to carbon emissions, businesses such as Condor can play a vital social role in providing freight and physical connectivity services for remote or island communities. In turn, these services can support the likes of healthcare, food security and employment opportunities. Certainly as vaccines supporting Covid-19 are distributed across the world, freight services will be a critical enabler of the delivery mechanism.

But this does not mean that the environmental impact of such operations can be, or is being, ignored. In the case of its Condor acquisition, the strategy is working to improve the environment profile of the business's fleet as well as its onshore activities. This will involve reducing waste and improving efficiency across the organisation, while also making a transition to cleaner propulsion technologies over the course of the decade. Socially responsible investors are also increasingly aware of their ability to shape the direction taken by investee organisations to expedite the transition to low-emission technologies.

Social infrastructure investment after the pandemic

Clearly, Covid-19 has created a widespread need for socially beneficial investment, but this need is unlikely to disappear as we emerge from the pandemic.

Firstly, the socioeconomic impact of the coronavirus is likely to be long-lasting: it already appears to have exacerbated income inequalities in many communities, with employment among better paid white-collar workers less likely to have been affected than those in customer-facing roles, for example, or jobs that cannot easily be carried out remotely.

It also remains to be seen what the long-term health impacts of Covid-19 will be and what steps might be necessary to mitigate them; and in the meantime, governments around the world are likely to need to make significant infrastructure investments in order to support national vaccination programmes.

But the recent rise in the importance of social investing may have helped create a better understanding among investors of the interplay between environmental

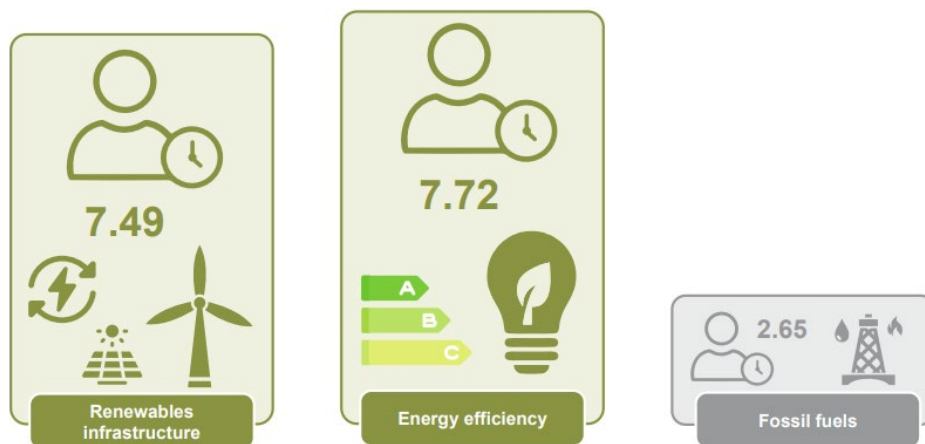
and social concerns: take investment in green infrastructure as one example. The likes of the EU see a new green deal as the ideal route out of the pandemic-induced recession because of its ability to create thousands of new employment opportunities, not just because it will help the bloc reach its emissions deadlines. Indeed, recent research suggests that investment in green projects has the potential to create up to three times as many jobs as investment in competing fossil fuel-based projects (Figure 3).

A reduction in reliance on oil and gas can have additional social benefits: improvements in air quality as a result of the switch to electric motor vehicles, for example, are expected to deliver major health benefits, and these will be felt disproportionately by those living in more crowded urban areas.

Ultimately, though, progress in minimising the impact of climate change will inevitably have huge social implications in terms of reducing the prevalence of extreme weather events, thereby limiting the extent to which they can ruin harvests, damage property and displace people in the decades ahead.

“Governments around the world are likely to need to make significant infrastructure investments in order to support national vaccination programmes”

Figure 3: Jobs per million investing in green projects vs. fossil fuels



Source: Will Covid-19 fiscal recovery packages accelerate or retard progress on climate change? May 2020 Cameron Hepburn, Brian O'Callaghan, Nicholas Stern, Joseph.

¹ <https://www.unenvironment.org/emissions-gap-report-2020>, 9 December 2020.

² Sandbag Climate Campaign, 2020-SB-Path-of-least-resistance-1.2b_DiGI.pdf (ember-climate.org), January 2020.

³ European Environment Agency, COVID-19 and Europe's environment: impacts of a global pandemic, 5 November 2020.

⁴ https://ec.europa.eu/info/strategy/recovery-plan-europe_en

⁵ <https://www.ft.com/content/3eda6c6f-265f-4804-a017-a260d1e101cc>

⁶ <https://www.theguardian.com/us-news/2020/nov/08/joe-biden-paris-climate-goals-0-1c>

⁷ Bank of America Merrill Lynch, May 2020.

⁸ https://ec.europa.eu/commission/presscorner/detail/en/QANDA_20_1257

⁹ <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/eu-says-higher-climate-goal-requires-350b-extra-energy-investment-per-year-60382093>

¹⁰ Columbia Threadneedle analysis, 2020.

¹¹ Bloomberg, November 2020.

¹² Columbia Threadneedle Investments, June 2020.

¹³ Lefdal Mine Data Center, <https://www.lefdalmine.com/cooling/#:~:text=European%20leading%20Cooling%20solution%20Lefdal%20Mine%20Datacenter%20is,used%20for%20cooling%20with%20a%205%20KW%20configuration>

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