Infrastructure investors are leading other real assets in the energy transition

By Sonny **MASERO**

Gaining a deeper insight into infrastructure obstacles and opportunities during the transition to net zero.

In October, EVORA Global and GLIO hosted a lunch with an insightful group of investment managers who are leading on the integration of ESG. In a number of ways, these leaders were ahead of other real assets, particularly real estate. There are obvious differences between direct investment in infrastructure and equity investment in both listed and private infrastructure companies, but there are some shared challenges.

The main challenge is that their investor clients have lots of diverse, individual views on ESG – ranging from a hard line on exclusion screening, through to being anti-ESG. The result is a split between "sector shifting" through full or partial divestment versus transitioning assets.

> *The lack of ESG capacity within infrastructure companies is a barrier for the successful delivery of transition plans.*

As reported in GLIO Journal issue 9,[1] strict criteria can see companies excluded with more than 5% revenues from coal generation, or even nuclear power exposure. In the latter camp, the successful transition of Danish Oil & Natural Gas (DONG) to renewable energy giant, Ørsted, is worthy of note.

1 https://en.calameo.com/read/005185466d83293b468ac?page=44

Making the transition

Effective stewardship and the use of voting rights could be the key to a successful transition. For listed companies, this could mean addressing investor demands on transition progress or, in the private sector, leaders prefer majority and full ownership to enact change.

Can all infrastructure assets transition to net zero carbon? Our guests felt that it was easier for real estate and that the measures were clearer for those assets. The plethora of carbon accounting standards doesn't provide clarity.

However, the Transition Pathway Initiative is an industry drive which is trying to provide useful, sector-specific guidance. The lunch conversation focused on operational GHG emissions, and there was no discussion of embodied carbon, which is a preoccupation for real estate. Other ESG categories, including green and social infrastructure, were not mentioned.

Like many others, these investment managers are being bombarded with information

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requests. This is time-consuming for them and for the infrastructure companies, where many of them do not have in-house ESG expertise nor resource. It is even harder for debt providers who are one step removed.

Lacking a standard baseline

There is no standardisation, and guidance developed for corporates is being forced into the requirements for real assets even when the risks are different. This means that, in some cases, data is being shared which doesn't represent the underlying operational ESG risks and opportunities for infrastructure.

EU regulations, like Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy, are expected to drive data collection and use. The UK, Singapore and Japan are all following suit. Even the US Securities Exchange Commission could require mandatory climate risk disclosure in line with the Task Force on Climate-Related Financial Disclosures (TCFD). Better guidance on how to interpret and use data this would be welcome, as guidance for real assets is scant.

The lack of ESG capacity within infrastructure companies is a barrier for the successful delivery of transition plans. Given the war for ESG talent and the shortage of supply in technical skills, this could be a systemic risk for real assets, both infrastructure and real estate. Proxy data will have to be used.

At the moment, the best quality disclosures are from a variety of companies who are open, transparent and prepared to engage with GLIO and GRESB. Many of these companies own and operate legacy assets which have a more material impact on the environment. This is reflected in the recent GRESB scoring, which values the availability of data and information transparency more highly than progress on material performance.

GRESB is the best available option at present, and there was a recognition that this doesn't make all of the ESG risks transparent for investors. This is clearly an area for development in the short to medium term.

Given the variety of investor information requests, there is an expectation that tailored metrics may be required, which adds to the confusion and makes standardisation more difficult.

Where ESG is being integrated into investment decisions, screening is a popular approach. ESG knowledge is appearing in investment committees. While there may not yet be ESG 'red lines', there are some amber ones which will, for example, reduce over time a fund's exposure to fossil-fuel intensive sectors.

Impact of fossil-fuel exclusion

There was a clear consensus that some sectors, like coal, will be fully excluded within this decade, if not already. Oil & gas infrastructure is being given more leeway, but the clock is ticking. However, utilities companies also own electricity infrastructure – essential transmission and distribution lines, which needs to grow and be renewed – so starving them of capital through strict screening could slow our shift to electrification of transport, buildings and industry.

Another approach to ESG integration is via valuations, with the discount factor tweaked to represent both downsides and upsides. Alignment with SDG objectives is also happening, but mainly focused around clean energy and climate change.

Both of these approaches require both forward-looking and historical data. Some managers are looking for this from third parties with some difficulty, but others insist that these models will only be created in-house. For the long-term holding periods of infrastructure assets, this forward-looking perspective has to be refined in the short to medium term.

Clarity over climate action and a clear policy framework will be a determining factor for both mitigation and adaptation infrastructure. Important decisions have to be made at inception to avoid making transitions impossible.

EVORA Global will continue to work with GLIO and our clients to make this evolving process easier, improving the quality of data and putting it to more effective use in decision-making.

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