Infrastructure investors are leading other real assets

In October, EVORA Global and GLIO hosted a lunch with a select and 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.

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

As reported in GLIO Journal issue 9[1], strict exclusion criteria can see companies with >5% revenues from coal generation, or even nuclear power exposure excluded. In the latter camp, the successful transition of Danish Oil & Natural Gas (DONG) to renewable energy giant, Ørsted, is a resounding success story. Effective stewardship and the use of voting rights could be the key to requiring a successful transition. For listed companies this could mean addressing investor demands on transition progress or on the private side majority and full ownership is preferred by these leaders 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 help provide clarity. However, the Transition Pathway Initiative is an industry initiative 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 present 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 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. 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 SFDR and the Taxonomy, is expected to drive data collection and use. The UK, Singapore and Japan are all following suit. Even the US SEC could require mandatory climate risk disclosure in line with TCFD. If this is accompanied with better guidance on how to interpret and use data this would be welcomed, as guidance for real assets is presently inadequate.

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

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 coming 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 of metrics more difficult.

Where ESG is being integrated into investment decisions, screening is a popular approach. ESG knowledge is appearing in Investment Committees and whilst there may not yet be ESG 'red lines' there are some amber ones. Reducing over time a fund's exposure to fossil-fuel intensive sectors. There was a clear consensus that some sectors, like coal, will be fully excluded within this decade, if they're not already. Oil & Gas infrastructure is being given more leeway, but the clock is ticking. However, utilities companies also own our electricity infrastructure – essential transmission and distribution lines, which needs to grow and be renewed, so starving them of capital through screening could slow our shift to electrification of transport, buildings and industry.

Another approach to ESG integration is in valuations, with the discount factor being 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 forward-looking, as well as historical, data. Some managers are looking for this from third parties, with some difficulty, but others are insistent that these models will only be created in-house. For the long-term hold 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.

Our lunch was a rich conversation, showing how much is already being done to integrate ESG into infrastructure investment decision and how much is still to be done. EVORA Global will continue to work with GLIO and our clients to make this easier, to make better use of the data available, to improve the quality and put it to use effectively in decision-making.