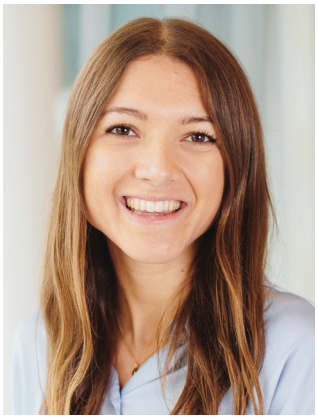
KEYNOTE INTERVIEW

Building a more sustainable tomorrow



Decarbonising the economy and building sustainable cities and communities means both investing in new infrastructure and adapting existing assets, says Infracapital's Alexia Savva

Sustainability has moved from being an investment theme to becoming the lynchpin for nearly every decision that infrastructure fund managers and their portfolio companies need to make. The increasingly evident effects of climate change, combined with shifts in societal attitudes and policymaking, present both risks and opportunities for investors. Alexia Savva, responsible investment manager at Infracapital, explains why it is vital to back the development of new, cleaner assets as well as continuing to future-proof existing infrastructure, and to foster new talent to build a more sustainable tomorrow.

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Q How do you see sustainability as a disruptor and how does this translate into opportunities?

Sustainability is disrupting every sector as issues such as climate change, population growth, biodiversity, human rights and consumer expectations rise up the agenda. Companies need to evolve and reprioritise to maintain their legitimacy and social licence to operate.

From a pipeline perspective, the increased focus on sustainability – from the critical need to modify practices and reduce environmental impact, to the advancement of technology and the digitalisation of infrastructure assets – presents opportunities for us. This now takes the form of supporting new businesses and sectors or transitioning businesses to more sustainable models – all with the ultimate aim of generating positive outcomes for our investors and society alike. When coupled with core infrastructure characteristics, we are seeing meaningful investment opportunities for us to support.

Q Could you give an example of such investment opportunities?

Supporting the energy transition is a key example of this. The focus on climate change and the critical need to accelerate the transition to a low carbon economy is generating an abundance of

emerging technologies complementing those that already exist to support the net-zero agenda and, therefore, a wealth of opportunities for infrastructure investors to explore.

The challenge is to determine which technologies have the staying power and longevity so as not to be superseded in a few years. This also goes beyond renewable energy generation to the storage and network infrastructure required to support it.

We have been an early mover in a number of industries that are actively providing solutions to 21st-century sustainability challenges. Examples include backing sustainable heating systems and heat pumps through our investment in Eteck in 2017, and electric vehicle charging infrastructure through our investment in Recharge in 2020. There are also many parts of our economies, whether industrial production, transportation or residual heating, that simply cannot be replaced overnight and therefore adaptation of existing infrastructure is of crucial importance.

The transport sector is at an inflexion point and, in parallel, there is growing demand for infrastructure systems to become more sustainable and cut emissions. In the logistics space, one of our portfolio companies, Inland Terminals Group, an inland terminals business in the Benelux region, seeks to provide a sustainable and efficient alternative to road transport using inland waterways to run a fleet of barges, some of which are hybrid and/or electric-ready.

It is helping to decarbonise supply chains, as customers increasingly seek to manage their Scope 3 emissions – this is an example of the interplay of sectors and the role that infrastructure plays, as the backbone of society, in the delivery of sustainability objectives.

Equally, if we look at the utilities sector, we are seeing decarbonisation and decentralisation affecting traditional business models. Our portfolio company Last Mile Infrastructure illustrates this. It designs, installs, owns and operates multi-utility networks in the UK, including those for gas, electricity, water and wastewater. We are working alongside the management team to innovate and maintain the longevity of its business model.

Last Mile's joint venture with heat pump infrastructure business Rendesco is an example – it offers residential and commercial developers ground source and water source heat pump and cooling infrastructure. In essence, providing housebuilders across the UK with a more sustainable and cleaner energy option for heating properties.

Q How much progress is being made on standardising data and being able to compare outcomes?

Data drives decisions and behaviour, so it is important to make progress in data availability and accuracy. We have done a lot as an industry on establishing standards to monetise many areas that sit under the "ESG" umbrella. However, while it is more straightforward to quantify areas such as greenhouse gas reductions or resource efficiency, there are other ESG factors that remain difficult.

How do you report on the future impact of opex spent on stakeholder engagement in construction projects, for example? There is a financial benefit if you don't have local opposition to a project or if you ensure you have strong and effective labour rights, but it is difficult to equate cost to benefit in financial terms.

Projects such as the ESG Data Convergence Initiative, together with increasing regulatory focus on reporting, will help with creating like-for-like comparisons and provide a better indication of what "good" looks like. However, we do need collaboration across the entire industry to ensure effective use of data. The push to collect increasingly vast amounts of data points continues to gain pace but we need to make meaning out of it all.

Q How do you see policy supporting infrastructure to become more sustainable?

Policy plays a significant role in facilitating capital flows and encouraging sustainable practices. We operate in an increasingly competitive global economy where long-term economic growth in Europe needs to be underpinned by infrastructure investment.

The energy transition as a means to limit and mitigate against climate change has strong support from international policy initiatives and that provides a catalyst for businesses to commit to change and develop solutions. EU policies and legislation – and those on a national level – are providing subsidies and tax and revenue incentives

that facilitate private investment in this space.

A retreat on net-zero policies, or the means to meet national and international commitments, can undermine corporate confidence, making strategic planning challenging. The UK, for example, has a legacy of leading on net zero, but we need a route to get there, and investors need stable policies if they are to commit over the long term. In areas such as gas boiler replacement and EV charging, the policy shifts will influence the speed of delivery.

Q Infrastructure is particularly vulnerable to the effects of climate change. How can you future-proof assets and businesses?

These are long-term investments, so resilience and adaptation are particularly important as this impacts the ability to deliver strong risk-adjusted returns. Technological advances, changes in regulation and policies, and natural disasters, for example, could leave assets at risk of being stranded.

The next generation of infrastructure will be subject to increasing degrees of complexity and we are already seeing the impact of climate change today, having witnessed a spell of significant climate events in 2023 alone. To manage this, we need access to granular data to drive and inform business mitigations and strategic decisions.

Climate risks are already material for a number of investors in infrastructure assets even if these are located in developed economies. We have run a physical climate risk scenario analysis on high- to medium-risk critical locations in our portfolio, across varying climate perils in different representation concentration pathways.

Understanding the knock-on implications to cost, through business disruption for example, is fundamental in risk and financial analysis. This exercise isn't without its difficulties due to the complex nature, and network aspect, of many infrastructure assets and their interplay with other adjacent sectors. The transition risk element side is also important – and we have touched upon the role that policy plays in this.

> *"Stakeholders increasingly want to see that sustainability is authentically integrated into business models and we need to be able to illustrate social and environmental outcomes"*

The other point is that social licence to operate is a potential vulnerability for infrastructure. It has always been important given the numerous stakeholders with which infrastructure assets interface, but it now encompasses a whole range of sustainability factors, including climate change, resources, digitalisation and population changes. Stakeholders increasingly want to see that sustainability is authentically integrated into business models, and we need to be able to illustrate social and environmental outcomes, which goes to the importance of data.

We consider all of this when we think about future-proofing our portfolio businesses, coupled with implementing effective corporate governance to help a business identify shifts and changing factors, ensuring it is resilient and adaptable.

Q How important is DE&I in all this?

Simply put, and putting the moral case to the side, we believe it drives resilience, innovation and success. Therefore, fostering more diverse talent and creating an inclusive environment for those of diverse backgrounds and experiences to thrive, is of fundamental importance.

It is an exciting time to be working within the infrastructure asset class. It is at the heart of the world's energy transition and will play a crucial role in the delivery of a sustainable future.

We are experiencing new pools of talent wanting to work for organisations that are purpose-driven – which aligns with the investment theses of responsible infrastructure managers. And we need diversity of thought and experience to identify new opportunities, to challenge traditional ways of working, to formulate innovative solutions – all aspects fundamental to the delivery of the infrastructure of tomorrow.

We are seeing the importance of this across the suite of sectors in which we invest. If we take the rail freight sector as an example, we continue to face a notable skills shortage caused by poor diversity, an ageing workforce and difficulty in attracting people into engineering disciplines. This comes at a time of major investment need and growth. The drive to foster a more diverse workforce, coupled with the culture to make such a workforce thrive, supports many social and economic outcomes.

We work in a sector where challenges are pronounced. This is why we are breaking the mould of traditional recruitment practices – we have sought to formalise our commitments for board and management team diversity at the portfolio company level. As an industry, we need to understand what the barriers to entry are. We helped establish the Infrastructure Industry Foundation, for example, which has raised close to £1 million ($1.22 million; €1.15 million) in support of a social mobility programme for the industry.

As a collective we have the opportunity, and arguably the responsibility, to move the dial and inspire and empower the next generation of talent. After all, we work in an evolving and exciting sector, and it is in all of our interests to lift up a new generation of talent and provide access to roles in the industry. ■