KEYNOTE INTERVIEW

The ripple effect of sustainable infrastructure

Infrastructure investment can be the catalyst required to revolutionise a community's way of life, says Ashwin West, head of sustainable infrastructure investment at BlueOrchard Finance, member of the Schroders Group

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Q Why is sustainable infrastructure an attractive investment proposition today?
Infrastructure as an asset class typically has a positive impact by its very nature. Sustainable infrastructure, however, considers the social and environmental effects of that infrastructure in a very deliberate manner. The objective is to avoid harm and maximise the benefits of the infrastructure being developed, and that is very appealing to investors today.

Q And why is emerging markets infrastructure debt appealing?
Many investors have been looking for higher-yielding instruments in the low interest rate environment we have experienced for many years. Structured debt has demonstrated that it can deliver those superior yields, while also offering a relatively low probability of default and a high recovery rate. Emerging markets infrastructure debt, meanwhile, tends to offer a higher margin than developed markets debt, but with a risk of default that has been shown as only marginally higher in recent years.

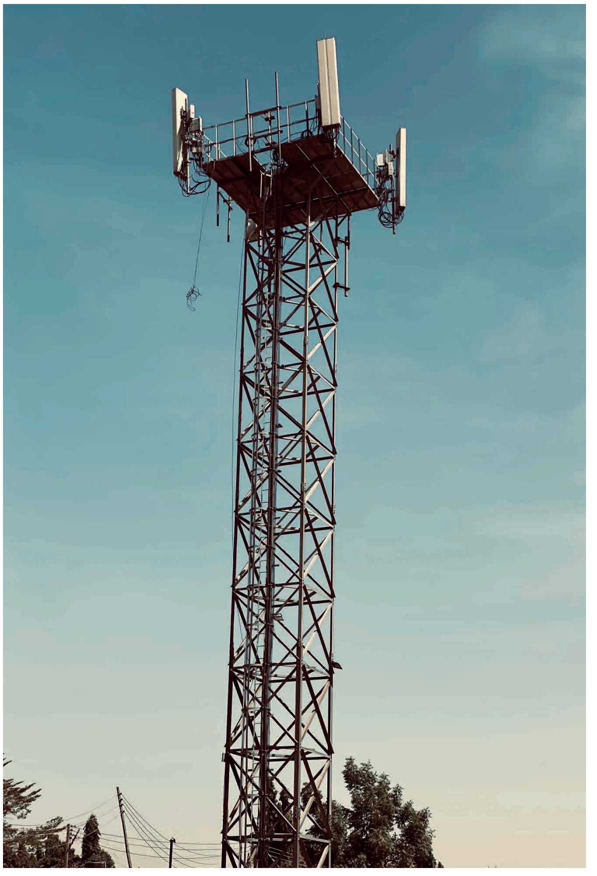
Q Energy is clearly one of the most significant areas of sustainable infrastructure. Where do you see the most interesting opportunities in that sector?
Renewable energy is a sector that everyone is looking at, given the global drive to achieve net-zero emissions. There are two elements to consider. The first is grid-connected renewable energy – large-scale projects that sell power to a national utility and supply it to households and businesses. The second is off-grid renewable energy, providing electricity to commercial and industrial customers that cannot rely on

Q What is the power of digital connectivity for emerging markets communities?
If you go into a rural village in Africa – Rwanda, for example – it may seem as though everyone has a mobile phone. What they don't always have, however, is reliable mobile connectivity or even electricity. If they want to use their phones, they will walk, often long distances, to another village and pay a fee to charge their phone and use that connectivity, before returning home.

By providing mobile phone towers in these rural settings, these individuals can suddenly access digital services through their mobile phones without wasting hours travelling.

For example, they can access mobile money reliably, which catalyses access to additional services, such as electricity or other utilities on a pay-as-you-go basis. They can obtain credit to purchase solar home systems that provide light, and the ability to charge their phones. Once they have a solar home system, they can start moving up the energy ladder, next gaining access to gas for cooking. No longer requiring wood, kerosene or charcoal saves them both time and money.

All of this is made possible by the installation of a mobile network tower in the village. That is the type of impactful and sustainable infrastructure that we like to finance.



a centralised power system and instead have to provide the power themselves.

They typically do this with diesel generators, either as a back-up source or possibly as the primary source of energy. But the cost of renewable energy has decreased significantly, and battery storage appears to be moving in the same direction. That means renewable energy plus battery storage now represents a viable and reliable replacement for these diesel generators.

We see this as a huge and growing investment opportunity, which both supports the energy transition and reduces the overall cost of energy for commercial and industrial users, at a time when utilities are routinely increasing prices, often in excess of inflation.

The other sector where we see opportunities is the shift from carbon-intensive forms of transport to greener alternatives – things like river barges, ports and logistics, and even rail. These are forms of infrastructure investment that are helping drive climate mitigation, but which don't necessarily get all that much attention from investors.

Q The importance of digital connectivity for communities has been highlighted through the pandemic. Is this another area where you see opportunity in emerging markets?
Absolutely. What we are talking about here is the infrastructure that provides connectivity in the mobile network operator universe. Over time, the mobile network operators have gone from owning their own towers to outsourcing towers to third-party operators that then provide the service back to them. We are seeing a lot more opportunities in that sector because, of course, the world is becoming increasingly reliant on digital communication and, as you say, covid has accelerated that trend as everyone was forced to work from home.

Many communities across Africa, and even Asia, have poor connectivity and sometimes no connectivity at all. These communities are being left behind from a technology perspective. They are missing out on access to services and on life-changing opportunities. The impact created by these digital investments is therefore huge.

Q How does Schroders, and BlueOrchard in particular, fit into the emerging markets sustainable infrastructure investment landscape?
In this space, you typically see two categories of investors. At one end of the

spectrum, you have the development finance institutions and international commercial banks that are looking to make investments of $100 million, or more, working primarily on very large-scale projects.

At the other end of the spectrum, you have the local banks, typically deploying much smaller amounts of capital and over relatively short tenors. The local facilities tend to be more in the form of working capital, or lines of credit that differ significantly from longer-term investments in a project.

We see a gap when it comes to financing mid-cap projects, which have long-term need for capital, but tend to fall in between the offerings of large-scale investment and short-term working capital lending. In this context, our products are well aligned to support infrastructure development based on both risk appetite and our ability to move deals quickly, in comparison to larger institutional lenders.

Q How do you tackle misperceptions around emerging market risk?

When you really delve into the data, the loss rates on project finance debt in emerging markets are not all that different than the loss rates in similar projects in developed markets. It depends on the region you are operating in, of course, but the difference is relatively small and more than offset by the potential for social and environmental impact.

Furthermore, when we look at emerging markets deals, we see many similarities in structuring and documentation as seen in even the most sophisticated developed markets transactions.

There are a number of risk mitigants that we can employ, including, amongst others, credit insurance and political risk insurance, that give the lender protection against borrower default.

Of course, we also look to implement debt service reserve accounts and have appropriate financial coverage ratios in place that prevent borrowers from undertaking certain activities. We structure deals to apply cash sweeps and have early warning mechanisms that flag any projects that are starting to head towards difficult territory financially, so that we can implement appropriate measures to manage the risk of default. These are all ways of reducing the overall risk of default, and managing recovery in the event of default.

"We see a gap when it comes to financing mid-cap projects"

Q How do you measure and manage the impact of your investments?

Impact is a part of BlueOrchard's DNA. It is incorporated into everything that we do. We have a proprietary framework, called the B.Impact framework, which we use, first of all, to evaluate the potential impact of an investment across a number of themes that are mapped back to the SDGs. That process generates an impact score. If a transaction doesn't meet a certain threshold, then it won't be considered.

Assuming it does pass, we then delve into the structuring of the transaction and at that point set KPIs that we monitor during the operational phase. The borrower is required to report back to us on those KPIs and we are required to report back to our investors.

We may adjust those KPIs based on that feedback loop, potentially looking at additional impact metrics or engaging with the borrower. It's a process of review, measure, monitor and report and an approach that we have used for a long time, constantly refining it, in the context of our broader private debt platform.

Q What does the future hold for sustainable infrastructure investment in emerging markets, and what are your plans as a firm?

I think the concept of doing well by doing good is well entrenched and that, after all, is what infrastructure sets out to do. But I do think we will see a change in the type of infrastructure that we are investing in. We are seeing a move away from larger core infrastructure projects to the smaller decentralised power projects and digital infrastructure investments.

That change is taking place due to a number of challenges that are becoming increasingly pronounced, including a lack of political will to create the necessary environment for large-scale sustainable infrastructure roll-out. That lack of political will means it takes a long time for those large projects to be developed, and developers don't have the opportunity to leverage learnings and create replicability. Certainly, we are not seeing many large-scale opportunities coming to market that are properly structured and bankable.

As a result, we are looking at infrastructure projects that don't necessarily require that same level of government interface or regulatory support. These projects won't even require sovereign guarantees or liquidity support in some cases.

In terms of our own plans, we will deploy capital in the infrastructure debt space with the goal of mitigating climate change and closing the SDG funding gap. Our product offering will expand over time with the goal of delivering positive impact and compelling returns for our investors. ■