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SUSTAINABLE LOW-CARBON MULTICURRENCY INVESTMENT

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Increasing long-term value

Mobilising private sector participation

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Sound public policy, aligned with private initiative to develop innovative financing tools, could deliver needed infrastructure investments. Global Public Investors can play a role by increasing their allocation to infrastructure assets in the long term.

Investments in infrastructure and other 'real' assets are becoming attractive to institutional investors aiming to improve portfolio returns in a very low yield environment. At the same time, a growing proportion of investors recognise climate change as a threat to financial performance because of physical or regulatory risk. These developments present investors with an opportunity to both bolster long-term value and contribute towards improving the quality of life of millions of people around the world.

Getting to climate-smart or 'sustainable' infrastructure is challenging because it requires the right combination of public and private action. Public investment alone is insufficient. But sound public policy, aligned with private initiative to develop innovative financing tools, could deliver the needed infrastructure investments.

The OECD estimates that $70tn of infrastructure investment is needed by 2030 simply to maintain current levels of global GDP growth. Between one fifth and one quarter of this is needed in emerging and developing economies to achieve the goals of sustainable development and poverty reduction.

Lack of infrastructure has an enormous economic and social cost. More than 1.3bn people – almost 20% of the world's population – still have no access to electricity. Around 768m people worldwide lack access to clean water; 2.5bn lack adequate sanitation; 2.8bn still cook their food with solid fuels (such as wood); and 1bn live more than 2 kilometres from an all-weather road.

Climate change adds a twofold challenge to infrastructure development. First, different and additional investment is needed to minimise its direct impacts, such as intensified flooding, droughts, and increased severity and frequency of extreme weather events. Second, to avoid 'lock-in' of fossil fuel-dependent infrastructure systems, growing economies need to shift to low-carbon development paths.

Putting a social price on carbon would provide an incentive to shift to low-carbon options. But even in the absence of this, other measures can be introduced today – such as planning and building denser cities, expanding and improving public transport systems, and increasing renewable energy sources' share of the global energy mix.

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The World Bank Group is a strong advocate of these low-carbon approaches to promote climate-smart infrastructure development. This is where adaptation to (infrastructure investment) and mitigation of (low-carbon growth/emission reduction) climate change come together. The World Bank holds the secretariat for the Partnership for Market Readiness – a global initiative under which 30 countries provide funding and technical assistance to develop and pilot market-based instruments to reduce greenhouse gas emissions – and participates in projects the programme supports to create second-generation carbon markets.

But even with good policy complemented by available public funding, private capital is needed to bridge the infrastructure gap – particularly projects that also address climate change risk. Institutional investors such as insurance companies and pension funds can play a role by increasing their allocation to infrastructure assets in the long term, as they seek predictable yield to duration to match their future liabilities and payments. Certainty about the conditions that sustain returns over time are key for these investors.

Public entities can take a number of actions to increase certainty and provide a stable environment for investment. Reducing the risk that a government, municipality, or other commissioning body will change the terms of a project subsequent to its funding (for example, changes in the tariff regime or removal of subsidy support to renewable energy) is critical to fostering an environment of certainty. The World Bank Group, including the International Development Association, the International Bank for Reconstruction and Development, the International Finance Corporation and the Multilateral Investment Guarantee Association, provides guarantees to help mitigate such risks.

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Similarly good data, transparency in a project's cash flow projections and clear rules of procurement play important roles, and explain why it is hard for many countries to create investable infrastructure pipelines. To address this difficulty, the World Bank created the Global Infrastructure Facility to facilitate the design and structuring of complex infrastructure projects, aimed at mobilising private sector participation and institutional investor capital.

The GIF can support climate-smart investments such as low-emitting power generation, power or gas transmission projects that bring efficiency to energy markets, and power distribution projects with significant potential for loss reduction. It also looks at mass transit projects, including metro, passenger rail and bus rapid transport systems, and water production and/or supply projects which address water scarcity, security, flood management, and other aspects of climate resilience.

Facilitating private sector lending constrained by new capital requirement rules is another area in which public entities can play an important role. The World Bank Treasury is developing innovative financial structures that not only reduce construction risk and create bankable projects, but also help private sector banks increase the availability of liquidity for investments in infrastructure assets with climate change adaptation components.

The World Bank Treasury has developed financing tools that address these challenges while funding its middle-income country lending business. For example, the IBRD has been involved in the green bond market since its inception and has been instrumental in its development. Since issuing its first green bond in 2008, the IBRD has issued $9bn through 120 green bonds in 18 currencies. Green bonds provide a way for issuers to diversify their investor base and mobilise more private investment for climate-smart projects.

Green bonds are encouraging a culture of disclosure on the use of funds raised on capital markets

The World Bank's first green bond introduced the concept of a second opinion and a transparent process, which has provided a solid foundation for the market's expansion. In addition, the World Bank Treasury initiated an effort to harmonise metrics and impact indicators for green bond reporting on renewable energy and energy efficiency projects – a move welcomed by investors appreciating the increased transparency.

The green bond market is encouraging a culture of disclosure on the use of proceeds and expected impacts for funds raised on capital markets. This can help the broader infrastructure bond market and sustainable capital markets in general.

In the area of disaster risk financing for emerging markets, the World Bank Treasury has issued catastrophe bonds, and executed or arranged risk transfer transactions such as weather risk derivatives and contingent financing facilities. For example, it arranged weather hedge transactions to help Malawi transfer the risk of drought to market counterparts. For Uruguay, whose energy supply relies heavily on hydropower, the World Bank Treasury helped design a contingent financing scheme triggered when drought conditions cause its energy stabilisation fund to fall below a defined level.

Combining supportive public policy and innovative financing tools that enable private participation requires sustained effort, and is the subject of much of the World Bank's continuing work in client countries. We are encouraged by the growing interest and shift of capital towards infrastructure assets. According to the 2015 Preqin Global Infrastructure Report, in June 2014 the amount of unlisted infrastructure assets under management had increased by 85% over the previous five years, reaching a record high of $296bn.

The case for supporting infrastructure investments, particularly those incorporating climate change risks and low-carbon options, is key to sustaining economic growth and poverty reduction. Official sector investors can act as both investors and stakeholders, promoting sound public policies and conditions for infrastructure financing. By using their assets for sustainable infrastructure, they can invest in a better future. ■

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