Infracapital

Infrastructure managers shifting gears to be able to quantify ESG, D&I initiatives

Chase McWhorter, Institutional Real Estate, Inc.'s managing director, *Institutional Investing in Infrastructure,* spoke with **Carolyn Pearce,** managing director responsible for investor relations and ESG for Infracapital. Following is an excerpt of that conversation.

What current trends are you seeing in ESG, and what are some areas of focus to create real value when it comes to ESG?

One of the trends in recent years has been a regulatory requirement for increased transparency, at the same time as an increasing demand from investors for greater data and greater evidence. Ultimately, this is a positive development because it requires GPs to be held accountable and evidence the improvements and actual value coming from ESG initiatives, and that is only going to increase over the next few years.

One current area of focus of investors is that: (1) You report on your carbon emissions or your climate risk and be able to actually quantify it; and (2) You make some sort of commitment to being net zero by a certain date in the future. Hard accountability is definitely the greater theme we are seeing in that space.

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There is also a new focus, with even greater momentum in the last quarter, on diversity-and-inclusion initiatives, particularly with the spotlight on racial equality. Some of this is likely the result of COVID-19 and people becoming increasingly aware of the wider community in which they operate. But also people are recognizing the benefits of having a more diverse team and the value of diverse thought. A few years ago, you would hear people say that it was very hard in the infrastructure sector to recruit diverse people, because, for example, we are sourcing from investment banks or typically looking for people who have experience in infrastructure investing to come into a fund, so there is not a diverse pool from which we can hire. But that is not good enough. We are asking ourselves, what can we do to go to the root of the problem? We are looking at driving initiatives starting at the schools to attract a more diverse pool of talent into the sector. You need to be part of the solution, rather than just saying, we are the byproduct of a wider societal issue. We are hearing from investors that this is an area they want to see greater focus and greater change.

So how do firms like yours go about generating that change?

You need realistic targets for different levels. For example, if we were going to say right now we want a 50 percent gender split at the managing level, that is difficult. At the very senior level, you are looking for a certain level of infrastructure experience. But we can make sure we recruit in a positively disproportionate way at the associate level, where you are hiring people out of universities or graduate schools. We are looking at a kind of rolling target for each level, and ultimately, over time, you should see that drive through toward leadership positions. As well as addressing the flow of people into the firm, something you have a lot more control over is the retention. Retention initiatives may include flexible working hours, mentorship, attractive maternity- and paternity-leave packages to ensure that you are not losing female employees once you hire them into the organization.

Last year, we launched our Infrastructure Investor Foundation to raise money toward cancer research for a colleague of ours who was diagnosed with a rare form of cancer. The industry got behind us and said, this is a fantastic idea, why don't we make this a permanent foundation that supports other causes? So this year, in light of COVID-19 and everything that is happening in the wider society, we have decided to focus on supporting the underprivileged, who don't get exposure to the same opportunities. How can we set up mentorships, or have our organizations going into schools and presenting about the sector, and raising awareness of the sector? Equally, we can offer internships and apprenticeship-type roles across not just funds, but portfolio companies, as well. The foundation is just starting conversations with certain charities and organizations across Europe, and we are also wanting to expand into America next year. A number of GPs fully support us, because everyone is recognizing we need to be doing more to get diverse talent in.

Elaborate on diversity and inclusion, and how that fits into meeting ESG standards. Can you share any examples at the portfolio-company level?

Infrastructure assets provide essential services. We are obviously integral to the communities in which we operate, so our staff should ultimately reflect the communities in which we operate. Deloitte did a study that concluded companies that have a more inclusive and diverse workforce are about 1.7 times more innovative. The infrastructure sector invests in long-term assets that need to have long-term value, but meanwhile the world is changing and constantly evolving, particularly in terms of technology. The need for infrastructure funds to be innovative is only growing. I remember a decade ago sitting in meetings and people would say, our sector should be a relatively boring sector given it comprised infrastructure for essentials such as water and energy — how wrong that is in light of infrastructure's critical role in addressing climate change. And then research has suggested that firms in the top quartile as it relates to gender diversity have better financial returns — about 15 percent better. So there is a business case for D&I, as well.

A focus for our portfolio companies recently has been employee mental health. Before when we used to speak about our employees' health and safety, we thought of it in terms of accident prevention and physical safety. Very often, the infrastructure portfolio companies have comprised a male-dominated workforce. There were real issues with regard to mental well-being, but there was stigma within a lot of the companies about employees communicating stress and problems like that. Consequently, across a vast array of our portfolio companies, this has actually been a big area to focus on — working to make sure portfolio companies are driving employee engagement and retention, making the companies attractive places for minorities to work in, and generally removing the stigma around mental health.

What are the investor attitudes toward ESG? How have you seen those evolve?

Not only do you see government regulation driving this greater disclosure, but also investors are now making serious commitments, and requiring evidence of measurable action. Investors want the data to show you are actually doing what you say you are doing. I think we will get to the point where GPs will risk losing access to capital if they don't meet a certain kind of standard around ESG. Ultimately we are investing in opportunities because there is a need for new infrastructure that addresses society's climate or sustainability challenges. A positive ESG impact is not just a pleasant byproduct but requires a more proactive approach and intention to ensure this. Investors have a material role to play in mobilizing and forcing the momentum behind ESG action.

Shifting gears a bit, what are some trends you've seen emerge from COVID-19?

People are becoming increasingly aware of the fragility of interconnected systems in the world in which we live and operate. As much as we might want to live in our own little silo, our lives are indelibly linked to the health of the wider economy and the global economy. The pandemic has made people alive to the need for much more sustainable lifestyles and sustainable businesses. As it relates to the infrastructure space, there is a much greater focus on the communities in which we operate, but also the long-term resilience of companies. Very few, if any, people imagined there could be a shock that would cause such a meaningful impact on certain infrastructure assets — typically stable, resilient businesses. For example, no one would have forecast when buying an airport that something would suddenly shut down your airport for a year or more. COVID-19 has made people much more aware of the fragility of any business.

In terms of the energy side of the infrastructure business, everyone is having to reconsider forecasts. Investors now are wanting to better quantify both the physical asset risk as it relates to any shocks that might come, but also that kind of transition risk that comes from the fact that we must evolve to a more green and sustainable energy mix, and governments will be focusing on "building back better." There were trends bubbling away, such as the fiber side, that obviously have been amplified by work-from-home requirements, and there will no doubt be a focus on making sure that there is digital inclusion, as it relates to fiber coverage. Meanwhile, in the face of all of the distraction from COVID-19 in the past year, the commitment to reach net zero by 2050 doubled, and that impacts a number of businesses with which we operate — transport businesses, rail businesses, gas networks.

Do you expect to see a pivot in managers' strategies toward impact-investment funds?

The market has coalesced around the definition for an impact investment — an asset that is likely to deliver material, measurable, positive societal impact, most likely by addressing one of the world's major environmental or societal challenges, and hopefully generating economic returns. In many ways, infrastructure has already been an impact investment, in that it provides a societal need and essential service. The current efforts from both GPs and LPs at the moment to be able to quantify their ESG performance will actually help more traditional funds get to the point where they can check that impact box, as well, albeit they will need to be intentionally embedded into strategy commitments. Investors who have increasingly large allocations to infrastructure want to be able to both make an allocation that makes sense from an economic point of view as it relates to their portfolio composition, but they also want to know that their money is "doing good" and is invested in sustainable investments.

A hybrid model is emerging where a number of successful existing managers are starting to offer impact strategies that co-invest alongside their existing funds. They will invest in the assets that check that impact box, and investors will get that consistent organizational discipline, the same team that they are familiar with, the same track record and same approach to managing those assets — along with the subset of assets that can satisfy the impact box.

CONTRIBUTOR

Carolyn Pearce

Managing Director, Investor Relations and ESG

Infracapital.Investor.Relations@infracapital.co.uk

CORPORATE OVERVIEW

Infracapital invests in, builds and manages a diverse range of essential infrastructure to meet the evolving needs of society and support sustainable long-term economic growth. Infracapital takes an active role in all of its investments to ensure they are adaptable and resilient, while working closely with local communities. Infracapital has raised and managed more than £6.5 billion ($9.02 billion) across six funds since 2001.

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