FINANCE
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Sustainable investing: megatrend **sustainable urbanisation**

Today, 3.4 billion people, or half of the world's population, live in cities. By 2030, the number will have risen to five billion – 60 percent of the global population.

Article by
Dr Mirjam Staub-Bisang
CEO AND MANAGING PARTNER, INDEPENDENT CAPITAL GROUP AG

Each year, an additional 75 million people will settle in urban areas, mostly in the rapidly growing emerging economies across Asia, Africa and Latin America. The urbanisation rates of developing countries are four times higher than those of developed countries. And megacities, or those with a population of more than 10 million, are on the rise. In 1950, New York was the world's only megacity; by 1990, that number had climbed to 10. Today, the number has nearly tripled to 28 megacities globally, with China alone counting six of them.

How cities grow will be an important factor impacting sustainability for decades to come. If their growth is not managed properly, cities can be a major drain on natural resources. Cities produce close to 70 percent of global greenhouse gas emissions. The environmental challenges of densely populated urban areas relating to waste disposal, energy efficiency, water and air quality are enormous. In many cities, the strain on infrastructure, including housing, sewage, electricity supply, and transportation, has become unbearable, resulting in a miserable quality of life for many.

Yet, if designed and managed right, a different standard emerges. Some of today's most liveable large cities, such as Singapore, Vancouver and San Francisco, stand out with their compact design, low carbon emissions, and green spaces. Sustainable cities focus on the natural ecosystem and try to protect it by reducing waste, improving energy efficiency, and conserving fresh water and clean air, hence ensuring healthy and sustainable living for decades to come.

And here lies the opportunity for sustainable investors: investments in sustainable urbanisation.

SUSTAINABLE INVESTING

What is sustainable investing? As markets become more and more interconnected, the effects of environmental and social pressures resulting from food, water, and energy scarcity; access to natural resources; climate change; environmental disasters and demographic changes increasingly affect investors globally. Sustainable investing is an investment approach that includes full consideration of environmental, social, and governance (ESG) risks and opportunities resulting from these global challenges and includes them in the overall investment process. It is not a new method of investing but rather purposely broadens the scope of traditional risk analysis and management. Sustainable investors are driven by a growing awareness that the consideration of ESG issues in the investment process – mainly in terms of asset allocation, investment selection, portfolio construction, as well as shareholder engagement and voting – is fundamental to assessing the value and expected risk and return of a portfolio of assets over the medium to longer term.

There are different established approaches to sustainable investing: (1) screening strategies which exclude investments in industries that are harmful to the environment or society as a whole; (2) systematic integration of ESG factors in the investment process; (3) thematic investments, with a focus on specific environmental or social investment themes; and (4) shareholder engagement with the purpose of influencing corporate behaviour. Moreover, different terms are used to describe the process of accounting for ESG risk factors in the investment process. While the term "socially responsible investing," for example, suggests an ethical perspective, "impact investing," describes and approach where investors accept a higher risk and/or lower returns to try to make a positive impact on the environment and society. Investments in environmental or social megatrends, such as resource efficiency, climate change abatement, population growth, or sustainable urbanisation – or clean cities, for that matter – can be considered thematic investments within a sustainable investment framework.

INVESTMENT OPPORTUNITIES IN SUSTAINABLE URBANISATION

Driven by high demand globally, companies that provide products and services related to the efficient use of natural resources, such as clean water, air, energy, waste management, and recycling services or technologies, have seen tremendous growth. China, for example, currently invests more than $150 billion annually to fight air pollution. Geberit, the Swiss multinational, profits from urbanisation by providing water-efficient sanitary and piping systems globally; the company has been a darling of (sustainable) investors for years, compounding at an average of close to 20 percent per year for the past two decades. Waste Connections, the American waste management company with a strong focus on materials recycling and reuse, has shown strong growth, creating value for shareholders and stakeholders alike. The exceptional growth of Thermo Fisher Scientific over the last decade has been driven by high demand in China for its air pollution monitoring systems. The Belgian Umicore has long sold off its mining business in Africa and has become the global leader in the recycling of so called electronic waste, such as copper wires from electronic devices.

Urbanisation is a key driver of infrastructure spending. Growing cities in developed and developing economies alike are in acute need of new or modernised infrastructure, as evidenced by crumbling bridges, broken highways, and leaking water pipes. The OECD estimates that over $40 trillion will be invested in urban infrastructure over the next 20 years. Due to public-sector budget constraints, investment opportunities arise for private investors, bridging the large financing gap. Investments in roads, ports, renewable power plants, gas pipelines, and telecommunication assets are in high demand, as they provide attractive, stable returns without the volatility of equity markets and a low correlation with traditional asset classes. Hence, institutional and high net worth investors with a long-term perspective are increasingly investing in infrastructure assets to diversify and thus improve the risk–return profile of their investment portfolio. Infrastructure investments are characterised by some of the following criteria: They meet key public requirements in everyday life, which results in a low elasticity of demand, the high investment costs for the construction of infrastructure assets lead to a (quasi-)monopoly situation with high barriers to market entry; moreover, they generally provide an inherent protection against inflation and regular, stable cash flows.

Healthy cities provide not only sustainable physical infrastructure, but also social infrastructure that addresses the need of a growing and ageing population. Hospitals, schools, public housing, community centres, and governmental administrative buildings are among the pillars of a well-functioning, just, and prosperous society.

HOW TO ACCESS THE ASSET CLASS

To access the asset class, investors follow two main approaches, namely investing in listed and unlisted infrastructure assets. Although both ultimately involve investments in infrastructure, they have certain fundamental differences in their investment profiles. Investors may buy the equity or debt of listed infrastructure companies or invest in listed investment funds or certificates, which bundle a number of individual infrastructure assets and/or companies. Listed instruments offer immediate access to the market and allow investors to easily establish globally diversified portfolios with relatively small investments. The downside of listed liquid infrastructure investments as compared with unlisted ones, is their higher level of volatility and their high correlation with asset classes, in particular equity markets.

In contrast, unlisted infrastructure investments come with the benefit of very low market volatility and consequently with diversification benefits for a portfolio of traditional investments. Direct investments typically require very large amounts of capital and thus are limited to large institutional investors, such as pension funds, sovereign wealth funds and insurance companies. Hence, infrastructure funds tend to be the investment approach of choice for most investors. Due to the illiquidity of unlisted infrastructure investments, they require profound due diligence prior to investing, yet they can compensate investors with stable single-digit to low-teen returns, depending on the chosen risk profile of the investment, which again depends in part on the type of asset, its region, and the financing structure.

Obviously, the investment examples mentioned here were picked from a plethora of opportunities in the context of sustainable urbanisation. Further examples can be found in sustainable real estate, such as resource-efficient office buildings, low-income housing or retirement homes, or also green bonds financing sustainable infrastructure projects in developing countries.

CITIES CAN TRANSFORM THEMSELVES

Cities can transform themselves, with New York being a prime example. In the late 20th Century, Times Square was best known for its traffic jams, neon lights and countless bars. Today, it has been transformed into one of the most innovative and people-friendly areas of any urban landscape. In 2007, Mayor Michael Bloomberg sought to shift the model for the city's growth by increasing revenues while cutting pollution and increasing resilience to climate change. The results have been impressive: carbon emissions were cut by 16 percent below 2005 levels, halfway to their 2030 target. The use of sustainable transportation increased thanks to the installation of more than 300 miles of bike lanes and the largest bike-share program in the United States.

Sustainability and sustainable urbanisation share a common goal: to meet the current and long-term needs of society. How we select, design, and manage the growth of cities plays a key role in how they affect society and the environment today, and for generations to come. **EG**

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ABOUT DR MIRJAM STAUB-BISANG

Dr. Mirjam Staub-Bisang, PhD, is the CEO and Managing Director of Independent Capital Group, an investment management and advisory firm focusing on sustainable investing across asset classes. She is the author of Sustainable Investing for Institutional Investors: Risks, Regulations, Strategies (Wiley 2012); and Infrastructure as an Asset Class: Investment Strategy, Sustainability, Project Finance and PPP (2nd ed., Wiley 2016). She is a Young Global Leader of the World Economic Forum. To find out more about Independent Capital Group please visit www.independent-capital.com