Catalyzing New Coalitions to Accelerate Co-Financing of Sustainable Infrastructure: Challenges and Opportunities

The Pocantico Center of the Rockefeller Brothers Fund, Tarrytown, NY
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President's Summary

The Office of the President of the 71st Session of the UN General Assembly convened a retreat on 12-14 June 2017 at the Pocantico Center of the Rockefeller Brothers Fund, in collaboration with the UN Environment Programme and the School of Advanced International Studies of Johns Hopkins University. The Retreat's focus and title was: "***Catalyzing New Coalitions to Accelerate Co-Financing of Sustainable Infrastructure: Challenges and Opportunities***". The Permanent Representatives of Canada and Jamaica to the United Nations, who are the co-chairs of the Group of Friends of Sustainable Development Goals Financing, also supported the meeting.

The Retreat brought together a diverse group over three days for a robust and wide-ranging discussion of how to finance sustainable infrastructure in developing countries. The group included senior government officials from some developing countries that will be presenting voluntary national reviews of their NDCs at the UN's High Level Political Forum in 2017 or 2018, along with senior representatives from the global private financial sector (including insurance companies, commercial and investment banks, asset managers, ratings agencies, and pension funds). They were joined by leaders from development finance institutions, academia, the UN Secretariat, and other international organizations.

Main Findings and conclusions

1. Despite the private sector-centric narrative around financing development, most infrastructure is actually (and will likely continue to be) financed by domestic resources, both public and private. This underscores the importance of developing local and regional financial markets, and shows the continued relevance of Official Development Assistance for technical cooperation, especially on tax matters, as well as for capacity building.

2. The issue of risk is a central element of the equation and deserves much more attention. Lack of clear methodologies for investment risk assessments and asymmetries in information about investment opportunities continue to result in market failures that hinder the flow of financing towards sustainable sectors. There can be difficulties in conciliating private sector aspirations and country priorities. Innovative risk sharing instruments and more efficient information exchange platforms need to be developed.

3. The UN can and should use its considerable convening power to catalyze robust pipelines of bankable projects, encourage new partnerships, and stimulate new coalitions of domestic and cross-border investors. These new coalitions can co-finance sustainable infrastructure to the operational stage, at which point the projects can be refinanced in packages that are well-fitted to the fixed income allocations of institutional investors. To facilitate this process, the UN could engage other international institutions (including the IMF, G7, G20, OECD, MDBs, NDBs, and major private sector financial and philanthropic institutions) in collaborative efforts to remove regulatory obstacles and align international strategies in support of Agenda 2030 and the sustainable development goals (SDGs), both at country and at global level.

4. The UN could devise a gathering of the world's top 10 of each area of the financial sector to discuss changes in regulation that they could all be on board with and that would advance sustainable finance.

In addition, the following specific requests emerged from the participants:

- Aligning Environmental, Social and Governance reporting guidelines with the Sustainable Development Goals should be undertaken as a priority and the standardization of such criteria by the corporate sector and investors should be encouraged. This will create a level playing field, and clarify for governments the standards against which their projects and investment proposals will be assessed.

- Credit Rating Agencies should take account of the latest, most accurate data available on developing and emerging market countries. These assessments should incorporate evaluations of key public and private projects, as well as macroeconomic conditions and other country-level factors. This combination will provide the strongest foundation for the resulting risk profiles, which shape the risk appetite of investors and influence the cost of capital.

- The Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD-DAC) should continue to review the way guarantees provided for sustainable investments are counted as Official Development Assistance, in order to prevent such guarantees from potentially increasing a country's debt sustainability ceiling, a threshold established by the International Monetary Fund (IMF).

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<u>Annex</u>

Background, Objectives, and Context of the Retreat

The overall goal of the Retreat was to explore a pathway along which continuing UN leadership could help to catalyze a major transformation in the global financial sector. A major objective was to identify new and innovative strategies for accelerating and scaling up financing of sustainable infrastructure, aligning these investments with the UN's Agenda 2030 and the Sustainable Development Goals (SDGs). The Retreat created an opportunity for governmental high-level officials to exchange views with senior managers from the public and private financial services sectors in order to deepen understanding of the opportunities and constraints that each of their organizations confronts on a daily basis. A second goal was to support developing countries in preparing for the HLPF. In that regard, developing country representatives gave examples of sustainable infrastructure projects that are high priorities for investment in their respective countries. Some of these functioned as case studies for the subsequent discussions.

Discussions at the Retreat illuminated the current context for investments in sustainable infrastructure. Developing Countries are not homogeneous and they confront the challenges of investment in sustainable infrastructure from very different perspectives and circumstances. As well, private sector participants observed that their respective organizations are not homogeneous and have quite different appetites for investment risk. These private sector organizations also have very different roles in the financial ecosystem and engage at different stages of the infrastructure development lifecycle.

Most participants expect that investments in sustainable infrastructure will be a key factor in achieving the SDGs in many countries. Another contextual element was the recognition that international agreements targeting prudential regulation (including Basel III and Solvency II) have raised significant regulatory barriers to investments in sustainable infrastructure. When combined with restrictions on sovereign borrowing and limits on the use of sovereign guarantees, the unexpected consequences of these prudential regulations are amplified, often blocking otherwise-attractive investments in sustainable infrastructure.

Mobilizing New and Additional Resources for Sustainable Infrastructure: What did we learn?

Discussions at Pocantico underscored the emerging realization that expanding investment in sustainable infrastructure will require **mobilizing capital from multiple sources**. Historically, the main sources of financing for successful infrastructure development programs have been domestic capacity to mobilize public financial resources through taxation, combined with the ability to deploy locally-raised, private capital resources, as well as, to a limited degree, Official Development Assistance in some developing countries . This pattern of reliance on domestic capital sources is likely to continue, but should be supplemented and facilitated by strategic, cross-border injections of new and additional resources (i.e., public, private, or philanthropic capital), accompanied by transparent guidelines on how to access these resources. In the last several years, a new pattern of cross-border investments has emerged. Indeed, there has been a notable increase in South-South capital flows among developing countries during this period (e.g., China's recent investments in the development of African mineral industries and plans for reinvigoration of the old Silk Road as a trade route between Asia and Europe). These and similar cooperative undertakings by other financial actors have emerged as a significant alternative to traditional, North-South flows.

The **application of public capital** at the early stages of project development (from either domestic or international sources) has multiple benefits. It helps to ensure that the benefits of investments in sustainable infrastructure devolve to citizens and other public stakeholders. It can also help to facilitate the commercial deployment of sustainable infrastructure technologies with which the local financial sector has little or no experience. The efficient use of public capital to offset perceived country risk is critical to create leverage and attract additional private capital, both domestic and international. However, not all infrastructure projects can or should be financed with private funds or even with blended funds—some public infrastructure projects in developing countries (e.g., roads, bridges, health clinics, schools, etc.) are likely to continue to be financed entirely with public capital.

Governments need to understand the needs and constraints under which private investors operate and the risk perceptions that shape their investment decisions**.** For example, governments should design and configure proposed infrastructure projects so that their projects match the risk-return profile of the investors they wish to engage. It might be beneficial for some governments to re-assess their policies, regulations, and capacity building activities in order to improve the business climate for investors. Some participants emphasized that creating an attractive environment for investment includes establishing the primacy of the Rule of Law, the enforceability of contracts, and a sense of confidence among investors that investments in sustainable infrastructure will earn a fair and secure rate of return. Having a continued conversation with potential investors, including through UN-facilitated country visits (if needed), was seen as highly beneficial to attract investments.

Private investors, for their part, need to understand the actual risks to investment in individual countries and separate that risk assessment from their pre-conceived ideas about a particular country. In some cases, it may be helpful for investors to engage early in the project development cycle, in order to inform project design in ways that enhance the bankability of the resulting projects. For private investors who are currently carrying zero or negative rate debt in the fixed income allocation of their portfolios, there is less risk to investments in sustainable infrastructure (i.e., projects that have adequate financial backstopping and that can be reasonably expected to generate secure returns of four to six percent per annum), than exists in a debt instrument that is guaranteed to have only zero or negative returns. Shifting these current assets into attractive sustainable infrastructure projects could unlock a substantial pool of capital and strengthen the balance sheet of the affected investment funds. Moreover, private investors who are beginning to incorporate some elements of the SDGs into their investment criteria might consider expanding their portfolio balancing initiatives in this direction, offsetting riskier investments with potentially more secure alternatives, thus increasing capital flows into sustainable infrastructure.

Participants agreed that **various aspects of risk must be addressed** during the formulation and design phases of infrastructure project development. While multilateral development banks are often well-placed to do risk assessment at country level, initiatives by private investor groups and ratings agencies can be extremely valuable to those seeking to assess the risk profile of specific investment opportunities in sustainable infrastructure. Financial instruments and guarantees have been developed in the climate finance space for addressing many of the risks that will also be confronted in sustainable infrastructure projects. The World Bank, the International Finance Corporation, the Multilateral Investment Guaranty Agency, the European Bank for Reconstruction and Development, the US Overseas Private Investment Corporation and others have developed innovative instruments to address issues of political risk, currency exchange volatility, and the operational risk of innovative technologies. Application of such guarantees has enhanced investor confidence in climate finance and could similarly help investors to hedge some of the risks arising during sustainable infrastructure projects, especially those that are not easily managed by project developers acting alone.

Furthermore, **international financial institutions (IFIs) and national- or regional-level development finance institutions (DFIs)** are facilitating the framing, development, and execution of sustainable infrastructure projects. DFIs, working together through the highly innovative International Development Finance Club (IDFC) are well-positioned to expand efforts to accelerate and catalyze investments in sustainable infrastructure by helping to build local institutional capacity and structure project finance agreements. DFIs also provide financial guarantees, design blended finance structures, and provide other risk-mitigating instruments to support private investors in sustainable infrastructure. These useful interventions can be expanded in support of a massive scale-up of these investments.

Participants discussed the **many potential points of intervention** and institutional roles that arise during the development and implementation cycle of infrastructure projects. For example, engaging host-country stakeholders in the design and decision-making around sustainable infrastructure is absolutely essential to gaining community acceptance. It is important to reinforce the role of domestic institutions (commercial banks, cooperatives, business associations and other local actors), both as financial intermediaries and as agents positioned to reinforce the capacity of local stakeholders to adapt innovate technologies to local market conditions. This will successfully engage these stakeholders in the on-going development of sustainable infrastructure programs and in the creation of a solid "pipeline" of bankable projects. As well, establishing effective management control of project sites -- along with acquisition of the necessary government permits -- is important for building investor confidence in local markets. In sum, successful engagement of all relevant stakeholders is critical to attracting both domestic and foreign investors.

Governments can help in stimulating the emergence of innovative "**co-financing clubs**" that are able to underwrite sustainable infrastructure projects. Configured according to common interests and reflecting local development priorities, these informal business coalitions can combine to support securitization of project finance in domestic and international markets, which will greatly expand access to investment capital. In some cases, the formation of co-financing clubs entirely within the domestic markets of host countries may lead to lower costs-of-capital for sustainable infrastructure projects than would have resulted from creating cross-border coalitions of investors and having to pay a risk-premium that reflects some investors' exaggerated perceptions of cross-border risks.

New financial structuring and de-risking instruments are being created today. These tools, such as guarantees, first loss coverage, investment platforms, and issuance of bonds and loans in local currency can supplement traditional public-private partnerships (PPPs). They allow financial institutions and government agencies to aggregate, de-risk, and securitize the financing of large numbers of sustainable infrastructure projects. They can help unlock institutional capital when used with capital-efficient financial instruments of sufficient size that investors co-financing these undertakings can be assured of a secondary market able to provide some liquidity for their investments. Furthermore, there are innovative applications of digital finance and "mobile money" that allow thousands of small, domestic, retail investors to share in the financing of national investment programs that are critical to advancing national development priorities. These approaches are emerging in developing countries right now. In the future, creative approaches to new digital financing tools, including fin-tech and block-chain technology, may expand financial inclusion in ways that promote and support the underwriting of sustainable infrastructure, and should be pursued.

The Way Forward: What is the Role of the UN?

The UN is committed to support the transformation of the global financial system and its alignment with the requirements of sustainable development. One important role for the UN in that process is to continue convening key players and help to create the powerful coalitions of interests that are needed to catalyze and accelerate financing of sustainable infrastructure. At a practical level, there is a need for intermediation; government leaders may not even know the identities of potential investors in sustainable infrastructure. The UN can, thus, play a critical role in bringing people and institutions together, reconciling the aspirations of governments with those of public and private investors. A powerful but under-exploited opportunity exists for the UN specifically: to convene major global institutions including the International Monetary Fund, the Financial Stability Board, the Bank for International Settlements, the Bretton Woods Institutions, other MDBs and DFIs, to discuss how updating traditional international approaches to financial stability might help to catalyze and scale-up the application of both public and private capital into secure, robust, and resilient investments in sustainable infrastructure. Simultaneously, the senior leadership of the UN could engage with political leaders in the G7, G20, OECD, New Development Bank and other emerging international institutions to accelerate investment directly into sustainable infrastructure. Such an engagement by the UN Secretary-General and Deputy Secretary-General could prove pivotal to rapidly achieving the SDGs and advancing these emerging priorities. .

In addition, the UN can continue to convene key governmental and financial sector actors with shared or aligned interests. Concentrating attention at the country- and sub-regional level, where the UN brings deep and intimate knowledge of local development challenges, the UN can bring together institutions and other stakeholders that face similar or common challenges in developing sustainable infrastructure. For example, the UN might bring together key players in sub-national entities and municipal governments to discuss the development of financing facilities able to underwrite a multi-city, multi-country program for improving the energy efficiency of government buildings and outdoor public area lighting on urban roadways and in municipal public spaces. There are other potential areas of future engagement. These include aligning commercial, philanthropic, and government entities to catalyze a new phase of performance-driven financing of infrastructure related to tropical forests and the protection of biodiversity. Building on the shared leadership of the UN and commercial banks in stimulating the early development of Green Bonds, the UN might encourage the creation of sovereign Green Bonds that could be used to protect domestic irrigated agriculture and improve water-use efficiency in regions vulnerable to the negative impacts of future climate change. By convening and leading the emerging global consensus on sustainable infrastructure, the UN can leverage its recent and substantial progress toward achieving the SDGs and Agenda 2030.

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