

Clean Investment Roadmaps: A framework for building clean energy economies

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Introduction to Impax

Founded in 1998, Impax is a specialist asset manager, with approximately £18.1bn (as of 30 June 2020) in both listed and real asset strategies, investing in the opportunities arising from the transition to a more sustainable global economy.

Impax believes that capital markets will be shaped profoundly by global sustainability challenges, including climate change, pollution and essential investments in human capital, infrastructure and resource efficiency. These trends will drive growth for well-positioned companies and create risks for those unable or unwilling to adapt.

The company seeks to invest in higher quality companies with strong business models that demonstrate sound management of risk. Impax offers a well-rounded suite of investment solutions spanning multiple asset classes seeking superior risk-adjusted returns over the medium to long term. Alongside our listed equity and fixed income strategies, we are one of the longest established private equity fund managers in the large and rapidly growing renewable energy sector.

Impax has ca. 170 staff across five offices in the United Kingdom, the United States and Hong Kong, making it one of the investment management sector's largest investment teams dedicated to sustainable development.

Executive summary

- Meeting the targets agreed in the Paris Agreement will require all governments to stimulate investment into clean energy economies, ideally using their Covid-19 recovery plans to jump-start this transition.
- Most of this investment will need to come from the private sector but efforts to mobilise private finance have so far been a source of frustration - for investors concerned about the lack of project pipeline, for policy makers trying to attract capital at scale, and for multilateral development banks (MDBs) seeking to bridge the gap between these two groups.
- Our Clean Investment Roadmaps framework reflects 20 years' experience of how policy makers can address this challenge by setting out five key steps they should take:
 1. Agree and publish clear sectoral objectives and investment requirements
 2. Build understanding within government of sector and project economics
 3. Implement investment-grade policy at all levels: sectoral, indirect and investment
 4. Provide implementation resources that address local circumstances and barriers
 5. Initiate a clean investment dialogue at the start of the process
- This framework offers a blueprint for the enhanced collaboration between policy and investment communities that will be needed if we are to deliver the climate goals of the Paris Agreement.

The challenge for policy makers

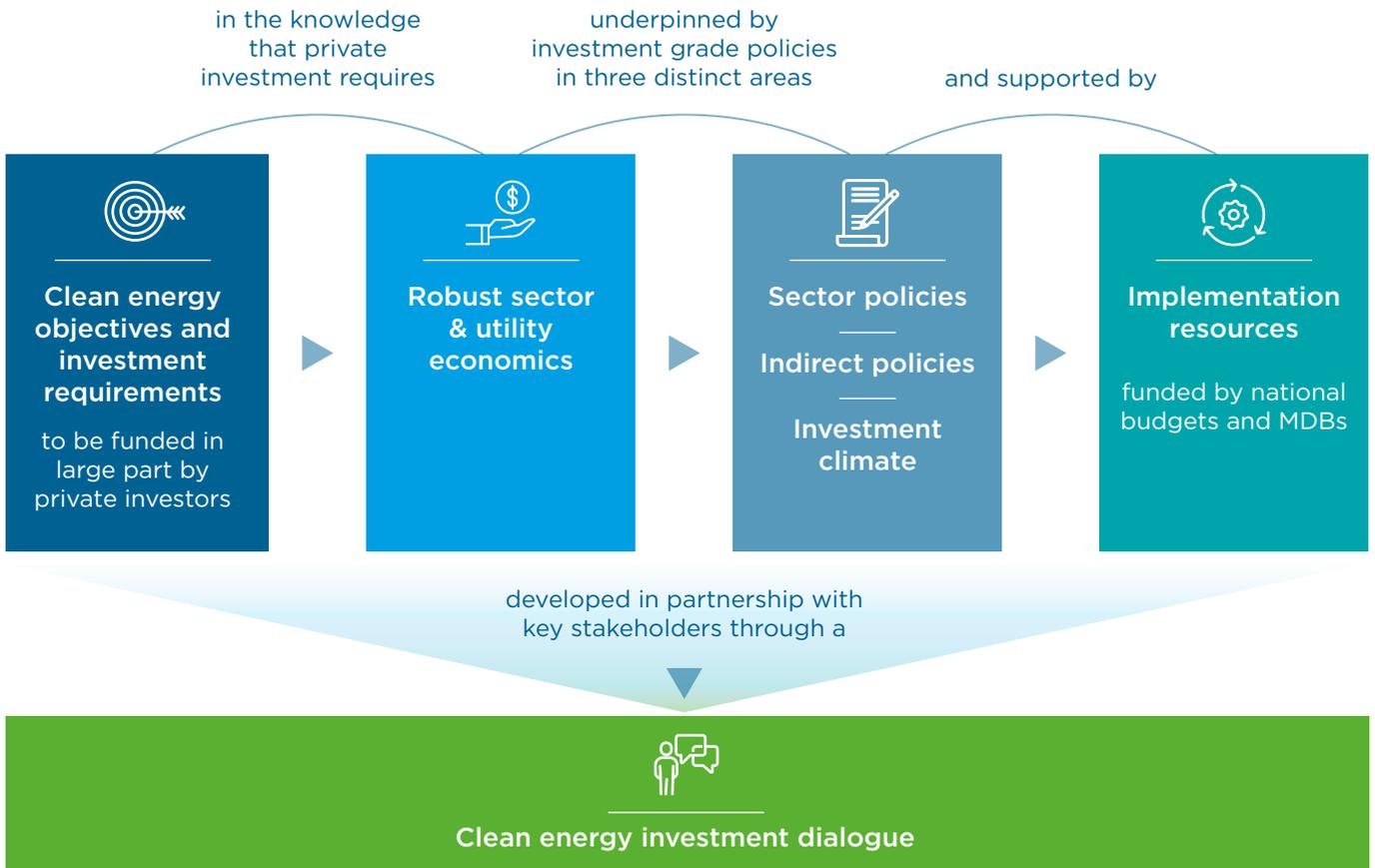
Ahead of COP26, attention is being focussed on how governments can efficiently, effectively and rapidly shape policy to stimulate the development of a clean energy economy (CEE). Given the job creation potential of building a CEE, governments are now urgently considering what role COVID-19 recovery plans can play in accelerating this transition. Although most governments are keen to see the bulk of the investment to develop a CEE come from the private sector, there appears to be limited input from private investment practitioners into policy design. While development finance institutions (DFIs) such as MDBs can help (through advice, technical assistance, and/or some concessional financial support), they do not have the capacity to offer 100% of the capital required.

Most OECD countries have significant experience with the development of a CEE and are in the process of raising their ambitions and extending or amending existing policy frameworks; they also typically enjoy attractive investment climates. By contrast, many developing countries have little or no elements of a CEE (or if they do, supply is heavily focused in one area such as large scale hydro and is not scalable); furthermore, many have relatively (or acutely) unattractive investment climates, which hamper investment across a wide swathe of markets.

Proposal - a five step framework for developing Clean Investment Roadmaps

Based on more than 20 years of experience investing in environmental solutions¹ and building on the work of others², we have produced a five-step framework for developing Clean Investment Roadmaps (Figure 1). This seeks to guide policymakers in middle-income countries in their quest to catalyse pipelines of investable projects in the energy sector. It can of course be modified to be applicable to different sectors as well as to countries in different income brackets.

FIGURE 1



Capital is mobile. Investors/financiers typically seek the best risk-adjusted returns from a wide choice of possible markets around the world.

Regardless of whether it comes from domestic or international sources, a high proportion of private capital is sourced from private savings (e.g. pension funds or accumulated insurance premiums). These are managed by agents that are incentivised to seek the best returns and may be unable to accept risk above pre-determined thresholds.

Policy implications: Countries seeking to attract capital to develop a CEE should ensure that the conditions for investment/finance in clean energy are attractive on absolute terms (see below) but are also competitive relative to other sectors and to other countries. Governments should start by setting clear clean energy objectives - with cross-government and ideally cross-party support - which identify the real-world changes required at sector-level and nature of the investment required³.

¹Including inputs into the UK's Electricity Market Reform via the Low Carbon Finance Group and clean energy investments in developing countries.

²Including the International Finance Corporation, the Inter-American Development Bank, the Climate Policy Initiative and the Climate Finance Leadership Initiative.

³Building on net zero sectoral roadmaps developed by the [Energy Transition Commission](#) and others.



Investors/financiers are primarily seeking attractive 'targets' with robust economics...

Individual projects (or operating companies such as utilities) must offer expected returns in line with or in excess of target returns and within an expected timescale. While the risk to those returns across a wide range of factors must also be acceptable. Efforts to support the development of pipelines of clean investment projects in the absence of these conditions are likely to prove unsustainable.

Policy implications: Policymakers should ensure that they have a sound understanding of the sector and project economics in terms of revenue, costs and risks. This is best achieved through expert analysis (from in-house and external sources) coupled with dialogue with investment practitioners. This will allow them to examine the perceived risk and returns from the investors/financiers' perspective and check that market design is optimal and underpinned by 'investment grade policy' which provides a clear investment case for deploying capital⁴. Greater certainty needs to be provided on all policy factors within the boundary of the transaction (split below into three distinct areas of sectoral, indirect and investment policy⁵).



...but will also take into account a wider range of factors related directly to energy policy...

Investors/financiers will often seek assurance in relation to risks from other issues that may impact them, either in the initial 'targets' or over the longer term as they seek to benefit from economies of scale by deploying additional capital.

Policy implications: In the energy sector, countries will need to understand the impact of direct policies including but not limited to (a) resource mapping, (b) clarification of land rights, (c) grid access rules, (d) permitting arrangements, (e) financial strength of key sector counterparties e.g. the grid company, (f) charging/revenue arrangements, (g) overall sector regulation, and (h) carbon pricing and other support mechanisms.



...while paying attention to indirect risks & issues in related sectors...

The delivery of successful investment returns will likely depend on an absence of material problems/bottlenecks in many other areas of the 'real economy', for example demand for electricity from other sectors. Other issues might arise from the broader business climate such as road quality, telecommunications, customs, and the availability of trained/experienced employees.

Policy implications: Countries should assess the drivers of energy demand and pricing in related sectors such transportation, housing and industry, and consider adjusting policies accordingly, for example establishing long-term roadmaps for the electrification of personal transportation. They should also review investor/financier perceptions of their business climate and consider both short-term changes and longer-term programmes to raise standards.



...and requiring that the wider investment climate is supportive.

In addition to reviewing 'real economy' issues, investors/financiers will examine financial market and legal factors. Particular attention would be paid to enforceability of contracts, property rights, the availability of insurance, currency volatility and convertibility, ownership and local content requirements, and political will (including government commitment to investment incentives for low-carbon solutions).

Policy implications: Countries should review investor/financier perceptions of these issues (using e.g. the investment readiness guidelines proposed by the [Climate Finance Leadership Initiative](#)), considering interventions to improve circumstances as well as policy instruments to mitigate risk in specific areas.

⁴With thanks to Kirsty Hamilton for inputs and comments (see in particular page 6 of [Principles for Investment Grade Policy and Projects](#) a report for the Capital Markets Climate Initiative, 2012). ⁵This can be addressed by programmes like [UK PACT](#) (Partnering for Accelerated Climate Transitions) which can support countries in developing robust and long-lasting policies in order to give greater certainty to investors that want to make clean investments.



National governments and DFIs can accelerate success by providing implementation resources responding to locally specific requirements...

As well as contributing to policy design at an early stage, national governments and DFIs including MDBs can play a crucial role in addressing investment barriers. For example, they can provide funding for feasibility studies and investment case development, or offer access to tailored blended finance solutions, such as concessional loans and instruments aimed at mitigating investment risks.

Policy implications: Countries should identify the specific barriers which are faced in mobilising investment into decarbonising individual sectors of the economy and engage with DFIs and other stakeholders to identify the available tools to address them.⁶



... and governments should integrate investment perspectives through early dialogue with key stakeholders including public and private sector financial specialists.

There is a wide spectrum of experience globally in the design and development of CEEs. Countries at an earlier stage can reduce the risk of sub-optimal policies by analysing that experience in the context of their objectives. They can do this by engaging with representatives of DFIs charged with supporting market development, and through discussions with individuals from investment/finance groups with the resources and potential interest to commit capital in due course.

Policy implications: Countries should engage local and international stakeholders with investment experience in their policy development processes at the earliest possible stage. This helps to attract private capital at scale and on reasonable terms. They should involve not only private sector developers and investors/financiers but also finance ministries and DFIs.⁷

This document gives policy makers an investor perspective on the shared challenge of mobilising investment needed to deliver the Paris Agreement. We hope that the framework set out above can offer a blueprint for collaboration between policy and investment communities in the context of COP26.

If you would like to discuss further, please get in contact with us at c.dodwell@impaxam.com.



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⁶See for example the country dialogues initiated by IDB through its [Sustainable Investment Program](#). ⁷See for example [Cote d'Ivoire's public-private renewable investment dialogue](#) supported by the IFC and the transaction-focussed [Climate Finance Accelerator programme](#) funded by the UK Government

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