An ESG Primer for PPP Units

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ESG & PPP

Why should PPP Practitioners keep ESG in mind?

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The story of ESG investing began in January 2004 when former UN Secretary General Kofi Annan wrote to over 50 CEOs of major financial institutions, inviting them to participate in a joint initiative under the auspices of the UN Global Compact and with the support of the International Finance Corporation (IFC) and the Swiss Government. The goal of the initiative was to find ways to integrate ESG into capital markets. The report made the case that embedding environmental, social and governance factors in capital markets makes good business sense and leads to more sustainable markets and better outcomes for societies.

Georg Kell, Jul 11, 2018, Forbes Magazine
The $E$ in ESG, *Environmental criteria*, includes the energy an organization takes in and the waste it discharges, as well as the resources it uses. $E$ includes carbon emissions and climate change.

The $S$, for *Social criteria*, addresses the relationships an organization has and the reputation it fosters with people and institutions in the communities where it operates. $S$ includes labor relations and diversity and inclusion.

The $G$, for *Governance*, is the internal system of practices, controls, and procedures an organization adopts in order to govern itself, make effective decisions, comply with the law, and meet the needs of external stakeholders.

*Based on Witold Henisz, Tim Koller, & Robin Nuttall, McKinsey 2019*
There is no “one best way” nor “silver bullet” to do ESG integration.

Governance is the ESG factor most investors are integrating into their process.

Environmental and social factors are gaining acceptance, but from a low base.

ESG integration is farther along in the equity world than in fixed income.

Portfolio managers and analysts are more frequently integrating ESG into the investment process, but rarely adjusting their models based on ESG data.

Findings of a (CFA/PRI 2018) survey of more than 1,100 financial experts
ESG investments now exceed $30 trillion

- 84% of millennials interested in sustainable investing, and a $30 trillion intergenerational wealth transfer is taking place.
- Long-term investors, such as mutual funds, pension funds, insurance companies and sovereign wealth funds, are interested in sustainability.
- 49 stock exchanges and more than 350 large asset managers have committed to ESG principles.
- 97 financial institutions in 37 countries have committed to the Equator Principles.
- People-First PPP concept and G20 Quality Infrastructure Investing have gained widespread recognition.
ESG has a big following

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<th>Company</th>
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Source: Responsible Investing: Guide to ESG Data Providers and Relevant Trends (Douglas et al., 2017)
Yet ESG has not had a noticeable impact on PPP

- Projects are still awarded like construction projects.
- Environmental and Social Impact Assessment is usually left to the winning bidder to do.
- Information about the project and the pipeline is not communicated to investors early on.
- Under political pressure, most PPP tenders are rushed through.
- Stakeholders and rating agencies tend not to be consulted.
- Governments have not yet fully internalized PPP as a means to deliver on the SDGs and to enhance the ESG dimensions.
PPP Units are generally not aware of the tools available from third-parties for project ESG assessment.

Source: Valuing Sustainability in Infrastructure Investments: Market Status, Barriers and Opportunities A Landscape Analysis Prepared by WWF Switzerland and Cadmus Group, March 2019
1. Maximizing the positive impact of infrastructure to achieve sustainable growth and development.
2. Raising economic efficiency in view of lifecycle cost.
3. Building resilience against natural disasters and other risks.
4. Integrating environmental considerations in infrastructure investment. (E)
5. Integrating social considerations in infrastructure investment. (S)
6. Strengthening infrastructure governance. (G)
UNECE People-First PPP Principles

1. Access and equity.
2. Economic effectiveness and fiscal sustainability.
3. Environmental sustainability and resilience.
4. Replicability.
5. Stakeholder engagement.

(UNECE is in the process of developing a PfPPP Impact Assessment Tool.)
Introducing the Value for Future Generations Concept

**Comprehensive evaluation of the social value of PPP/DFBOM arrangements**

- Project proposal
- Project Appraisal (CBA & financial analysis)
- Economic outputs: NPV, IRR, BCR...
- Financial outputs: NFV, FRR, ROE...
- VFM: insight into the advantages of PPP regarding costs savings, risks mitigation and services quality
- VFP and VIF provide a complementary insight into the SOCIAL VALUE of PPP/DFBOM arrangements
- IREM's outputs (GAP, GUI, T&S, IRESI)
- Delivered impact on the Value for People (VFP) and the Value for the Future (VIF)

**Analysis of Intergenerational Redistribution**

- T&S = -8.9 g
- IRESI = 0.71
- PUBLIC DEBT EMISSION
- PPP DEAL
- T&S = +9.6 g
- IRESI = 0.15
- PROJECT PROFILE OF INTERGENERATIONAL REDISTRIBUTION EFFECTS: FINANCIAL BURDEN (PPP + 30 YEARS OFFSET)
PPP units will ignore ESG at their own risk.

Truly successful and sustainable PPPs require not just getting a rating. They entail paying close attention to:

1. Value for Money
2. Value for People
3. Value for Future Generations
The floor is open for questions
Please use the Q & A box