Scott Minerd

Chairman of Investments and
Global Chief Investment Officer
Guggenheim Partners

Ensuring a Return on Sustainable Development

We have reached an inflection point where doing right for the world and doing well for investors are converging.

The Western Pennsylvania of my youth was a magical place, with bucolic parklands and architectural gems like Frank Lloyd Wright's Fallingwater. The decline of the steel industry over subsequent decades has left this beautiful countryside scarred with abandoned mills and rife with the toxins and refuse of a dying industry. This experience informs my perspective when I think about how to tackle the problem of funding the estimated $2.5 trillion gap in annual global infrastructure needs: how can future development avoid the mistakes of the past?

Notwithstanding President Trump's commitment to reopen shuttered steel mills, the legacy of the steel towns of Western Pennsylvania carry lessons to be applied to the construction of new factories and infrastructure today. There must be a framework in place that measures and monitors each project's environmental, social, economic, and regulatory impact. Only when policymakers and investors make decisions based on a sustainability quotient that effectively evaluates these four factors will sustainable investing become the true north by which every investment compass must navigate.

Today, there are pockets of capital devoted to sustainable development investing, but not in sufficient size. Publicly traded or bank-owned asset managers have so-called retail money and other portfolios devoted to classic Environmental, Social, and Governance (ESG) mandates, or impact investing, but that capital doesn't approach the scale needed. Other sources of funding seek to leave the world a better place, but without much of a return expectation. This is philanthropy, not investment capital.

But an awakening is near for the insurance companies and pension funds that control some $60 trillion in assets with 30- or 50-year investment horizons. These stewards of capital are increasingly being held accountable for the types of investments they make. Increased portfolio transparency, a growing social consciousness among

The Sustainability Quotient

younger people, and empowered citizen-reporters using their smart phones and social media are exposing—and calling out—institutions that do not use their investment might to serve a higher purpose. We have reached an inflection point where doing right for the world and doing well for investors are converging.

Institutional investors with long investment horizons are becoming more interested in sustainable development opportunities, but they must be engineered to contain the four key attributes at their inception, before capital is committed. We call this framework of attributes the Sustainability Quotient.

First, for sustainable development investing to flourish as an institutional asset class, the project's investment proposition must meet the hurdle return rates needed to fund long-term liabilities, which for long-term debt investment are as low as 5-6 percent. With a broad list of potential models for sustainable development investment—such as permanent capital vehicles, securitizations, and strategic partnerships—institutional investors will have the ability to invest across geographies and sectors.

Second, these projects and investment instruments will need good governance characteristics. All developments must adhere to the laws and regulations of their local jurisdictions. More than that, the investments must be transparent, demonstrably free of conflict and corruption, and fully compliant with the investment regulatory regime of the investor base. This attribute also acknowledges that local and national governments are essential partners in the development of the project and the success of the investment.

Third, the project must be environmentally sound and respect the "natural capital" of the region—its air, soil, and water. For a project to be deemed environmentally sound, it is critical for subject matter experts to provide benchmarks, assessments, and analysis. For several years, we have partnered with organizations that are uniquely positioned for this important task, including the World Wildlife Fund, the UN Foundation, and the Natural Capital Project. These partners are actively engaged in helping to determine the absolute and relative environmental value of proposed development projects.

Fourth, a project must be measured by its social impact. It is not enough for a project to simply do no harm—it must provide transformative social benefits in partnership with the local population. For example, studies must be done that demonstrate how communities could benefit economically, or if women and minorities are afforded new opportunities, or how indigenous peoples are protected.

The need for sustainable development is stark.

The need for long-term sustainable development is stark: huge numbers of people around the world lack access to clean water, basic sanitation, or a reliable electric grid. More advanced economies face crumbling infrastructure in the areas of transportation, sanitation, and energy. By ensuring that investments demonstrate the four attributes in our sustainability quotient, I believe it is possible to achieve the true north of investing with committed capital from institutional investors. Otherwise, it is clear that projects on the drawing board and in the pipeline won't get funded and built.