GUGGENHEIM

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Guggenheim Investments

The Guggenheim Sustainability Quotient for Institutional Investors

At its core, sustainable development means investing in safe, reliable infrastructure and financing projects that will power our world, feed our people, and foster growth in ways that preserve and protect our environment. Without sufficient infrastructure economic growth is constrained, energy production and utilization is inefficient, and the quality of life for society at large is degraded.

The world's infrastructure needs are significant, with large parts of the world lacking access to the basic necessities of human life. An estimated 663 million people lack access to clean water, 2.4 billion people lack access to basic sanitation, and 1.1 billion people lack access to reliable electricity. US $4.5 trillion is needed annually to fulfill the 17 United Nations Sustainable Development Goals (SDGs) from now until 2030, with a current annual shortfall of US $2.5 trillion1. The necessity for upgrading infrastructure in the developed world is also significant: In the United States alone, the funding gap for new infrastructure needs is an estimated $144 billion per year through 2025, according to the American Society of Civil Engineers.

Meeting the world's infrastructure investment needs will require a finance approach that blends contributions from both the public and private sectors. Institutional investors with long investment horizons are becoming more interested in sustainable development opportunities, but the sector is still evolving into a bona fide institutional asset class. The challenge in making this transition from individual project finance investments to a category of investments with shared attributes and standards is that it lacks a set of organizing principles and measurements. What attributes must an infrastructure investment possess in order for it to be considered sustainable? How are these attributes measured to ensure that the project possesses them?

Guggenheim has developed a model for establishing the attributes of a sustainable investment called The Sustainability Quotient. In this construct, an infrastructure or development project must be engineered to contain the four key attributes of our Sustainability Quotient at their inception before capital is committed: **Financial Return, Good Governance, Environmental Soundness,** and **Social Impact.** We believe that by seeking investments that demonstrate the four attributes in our Sustainability Quotient it is possible to achieve the true north of investing with committed capital from institutional investors.

The Four Attributes of the Guggenheim Sustainability Quotient

Financial Return

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. We believe infrastructure investment can help institutional investors reach their goals. Some of the potential benefits include attractive risk-adjusted returns, low correlation to other asset classes, stable cash yield, long-lived physical assets, barriers to entry for competitors, and a measure of inflation protection.

The shift that is occurring in infrastructure investment and project finance is profound: No longer will investors have to make a trade-off between sustainability characteristics and financial returns.

Within the context of a global consensus for sustainability, long-term investors can maximize value by delivering sustainable infrastructure solutions, which may reduce risk, and enhance political and social feasibility. As public interest in the sustainability of future infrastructure development grows, lack of consideration for a project's sustainability may even hurt long-term financial returns. The cost of remediation—reverse-engineering a project to address overlooked sustainability issues—can be much higher than meeting sustainability standards from the project's inception, again threatening the long-term profitability of a project.

As more institutional investors build such factors into their analysis and begin to allocate more of their long-term investments to sustainable development, financing will increasingly depend not only on the health of the environment or community in which the development is taking place, but on the long-term health of the development itself. It will be incumbent on project planners, sponsors, and stakeholders to ensure that the sustainability of a project is also viewed through the perspective of delivering institutional-class returns on long-term investments.

Good Governance

Sustainable projects and the investment instruments that fund them will need good governance characteristics for institutional investors to make significant commitments for long-term funding. All developments must adhere to the laws and regulations of their local jurisdictions and 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.

Within the broad imperative for good governance, Environmental, Social and Governance (ESG) principles should also be considered, specifically as they relate to security selection, valuation, and risk mitigation in the investment process. The governance criteria include ethical

and accurate accounting, audit, and disclosure practices, exemplary corporate behavior, and equitable board structures for the entities involved in the development project.

Infrastructure assets have useful lives that often exceed 50 or 100 years, making sustainability and the accounting of environmental or social externalities particularly critical. Despite these facts, the field of infrastructure sustainability accounting and assessment tools is relatively underdeveloped compared to certain other, more mature asset classes.

Public sector regulatory guidelines are further along in their development and reception. Governments have been regulating infrastructure projects and measuring impacts and practices to ensure compliance with environmental or social standards for many decades, and these regulatory models have carried over to accepted project-level policies of international financial institutions supporting infrastructure investments across the developing world. Regulatory reviews have generally focused on the preservationist analysis of whether, what, and where to build. Infrastructure accounting tools and project rating systems generally pick up where public sector regulations end, but there is still work to be done to focus on management practices and sustainability performance indicators of operating assets.

Environmental Soundness

Sustainable projects must be environmentally sound and respect the natural capital of the region—its air, soil, and water.

Badly managed projects can have disastrous consequences for the environment and community in which they are based. Irresponsible waste management, toxic biproducts of industrial processes, and overuse of natural resources can take communities and their environments decades to recover from. It is vital that an analysis of every project's environmental soundness is carefully integrated at inception and draws on the expertise of partners who specialize in different aspects of the entire matrix of environmental soundness.

For a project to be deemed environmentally sound, it is critical for subject matter experts to provide benchmarks, assessments, and analysis. The need for this detailed examination is not just to benefit the long-term health of local communities, but also to the health of long-term investment opportunities. Environmental disasters such as oil spills or chemicals leeching into the local water supply can take decades and billions of dollars to address, which is a significant threat to long-term shareholder value that can be easily mitigated by managing the project to the highest environmental standards from the outset.

With this as backdrop, WWF and Guggenheim Partners commissioned members of the Stanford Global Projects Center to identify and analyze the various metrics that have been established by multiple organizations to assess the sustainability of infrastructure investments. Such evaluations are not new, but there has been a recent proliferation of these metrics, each with its unique purposes and criteria. As measuring sustainability garners greater acceptance, understanding the range and application of these metrics will allow investors, companies, governments, and citizens to pursue infrastructure investments that can lead to economic growth that is balanced against the moral and ethical considerations shared by all stakeholders.

Social Impact

As institutional investors face increased pressure from stakeholders for portfolio investments to provide fair returns while also creating positive social impact, it is no longer enough for a project simply to do no harm; it must provide transformative social benefits in partnership with the local population. For example, studies must be conducted that demonstrate how communities could benefit economically, if women and minorities are afforded new opportunities, or how indigenous peoples are protected.

There are countless examples of how economic development failed to take into account the long-term social impact of its planning or progress. The U.S. steel industry, for example, supported many American families in the immediate post-war period, but without sufficient consideration for the long-term sustainability of its business practices, when the steel industry collapsed it plunged entire communities into economic depression that persists today.

A sustainable approach to project development takes into account not just the project itself, but the economic impact on the community in which it is based. Sustainable development that provides new employment opportunities to a community fosters the growth of the local economy and can create new development opportunities. Factoring in social impact can help perpetuate economically productive activities that can continue to benefit long-term investors even after the initial project has completed its effective lifespan, at the same time insulating potentially vulnerable communities from the devastation of poor planning.