Sustainable Infrastructure Debt Fund

Kellogg-Morgan Stanley Sustainable Investing Challenge

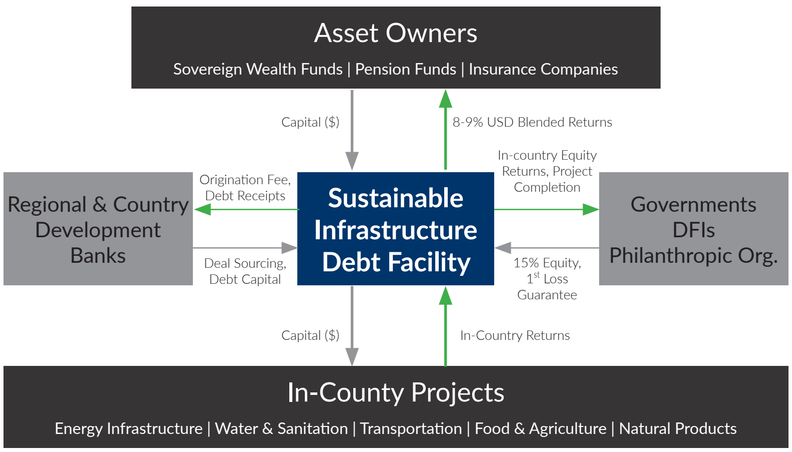
Investment Thesis

We propose building a dedicated asset-management organization, in partnership with a large asset owner, that facilitates capital flow to sustainable infrastructure projects in key developing countries by using DFI, philanthropic, and government equity financing to enhance the credit profile of sustainable emerging market projects sourced through regional and country specific development banks.

Challenge

There is at least a $1 trillion annual financing gap for sustainable infrastructure initiatives[1]. Emerging market ("EM") governments and philanthropic organizations do not have the financial firepower necessary to bridge such a gap. Meanwhile, there is currently as much as $18 trillion dollars invested in low or negative yielding fixed-income assets managed by institutional investors in developed countries who are struggling to find ways to service their long-term liabilities[2]. However, private capital fails to flow to fill these gaps due to several factors: 1) Large asset owners typically invest in funds with established histories and track record of returns. 2) The risk-adjusted returns of emerging market debt are generally too low for large investors to justify. These factors combined result in little incentive for fund managers to seek out opportunities beyond the typical industry offerings. However, a purpose-built investment product could bring together these disparate groups and create an offering that would alleviate these issues. The SIDF fund structure could help drive a dramatic scaling of investment in sustainable projects in emerging markets. Doing so would effectively generate credit returns for investors, drive meaningful impact in combating global climate change, and build a next generation green economy.

Proposed Solution and Impact



The proposed SIDF would be a vehicle for deploying sustainable infrastructure capital through medium-term debt financing. This structure would help solve these problems by:

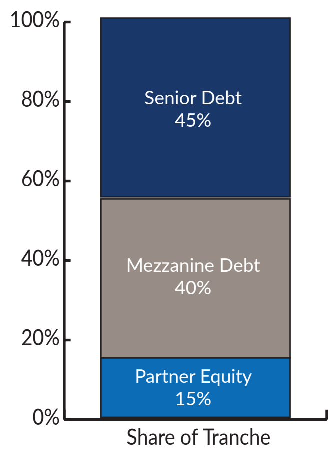
1. Leveraging equity capital from public, philanthropic, and DFIs to provide a first-loss risk hedge for large institutional investors.
2. Partnering with a large asset owner (eg. Vanguard), potentially through a joint venture, to provide legitimacy, a large investor base, and important resources such as currency risk hedging.
3. Matching de-risked, large-scale private financing to investment-grade projects and fund managers in emerging markets.

Under the SIDF structure, our partners would supply 15% "sponsor" equity, representative of their financial interest. Equity capital would be combined with DFI sponsored vetting of deals to ensure that our capital is being deployed to secure projects. Debt capital from institutional investors would then be deployed in a two-tranche debt facility. The senior debt offering would represent about 40% of the fund's total capital and target 5-7% returns in USD. The mezzanine debt facility would represent the remaining 45% of the fund and would target returns in the 10-15% range. Finally, the fund would address the credibility gap by developing a partnership or joint venture with a large asset management organization that is looking to further develop its impact investing presence; a strategy that we are already observing in the market [3]. By bringing the right set of partners together, we believe this type of structure would allow us to source well-structured, credit worthy, scalable projects, and crowd in private capital by developing more reasonable risk/reward profiles.

Key Fund Details

Fund Size	Target First Close - $1 billion
Asset Class	Dual-Tranche Debt Facility
Project Focus	Energy, Water, Sanitation, Transportation, Food/ Agriculture, Coastal Resilience, Green Buildings
Target Investors	Sovereign Wealth, Pension, Insurance Funds, and University Endowments
Target Returns	5-7% net in USD (senior tranche) 10-15% net in USD (mez. tranche)
Deal Size	$25 million -$100 million
Debt Term	3 - 5 years
Fees	1% per annum on deployed capital
Next Steps	12-18 mo. and a budget to build fund structure, vet deal pipeline, and develop partnerships

Capital Structure



Financing available from the SIDF would be broken up into three tiers;

Senior Debt: 5-7% coupon senior debt

Mezzanine Debt: 10-15% coupon subordinated debt targeted debt investors with a higher risk tolerance/return expectation

Partner Equity: Project equity provided by governments, DFIs, and philanthropic partners

Blended, fund would target 8-9% returns

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Proposed Solution and Impact (cont.)

Lowering the barriers for investing in EM sustainable infrastructure will allow more of the $18 trillion in latent capital to flow into the development of sustainable growth in undeserved countries. This capital flow will not only be profitable, but create lasting benefits for the world economy.

Investments will be deployed in strategic EM economies that need capital for sustainable investment and that are of mild to moderate credit risk. The highlighted developing countries represent over a third of the world population[4], and a quarter of GHG emissions[5], but just 14% of world GDP[6]. These countries also all achieve at least a "C" country risk rating from Euler Hermes[7], suggesting investiblity with credit enhancement.

Deal Sourcing

The SIDF would be able to tap into the deal pipeline of regional and country-specific development banks (such as the CAF or the African Development Bank). These groups would be incentivized to bring projects to the SIDF by the large amounts of capital the fund can deploy. They would serve as a first screen for investible projects. Development banks would also be aligned to our mission of deploying impactful capital. By utilizing the local knowledge of projects, community needs, and investment norms, the assistance of these banks would also help our fund significantly cut down on project lead acquisition costs and initial due diligence for the SIDF, helping it to offer modest fees. Blended finance availability should also open up the development of future deal flow that has not yet been explored.

Example Projects

Projects Types	Anticipated Impact
Energy & Transportation Infrastructure	Finance renewable energy & public transit projects; reducing GHG emissions and providing electrical access to new communities
Water Infrastructure & Sanitation	Invest in green storm-water infrastructure and coastal resilience projects that will improve wetland ecosystems and local community health
Food, Agriculture, & Natural Products	Provide loans to producers to convert traditional agricultural & forest products operations to sustainable and regenerative practices

Case Study - Tropical Landscapes Finance Facility RLU[8]

Description: The TLFF deploys long-term capital towards sustainable development in Indonesia. The RLU project uses the bond proceeds to plant a sustainable rubber plantation, repaid by the rubber off-takers. This deal includes protections for wildlife, community members, and provides buffer zones for Bukit Tigapuluh National Park.

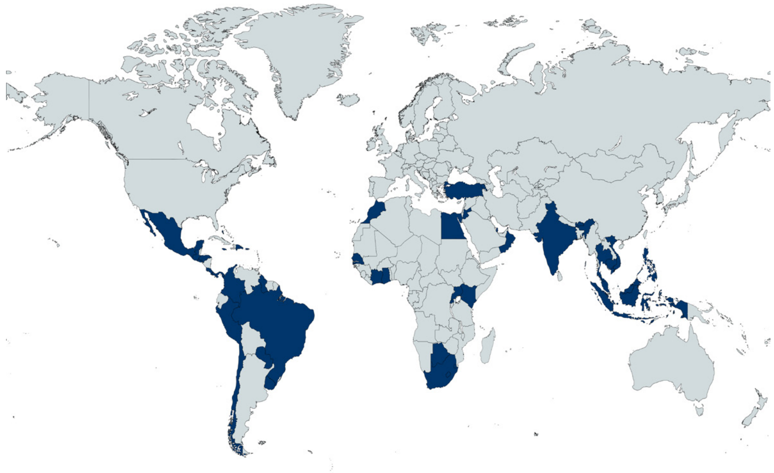
Deal Terms: $95 million Bond, 2% - 9% Coupon, 5-15 year bonds

Partners: Tropical Landscapes Finance Facility (Debt Issuer)
Groupe Michelin/PT Barito Pacific (Rubber Off-Taker)
ADM Capital (Monitoring)
U.S. AID Development Credit Facility (Guarantor)

Notes

1. SDG Spending Gap Equivalent to $1 Trillion Annually - IISD
2. World's Negative-Yield Debt Pile at $18 Trillion for First Time – Bloomberg.com
3. See HSBC/Pollination Capital or TNC/RRG Capital Joint Venture as examples
4. Worldometers - Population by Country
5. ClimateWatchData.org
6. Worldometers - GDP by Country
7. Euler Holmes Country Risk Schedule as of January 2021
8. TLFFIndonesia.org/project-pt-royal-lestari-utama-2020

Target Geographies



BANCO DE DESARROLLO DE AMÉRICA LATINA

BANQUE AFRICAINE DE DEVELOPPEMENT / AFRICAN DEVELOPMENT BANK

IsDB البنك الإسلامي للتنمية Islamic Development Bank

ADB Asian Development Bank

Risk Factors and Mitigation Strategy

Risk Factor	Mitigation Strategy
Inadequate Deal-flow	Develop large list of investible projects in 12-18 months before going to market, solicit inbound project proposals
Project Performance Risk	Diversify portfolio debt to mitigate effects of defaults in any one project or country or region
Investor Risk-Aversion	Partner with large, well-know firm; particularly one with a innovative culture and interest in developing sustainable product offerings
Currency Risk	FX Hedging Facility provided by large asset management partner

Mission Alignment & Investment Criteria

Mission alignment of the SIDF team, governance structure, and partners, is crucial for the success of such a venture. The primary mission of the SIDF will be to sustainably deploy capital, not to make its team and partners outrageously wealthy. As such, compensation and fees will be kept at reasonable levels. Similarly, while an established asset manager partner will be crucial for the fund's credibility, care must be taken to ensure the partnership is constructed such that profit motives of large organizations do not supersede the mission of the SIDF. Individual projects would be selected by SIDF management based on financial and impact metric performance with additional consideration being given to how projects would fit into the existing portfolio construction. To be eligible for funding, project must meet both expected return criteria as well as benchmark environmental, social, and governance metrics.