SUSTAINABLE TRENDS

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STRANDED ASSETS POSE SIGNIFICANT INVESTMENT RISK

The University of Oxford defines stranded assets as assets suffering from unanticipated or premature write downs, downward revaluations or conversions to liabilities. Equity research analysts from firms such as Goldman Sachs, Citibank and Deutsche Bank have named the thermal coal sector as the most likely to be stranded among fossil fuels. Investor interest in identifying the true value of existing oil and gas reserves is intensifying following write downs by major oil and gas companies, such as Royal Dutch Shell and BHP Billiton, which announced one on hydro carbon reserves amounting to USD5bn. (Sustainable Insights: Edition 5; Article 4)

The increasing availability of renewable energy technologies and stricter environmental regulations have made fossil-fuel-related assets, which make up to 30% of major stock exchanges, an investment risk; However, assets in other industries may suffer similar revaluations as consumer preferences and regulations evolve.

Stranded assets are also emerging in the natural gas sector with oil producers opting not to invest in the infrastructure necessary to collect, process and market it as oil is more valuable. However, the percentage of natural gas flared has declined to 29% of production in May 2013 from 36% in September 2011. (Sustainable Insights: Edition 2; Article 2)

A University of Oxford report has highlighted the significance of stranded assets in agriculture, based on the threat it poses to the environment. The ongoing agri-boom is further increasing the risk of stranded assets owing to high commodity prices and poor yields in certain geographies. (Sustainable Insights: Edition 3; Article 2)

A new take on stranded assets, tobacco manufacturers: The Economist reports that tobacco-backed bonds – introduced in 1998 – are at risk of default if Americans continue to quit smoking at the current rate. The bonds were launched after cigarette manufacturers agreed to pay out a projected USD200bn over 25 years to cover the tobacco-related healthcare costs of 46 states. Bloomberg believes there is now USD100bn worth of tobacco-backed bonds. Original forecasts were for annual payments of USD8bn but the payout has fallen short at USD6.5bn, mainly because of falling cigarette sales. Ratings on most tobacco-backed bonds have dropped from A- to BB+, owing to cigarette manufacturers' declining income in the wake of plunging domestic consumption. (Sustainable Insights: Edition 7; Article 2)

LARGE ASSET MANAGERS PUT SUSTAINABLE INVESTING IN THE SPOTLIGHT

According to a UBS Research Focus report, sustainable investing will continue to grow, mainly due to increasing investor focus on long-term sustainable returns. UBS claims that companies are integrating ESG considerations into their investment decisions for two main reasons: 1) it provides them better information on which to base such a decision, and 2) it helps them create sustainable shareholder value. It also cites research that suggests companies that focus on ESG issues can improve their access to finance. The report states that the evolution of this concept has been facilitated by better information on ESG issues and the availability of such information across a wide range of assets. (Sustainable Insights: Edition 1; Article 3)

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Global asset managers are increasing their focus on sustainable investing in the wake of regulatory requirements and growing client demand. Government-backed regional banks are also raising funds for energy-efficient projects.

Bank of America (BAC) has announced a major push towards ESG investments for its retail and high net worth clients; this includes a socially responsible investing proxy-voting arrangement with Institutional Shareholder Services. BAC has said the move aims to address a growing requirement among its investors to align their investments with ESG issues. The investments offered are organized around the themes of environmental stewardship, human capital practices and corporate governance. (Sustainable Insights: Edition 5; Article 2)

In August 2013, the world's largest sovereign wealth fund, the Norwegian Government Pension Fund Global ('oil fund') with USD818bn in AuM, appointed a corporate governance advisory board to actively influence appointments to boards of companies where it held a share exceeding USD1bn, ensuring that investment decisions align with the fund's sustainable values. The Government also has plans to establish a separate mandate for the fund's investments in renewable energy assets, which if implemented would make the 'oil fund' the single-largest clean energy investor with USD10bn p.a. (assuming it invests a minimum 5% of its AuM – the target set for its property investments). (Sustainable Insights: Edition 3; Article 1)

PRESSURE ON COAL INDUSTRY CONTINUES TO INTENSIFY

The EIB's emission performance standards announced in June 2013, which prohibit the bank from investing in plants that emit more than 550g CO2/KWh, will effectively block funding for conventional coal-power-plants whose emissions exceed 1,000g CO2/KWh. Over the past five years, the EIB has reduced funding to coal and lignite power stations to approximately 1.5% of its annual EUR12bn energy sector spend.

The European Investment Bank (EIB) is phasing out funding for coal plants and is targeting 25% of its overall annual funding for climate action.

Gas-based power plants stand to gain from this move as the EIB believes that 'gas is expected to remain a transition fuel to a low carbon energy system'. The EIB's announcement follows the World Bank's decision to fund coal projects only where there are no alternatives available. (Sustainable Insights: Edition 1; Article 1)

Australia's Galilee Basin is facing increasing pressure to halt coal exports to Asia to fuel power stations. The AUD6bn rail and coal project in which Aurizon Holdings (AZJ AU) is considering a significant investment is one such project. The project's production start date has already been delayed to 1Q17 following objections by environmental lawyers to the project's mining lease. Another project that might come under scrutiny is Waratah Resources' (WGO AU) China First Project, also located in the Galilee Basin, which plans to mine 40mt of coal a year starting in 2016. (Sustainable Insights: Edition 6; Article 2)

A study published in the Journal of Environmental Studies and Sciences has found that renewable energy from wind and solar is economically more efficient from a social cost-benefit perspective compared with energy from coal. The study also found that it is cheaper to replace a coal-fired power plant with a natural gas-fired plant when compared with keeping an existing coal plant operational. The report has also identified natural gas as the most efficient of all energy sources, based on the social cost of carbon (SCC) calculated by the US government. (Sustainable Insights: Edition 9; Article 3)

FIERCE DEBATE TAKING PLACE OVER THE PRICING OF RENEWABLES

The renewables industry in China is facing some setbacks due to excess supply while the global development banks expect to invest in more renewable energy over the next year.

On the heels of news that the Chinese solar industry is at risk following excess supply and declining panel prices, Chinese authorities are pushing to limit new solar panel production plants by banning increases in current manufacturing capacity. The move aims to limit pure capacity expansion and mandates solar companies to spend either 3% of annual revenue or USD1.5m on research and development and on upgrading equipment. (Sustainable Insights: Edition 9; Article 1). The industry, which has historically been buoyed by government subsidies, had an installed capacity of 49GW of solar panels compared with global demand for just 36GW in 2012. (Sustainable Insights: Edition 7; Article 1)

Bloomberg New Energy Finance expects development banks to invest 15-30% more year-on-year in renewable energy during 2013. This follows a 25% YoY increase over the past five years during which time the banks disbursed USD425bn.
(Sustainable Insights: Edition 8; Article 2)

Has declining prices and greater investment into renewables lowered the cost of electricity from renewable energy? No, says the Chairman of the German Council of Economic Experts. EU data shows that Germans pay more for electricity that any other nation in the Union, except Cyprus and Denmark. They also pay twice as much as the US. The high fee is a result of the nation's goal of sourcing 50% of its electricity needs from renewable energy by 2030. This is likely to cost Germany EUR1tn over the next 25 years. (Sustainable Insights: Edition 9; Article 2)