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Financing the just transition at scale in South Africa and beyond

THOUGHT LEADERSHIP

Asset managers' role in driving the just transition

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Asset managers – driven by improved alpha returns and frustrated by compliance-based ESG frameworks – are central to the success of South Africa's just transition to a low-carbon, climate-resilient economy. Constrained by a weak pipeline of scalable renewable energy projects, asset managers may be overlooking lucrative opportunities within the broader just transition space. The market is gaining momentum in financing the just transition and testing innovative ideas to unlock the investment pipeline and drive change at scale.

There is a massive need for de-risked capital to fund South Africa's just transition and meet global decarbonisation goals that aim to limit a temperature increase to 1.5°C (Paris Agreement). An enhanced approach to just transition financing requires reconsidering ESG exclusion lists and the narrow focus of the Renewable Energy Independent Power Producer Procurement Programme (REIPPPP), with an understanding of how to de-risk financing models to unlock and scale a broad range of projects.

Key considerations

1. **Innovation for a first-mover edge**
   Asset managers need innovation, speed and scale for a first-mover advantage that transcends traditional ESG frameworks and navigates the just transition for enhanced strategies.
2. **Comprehensive capital mobilisation**
   Capital mobilisation opportunities extend beyond renewable energy to include transmission, storage, green hydrogen and socially impactful initiatives supporting workforce transition.
3. **Overcoming finance challenges**
   Overcoming challenges requires decisive action, tools like guarantees and multilateral opportunities with de-risking support. Understanding the just transition enhances strategies for scalable inflows, returns and increased business profitability.
4. **Strategic alignment for societal impact**
   Portfolios should align with evolving regulations and meet stakeholder expectations in the just transition. This includes unlocking untapped inflows with additive benefits for society and aligning with ESG and SDG expectations.

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EXAMPLES OF JUST TRANSITION INVESTMENT APPROACHES

Inspired Evolution's 10-year closed-ended private equity fund, Evolution II, launched in 2017, focuses on clean energy infrastructure projects and technology-based growth companies, with R4.1bn in commitments.

SA's Green Outcomes Fund highlights the use of catalytic capital (with a mobilised investment of R488.1m) to empower small-scale enterprises.

The BlueOrchard InsuResilience Investment Fund (IIF) (which raised R960m in 2023) employs an innovative financing approach that combines a private debt sub-fund and a private equity sub-fund with a first loss tranche.

GAWA Capital's Kuali Fund, an R6.2bn private debt and equity fund, supports climate change resilience in Latin America and Asia. It invests in financial institutions and climate solution providers to increase climate solutions for smallholder farmers and small businesses.

Broadening the horizon

There is a shift to move investor focus from climate action to a just transition, as the focus broadens to achieve various technical transitions as well as socio-economic goals.

$94.8 trillion	The gap between current commitments and the required investment for emerging markets to achieve the transition to net-zero by 2060 (Ninety One, 2022).
$4 trillion	The estimated annual global clean energy investment needed to meet the net-zero emissions target by 2050 (IEA, 2021).
$2.8 trillion	World's climate-focused funds – goal for 50% of these to adopt just transition criteria by 2026 (Impacting Investing Institute, 2023).
R210 billion	SA's REIPPPP committed investment from 2010 to 2011, which connected 6.3GW of renewable capacity (DoE, 2022).

Diversifying investment portfolios presents various avenues for growth and sustainability:

Transmission investments
Asset managers can explore investments in transmission infrastructure to enhance the efficient distribution of renewable energy.

Private Power Purchase Agreements
Beyond traditional REIPPP, asset managers can explore engagements in various sectors like NTCSA, gas round projects and BESS rounds through private Private Power Purchase Agreements (PPAs).

Ancillary services
Asset managers have opportunities to provide grid balancing and stability services, contributing to the reliability of the energy system.

Private battery solutions
Asset managers can focus investment on projects developing and deploying advanced battery technologies, addressing the intermittency of renewable sources.

Green hydrogen (Gh2)
Investment opportunities exist in green hydrogen production, storage and utilisation projects, serving as a clean energy carrier.

Emerging technologies
Asset managers can explore innovations such as floating solar (installing solar panels on bodies of water) and Small Modular Reactors (SMRs) in nuclear power for unique investment opportunities.

The transition will aim to go beyond physical access to electricity and address broader aspects of energy poverty, ensuring that the benefits of renewable energy reach all segments of society:

Clean transportation
Asset managers can invest in electric vehicle infrastructure, charging stations and companies involved in electric vehicle manufacturing.

Carbon Capture and Storage (CCS)
Opportunities exist for asset managers to identify and invest in projects that capture and store carbon emissions from industrial processes and power generation.

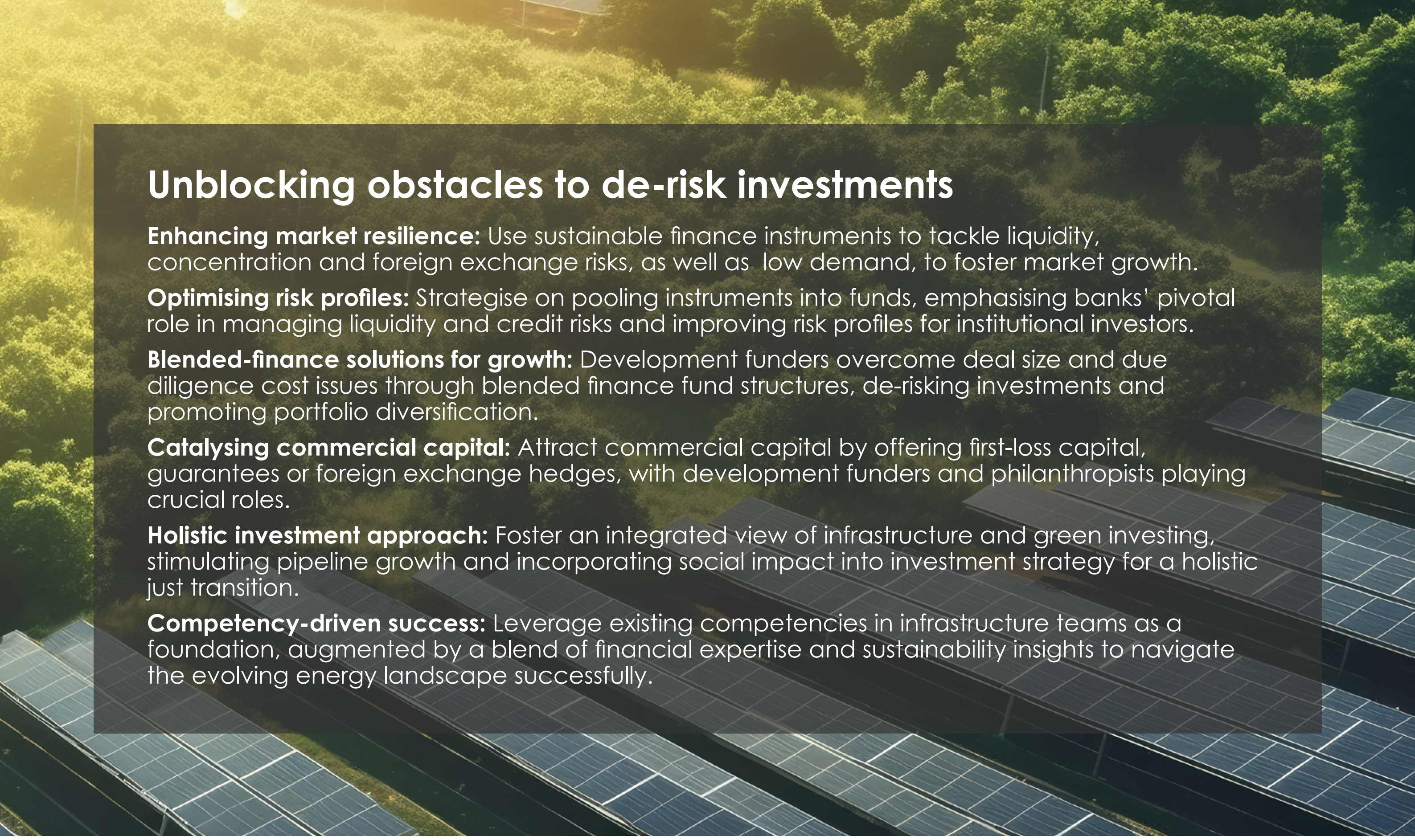
Cross-border energy trade
Asset managers can explore innovations such as floating solar (installing solar panels on bodies of water) and Small Modular Reactors (SMRs) in nuclear power for unique investment opportunities.

Water management
Asset managers can consider investments in water management projects, especially those focusing on efficient water use and conservation in the context of climate adaptation.

Municipal infrastructure improvement
Asset managers can explore opportunities in projects enhancing municipal infrastructure, aligning with the adaptation goals and contributing to the overall improvement of urban resilience.

Sustainable manufacturing practices
Asset managers can invest in projects focused on energy efficiency, eco-friendly materials and processes, circular economy principles and low-carbon production.

As we navigate the complexities of the just transition, asset managers have the opportunity to look beyond conventional climate solutions. Investing in green hydrogen, advanced battery technologies and cross-border energy trade diversifies portfolios and propels us toward achieving holistic, sustainable progress. This approach addresses climate action and fosters socio-economic resilience, marking a significant step forward in our collective journey to net-zero.



Unblocking obstacles to de-risk investments

Enhancing market resilience: Use sustainable finance instruments to tackle liquidity, concentration and foreign exchange risks, as well as low demand, to foster market growth.

Optimising risk profiles: Strategise on pooling instruments into funds, emphasising banks' pivotal role in managing liquidity and credit risks and improving risk profiles for institutional investors.

Blended-finance solutions for growth: Development funders overcome deal size and due diligence cost issues through blended finance fund structures, de-risking investments and promoting portfolio diversification.

Catalysing commercial capital: Attract commercial capital by offering first-loss capital, guarantees or foreign exchange hedges, with development funders and philanthropists playing crucial roles.

Holistic investment approach: Foster an integrated view of infrastructure and green investing, stimulating pipeline growth and incorporating social impact into investment strategy for a holistic just transition.

Competency-driven success: Leverage existing competencies in infrastructure teams as a foundation, augmented by a blend of financial expertise and sustainability insights to navigate the evolving energy landscape successfully.

The macro-economic context

South Africa is heavily reliant on coal for energy production but is battling aging infrastructure and energy security amid high levels of poverty, unemployment and inequality. The need to transition is based on global pressure and complex domestic challenges, with some key macro-economic developments driving the transition:

- Global greenhouse gas emissions must be reduced by 43% by 2030 for a 1.5°C global warming limit; COP28 nations endorsed a just reduction in fossil fuel use to achieve net-zero objectives by 2050.
- South Africa committed to reducing carbon emissions to 350-420 million tonnes by 2030 (Nationally Determined Contributions (NDCs) legislated in the Climate Change Bill, 2022).
- European Union's Carbon Border Adjustment Mechanism (CBAM) imposes carbon tax on high emission imports; asset managers need to reassess investments in carbon-intensive sectors.
- Job losses in coal, oil, gas and automobile sectors pose risks; addressing socioeconomic impacts will be crucial for public support and a successful transition.
- Initiatives requiring funding stem from the principles contained in the Just Transition Framework, which focuses on distributive justice, restorative justice and procedural justice.
- The Just Energy Transition Investment Plan 2023-2027 (JET-IP) commits $9.3bn from foreign countries for South Africa's decarbonisation efforts, particularly in the electricity sector.
- The JET-IP, constituting 10% of the required investment to 2027, aims to catalyse further finance and alleviate the impact of the energy transition on workers and communities.

Funding for the just transition, estimated at R2.4tn up to 2030 and R8.5tn up to 2050, focuses on these initiatives (Draft JTFM, 2023):

- **Workforce development**
  Reskill workers in fossil fuel industries to enable their participation in emerging low-carbon sectors.
- **Economic diversification**
  Fund start-ups and SMEs for economic diversification in decarbonising regions.
- **Sustainable agriculture**
  Invest in climate-resilient agriculture for food security and environmental sustainability.
- **Clean energy & infrastructure**
  Ensure equitable access to clean energy and fund climate-resilient infrastructure.
- **Social protection**
  Provide transitional support, including social security, unemployment insurance and education stipends.
- **Community engagement & stewardship**
  Financial support for community involvement in decision-making and environmental projects.
- **Innovation & capacity building**
  Support local research, innovation, and capacity building for a smooth transition.

South African investments in just transition sectors

It is evident that investments in the just transition space have only touched the surface. This is likely to accelerate due to various changing conditions but particularly the amendments to Regulation 28, where 45% of domestic assets can be invested in infrastructure.

R102 billion	Infrastructure (2022)
R176 billion	Listed infrastructure bonds (2022)
R23.2 billion	Listed social infrastructure (2021)
R813 million	Listed agriculture (2021)
R42 billion	Listed transport (2021)
R249 million	Environmental services (2021)

Source: ASISA, Prescient

Other factors to consider

- **Capitalising on ESG reporting standards**
  ESG reporting standards, such as IFRS S1 and S2, highlight the financial impact of sustainability and climate risks, offering asset managers an opportunity to fund necessary company changes.
- **Strategic role of aligned asset managers**
  Asset managers aligned with initiatives like Net Zero Asset Managers, CRISA 2 and PRI will be pivotal in the just transition, focusing on effectively mitigating climate change risks.
- **ESG emphasis in decision-making**
  The growing emphasis on ESG factors is becoming pivotal in investment decisions, with end investors seeking alignment between financial objectives and strategies that actively support the just transition.

Strategic positioning for asset managers

Asset managers can enhance their just transition approach within existing infrastructure funds:

- By creating a specialised focus area within these funds, asset managers can focus on opportunities that align more closely with the nuanced requirements of a just transition.
- Specialisation allows for a deeper focus on projects contributing not only to infrastructure development but also addressing just transition criteria.
- This will position asset managers to create additive impact while optimising returns.

Recognising and leveraging evolving market and stakeholder demands for sustainable investment opportunities provides several benefits:

- **Market alignment:** Aligns the portfolio with market trends, broadening its appeal.
- **Risk management:** Mitigates long-term ESG risks, bolstering portfolio resilience.
- **Regulatory compliance:** Compliance minimises legal and reputational risks.
- **Reputation and brand value:** Meeting societal expectations enhances the asset manager's reputation.
- **Innovation and leadership:** Asset manager will be seen as a driver of financial innovation and positioning itself as a leader in responsible investing.

Venturing beyond traditional boundaries

- Explore financial opportunities from the just transition for innovation.
- Consider unconventional financial mechanisms for unlocking new opportunities.
- Utilise parallel funds with unique focuses, risk profiles or structures.

Alignment with government goals

- Essential to align private sector objectives with government goals.
- Enhances legitimacy and trust between partners.
- Opens doors to leverage and scale projects in infrastructure, automobiles, and agriculture.
- Fosters collaborative efforts for mutual benefit.

To stand out and become leaders in the field, asset managers can develop a set of just transition criteria. This goes beyond the sustainable development goals (SDGs) and ESG approach, focusing on objectives specific to South Africa.

Examples include:

- **Impacting Investing Institute's Just Transition Criteria (2023)**: intended for investors to align products, like investment funds, with the goal of supporting a just transition to net-zero.
- **World Benchmarking Alliance's Just Transition Methodology (2021)**: Methodology for companies to assess their contributions to a just transition.
- **The PCC's Just Transition Finance Mechanism (JTFM):** The PCC is developing a tagging framework as an evaluation tool to assess whether proposed projects contribute towards a just transition. Krutham assisted in the development of the draft JTFM.

Concluding thoughts

The pivotal role of the just transition in addressing South Africa's socioeconomic and energy challenges emphasises the strategic imperative for asset managers. Rather than consolidating existing efforts, asset managers must carefully evaluate their investment strategies to ensure alignment with the complexities of this transition.

An additive approach, incorporating new and targeted investments in renewable energy, sustainable infrastructure and community engagement, provides an integrated strategy to address specific facets of the transition. This nuanced approach positions asset managers to make a meaningful impact, fostering sustainable, inclusive and resilient solutions tailored to South Africa's unique requirements while navigating evolving market dynamics.

Talk to us about how we can help you navigate the just transition

Krutham encourages asset managers to re-evaluate their portfolios, seek expertise in understanding and capitalising on just transition opportunities and reconsider their climate change strategies to focus on a just transition that incorporates social and environmental considerations (and influence a market to shift in that direction).

We specialise in just transition consulting, working with clients in various sectors. Our notable projects include collaborations with the Impacting Investing Institute, Africa Climate Foundation, Presidential Climate Commission and the World Bank. Our team offers research-led consulting services covering policy analysis, political insights, market research, macroeconomic capital markets and strategic research. We assist diverse capital entities, from hedge funds to philanthropies, in navigating opportunities and risks associated with a just transition.

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