RBC Global Asset Management

Beyond ESG and Green Bonds:
There's Another Way for Investors to Address Climate Change

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As the appetite for ESG and green bonds hits record highs, the million (or, well, trillion) dollar question remains: Are investors really getting the most impact for their buck?

The unfortunate answer is that, given all the hubbub surrounding the green finance space, many likely don't even know. They may be investing in a green bond, for instance, that, despite being priced higher than a normal bond, is earmarked for investments that are part of a company's normal course of business, like a utility's grid modernization project. Or a sustainability bond largely devoted to refinancing debt from previous eco-based initiatives. Or a company whose net-zero pledge might ultimately have little impact on the communities most impacted by climate change.

The confusion is understandable. While some guidelines are gaining significant traction, no set standards are in place for such investments; tellingly, there are more than 20 different labels for sustainable bonds alone, all of which align with different frameworks and guidelines, according to the 2020 Journal of Environmental Investing Report.

But as climate change continues to put our most vulnerable communities at risk, investors should be putting their money towards climate-focused impact investing solutions, rather than companies who are often a significant part of the problem.

Paradise, California, or, how climate change hits our most vulnerable populations the hardest

The story of Paradise, California, is the story of how climate risks can trap low-to-moderate income (LMI) communities in a cycle of economic instability – and underscores why investors should invest in solutions that directly help these communities.

In 2018, California's deadliest and most destructive wildfire (donned the Camp Fire) ravaged Paradise, burning down 90 percent of its structures and displacing up to 50,000 residents. Because of California's affordable housing shortage, many of these residents were already economically disadvantaged – like any number of other LMI individuals around the country, they could afford housing in Paradise in large part because of the very climate risks threatening to take that housing away. What's more, these conditions meant Paradise's LMI residents couldn't afford to self-insure, and even if they could, rising housing costs in the area meant they often couldn't purchase a house with the insurance money they received.

As a result, large numbers of displaced residents faced housing instability. On the eve of the initial pandemic lockdown, for instance, 23% of unsheltered people in all of Butte County (home to Paradise and neighboring areas) were homeless because of the Camp Fire.

What options do individuals and families like these have? Many want or have no choice but to return to Paradise. But as housing and insurance costs in the region continue to grow, they're struggling to rebuild. There's a reason that, according to data compiled by CSU-Chico, new owners now represent the majority of building permit applicants in Paradise. They'll either continue to struggle to source new housing or find themselves right back where they started – where wildfires present an ongoing threat.

Such tribulations are emblematic. As Laurie Schoeman, National Director, Resilience and Disaster Recovery, at Enterprise Community Partners, stated in a recent briefing, "Areas that are facing extreme shortages of affordable housing units are also extremely vulnerable to coastal flooding, hurricanes, extreme heat, earthquakes, and fire. There is a strong relationship between affordable housing and climate risks, which puts those dependent on affordable housing at extreme risk of losing housing." She cites a representative statistic: 400,000 federally subsidized homes reside in a floodplain.

A government report released shortly after the Camp Fire concurred. Writing in response to hurricanes Harvey and Florence, its authors wrote, "Some property owners can afford to modify their homes to withstand current and projected flooding and erosion impacts. Others who cannot afford to do so are becoming financially tied to houses that are at greater risk of annual flooding."

What investment stakeholders need to know

Fixed-income investment strategies do exist that can directly address climate change's impact on communities like Paradise – rather than support the companies who, more often than not, are part of the problem.

Take the Forest Resilience Bond, which deploys private capital to finance forest restorations on private and public lands. Here's how it works: Fixed-income investors put money in a special purpose vehicle (SPV); this vehicle supports the Forest Resilience Fund, which in turn funds implementation partners who do work on the ground (forest thinning, prescribed fire practices, etc.) that reduces wildfires and protects and enhances the ecosystem. The beneficiaries of those services – water and electric utilities, insurance companies with fire risk exposure, local and state governments – then pay back that SPV over time, and thereby the investors.

A nonprofit, Blue Forest Conservation, collaborates with other nonprofits and academic institutions to evaluate restoration projects, develop contracts, and establish agreements. The goal, as Blue Forest's co-founder Nick Wobbrock said during a recent webinar, is to "make it look as boring as possible" by mimicking the simplicity of an infrastructure or mortgage investment: standardized, uniform loans repaid by multiple sources over time, with blended money (and risk-sharing) from local, state, and federal governments and utilities. The risk/return profiles are comparable to other fixed-income strategies and green and sustainability bonds.

It's this model that provides scale for these solutions and accelerates investments in the pipeline. In California, we've invested in projects funding small businesses specializing in landscape and water conversation, affordable housing for homeless veterans in Santa Barbra, and the State Water Project, aimed at delivering water to areas of need throughout the state – among many others.

This is just the tip of the iceberg. New, climate-focused investment solutions are out there and growing in number, and most will directly address climate risk and the LMI individuals who are most vulnerable to those risks.

Yet offering these investment vehicles and putting enough private capital behind them to drive transformative change are two different things. For us to maximize our full impact investing potential, investors need to sift through all the ESG noise and ensure their dollars go towards the most meaningful solutions.

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