Willis Towers Watson PODfolio_episode_7_

The weird and the wonderful – part 1 (Climate change)

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KATIE SIMS: If you're growing things like tomatoes, peppers, cucumbers in these modern very technologically advanced greenhouses, you can grow 10 times more food with using 10 times less water. So it's a much more sustainable way of generating the food that we need to eat.

Welcome to The PODfolio, Willis Towers Watson's investment podcast series, where we'll give you an update on the latest developments across global markets and talk to expert guests on hot topics that matter to institutional investors and their portfolio.

LOK MA: Hello. And welcome to The PODfolio investment podcast. I'm your host Lok Ma.

And I'm delighted to welcome as our guest Katie Sims, who is our global head of multi-asset growth solutions. So good morning to you, Katie.

KATIE SIMS: Morning, Lok.

LOK MA: We have a very cool theme today. We're going to talk about some of the more unusual investment ideas that we've been putting forward. Ways of generating a return that hopefully our listeners will be less familiar with. And obviously, by their nature, these things will just be interesting in themselves.

But there's also more of a serious point that we want to make as well, which is, you know, why do we want to invest in something that's less familiar to us? What advantages might that bring to a portfolio?

So Katie, first of all, before we go through various different kind of innovative ideas, how does your team come up with these kind of ideas? Where do you get your inspiration from?

KATIE SIMS: Thanks a lot. Well, it comes from a number of sources, actually. So as you know, we have a large global research team who are in constant contact with the asset management community. And so a really important source of the ideas is actually managers bringing them to us, because we have those relationships and we have the track record of working with managers and deploying capital.

So that's kind of the main source. But we also get ideas from our Thinking Ahead Institute, who have identified a number of megatrends that they expect to play out over the next decade or so. And so that gives us some themes upon which we can explore working out how we can invest along across those themes.

There are also, you know, ideas that come from our portfolio construction teams. So we can look at the portfolios that we're building for clients and identify where there might be any gaps or where we might want to express certain views. And then we task the investment research team with finding those ideas.

And then also asset research. So we do a lot of work with economists and looking at how markets and economies are developing. And that can also identify areas that we expect will grow in the future, and therefore, we want to make investments.

So we have to be open to a wide range of inputs, but that means that we get a very broad range of ideas that we can consider.

LOK MA: Right. And I think we've got quite a few ideas we want to give you a flavor of, those of you who are listening in. So shall we start with a few? I mean, you mentioned the idea of megatrends. Can you just give us, you know, some examples based on one of these?

KATIE SIMS: Sure. I mean, well, climate is probably the most important and most visible megatrend that has been identified. And I'm sure that many investors will be familiar with the concept of environmental, social and governance issues when you're investing. But climate is probably one of the biggest risks to the planet, to society and to businesses. And so there's a range of things that we have done in that area, from investing in solar and wind energy generation, to more sustainable ways of growing food, to helping low income families reduce their energy bills. So that's probably one of the most important areas we focused on in the last five or so years.

LOK MA: Can you just give us some specific examples of how you kind of help investors get money into the ground for these things?

KATIE SIMS: Yeah, sure. So it's important to note that we always partner with specialist investment managers when accessing these ideas. And that's critically important when you're investing in operational assets. You need to have people that really understand how they work, what the risks are, and have the experience of managing that.

So well-- but you can access it across kind of all different asset classes. So we've had some investments in really low risk secure income end of the spectrum. We've had some credit investments and then also some private equity infrastructure and real estate investments in that space. So there's a really wide opportunity set, depending on your risk and return appetite.

LOK MA: And Katie, you mentioned a few different examples of investing in these kind of ideas. I think one of them was solar power, was it? Do you want to just give us some examples of how you invest in these things?

KATIE SIMS: Solar power is a really good example of something that you can access in a low risk and low return and a potentially high risk high return way. So our first investment into solar panels was after the 2011 nuclear disaster following the earthquake in Japan.

So Japan, as a country, were very reliant on nuclear power. And the risks of that became very apparent, particularly being in an area where there's quite a lot of tectonic activity. So the government wanted to transition its power generation away from nuclear into more sustainable sources of energy, solar being a key one that they focused on.

We worked with a manager that we had known for quite some time, who came to us with a co-investment idea to essentially build farms of solar panels, taking advantage of the government subsidies that the Japanese government was making available at that time. And it

was great opportunity that came to us, because we were the only people they approached. They said, we need the due diligence turning around in two to three weeks so that we can get this deal. So we sent our research team out to Tokyo. They did all the work in the time frame that was required, which enabled us to invest.

So if you think about the risks that we were taking on and investing in this project, they were, first, regulatory risk that the Japanese government would renege on its subsidy obligations, which seemed a fairly remote risk, given their urgency to transition their energy supply away from nuclear. And the second big risk was construction risk, which actually, you know, it's not that complicated to build solar farms. The solar technology has improved vastly in the last few decades. And so it's a case of wiring some panels in on some fields. So you know, not the most terribly complicated thing to build.

And then the other thing you need to think about is, well, what is your exit strategy once you have, you know, built this thing, got it working and got a stable revenue generation? And interestingly, what we ended up doing was selling it to a Japanese pension fund, who were-- wanted to be a long term owner of these assets that generated a reliable income linked to inflation. And so we got a much better than expected exit on the strategy, and we ended up returning three times the capital that we invested to our clients that invested with us. So that's a really great example on the higher risk end of the spectrum.

And then on the lower risk end of the spectrum, it's doing exactly what that Japanese pension fund was doing and being a long term owner of operational renewable assets, like solar farms, like onshore and offshore wind farms, that, you know, are producing steady cash flows and, in most parts of the world, underpinned by government subsidies, meaning that you have quite a lot of certainty over the returns that are going to be generated from those assets. And you're helping to support the transition to a less carbon intensive economy.

LOK MA: So the same kind of idea, solar power, you know, different flavors of it. Some higher risks, higher returns. Some lower risk, lower return.

One of the things that kind of struck me is when you mentioned kind of long term inflationary, you know, regular payments that you receive on these kind of investments. Sounds quite a bit like the pattern of payments that, for example, a pension scheme might pay out to his members. So does that kind of correspondence make these things more attractive? Do you take that into account when you think about using these-- especially for pension investors?

KATIE SIMS: Yeah, absolutely. So that's why pension schemes are buying these types of assets, frankly, because it helps to mirror the payments that they need to make to their beneficiaries. And it's nice because those income streams aren't linked to the broader economy. They're not linked to how well the stock market is doing so.

So you get two benefits. You get that regular cash flow. And often, these things, that they pay the cash flow out to you, so you receive it into your bank account when you're needing to make the payments out to your pensioners. But then you also get the diversification aspect, because it doesn't behave-- the price of these things don't behave in the same way that equity markets or bond markets are behaving. So it helps to provide other portfolio benefits.

It's important to note as well that buying long term infrastructure investments isn't the only way to access solar power. So we have another example of a credit strategy in the US, where we actually worked with a local company that is a leading residential solar system developer focusing on low to moderate income families which actually most of the large national solar players had ignored. So what this company was doing is helping to lower electricity bills for homeowners through solar installations and energy efficiency upgrades on their houses.

And they were focused in, actually, New Orleans, following Hurricane Katrina. When the city was trying to rebuild itself, they saw an opportunity to help struggling families sort of help with reducing the bills, effectively. So we worked with this firm to structure some debt funding for them to help them, basically, expand their operations beyond just New Orleans into Connecticut and New York and New Jersey.

And we also partnered with the nation's first green bank. So we're the senior lender and the green bank is the junior lender in this structure.

And so what this project has helped to do is it's going to enable renewable power generation of 59 million kilowatts per hour, which is going to save 41,000 metric tons of CO2 per annum. So these are going to have a really positive impact on the environment, but it's also going to help up to 18,000 families benefit from energy savings, which is going to total around $11 million per annum of savings across those households. So it's got a really positive social impact for those families that are struggling to rebuild following the hurricane, but it's also got really positive environmental impact.

LOK MA: So again, same idea. Solar power, another way of investing, except this time as debt and credit instead of a kind of equity and infrastructure.

Katie, I know you've got quite a few different types of investments under this overarching theme of climate change. Shall we go through one or two more? Any other ones you want to talk about?

KATIE SIMS: Yeah. Because I think people typically focus on reducing emissions when it comes to energy generation, but there are some other areas as well that governments are trying to work on. And one of them is reducing energy emissions when it comes to generating heat.

So a really great example-- and again, this spans multiple themes, because it's also interconnected as, you know, real life is. But taking the renewable heat idea, one of the key drivers of-- or one of the key costs associated with growing fresh fruit and veg is either you're growing it in hot countries and then you're transporting it halfway across the world to places like the UK or northern Europe, where they can't grow this crop effectively themselves and you've got a massive carbon footprint from doing that, or you're using greenhouses or hothouses, which just take lots of energy to basically heat them to have the right growing atmosphere.

So what we have done is looked at building greenhouses that take waste heat from places like power plants or sewerage treatment works so they're having that renewable input of the heat, but it also has some other really significant benefits.

So if you're growing things like tomatoes, peppers, cucumbers in these modern, very technologically advanced greenhouses, you can grow 10 times more food with using 10 times less water. So it's a much more sustainable way of generating the food that we need to eat. It also reduces the need for using pesticides, which can sort of pollute rivers and groundwater. And it reduces that carbon footprint that I talked about in terms of having to transport the food across the world.

So one of the investments that we've made in this area is in the UK, where the government is actually providing subsidies for renewable heat. So again, it's another kind of low risk way of accessing these ideas. And in the UK we consume 500,000 tons of tomatoes every year, which is a lot, but 80% of those are imported. So if we can start using this technology to grow more locally, then we can really reduce our carbon footprint.

LOK MA: And are these co-investments again?

KATIE SIMS: Yeah. So this is a co-investment that we've done in the UK to build a couple of the world's largest and most technologically advanced greenhouses. But we also have some investments in the US. There's not the same regulatory support in the US, so it's not-- it's on a different end of the risk spectrum.

But again, in the US you've got huge transport on the ground between where crops are grown and where they're consumed. And using this greenhouse technology, it means that you can utilize land that otherwise wouldn't be arable, it would just be sort of wasted space as it were. And then you can bring the growing much closer to where it is consumed. So it's really applicable all the way across the world.

LOK MA: Yeah. And I just want to kind of point out how different these things feel like compared to just investing your money, buying a stock in a company, an equity share or buying a corporate bond. These are things where, you know, the investor, in a way, kind of you end up getting your hands dirty and kind of getting into it. Also getting your hands dirty because you're growing things as well, touching all the soil.

[LAUGHTER]

Any-- I think we've probably got time to do one more under the theme of climate, Katie. Do you want to go through another example?

KATIE SIMS: Yeah. So another really interesting one that we've just invested in recently is a forestry idea. So across the world, everybody is trying to offset their carbon emissions through kind of carbon capture. And the best or the most natural way to do that is to plant trees who take in the CO2 and capture it and remove it from the atmosphere.

So one deal that we've done recently is to acquire some redundant or unused agricultural land in the north of England and Scotland. And using-- again, there are grants available from the government, because the government wants to improve the use of land for forestry in the UK, and there are other initiatives around the world. But essentially, we're going to transform this land from being unused grazing pasture land to plant trees and build a forest and capture lots of carbon.

And again, this is quite a kind of high risk, high return strategy, because you need to make sure that the trees take and they grow well and that you kind of execute that establishment of the forest. And then, similar to the Japanese solar idea, you'll then sort of look to sell it on to somebody that's going to be a long term owner of these types of assets. And so it's just another way of thinking about how you can contribute to the climate change problem.

LOK MA: And just to be clear, Katie, I mean, these forests they're staying as forests, right? It's not-- the aim is not to kind of produce timber and wood for building?

KATIE SIMS: Yeah. Absolutely. So the idea is that we would hold the forest for three to five years until the trees have fully established themselves, and then sell them to somebody that wants to own them for the long term.

LOK MA: So lots of interesting examples under the theme of climate change. I think we're going to pause here and pick up this conversation in a kind of part two of this podcast. Katie, do you want to just give us a quick teaser of what other themes you would like to talk about?

KATIE SIMS: The interconnectedness of the world means that, actually, there will be some climate change that comes through the other themes, but we're also going to focus on technology and innovation and social impact.

LOK MA: OK. So please now head on over to part two of my conversation with Katie.

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KATIE SIMS: You've been listening to a Willis Towers Watson podcast. For more information, visit willistowerswatson.com.