The Role of Private Credit in the Transition to A Low Carbon Economy

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In a paper last year, MIM discussed the investment opportunity presented by the global transition to a low carbon and resilient economy, one of the most significant economic transformations of the post-industrial age. To achieve the Paris Agreement objective to limit global warming to 1.5°C by the end of the century, the Intergovernmental Panel on Climate Change (IPCC) states that global GHG emissions will have to peak by 2025, before declining by 43% by 2030 and reaching net zero by the early 2050s.[1] To accomplish this, a comprehensive economy-wide transition is required. This involves profound business transformations across major industries, including high-emitting industrial sectors. It also requires substantial investment in modern infrastructure, wide-spread adoption of mature technologies, and development of emerging technologies on a global scale.

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The Investment Opportunity

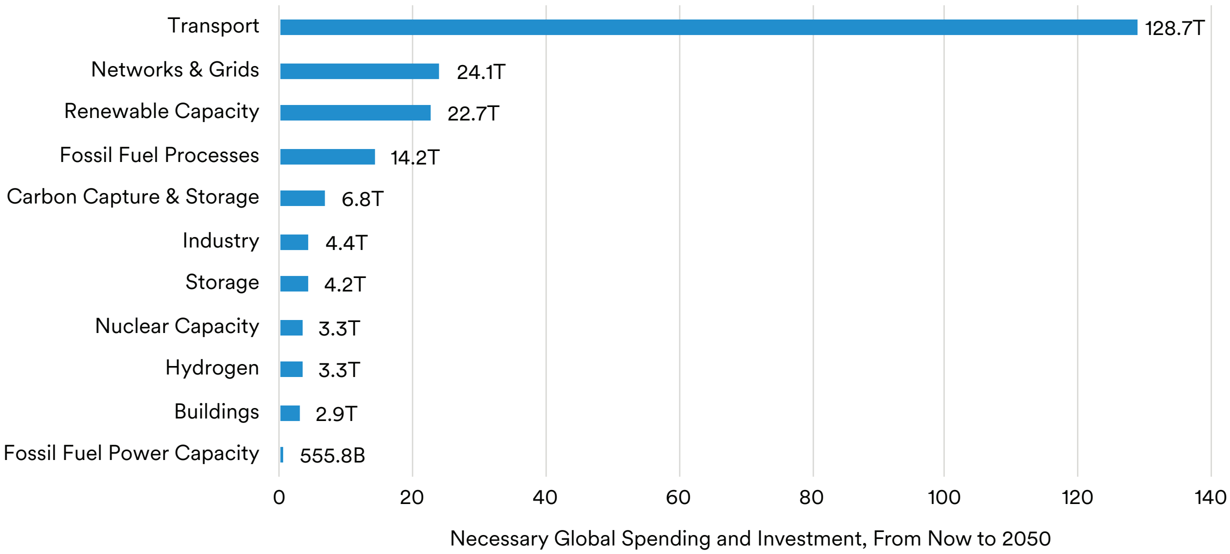
The funding required to facilitate the transition will be substantial. Bloomberg New Energy Finance (BNEF) reports that global energy transition investment in 2023 hit a record level of US$1.8 trillion, yet this falls well below the necessary pace. BNEF estimates that an average annual investment of US$8 trillion is needed from 2024 to 2050. This estimate, recently revised upward, reflects the escalating costs of transition due to current underinvestment. In total, BNEF's revised forecast for achieving zero global emissions requires an investment of US$215 trillion between 2024 and 2050,[2] up from the previous estimate of US$196 trillion. This represents a substantial opportunity for private investment.

The International Energy Agency (IEA) projects that approximately 70% of transition finance funding will come from the private sector as governments and supranational entities are unable to shoulder the enormous cost alone.[3] To uphold the Paris Agreement and mitigate more severe global warming effects, a significant portion of this investment is required within this decade. This urgent need underscores the unique opportunity for investors to contribute to and invest in the transition, shaping our collective future for the coming decades.

While it's often assumed that investment in transition primarily targets risky, emerging technologies, the reality is that investment is needed across all levels of the capital spectrum. Most of the funding is expected to support mature businesses and technologies, such as clean transportation and the expansion of electricity networks and grids. Furthermore, the evolution of some emerging technologies will likely be driven by leading firms in hard-to-abate sectors. These companies possess the necessary expertise and resources and are increasingly motivated by consumer demand and policy incentives to reduce their carbon footprint. This includes industries like steel and cement production, as well as complex, high-emission sectors like shipping and chemicals.

Estimated Global Transition Spending and Investment by Technology From Now to 2050

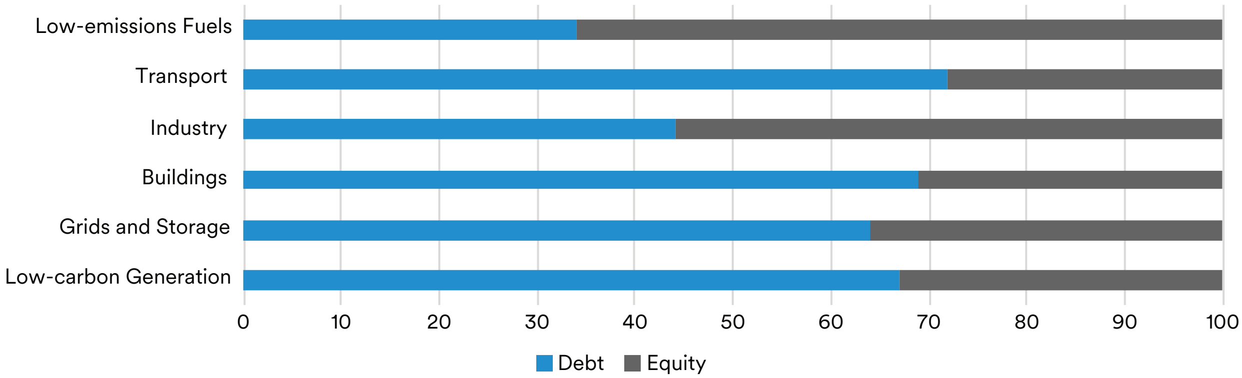
Zeroing global emissions by 2050 could cost $215 trillion, but that will avoid even worse economic losses, and most will go to mature electrification tech.



Source: BloombergNEF

Significantly, the IEA estimates[4] that the bulk of the necessary investment will likely be in the form of debt financing. This reflects the maturity of the industries under transformation and the potential high cost of equity.

Typical Capital Structure of Clean Energy Investments in Emerging and Developing Economies in IEA Climate-Driven Scenario



Calculations based on Bloomberg (2021), Bloomberg Terminal; Damodaran (2021), Data: Current; and Refinitiv Eikon (2021), Eikon Data.
Appears in The Cost of Capital in Clean Energy Transitions

Private Transition Finance

Considering the substantial need for transition finance investment this decade, primarily through debt financing, and the rising significance of private credit markets, we believe private credit transition strategies present a promising investment opportunity. These strategies, in our view allow investors to achieve higher yields than in recent years, generate positive impact and safeguard against the increasing materiality of climate risk.

Private credit markets, being largely relationship-based, enable collaboration between borrowers and investors and offer unique opportunities for engagement. Historically, private credit has offered investors diversification from public bond markets, a potential spread premium over comparable public corporate bonds, and risk mitigation through covenants and/or collateral. Therefore, properly structured private credit can deliver dual benefits of income generation and positive impact.

With over a century of experience in private credit markets, MIM has substantial expertise in corporate, infrastructure, and asset-backed credit and sustainability. Our emphasis on mature industries and technologies positions us to contribute significantly to the pivotal transition finance opportunity in areas like electrification and renewable energy, where the primary challenge lies in commercial deployment versus technological viability.

MIM's private credit transition strategy supports the energy transition by providing loans to (i) forward-looking corporate borrowers well-positioned to capitalize on global decarbonisation trends; (ii) essential infrastructure assets like electricity networks, renewables, transport, and digital communications which are crucial for financing a just transition; and (iii) private asset-backed finance sectors such as residential solar and green buildings.

We categorize transition issuers into four groups, offering a wide range of opportunities. Addressing climate change requires a comprehensive approach, involving innovation and ambition in hard to abate sectors in addition to investment in assets and activities that are already green.

- **Hard to Abate:** Critical industries which account for a significant share of global GHG emissions. Technological solutions in these sectors are either nascent, or require significant capital investment and support to reach deployment at scale and cost parity with existing fossil fuel-based processes.
- **Transition Aligned:** Issuers undertaking ambitious steps to integrate climate change mitigation and risk management into their long-term business strategy to align their GHG emissions with the Paris Agreement targets.
- **Transition Enabling:** Products, services, technology, and infrastructure which enable, support or facilitate decarbonization.
- **Adaptation and Resilience:** Critical infrastructure and activities, such as water, waste management and agriculture which are vulnerable to effects of climate change.

Applying this framework, we believe our private credit transition strategy can offer investors a range of benefits:

Enables asset owners to align their portfolios with the net zero agenda and meet their net zero targets. Our transition strategy can directly help asset owners meet their own decarbonisation targets, including commitments under initiatives such as the Net-Zero Asset Owner Alliance. Our industry-inclusive approach supports real-world decarbonisation versus restricting investment to already low-carbon sectors, which while important, can lead to portfolio sector bias and fails to address the need to reduce GHG emissions in hard to abate sectors to achieve the Paris Agreement objective.

Provides diversification versus public bond issuers. This allows investors to support transition for companies not typically accessible through the public bond market, as well as investing directly in transition infrastructure. Examples include clean mass transport; clean energy and electrification; energy-efficient digitalisation; and promoting resilience, such as flood prevention infrastructure.

Holistic sustainability approach. Our transition strategy is based on bottom up, fundamental credit and sustainability research. Our credit and sustainability teams conduct independent analysis and each potential transition investment must pass separate review by both teams. The transition review involves an assessment of the borrower's net zero alignment and/or enabling function coupled with a comprehensive ESG risk analysis. This two-fold approach therefore requires both positive transition impact and responsible ESG risk management to address climate change as a long-term systemic risk.

Engagement on sustainability topics. Private credit allows for a direct relationship with senior management and equity sponsors to help improve understanding of decarbonisation and responsible practice, both prior to investing and on an ongoing basis to monitor performance.

Promotion of greater transparency. Private credit issuers often disclose less sustainability data than public bond issuers. With growing investor and regulatory attention on private markets, as well as the acknowledgement of private credit's important role to play in the transition, this is changing but requires forward-looking investors to help expedite improved disclosure. Our approach requires sufficiently high levels of disclosure to enable robust verification and reporting.

Comprehensive sustainability and impact reporting to evidence portfolio impact. We offer reporting that includes metrics under notable frameworks, such as the Taskforce on Climate-related Financial Disclosures (TCFD)[5] and the EU's Sustainable Finance Disclosure Regulation (SFDR), as well as proprietary methodologies to demonstrate portfolio net zero alignment. Our detailed sustainability and impact reporting is enabled by our fundamental research approach, supported by consistent engagement with borrowers and continuous innovation on impact measurement. MIM's reporting has been recognized by Environmental Finance's Sustainable Debt Awards 2024 for Impact Report of the Year.[6]

Examples of Private Credit Transition Finance

MIM Transition Group	Corporate Private Placement	Infrastructure Debt	Private Asset Backed Finance
Hard to abate & major emitting	• Energy utility with robust emissions-free generation strategy under a net zero by 2050 plan • Chemicals producer with sound decarbonisation plan	• Renewable energy generation • Decommissioning of coal-fired generation plants • Green data centres	• Green commercial property
Aligned	• Light industries, such as a food and beverage company, decarbonising its operations and products • Services companies with net zero aligned strategies	• Hospital or university energy efficiency improvement projects • Fibre-to-the-home broadband with stringent GHG emissions targets	
Enabling	• Heat pump manufacturer • Energy efficiency components manufacturer • Engineering services company supporting green technologies	• Rail infrastructure • Electricity transmission & distribution • Offshore wind servicing vessels	• Residential solar lease and loans
Adaptation & Resilience	• Waterways management	• Flood prevention infrastructure	

In summary, we believe transition finance poses one of the most exciting and wide-ranging investment opportunities available today, with private credit offering unique strengths to invest in this theme for both income generation and positive impact.

Endnotes

1 IPCC, 2022
2 BloombergNEF, *New Energy Outlook 2024*
3 International Energy Agency (IEA), *The Cost of Capital in Clean Energy Transitions*, 2021
4 IEA, The Cost of Capital in Clean Energy Transitions, 2021
5 TCFD recommendations to transition to IFRS Sustainability Disclosure Standards
6 Impact report of the year (for investors): MetLife Investment Management: Environmental Finance (environmental-finance.com). This award continues a multi-year award-winning track record under Affirmative Investment Management (AIM), a dedicated impact fixed income fund manager which MIM acquired in December 2022.

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