SUSTAINABLE FINANCE IN THE UAE
BUILDING ON THE MOMENTUM OF THE DUBAI DECLARATION
Over the last decade, concerns around major issues like climate change, air pollution and water scarcity have grown significantly, both here in the Middle East and across the globe.

The level of investment required to tackle these challenges will be beyond the budgets of any individual nation. The global nature of many of them also means that a coordinated response will be required from the public and private sectors across the world.

The Climate Change agreement that was struck at COP 21 in Paris in 2015 was an important milestone. It established a binding set of targets for the first time, and a consensus on the need for better collaboration to develop solutions around how to finance the actions required to safeguard our planet for future generations.

Momentum continued to build throughout 2016 and COP 22 in Marrakech reinforced the pervading view that capital investment needs to have a much stronger ‘conscience’. Moving forward, projects that receive funding cannot be at the expense of the environment, support unsafe conditions for local workers, or create negative impacts on local communities.

A challenge has been set for the finance community and industry to now come together and usher in a new era where priority is given to those programmes that can help to deliver against ‘a triple bottom line’, creating social, environmental and economic benefits.

“COP 22 in Marrakech reinforced the belief that future capital investment needs to have a much stronger ‘conscience’. The impact of this investment cannot be at the expense of the environment or local communities.”
WHAT DOES THIS MEAN FOR PROJECT FINANCE?

This shift in mindset has big implications for the project finance world. The Paris agreement means that access to finance now comes with much broader governance expectations both for lenders and those parties who are seeking to secure investment in their projects.

In the past, the key parameters for investors when it came to assessing whether to lend to a project was around whether it met their internal rate of return (IRR) requirements. This was a relatively simple model to understand for parties on both sides of the table. However, on some occasions, it resulted in decisions that over-emphasised financial return rather than the social and environmental impact.

Most financial institutions understand that they now share in the responsibility for the operations that they finance. However, the focus is no longer just on ensuring that these projects do not have unacceptable negative impacts. There’s an emerging expectation that this investment should help to deliver social and environment benefits as well as a financial return. Forward-thinking organisations are embracing this challenge not just in the projects that they support, but also in addressing any Environmental, Social & Governance (ESG) risks around how they manage their own firms.

Borrowers are also increasingly aware that in order to secure finance (whether that’s debt or equity), they must be able to measure their ESG performance. A failure to do so could mean they’re unable to access funding streams, or they could end up paying a premium for it.

Globally, this has resulted in an unprecedented demand for access to, and clarity on, best-practice global ESG standards. Proprietary research from Arcadis underlines this point with the number of signatories to the UN’s Principles for Responsible Investment (PRI) rapidly increasing. Similarly, as Figure 1 shows, the value of assets currently being managed in line with the PRI guidelines is also rising quickly as well.

“*We are seeing increasing momentum in the drive to create global financial systems and institutions that are resilient to climate change, and financial services companies that are building sustainable development into their core business strategy.*”

- Eric Usher, United Nations Environment Programme (UNEP) Finance Initiative Head

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**Figure 1**

**GROWTH OF THE PRI INITIATIVE AMONG ASSET OWNERS AND INVESTMENT MANAGERS**

*Source: [www.unpri.org](http://www.unpri.org)*
This shift in focus within the global finance community is also reflected in the UAE as well. Local concerns around big issues like water scarcity, youth development, labour conditions and economic diversification have been actively considered and factored in to the national vision and recent policy updates.

The UAE’s Vision 2021 includes a sharp focus on improving the country’s environmental performance and promoting sustainable initiatives as part of the transition to a low-carbon economy. This theme was developed further in the UAE Green Agenda 2015 - 2030, which set a target to transform the national economy into a green economy over the next fifteen years.

One of the challenges that has inhibited progress so far is a financing gap for sustainable projects, which some analysts have pegged at US$10bn. However, there’s a strong commitment to try and address this issue with senior officials acknowledging the long-term benefits that investment in sustainable projects can deliver.

In a recent address, the UAE’s Minister of Climate Change and Environment cited a report that indicated investing 1-2% of GDP in the green economy will bring the country a 4-5% increase by 2030.

In 2017, more detail is likely to emerge on the government’s ‘Environment Post 2019’ programme. Early indications are that it will include a focus on accelerating funding via a green route, including the use of green bonds. These are growing in popularity in other parts of the world and could have strong potential in the Middle East region as well.
WILL THE DUBAI DECLARATION ACT AS A CATALYST?

At the most recent United Nations Environment Programme (UNEP) Finance Initiative meeting that took place in Dubai in October 2016, eight banks from within the UAE came together to sign the ‘Dubai Declaration on Sustainable Finance’.

As part of this agreement, NBAD, Commercial Bank of Dubai, Dunia Finance, Emirates NBD, HSBC, National Bank of Fujairah, RAK Bank and Union National Bank, established a new fund that will help to support a range of sustainable projects over the next five to ten years.

The fund will be targeted at both large-scale programmes and smaller-scale initiatives on an individual or community basis. It provides a strong boost to the UAE’s Green Development Strategy which included a commitment to prioritise investment in sustainable projects.

The Declaration recognises the important role that the finance sector can play in enabling a climate-resilient, inclusive green economy, and in promoting sustainable development within the UAE. It offers a strong signal to the business community and wider industry that sustainable investment is an area that both the government and finance sector are committed to supporting.

The commitment positions the UAE extremely well in terms of taking a leadership position on this important issue, and could serve as a great example for other countries within the region as they begin to address similar challenges in the future.

“We need to work towards improving the bank financing for green projects in the UAE, and to find the best way to contribute to the government’s efforts to change the flow of investments in the field of sustainability.”

- Mubarak Rashid Khamis Al Mansouri, Governor of the Central Bank of the UAE
BUILDING ON THE MOMENTUM FROM 2016

In 2017, the wider business community has a role to play in helping to sustain the momentum that was established following the launch of the Dubai Declaration last year. There’s a clear appetite to support this at both a government level and within the finance and construction communities, and the challenge now will be to come together and define a way of working that gives all parties the confidence to move forward.

Financial institutions need to set an example for the wider industry on how to manage their own direct and indirect environment and social impact, and provide absolute clarity on how borrowers can access the capital to support their initiatives. This includes specific detail on the types of projects they are most inclined to fund, and the ESG requirements that borrowers will be required to adhere to in order to access funding streams.

Five areas that financial institutions should focus on to help build momentum in this area include:

1. Agree on the key areas of risk they will focus on when it comes to assessing whether to place capital in a project.
2. Be clear with borrowers on the parameters they will be assessing, including baseline performance, and the requirements they will expect in terms of ESG compliance.
3. Develop a detailed strategy on how to capture data from the projects that they fund, so that the full benefits can be easily and effectively reported.
4. Identify ESG and climate risks within their existing investment portfolio, and work out enhancement initiatives to support the wider transition to low-carbon investment.
5. Focus on improving ESG literacy within their organisations by launching training on how to manage their own direct and indirect environmental and social performance. This should be targeted at both the board level as well as credit risk and/or project finance teams within the banking division.

On the other side of the table, project owners looking to borrow capital will need to become much sharper at identifying potential ESG risks within their schemes, and at articulating how they will go about addressing these risks. This will help to build confidence with banks that they will not be inheriting any future liabilities if they do provide the capital to kick-start a worthy initiative.

Five areas that borrowers should focus on to build stronger relationships with private finance bodies include:

1. Carry out due diligence reviews to ensure their project plans comply with the requirements set out by the banks, before they make a formal submission.
2. Where risks have been identified (major and minor), develop clear improvement strategies that demonstrate how they will look to adhere with a bank’s risk principles.
3. Use ESG assessments to set clear KPIs, and identify where and how further value could be generated from their projects once capital has been provided.
4. Develop a plan on how to capture data to demonstrate the positive impact of their activities – this should then be shared with lenders, analysts and other stakeholders.
5. Carry out regular benchmarking and peer reviews to identify how and where to drive continued improvements in this space.
A CLEAR DIRECTION OF TRAVEL

Since the Paris agreement was struck at COP21 in late 2015, there has been a much stronger consensus on the importance of responsible investment and robust ESG reporting. The establishment of a task force on Climate Related Financial Disclosures (CFD) is another positive step and will hopefully provide a clearer framework on how the disclosure of carbon and climate risks should be incorporated into financial reports.

In advance of this, the UAE can consider some of the approaches that have already been trialled in other countries. South Africa offers one good example. Integrated reporting is compulsory for all listed companies and is already delivering tangible benefits. This framework enables organisations to show how they create value in a range of areas including financial, manufactured, intellectual, human, social and natural, ultimately helping to demonstrate a much richer impact.

Whilst the key driver behind this focus on sustainable investment may be non-financial benefits, it’s worth noting that several funds are already indicating that they’re seeing substantial returns from projects that invest in sound ESG governance. A recent report by the Boston College Center for Corporate Citizenship and McKinsey echoes this point, with their research showing that projects that are underpinned by good ESG deliver a higher financial return than standard capital projects.

This economic case should not be underestimated as it will help to support the more fundamental change that’s needed in terms of shifting mindsets away from a focus on short-term returns, to one that centres on opportunities and long-term social, environmental and economic gains. Good progress has been made over the last 12 months and the direction of travel is clear both within the UAE and in other parts of the globe.

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CONTACT US

If you would like to discuss any of the points raised in this paper in further detail, then please get in touch:

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