FORTUNE + HANNON ARMSTRONG

The case for climate positive investing

Hannon Armstrong believes every investment should improve our climate future. Here's why that approach is amplifying the firm's financial success.

As the physical impact of climate change has become increasingly urgent, causing billions of dollars in economic loss and irreversible environmental damage, investors and businesses are asking tougher questions about the long-term viability of their energy infrastructure and resources—and how to slow down rising carbon emissions exacerbating global warming. For future-focused and purpose-driven investment firms like Hannon Armstrong (NYSE:HASI), the first U.S. public company solely dedicated to investments in climate solutions, making the environment a priority is not a necessary inconvenience of doing business today but the motivating factor in its business model.

The value of assets that carry sustainability considerations grew to $17.1 trillion at the start of 2020, up more than 40% from 2018, according to the Forum for Sustainable and Responsible Investment. And interest is growing: Institutional investors surveyed by BlackRock last year said they plan to double their allocations to assets that use environmental, social, and government (ESG) considerations over the next five years.

Elsewhere, financial institutions are reconsidering the risks associated with investments that ignore the climate equation. Five of the biggest U.S. banks even pledged to reduce investments in fossil fuel extraction and power generation as they sharpen their focus on green finance.

“Every day, we are seeing investors exit businesses that are carbon-intensive,” observes Jeff Eckel, Hannon Armstrong’s chairman and CEO. And that’s paying off for many of the world’s largest renewable energy developers and sustainable infrastructure providers.

Investing in a sustainable future

With more than $7 billion in clean energy and sustainable infrastructure assets under management, Hannon Armstrong’s client list boasts some of the world’s largest companies in these areas. One example is its $540 million commitment to ENGIE North America, a premier independent power producer and energy-efficiency services provider based in Houston, to back a large portfolio of grid-connected onshore wind farms and utility-scale solar plants. The venture will help install 2.3 gigawatts of renewable energy generation across 13 projects in Kansas, Oklahoma, South Dakota, Texas, and Virginia. Hannon Armstrong’s equity investment in the wind and solar portfolio will avoid an estimated 1.1 million metric tons of carbon dioxide emissions (CO_2) in the first year of operations, equivalent to the CO_2 emissions from 125,000 U.S. homes’ annual energy use.

But marquee partnerships like the one with ENGIE are just one way Hannon Armstrong is striving to make a major impact in energy solutions. The firm also sees a big opportunity in financing “behind-the-meter” projects that help educational institutions, government agencies, and companies reduce energy consumption and carbon dioxide (CO_2) emissions. The capital might be used for lighting or heating, ventilation, and airconditioning updates that reduce energy consumption. Or it could support on-site solar, or combined heat and power systems that might improve an organization's resilience by decreasing its reliance on the electric grid.

The profits of climate positive impact

When vetting new investment opportunities, Hannon Armstrong applies potential transactions to the same due diligence and attention to return on equity applied to any conventional investment, Eckel says. But the firm also uses a novel metric to consider externalities such as climate change when screening potential investments. To meet its requirements, a transaction must either reduce CO_2 emissions, have a neutral outcome, or provide another environmental benefit, such as reduced water consumption. "Where is the elusive climate change line?" Eckel says. "If your investments are increasing carbon in the atmosphere, then it's on the wrong side."

To promote transparency in this area, the firm developed a tool called CarbonCount®, which measures the efficiency for which capital is being used to reduce CO_2. And when deciding between potential projects with comparable returns, priority is given to those that earn higher CarbonCount scores, Eckel says.

That approach is paying off for Hannon Armstrong. Since its initial public offering in 2013, the company has outperformed both the S&P 500 and the S&P Global 1200 Energy, an index that includes a heavy concentration of fossil fuel companies. Hannon Armstrong stock also had a more than 100% gain in 2020, and analysts at Bank of America and J.P. Morgan and are among those who remain bullish on the company's future, listing its stock as one of their top picks going into 2021.

The company believes that if carbon counts—and because of climate change, it does really count—and capital is scarce, its team needs to make the most impactful investments. And the stability those choices provide in uncertain times is one of its core differentiators among the competition. "We know who we want to do business with, and our clients know they have a partner who shares a long-term vision for why they want to own these assets," says Eckel. "Over time, we believe we will earn better risk-adjusted returns investing with this commitment and discipline."