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Unlocking the enormous impact potential of battling the water crisis

Many countries struggle with water pollution and deficient access to clean water. Governments and companies are working on solutions through innovation, renewable energy, and recycling. “By providing much-needed capital, investors can unlock significant positive environmental and social change,” claims Samy Muaddi, head of emerging markets fixed income, and Matt Lawton, portfolio manager of a global impact credit strategy at T. Rowe Price.

Emerging markets are disproportionately affected by pressing issues such as water scarcity, water pollution, overfishing, and inadequate sanitation infrastructure. Billions of people globally lack clean and safe water, and sanitation. The water situation is particularly acute in emerging markets due to a combination of rapid urbanization, weak governance, and insufficient investment in water infrastructure.

This water crisis is widely recognized as one of the most significant challenges of our time. Two of the seventeen Sustainable Development Goals of the United Nations are directly related to water: SDG6 – clean water and sanitation – and SDG14, which aims to protect life below water. However, both are among the most underfunded of all SDGs.

Muaddi: “To reach the targets of SDG14 by 2030, an estimated 175 billion US dollars of investments would be needed every year. We are far away from that number. Only 10 billion has been invested, not per year but over the last five years! This leaves an immense investment gap. The situation around clean water and sanitation is not much better.”

Recognizing the scale of the challenge, several governments in emerging markets have started to prioritize water infrastructure in their development agendas, thereby creating substantial opportunities for private investment.

Blue bonds: dedicated funding for positive change

Investors can funnel capital through equity and bonds. Blue bonds, an emerging class of fixed-income securities, specifically target initiatives that seek to improve ocean health, battle habitat destruction, and provide sustainable water resources. Unlike green bonds, which broadly focus on environmental projects, blue bonds only address aquatic challenges, making them distinct within the spectrum of sustainable bonds.

Water-related projects often serve both developmental and sustainability goals, according to impact investor Lawton. “Investors help solve critical problems, but they also tap into a range of emerging opportunities in the blue economy. Of course, economic development must be sustainable.”

The vibrant blue economy represents a diverse and growing investment opportunity, spanning multiple industries from tourism to marine transport. Ocean-linked sectors alone contribute 2.5 trillion USD to the global economy and support over 30 million jobs worldwide, according to the United Nations Environment Programme Finance Initiative.

Financing solutions and ‘blue’ development is expected to generate financial returns for investors, but more importantly, create a significant positive impact, such as improved biodiversity, enhanced climate resilience, and stronger economic growth in coastal communities, which often are among the poorest populations in emerging markets.

A multitude of projects to invest in

Blue bonds in emerging markets are predominantly issued by governments. The first emerging market blue bond was issued by the Seychelles in 2018 to expand marine protected areas and sustainable fisheries. More recently (2023), a sovereign blue bond was issued by Fiji to fund 18 blue projects that promote sustainable use of ocean-based resources to support economic and social development. According to the Fiji government, the bond was oversubscribed by three times the issuance amount. <https://www.fjitime.com.fj/fjisis-sovereign-blue-bond-oversubscribed/>

Many water-related projects are traditionally thought of as public-oriented investments, but governments can’t solve the water crisis alone. Muaddi: “I have been investing in developing countries for almost 20 years now, and it has become clear to me that we are currently experiencing the most significant period of sovereign distress, probably since the 1980s. The private sector must step in and be a part of the solution. The water crisis doesn’t wait for our debt issues to get resolved.”

One of the most pressing social problems today is the scarcity of freshwater. Demand in emerging markets has seen a sharp increase due to population growth. Muaddi: “The current water infrastructures cannot handle as many people as we have today versus 40 years ago when these infrastructures were built. Investments are needed for infrastructure projects, but also for smart initiatives in water-intensive industries and agriculture. Agriculture accounts for 70% of freshwater usage.”

Another major issue: good sanitation is lacking in many places. Muaddi: “I visited favela communities in Brazil – the communities built on hills – and I can tell from first-hand experience that it’s tough to get clean water uphill and resolve the huge problem of dirty water coming downhill. This impacts people every day. We have the technology to fix this, it just needs to get funded by water utilities.”

The blue economy offers strong investment cases

The specific class of blue bonds will allow investors to help impact water sustainability, offering investors a clear path to contributing to two underfunded UN Sustainable Development Goals. As such, blue bonds may also provide a dedicated asset class for diversification in an impact portfolio. Because water projects are chronically underfunded, impact investors can make a real tangible contribution from day one, explains Lawton. In this sense, investors can achieve a high degree of additionality, an important criterion in impact investing.”

Because so much capital is needed and most governments and many companies are feeling the urgency of finding solutions, blue bonds aim to deliver a good financial return to investors. As with green bonds, the interest rates are currently competitive compared to traditional bonds.

Lawton: “Early investors in this relatively new market also have the first-mover advantage to shape the market and help influence the development of a blue bond infrastructure and monitoring framework. In addition, investors will gain recognition as pioneers in a worldwide blue mission, creating meaningful progress and positive impact.”

All investments are subject to market risk, including the possible loss of principal. Blue bonds carry investment risks, which include credit risk and interest rate risk. Emerging markets are less established than developed markets and therefore involve higher risks.

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