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SUSTAINABLE LOW-CARBON MULTICURRENCY INVESTMENT

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Long-term low-risk returns

GPIs looking to invest in infrastructure

Eugene Zhuchenko, Long-Term Infrastructure Investors Association

The share of global infrastructure assets financed by governments is steadily declining, but official and institutional investors are managing capital that can be well placed in infrastructure, as they can afford long-term allocations and are seeking low-risk returns.

Infrastructure assets – including roads, ports and airports, energy and telecommunication networks, water management systems, hospitals and schools – are the enablers of our everyday life and among the most capital-intensive businesses from an investor perspective.

Even though governments continue to finance the majority of infrastructure assets globally, their share has been steadily declining over the last three decades. Today, official, institutional and private investors are funding a substantial portion of world's infrastructure stocks – at least 10% in transport and 30% in energy.

Governments and infrastructure investors agree that upcoming financing needs are vast. Consultancy McKinsey has estimated that, on average, $3.8tn will have be allocated to new infrastructure developments globally each year until 2030. This is more than the nominal GDP of countries such as Germany, the UK or France.

Increasing pressure on public finances means that the role of governments as infrastructure financiers will continue to shrink. Other investors are ready to step up. But for many the rules of the game need to change.

Official investors, such as national and multilateral development banks, and institutional investors such as insurers and pension administrators, are managing capital that can be well placed in infrastructure, for several reasons. They can afford long-term allocations and therefore enable capital and ownership stability in the infrastructure assets.

They are seeking recurring, low-risk returns that support their development objectives or match the pattern of future pay-outs to their constituents. Relatively low elasticity of demand for infrastructure services means that the financial performance of infrastructure moves less in tandem with other asset classes, and consequently has a diversifier effect on a wider investment portfolio.

Globally, the main problem is not a lack of projects but a lack of information about projects.

Infrastructure comprises less than 2% of the assets that official and institutional investors manage globally

However, infrastructure comprises less than 2% of the assets that official and institutional investors manage globally. To assess whether this signals a lack of investable infrastructure or lack of investor appetite compared with other asset classes, it is useful to take a closer look at the capital demand and supply situation.

The history of transactions in infrastructure equity and debt proves one thing – money is not a problem. With some of the latest deals struck not even at 'high single digit' return for assets with material revenue risks, investor money has been clearly chasing deals. The low availability of 'de-risked' infrastructure has coincided with a surge in appetite for safe haven assets, which has grown steadily since the 2008-09 financial crisis. Globally, the main problem is not a lack of projects but a lack of information about projects.

Several initiatives to bridge this information gap are progressing. Under the wings of the Investment Plan for Europe, also known as the Juncker plan, in early 2016 the European Commission launched the European Investment Project Portal and the European Investment Advisory Hub, major information gateways to greenfield infrastructure projects in Europe and investment support resources. Established and financed by the G20, the Sydney-based Global Infrastructure Hub, is building a database of greenfield and brownfield infrastructure projects globally that will enable investors to gain an early view of potential deals.

Several private information brokers have been building out pipeline databases in project finance. But information efficiency in developed markets remains relatively low and is even lower in emerging markets, where the universe of infrastructure development propositions is much wider.

Information inefficiencies of a different kind characterise the topic of capital supply to infrastructure. Despite several decades of private money involvement in infrastructure, the asset class does not have a clear common definition from a financial investor perspective.

Infrastructure is an asset class with predictable returns and low exposure to financing and operational risks.

Solvency II, the framework of financial regulation for managing risk exposure that is binding on many institutional investors in Europe, was amended in April this year to define infrastructure as an asset class with predictable returns and low exposure to volume, financing and operational risks. It sets the very important precedent of translating a common wisdom of what infrastructure is and is not into a set of crisp, testable definitions. It also recognises the benefits that investing in infrastructure should carry from the portfolio risk management perspective. The proposal stipulates an approximate 30% reduction in capital risk charges that infrastructure investors should maintain compared with current requirements.

Other financial regulators are reviewing policy measures with similar stimulating effect for non-public infrastructure financiers. The US Treasury has proposed a new loan programme – 'Financing America's Infrastructure Renewal' – aimed at stimulating public-private partnerships across different infrastructure sectors.

The infrastructure investment marketplace should become more organised to enable growth

The infrastructure investment marketplace has expanded and will grow much larger in the near term. But to enable this growth, the marketplace should become more organised. Both investors and governments need greater transparency and cohesion when it comes to defining investment projects, capital allocation requirements and partnership models.

Founded by and for investors, the Long Term Infrastructure Investors Association has been active in this domain since 2014. It enabled the EDHEC Infrastructure Institute in Singapore to establish a platform for financial benchmarking of long-term infrastructure. Drawing on investment data from a number of contributors, the platform provides unique portfolio insights for investors and regulators.

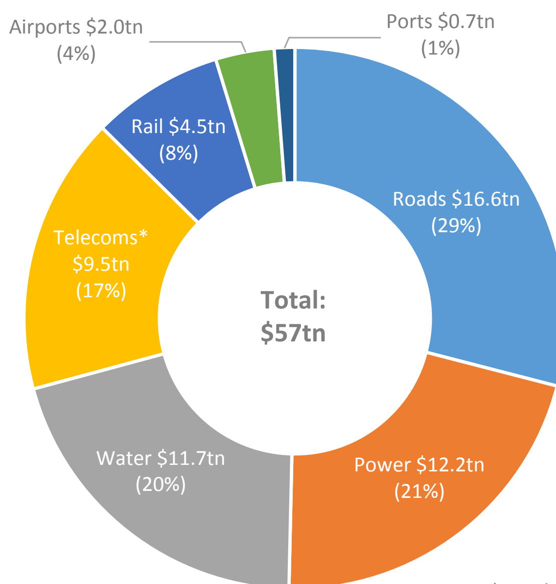
The association has been working with several policy-making bodies to shape infrastructure legislation, including Solvency II. It is also helping several governments build their implementation capacity for infrastructure projects, specifically to develop a carbon reduction pipeline following December's climate agreement in Paris.

Despite its long history, infrastructure is still in its infancy as a mainstream asset class. Alignment and active co-operation between official investors, institutions and governments will increasingly drive the marketplace's evolution. ■

Eugene Zhuchenko is Executive Director of the Long-Term Infrastructure Investors Association.

Investment in roads, power and water needed over next 15 years

Required global infrastructure investment 2013-30, 2010 prices



*Brazil, China, India and OECD countries only

Source: McKinsey Global Institute