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Stronger greenfield yields

Reduced brownfield investment returns

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Sovereign funds are increasingly investing in the infrastructure sector, but often fail to address where their capital could be deployed most beneficially. A preference for what they deem relatively 'safe' investments actually exposes them to the danger of higher risks.

Sovereign funds have joined the ranks of other investors – pension plans, insurance companies, foundations and endowments – which invest in the infrastructure sector. But as with their fellow investors, they often fail to address where their capital could be deployed most beneficially.

Most investors in infrastructure today see the asset class as a repository for those parts of their overall portfolios focused on relatively lower risk, lower return opportunities. Perversely, this preference for what they deem relatively 'safe' investments runs the danger of increasing the risks they are taking.

The fashion to invest in the ownership of established 'brownfield' operating assets – as opposed to new 'greenfield' assets – has driven up prices and forced down yields of such investments in OECD countries, to the point at which many observers now feel the rewards are no longer commensurate with the underlying risks. This concern may not be as valid as many think. The yield reductions associated with higher prices are in part a recognition of the new longer-term reality of lower growth, lower inflation, lower overall returns in all asset classes and lower yields generally. Brownfield assets have undoubtedly seen a marked diminution in returns.

Yet the returns on greenfield developments in both developed and emerging markets have depreciated much less than those for brownfield projects. This great missed investment opportunity of our age is an area to which sovereign funds and central banks should pay serious attention.

It is these bodies whose core mission and nature is focused on stability and sustainable, long-term progress, and whose cost of capital is the lowest of all types of institutions. These bodies are, by definition, closest to government and regulators, and to being able to influence the wider financial sector by promoting the catalytic role of good law, good regulation and good financing.

These organisations should be at the forefront of greenfield development. But in practice we find that they are often less prepared to invest in greenfield development than other types of investor.

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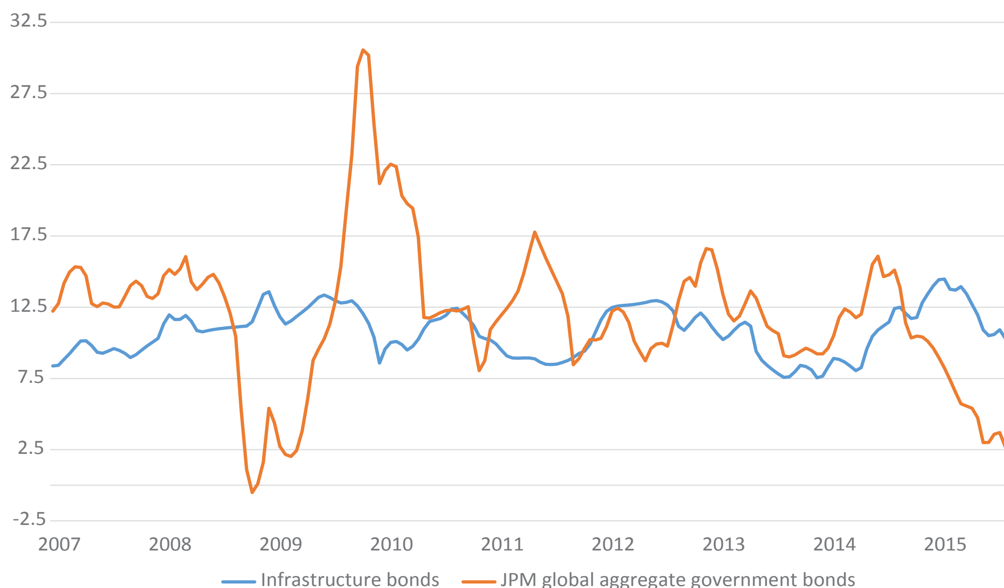
Steady returns on infrastructure bonds

Return on infrastructure bonds, %, 2007-2015



Source: S&P Dow Jones Indices

The worldwide development of new greenfield assets is the supreme infrastructure investment challenge of the modern age.

What better use of capital could sovereign funds and the investment divisions of central banks make than to promote the transgenerational benefits of long-term economic and social infrastructure? Better schools enhance education. Better health facilities enhance national health. Better transport and energy enhances economic growth, sustainability and improved environmental outcomes.

The perception of greenfield risk in infrastructure is misconceived. I believe governments can do much more to improve their procurement capabilities in a way that would enhance the realisation of true, sustainable, aligned partnerships between the public and the private sectors.

Governments could do much more to ensure that both they and national and international regulatory bodies do not act in ways which perversely disincentivise longer-term private sector institutional investment.

Infrastructure investment is the pre-eminent catalyst of economic development and social progress

Infrastructure investment, when successfully pursued, is the pre-eminent catalyst of economic development and social progress. The multiplier effect exceeds that of all other investment classes, for many reasons.

Investors receive – as with any investment in any sector – the direct returns derived from the specific infrastructure investment opportunity. The consequent improvement in infrastructure raises the returns of all companies which use that infrastructure. The general public – consumers, users, workers, pensioners – benefits from the resulting efficiencies. This leads to enhanced GDP and social infrastructure and wellbeing, reducing national financing costs. The associated economic development underwrites greater social cohesion, reduces poverty and makes individual nations safer and better, not only for their own people but for neighbours and partners.

This raises the question of why there is such a deficit in infrastructure investment almost everywhere in the world. Why are developed countries such as the US, the UK, and many continental European states so far behind in building new projects and rebuilding their old infrastructure? Why are the emerging markets of Africa and India so far behind in their investment in necessary energy, transport and social infrastructure?

There are many reasons. In some countries, there is too much democracy with the need to corral too many interest groups. In others, it is too much corruption and too little democracy. In most countries, it is a lack of vision and ability to take the true overall economic and social benefits into the public accounts.

Furthermore, in many countries there is a continued reluctance on the part of the government and public sector to establish meaningful aligned partnerships with the private sector. In most countries there is a depressing lack of longer-term thinking and political leadership, as well as an inability to prepare and invest for the future.

Central banks are seeking investment in short-term assets despite low liquidity constraints

Changes are afoot and organisations such as the Long Term Infrastructure Investors Association are playing an enlightening role. Of course, some sovereign funds are showing greater leadership than others. But for central banks, there is still little evidence that they are prepared to support investment in infrastructure rather than investment in much shorter-term assets, despite being the least liquidity-constrained of all institutions.

True partnerships between sponsoring organisations, robust contractors and aligned concession operators, private sector financiers, enlightened government agencies – whether as co-financiers, guarantors or insurers – can deliver great projects. The Thames Tideway Tunnel is a good example in the UK today.

Historians will come to say that, in the years after the 2008-09 financial crisis, the nations of the world failed to seize the opportunity to enable the development of the world's infrastructure at a time of low financing costs. Franklin Roosevelt, US president between 1933-45, saw things differently and was able to show leadership in infrastructure investment following the Great Depression of the 1930s.

It is not too late for governments, sovereign funds and central banks to play their part in what future generations could still recognise as another great age of infrastructure development. Passing the parcel of existing brownfield assets from one owner to another, despite improvements in capacity undertaken by each new owner, and while beneficial, is not enough in itself.

The worldwide development of new greenfield assets is the supreme infrastructure investment challenge of the modern age. We must each play a fuller part. This includes sovereign funds, central banks, governments and regulators, as well as all other public and private sector investors, contractors, concession operators and financiers. ■

John Campbell is Chairman of Campbell Lutyens & Co.