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Bridge over troubled water

An interview with GLIO Members

By James **WALLACE**

To weather tough economic times, more investors are considering listed infrastructure. But increasingly, the asset class is looking attractive in any climate.

Historically, the infrastructure asset class was only accessible to the private sector – large institutional investors such as pension funds or life insurance companies, looking for long-term stability, who had the necessary upfront resources. Since the early 2000s, however, publicly traded listed companies have emerged on the investment landscape, creating new ways to deploy funds.

As Jeremy Anagnos at CBRE Clarion explains, "There are different ways to own an infrastructure asset, and different ways for investors to access it. A large pension fund, for example, has enough capital to go directly to the asset, but that's challenging for most investors and there's a scarcity of assets available. So what you're seeing now is smaller institutional investors buying listed companies to gain their allocation to infrastructure assets. Frankfurt Airport, for example, is owned by German listed company Fraport.

Our focus is to manage a portfolio of shares in these companies, which have the same attributes as the underlying asset, but are publicly traded, and every day they are marked to market."

Anagnos believes that the popularity of listed infrastructure has grown significantly since the global financial crisis. "People want a different risk-and-return profile in their equity portfolio," he says. "They want something that doesn't behave in the same way, with defensiveness and lower volatility, so you're seeing these funds targeting infrastructure, both unlisted and listed."

Infrastructure assets are defined as essential tools for our society and economy, and therefore in constant demand – airports, toll roads, seaports, utility power grids, cell phone towers, waste facilities, energy pipelines and water utility systems among them. As Manoj Patel at DWS explains, "These companies tend to operate in a monopolistic environment with consistent end-user demand and little to no pricing >

competition. Over the long term with listed infrastructure, the cash flows generated from owning or operating these assets are visible and predictable. These companies have unique and diversified return streams, with the added benefit of daily liquidity."

Ben Morton at Cohen & Steers elaborates on this. "The asset class is defined as companies that collect fees for usage, who are governed by regulation, concession agreements or in some cases contracts, and that adds to the predictability," he says. "You get equity-like returns, but with lower volatility than broader equity markets. That's pretty compelling."

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Ongoing popularity

It seems that the popularity of listed infrastructure is not going to change anytime soon. "We expect the listed market to grow, with more investors looking for a defensive asset class to reduce their overall equity beta and enhance diversification," says Frank Greywitt of DWS. "Also, the need for new infrastructure assets around the world will provide a long-term tailwind."

Investors are also turning their attentions towards listed from the private market. "There's a limited number of deals in infrastructure being chased by a growing number of private funds, with a massive amount of dry powder – committed capital that needs to be invested," explains Ben Morton. "So institutional investors are wanting to add a sleeve of liquid or listed infrastructure to their portfolios. This is partly due to the liquidity that listed affords versus the lock-ups of private, and because the opportunities for private are so limited at the moment."

Fraser Hughes of the Global Listed Infrastructure Organisation (GLIO) has also seen investors split their money between private and listed. "Assets under management (AUM) in the listed infrastructure space have risen in the last decade – $93 billion by December 2018 – and we think that will continue as a long-term trend. One of the reasons for this is the competition for private assets. To build up a broader infrastructure allocation, in some cases, investors will view the listed market as a complement to their private infrastructure investments. On the private side, asset scarcity and investor competition in the space have pushed up multiples, so private assets look expensive versus listed right now."

Private vs. listed

There are fundamental differences between the listed and private sectors, as Jeremy Anagnos explains. "When somebody raises a new private fund, they are effectively asking for money to buy assets, and there is a challenge to find assets to buy," he says. "With the listed market, the companies already own all of their assets, so when you buy their stock you're not creating new capital for them to invest; you're buying existing capital, and these companies will spend money on updating what they already own, improving their facilities from a safety, reliability or efficiency standpoint.

"So due to the demand and supply imbalance, valuations are high in the private market. But with listed you're buying an existing asset base that is being reinvested in. The fundamental characteristics of why you would choose that asset class are the same, you're just owning it in a different structure."

Trends and regulations

By their very nature, tied to an economic or social need, infrastructure assets will be subject to government regulation. For Ben Morton, this is something investors need to be mindful of. "It's perhaps the biggest challenge to investing in any kind of infrastructure, listed or unlisted," he says. "With these entities being regulated or concession-based, you do get predictability, with a consistent pricing model and sustainability of demand, but one wild card is political intervention – and we've seen that disproportionally impact the infrastructure at times of economic stress."

Governments may target infrastructure companies to confiscate economics and ease cost burdens, and if assets are renationalized, which the Labour Party in the UK says it will do if it gets into power, what then? The only answer, according to Morton, is to closely monitor a sector or country, keeping tabs on the political and regulatory risks.

There are also trends to be wary of within infrastructure. "Climate change and carbon reduction are huge topics right now," says Jeremy Anagnos. "There are mandatory emissions reduction goals, and we're trying to replace coal and nuclear with renewables – building wind farms, on-shore and off-shore, and solar farms, with panels covering entire fields." He continues, "You also need the infrastructure to store and transfer the energy produced – typically a utility that is shutting down its coal plants will contract for new renewable assets, like a wind farm, and the assets will provide

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for a secure cash flow stream. And the cables built for the transmission to connect the wind farm to the grid are done under regulation, so the companies get to spend money under a regulated construct, and thus improve their earnings growth potential.

"But we're not quite there with renewables yet – and gas is a cleaner alternative to coal and nuclear, and it's cheap and abundant in the USA. But again, you need the infrastructure, the generation assets, the pipelines, and so on. So lots of companies are benefitting from gas and renewables."

Knowing the risks

Can other government factors affect listed infrastructure? Brexit in the UK, for example? Or the trade disputes between the USA and China? And if something unexpected happens, such as a bridge collapsing, or if an asset is impacted by a natural disaster or bankruptcy?

"With Brexit, we've actually seen some of the UK companies in our universe do quite well during the uncertainty," says Ben Morton. "That's because they're utilities, and the most defensive parts of the UK market. Investors are more likely to gravitate towards these assets when there is uncertainty."

Similarly, the bankruptcy announcement earlier this year of Pacific Gas & Electric Company (PG&E), the investor-owned utility with publicly-traded stock overseen by the California Public Utilities Commission. "It highlights the need for investors to continuously review political and regulatory regimes, to make sure that the infrastructure companies governed by them are adequately prepared in the case of extreme events," Morton adds. "It reminds us to be vigilant of corporate governance, not only in terms of infrastructure but in any form of business."

Future trends

What does the future of listed infrastructure have in store? Will emerging sectors like data centers play a role? Some argue that the $1.1bn acquisition of AT&T's data center portfolio by Brookfield Infrastructure Partners recently suggests that it will be. "Towers and data centers are among the fastest-growing sectors of the infrastructure universe," explains Ben Morton. "But we're not going to change tactics and chase growth in non-core infrastructure business, because then we'd lose the investment characteristics we're looking for. That downside capture goes away or we become more volatile."

Will Environmental, Social and Governance (ESG) factors take effect? "It's increasingly important to the decision-making process," Morton adds. "That's largely because many of the businesses we invest in are industrial in nature. We just need to be aware of a company's policies with regards to ESG, and be certain that they're moving in the right direction."

As Fraser Hughes points out, the subject of ESG is already being taken more seriously in many circles. "The Global Real Estate Sustainability Benchmark (GRESB), which has developed into the global standard for real estate funds and companies, is currently working on a public infrastructure disclosure using the GLIO coverage of 140 core infrastructure companies," he says. "So they look at these listed companies and the quality of their public disclosure around ESG – that data will be very useful when it comes to analyzing investment opportunities."

And what of listed infrastructure's continued popularity? "We're following a pattern that we saw 20 years ago with real estate, with initial institutional allocations made in the private space," Ben Morton concludes. "That parallel is happening now with infrastructure, but it's still in the early stages. We believe we're going to see continued growth in listed infrastructure allocations from institutional investors worldwide."

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