

INFRASTRUCTURE

Infrastructure Investing in Europe



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How has investing in infrastructure evolved since the beginning of this century?

Private investment in infrastructure has become increasingly accepted by Western democracies as they grapple with the demands of ageing infrastructure and increased fiscal constraints. At the same time, pension funds and other large institutional investors have been attracted to the robust income streams generated by these types of assets. This trend has transformed the infrastructure investment market.

We are seeing specialist infrastructure funds, pension funds, Middle-Eastern investment trusts and insurance companies all seeking exposure to this sector. Consequently, government agencies and investors have become more sophisticated in their dealings and approach to valuation, service delivery and risk allocation.

Why is there renewed investor interest in this asset class?

Investors such as pension funds are searching for real assets that generate long-term returns to match their long-tailed liabilities. Pension funds are well suited to be the long-term providers of capital for infrastructure assets.

This interest is growing as investors seek relatively predictable and stable underlying cash flows, as the opportunity set widens and infrastructure markets deepen. Investors are also increasingly aware of the diversification benefits offered by infrastructure when included in an investment portfolio.

What sectors do you categorise under infrastructure?

A key feature of infrastructure investment is the relatively stable demand for the good or service produced by the operating business. In this context, essential services such as the provision of water, gas and electricity as well as transport services such as highways, rail, ports and airports, fit this category. Often, these assets have regulatory frameworks which govern the pricing of services and the rate of return that can be generated. Investors are attracted to the stability provided by these regimes.

Apart from these "economic" projects, there is a range of "social" infrastructure projects such as schools and hospitals that are often included in this category. Increasingly we are seeing investors make allocations to non-traditional sectors which display characteristics of infrastructure such as car-parks and university housing projects.

Why are you focusing on harnessing its potential in Europe? Why not North America, or Africa and Asia?

We are focused on Europe because of the relatively stable and transparent regulatory regimes, the need for private funding and deregulated capital markets. Our long track record in the Australian market has braced us with skills and experience which can be leveraged successfully in Europe, particularly the UK. We have an established presence in London, allowing our team to take advantage of investment opportunities in this market.

The US market offers substantial opportunity for infrastructure investment because of its sheer size and legacy of government under-investment. It is inevitable that private investment will play an increasing role in developing new assets and providing investment for existing facilities. Currently, there are a number of legislative, tax and regulatory obstacles to significant levels of private investment. We anticipate that the commercial logic of private investment will eventually overcome these obstacles.

There is no doubt about the infrastructure needs of

Asian economies, particularly the fast growing China and India. These markets offer opportunities that are typically of a different risk and return profile to the available opportunities in Europe. At this stage, investors are generally more attracted to the core infrastructure returns available in Europe.

What are the different investment instruments available to an investor, interested in investing in infrastructure today?

One of the features of the increasing sophistication of the infrastructure market is the range of options for investors. This includes the listed market, private unlisted funds, and direct exposure to assets, which is increasingly prevalent among pension fund investors.

What is/are your instruments of choice? Why?

With the complex nature of these assets, we believe investors are best served by investing in a professionally managed pooled fund. We have established an open-ended core-plus style of fund, which is aligned with the nature of the underlying assets and the investment objectives of investors. At the same time, larger more sophisticated investors may require exposure on a direct basis.

What are the risks and do the rewards compensate them?

There are specific risks associated with infrastructure investment that need to be managed to deliver forecast investment returns. Of particular importance to infrastructure investments is the identification and management of demand risk, financial risk, construction risk, operational risk and regulatory risk. These risks can be mitigated by appropriate risk allocation and management over the project's life cycle. Specialist skills and experience are critical for the identification and management of these risks.

Infrastructure investment offers an "inefficiency" premium because of the more specialised nature of the investment, the complexity of the businesses and the difficulty of gaining access. There is the opportunity to derive attractive risk-adjusted returns from the application of risk management at the asset and portfolio level.

What is your outlook on this space and the challenges that lie ahead?

The role of infrastructure investment in the long-term asset allocation framework of pension funds and other long-term institutional investors is here to stay. At the same time, the involvement of private investment in the provision of infrastructure services is becoming increasingly accepted across the political spectrum. However, the mechanism for bringing the capital and the opportunities together is still evolving. We believe the development of long-term, diversified portfolios with specialist managers is a logical part of this evolution.

We expect to see further competition for these assets, as more investment funds are mobilised. Notwithstanding this competition, infrastructure investment is likely to continue to offer attractive risk-adjusted returns. The Australian experience demonstrates that there is still the opportunity to generate such returns in a sophisticated market.

A key challenge for investors will be maintaining investment discipline in a competitive environment and managing the multiple stakeholder issues that arise from the critical role that these projects play in their communities.