

# The HUB

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS

## Infrastructure: why investing over the (very) long term is worth the wait

**For investors willing to commit for 15 or more years, the financial and non-financial rewards from essential infrastructure assets are compelling**

Infrastructure offers a multiplicity of rewards for those willing and able to invest for 15, 20, even 25 years in illiquid assets. In addition, the emergence of an active secondary market over the last five years has seriously increased the liquidity of shares in infrastructure funds which are now often traded at NAV-plus.

A very long-term outlook allows investors to not only identify the major themes that will drive economies in the coming decades, but gives investors the time to fully immerse themselves in those themes and benefit from them.

Time allows investors to properly engage with and, even, drive ESG issues. This is particularly relevant to infrastructure, where assets underpin essential services, playing a critical role both in everyday life and long-term ESG themes.

And, as a reward for their patience, investors receive considerable security over their capital and recurring payouts that compound year after year, over long time-horizons.

### How the key megatrends are evolving

Digitalisation and the transition to green energy and a decarbonised world are the key megatrends, according to Vauban Infrastructure Partners, an affiliate of Natixis Investment Managers.

Gwenola Chambon, chief executive of Vauban, which specialises in mid-market deals, says the digitalisation and energy transition megatrends will evolve over decades, requiring vast amounts of capital. "The European pipeline of deals for core infrastructure to address these megatrends is massive for the next ten years and considerably exceeds the supply of capital," says Chambon.

The investment required to meet the European Digital Agenda by 2025 ranges between €65 billion and €100 billion a year. And the funding needs identified in the agenda do not even incorporate the requirement to upgrade existing infrastructure.

The digitalisation megatrend was established well before the pandemic, but has since accelerated. In particular, the crisis revealed the need for major investment in fibre networks. Other emerging infrastructure needs include next-generation data centres, which are smaller facilities located close to the populations they serve.

The green transition megatrend in many instances is closely related to the digitalisation theme. The emergence of smart electricity grids, for example, allows digital technologies to monitor and manage the distribution of power from different generation sources to final consumers. Smart grids offer



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### Key takeaways:

- A very long-term outlook allows infrastructure investors to identify the major themes driving economies and fully benefit from them.
- A long time-horizon allows investors to properly engage with – and drive – ESG issues. In an asset class providing essential services, ESG is not only desirable but mission-critical.
- The long-term nature of infrastructure with its resilient and long-term contracted cash-flows indexed to inflation can mitigate the effects of rising inflation and interest rates, energy price spikes, and even recession.

innovative opportunities for collaboration between electricity, gas, heat and telecommunications networks.

In transportation, digitalisation enables new mobility solutions such as electric mobility, autonomous vehicles, MaaS, free-floating mobility, and so on.

The overlap between the megatrends can be seen in Vauban's acquisition last year of a fully green data centre in Iceland, which is able to store and process data using green energy only.

"This was an important deal," says Chambon. "Data centers are huge consumers of energy so they must gradually transition to energy supplies based entirely on renewable energy." Iceland has proved an efficient location for data centres, given its cheap and clean energy and the northerly climate which naturally cools heat from processors.

## ESG impact is necessarily a slow burn

As with investing in megatrends, creating genuine ESG impact is also a very long-term activity that can only be addressed through a long-term investment commitment. "Enhancing climate change resilience and aligning your assets with the 2C scenario can't be done in a couple of years," says Chambon.

To ensure that Vauban managers and the management of its assets cleave closely to their ESG ambitions, Vauban has instituted KPIs linked to the ESG performance of assets. These KPIs, which are set at an investment's inception, are closely monitored. Performance is assessed on a yearly basis, with variable compensation linked to how well performance matches the KPIs – both financial and ESG.

"We don't make the KPIs an easy tick," says Chambon, "they are designed to push management teams to make a difference." A dedicated ESG director helps brainstorm and set Vauban's ESG policies, in tandem with the teams responsible for each investment. The director plays a part in the asset management of each investment and co-ordinates company ESG efforts, while the monitoring of assets for ESG impact remains the responsibility of the investment team.

Vauban is a founding member of the GRESB Infrastructure initiative, and an active participant in the GRESB

advisory board, involved in the design of assessment methodologies and processes. The firm was named European ESG coordinator of the year in the IJ Global Awards 2020.

In addition, Chambon sits on the Infrastructure Advisory Committee of the United Nations Principles of Responsible Investment (UNPRI). The committee advises the UNPRI on the long-term strategic direction of its infrastructure workstream and supports key projects and initiatives.

## Why a commitment to stakeholders is mission-critical

How infrastructure managers engage with stakeholders is a key ESG issue. The growing role of private infrastructure investment in society is increasingly recognised by users and stakeholders, and political classes seek to ensure that value is shared, and the long-term futures of communities secured.

To gain legitimacy in the eyes of stakeholders, infrastructure must be beneficial, inclusive and have a long-term outlook. "Investing with a long-term view is a key factor in aligning the interests of all stakeholders – investors, industrial companies, employees, public-sector stakeholders and users – with the needs of the real economy," says Mounir Corm, deputy chief executive of Vauban.

Key questions to stakeholders are: how can we improve things for you, how can we enhance collective value? This approach, he says, represents a different mindset from mainstream infrastructure thinking. It demonstrates to stakeholders that the infrastructure manager has a long-term mindset, that the strategy is sustainable and that the capital invested represents a non-financial commitment, as well as financial.

Working in harmony with industrial partners enables funds to be deployed in a timely manner, reducing costs to investors and ensuring they receive returns earlier so they can be reinvested in further projects.

"Gaining legitimacy is not a nicety," says Corm. It is essential to the investment strategy. Gaining the trust of all stakeholders is critical to sourcing deals, avoiding overruns, minimising costs and, ultimately, maximising returns."

## Resilience to macro-economic headwinds

Rising inflation and interest rates, a nascent energy crisis, and possible recession are on the minds of investors. The long-term nature of infrastructure can mitigate these concerns.

Inflation is generally positive for infrastructure since revenue streams from core assets are correlated to inflation. And Vauban's considers that its infrastructure investors are protected from rising interest rates, as its infrastructure assets are financed over the very long term using fixed rates.

While recession is never welcome, Vauban's assets are well diversified and have limited correlation to GDP. Corm says: "We have been in this space for 15 years, facing the financial and COVID crises without impact on returns. We expect this time to be no different."

However, infrastructure's inherent defences against macro-economic headwinds, cannot be deployed at the expense of stakeholders. For instance, Vauban's energy-related services have a legal option to increase energy prices to reflect market pricing. In practice, in line with Vauban's commitment to add value for all stakeholders, it does not increase prices of energy-related services to the maximum allowed during periods of high energy inflation.

"It is not sustainable to increase energy prices to the maximum allowed if we are to maintain long-term relationships with stakeholders," says Corm.

## A shift in investor mindsets

The resilience of pan-European core infrastructure is one reason why allocations are rising fast. "Investors are making larger allocations to core infrastructure than in the past," says Chambon.

"They want financial resilience combined with sustainable assets that do good in communities. There has been a shift in mindset: investors firmly recognise that in an asset class providing essential services, ESG is not just desirable but necessary."

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