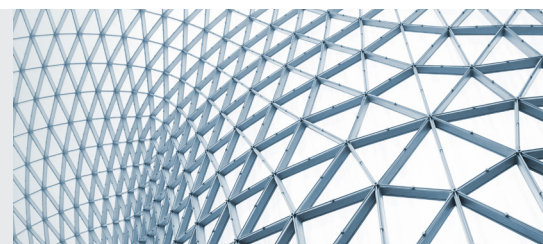


# The HUB

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS



> Find out more:  
[im.natixis.com/en-institutional](https://im.natixis.com/en-institutional)

## Secure income and green infrastructure: an unlikely marriage?

How to source stable, long-term cashflows from infrastructure debt with a strong ESG focus

### Key Takeaways

- Institutional investors must secure sustainable income while meeting increasingly demanding ESG expectations. The challenge to meet both objectives is considerable.
- From 2017 through 2035, the world will need \$69 trillion of investment in infrastructure<sup>1</sup>. The global market for infrastructure debt reached \$280bn in 2018, with more than 900 transactions.
- Infrastructure debt based on renewables has expanded by a factor of 9 since 2005<sup>2</sup>, and is likely to grow further, leading to more green mobility projects and energy-efficient public buildings.

If you feel under pressure to find secure and sustainable income streams, you are far from alone. As stewards of institutional assets, you may also be under growing pressure to source those income streams under tight ESG constraints.

Let's take a moment to consider what this means. The underlying beneficiaries of the assets you manage need secure income that is stable even as markets rock and roll through financial cycles. But because those beneficiaries, and society at large, now expect assets to be managed according to (some version of) ESG principles, investments should also enhance society and the environment. Or at least not do harm to them.

Infrastructure debt provides an opportunity to meet both objectives. If investors lend to ESG-focused infrastructure projects which represent secure credits and are operated well, they can receive returns which both match long-term liabilities and improve society, the workplace and the environment.



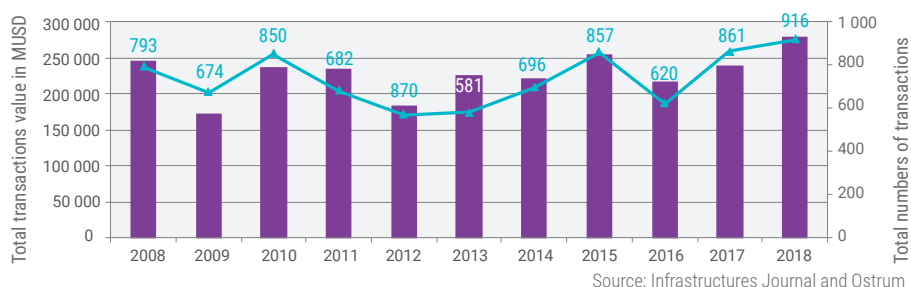
**Céline Tercier**  
Head of Infrastructure  
Finance,  
**Ostrum<sup>1</sup>**  
ASSET MANAGEMENT

### Green assets are a growing part of infrastructure

Infrastructure refers to anything that is built and operated: it includes road, rail, hospitals, schools, and energy (both conventional and renewable). Infrastructure debt finances the projects required to build, operate and maintain these assets. From 2017 through 2035, the world will need a total of \$69 trillion of investment in infrastructure to support current economic growth projections<sup>1</sup>.

Governments have limited resources to fund these needs. Therefore, private resources will have an important role to play. Banks, that were historically major

### A stable global debt market



1. Source: McKinsey Global Institute, Bridging Global Infrastructure Gaps, October 2017. / 2. Source: CO<sub>2</sub> emissions from fuel combustion, International Energy Agency 2018.

# The HUB

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS



players in the financing of infrastructure, now face more and more regulatory constraints, especially as far as long-term maturity loans are concerned. This creates a huge opportunity for institutional investors to enter this global, deep and stable market comprising over \$200 billion transactions every year<sup>2</sup>.

Infrastructure is a diverse market, focused primarily on the dynamic regions of Europe and the Americas, which make up 70% of the market. However, Asia is the fastest-growing region.

Renewables in particular is a growth sector, having expanded by a factor of 9 since 2005. The opportunity in renewables and green assets is likely to grow, driven by market demand, regulation and government's target. As energy and transport are the biggest contributors to CO<sub>2</sub> emissions<sup>3</sup> (69% of the total CO<sub>2</sub> fuel combustion), it is likely that renewable energy, green mobility and energy-efficient building will offer sizeable opportunities for investors.

The French Energy and Ecological Transition for Climate (EETC) label<sup>4</sup>, launched at the end of 2015 in the wake of the Paris Climate Agreement, is indicative of the direction of travel for governments and regulators. The EETC label requires that the majority of investments in a portfolio contribute to the financing of a greener economy. It also requires measurement of the environmental footprint of the portfolio, encompassing impact assessments on climate change, natural resources (including water) and biodiversity.

Investing in oil, gas, coal and nuclear sectors is prohibited by the label, which places considerable emphasis on energy transition, particularly the development of solar, wind, hydro, tidal, smart meter, batteries, waste to energy, heating network and biofuels.

The law is also designed to have impact beyond the energy sector, extending to efficient and green transport, buildings, water and telecoms.

## Reducing the financial risks of green assets

Green assets, and especially renewables, represent a growing part of the

infrastructure universe, with a potential for high returns. However, some investors worry that renewables have to take high risks for the returns they produce.

In reality, investing in renewables doesn't have to be high risk. "The best way to earn money is not to lose any," says Celine Tercier, Head of Infrastructure Finance at Ostrum Asset Management, an affiliate of Natixis Investment Managers.

One way to invest in infrastructure while reducing the risk of losing money is by investing in the financing of infrastructure. Quite simply, debt is less risky than equity.

If the debt instrument used is senior secured debt, then the protection is at its strongest; investors in senior secured loans have first call on the asset if something goes wrong. And with pure infrastructure project finance, as long as the covenants and agreements have been properly structured, the protections are far stronger than for corporate bonds.

Default rates in infrastructure debt are extremely low, averaging just 0.56% a year since 2005 and suffering no spikes even during the financial crisis.

The recovery rate when a loan defaults is 77%. Even though this implies a loss of 23%, the low default rate ensures that overall losses are minimised and risk-adjusted returns increased.

In fact, the recovery rate of Ostrum AM's infrastructure debt managers is 100% over some two decades. The reason for this, says Tercier, is careful structuring and close monitoring. "Our credit documentation asks that the borrower inform us of all problems, proposes remedial plans, allows us to work with them on remedial plans, validate the plans and monitor ongoing progress," says Tercier.

"We select transactions with strong covenants to control and protect our investment. And if there is a problem, we have a strong security package (especially pledge of the borrower's shares, contracts or bank account) to solve it," she adds.

Another way to protect capital and income is by investing only in essential assets. No matter the state of the economy, there will always be need for energy, for schools, for hospitals.

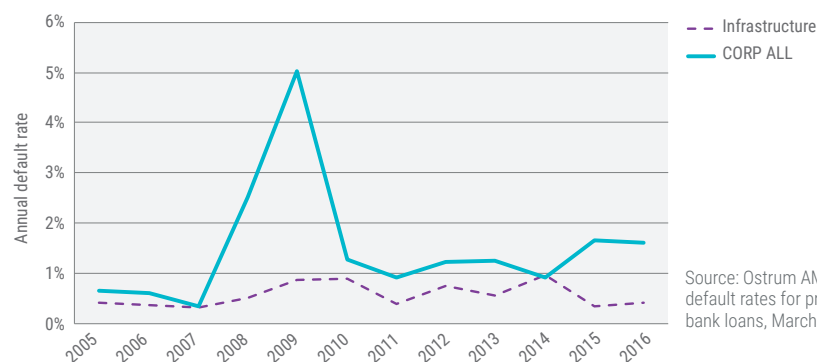
For example, Ostrum AM's strategy invests in many forms of transportation infrastructure (including bridges, tunnels, seaports, and railways), but excludes non-essential assets, such as parking lots, which are not strategic.

In the renewables sector, Ostrum AM considers all assets as essential, including solar farms, wind farms, biomass and energy from waste. All conventional power and natural resources assets are excluded. In the social accommodation sector, while healthcare and education facilities are essential, senior housing is not, because of a large component of real estate risk.

Countries need essential services as part of their sustainable development plans so all parties have a strong interest in defending essential assets that encounter problems. This is not always the case with non-essential assets. "Our experience shows that when things go wrong, we can find a solution if it's an essential asset," says Tercier.

The next line of defence against capital loss is to be credit-focused and conservative. In the renewables sector in particular, a technology must be commercially-proven to protect capital over the life of the transaction. In addition, the minimum rating for a transaction to

## Infrastructure debt offers high credit quality



Source: Ostrum AM and Moody's default rates for project finance bank loans, March 5 2018

2. Source: Infrastructure Journal. 3. Source: CO<sub>2</sub> emissions from fuel combustion, International Energy Agency 2018./ 4. Source : [www.ecologique-solidaire.gouv.fr](http://www.ecologique-solidaire.gouv.fr)

# The HUB

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS



be included in Ostrum AM's portfolio is BB and the overall strategy must have an investment grade rating.

Diversification of risk factors is important to avoid sector or asset-type concentration. Diversification is achievable given the depth of assets available in infrastructure. In fact, the difficulty lies in transaction selection and being sufficiently stringent in transaction analysis. "We select only 4% of the global pipeline, favouring the most attractive risk-return transactions," says Tercier.

## Balancing risk against returns

Risk management is more than the reduction of risk. The key is to manage risk to optimise returns. For this reason, Ostrum divides risks into two buckets: risk reducers, and return enhancers. The managers dip into each of these buckets to create a risk profile that targets risk-adjusted returns that are superior to investment grade corporate bonds.

Assets in core countries such as Germany, France, the US, and Canada, for instance, are seen as risk reducers and reside in the first bucket. Assets in the periphery, often in southern European countries such as Spain and Italy, are considered as return enhancers because of their less certain business and legal environment, and are in the second bucket.

Similarly, core sectors such as solar, roads and hospitals, are risk reducers because of the relative lack of complexity involved in building and operating the assets. For instance, it is fairly straightforward to operate a school – the operator is responsible for providing a sturdy building with light and power (but not responsible for the trickier task of teaching children). On the other hand, offshore wind is a return enhancer, because it will typically have to be assembled in the deep sea, where weather conditions might prohibit easy building and maintenance.

Nature of cashflows is also considered. Schools and hospitals normally have long-term agreements and therefore long-term and stable income streams, so are risk reducers. But cashflows from broadband networks, for example, may depend on shorter-term contracts with

operators and ultimately with individuals, so are less secure. Broadband networks are return enhancers.

Construction risks are also distributed across the two buckets. Brownfield assets have already been built, so there is no construction risk involved and this reduces the strategy's overall risk. The Ostrum AM strategy is focused predominantly on brownfield. However, Ostrum AM is able to finance projects from scratch and this, when managed robustly, enhances returns.

Overall, the key is to balance the risk reducers with a good amount of return enhancing projects that should justify the extra risks taken on board.

## Transparency helps to deal with ESG risks

Financial risks are a critical consideration when investing in infrastructure debt but there are also ESG risks: primarily the risk that transactions are less green than they first appear to be.

A strategy based on project finance transactions, rather than on investments in corporate bonds, enables better control of this risk. Ostrum AM selects transactions where the issuer must stick to the terms agreed. A solar project, for example, must produce green electricity and nothing else.

If the asset operator wants to change its business model, it has an obligation to ask the lender. The project finance structure therefore provides useful transparency. "We can be sure that 100% of the turnover of the portfolio is from eco-friendly sources," says Tercier.

In addition, environmental studies

should be carried out to assess the effectiveness of each project and, in France, precise carbon measurements must be produced to comply with EETC

## Access to deals

Unlike buying listed assets, infrastructure loan origination requires deep sourcing and structuring capabilities to ensure access to transactions with high relative value.

The sourcing network for this asset class includes industry and financial sponsors and a variety of banking activities operating across many different regions and sectors. The breadth of the network helps gain access deals of all sizes, diversifying the infrastructure debt portfolio.

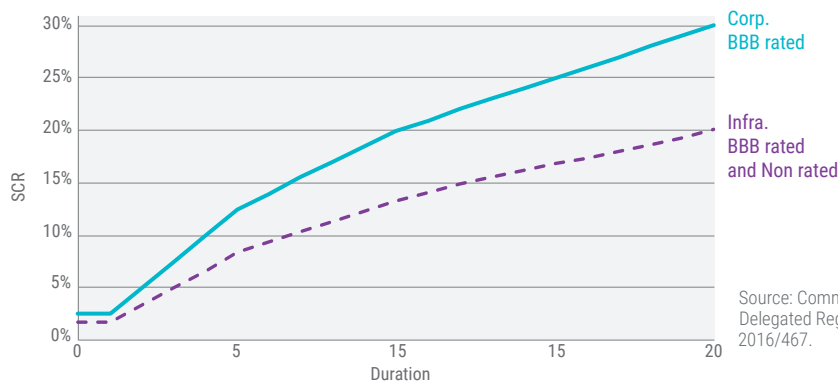
Experience is essential to successful sourcing. Ostrum AM's former lending-side bankers have over 20 years of experience each, structuring over 300 transactions with only five defaults and a 100% recovery rate over two decades. The team was a pioneer of infrastructure debt mandates for investors with over \$5 billion of committed capital.

## An illiquid strategy with flexibility

The strategy suits institutions looking to match very long-term liabilities and which have a liability profile which allows for considerable illiquidity. Investing in infrastructure debt can also help reduce volatility in the overall portfolio.

The strategy particularly suits investors willing to allocate to assets that can have a significant and positive effect on energy transition, and therefore a beneficial climate change impact.

## SCR Infrastructure VS SCR Corporate



# The HUB

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS



While the strategy typically matches durations of around 10 years, it is possible to match even longer duration liabilities. Ostrum AM's active approach to portfolio construction allows it to reinvest repaid loans in order to maintain institutions' invested capital at a maximum. This can lead to longer-horizon returns, enabling investors – where required – to match liabilities of longer than 10 years. Reinvestment also allows the strategy to benefit from potential rises in interest rates over time. In addition, the strategy allocates to floating rate loans in order to minimise interest rate risk.

As a result, the gross target return is 3% above the base rate for European assets and 5% above the base rate for US assets<sup>5</sup>.

For European insurers, the strategy offers favourable treatment under Solvency II, with a SCR spread reduction of at least 30% compared with investing in corporate issuers.

## A marriage made in heaven?

Opinion on the green sector is split, with some investors seeing a great opportunity, while others remain wary. The fact is that green investments are growing faster than most other asset classes, and governments and investors alike are pushing investment firms and their clients towards more sustainable practices.

Even in the US, the move among individual States and investment

firms towards renewables and other sustainable investments is gathering speed. With a robust, methodical approach, investors should benefit from the continued expansion of the asset class, of which infrastructure debt is a pivotal element.

It inherently delivers stable cashflows and naturally gravitates towards sustainable assets. "Infrastructure debt should increasingly appeal to investors requiring both consistent income and ESG-compliant assets," says Tercier. "Infrastructure debt naturally responds to both these needs."

Written on 6 March 2019

**Main risks related to Ostrum's infrastructure debt strategy:** Loss of capital, no assurance of investment return; illiquidity; performance of assets (especially linked to construction risk, nature of cash flow risk) incl. general counterparty risk, general economic and market conditions, changes in general law and regulation and taxation, risks associated with the deployment of the strategy.

<sup>5</sup>. This target return is not a forecast of future performance. It only aims at illustrating mechanisms of your investment over the investment period. Valuation (up or down) may fluctuate and deviate from this target return.



# The HUB

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS



## ADDITIONAL NOTES

This material has been provided for information purposes only to investment service providers or other Professional Clients, Qualified or Institutional Investors and, when required by local regulation, only at their written request. This material must not be used with Retail Investors.

**In the E.U. (outside of the UK and France):** Provided by Natixis Investment Managers S.A. or one of its branch offices listed below. Natixis Investment Managers S.A. is a Luxembourg management company that is authorized by the Commission de Surveillance du Secteur Financier and is incorporated under Luxembourg laws and registered under n. B 115843. Registered office of Natixis Investment Managers S.A.: 2, rue Jean Monnet, L-2180 Luxembourg, Grand Duchy of Luxembourg. **Italy:** Natixis Investment Managers S.A., Succursale Italiana (Bank of Italy Register of Italian Asset Management Companies no 23458.3). Registered office: Via Larga, 2 - 20122, Milan, Italy. **Germany:** Natixis Investment Managers S.A., Zweigniederlassung Deutschland (Registration number: HRB 88541). Registered office: Im Trutz Frankfurt 55, Westend Carrée, 7. Floor, Frankfurt am Main 60322, Germany. **Netherlands:** Natixis Investment Managers, Netherlands (Registration number 50774670). Registered office: Stadsplein 7, 3521AZ Utrecht, the Netherlands. **Sweden:** Natixis Investment Managers, Nordics Filial (Registration number 516405-9601 - Swedish Companies Registration Office). Registered office: Kungsgatan 48 5tr, Stockholm 111 35, Sweden. **Spain:** Natixis Investment Managers, Sucursal en España. Serrano nº90, 6th Floor, 28006, Madrid, Spain. In France: Provided by Natixis Investment Managers International – a portfolio management company authorized by the Autorité des Marchés Financiers (French Financial Markets Authority - AMF) under no. GP 90-009, and a public limited company (société anonyme) registered in the Paris Trade and Companies Register under no. 329 450 738. Registered office: 43 avenue Pierre Mendès France, 75013 Paris. **In Switzerland:** Provided for information purposes only by Natixis Investment Managers, Switzerland Sàrl, Rue du Vieux Collège 10, 1204 Geneva, Switzerland or its representative office in Zurich, Schweizergasse 6, 8001 Zürich. **In the British Isles:** Provided by Natixis Investment Managers UK Limited which is authorised and regulated by the UK Financial Conduct Authority (register no. 190258) - registered office: Natixis Investment Managers UK Limited, One Carter Lane, London, EC4V 5ER. When permitted, the distribution of this material is intended to be made to persons as described as follows: in the United Kingdom: this material is intended to be communicated to and/or directed at investment professionals and professional investors only; in Ireland: this material is intended to be communicated to and/or directed at professional investors only; in Guernsey: this material is intended to be communicated to and/or directed at only financial services providers which hold a license from the Guernsey Financial Services Commission; in Jersey: this material is intended to be communicated to and/or directed at professional investors only; in the Isle of Man: this material is intended to be communicated to and/or directed at only financial services providers which hold a license from the Isle of Man Financial Services Authority or insurers authorised under section 8 of the Insurance Act 2008. **In the DIFC:** Provided in and from the DIFC financial district by Natixis Investment Managers Middle East (DIFC Branch) which is regulated by the DFSA. Related financial products or services are only available to persons who have sufficient financial experience and understanding to participate in financial markets within the DIFC, and qualify as Professional Clients or Market Counterparties as defined by the DFSA. No other Person should act upon this material. Registered office: Office 603 - Level 6, Currency House Tower 2, PO Box 118257, DIFC, Dubai, United Arab Emirates. **In Japan:** Provided by Natixis Investment Managers Japan Co., Ltd., Registration No.: Director-General of the Kanto Local Financial Bureau (kinsho) No. 425. Content of Business: The Company conducts discretionary asset management business and investment advisory and agency business as a Financial Instruments Business Operator. Registered address: 1-4-5, Roppongi, Minato-ku, Tokyo. **In Taiwan:** Provided by Natixis Investment Managers Securities Investment Consulting (Taipei) Co., Ltd., a Securities Investment Consulting Enterprise regulated by the Financial Supervisory Commission of the R.O.C. Registered address: 34F., No. 68, Sec. 5, Zhongxiao East Road, Xinyi Dist., Taipei City 11065, Taiwan (R.O.C.), license number 2018 FSC SICE No. 024, Tel. +886 2 8789 2788. **In Singapore:** Provided by Natixis Investment Managers Singapore (name registration no. 53102724D) to distributors and institutional investors for informational purposes only. Natixis Investment Managers Singapore is a division of Ostrum Asset Management Asia Limited (company registration no. 199801044D). Registered address of Natixis Investment Managers Singapore: 5 Shenton Way, #22-05 UIC Building, Singapore 068808. **In Hong Kong:** Provided by Natixis Investment Managers Hong Kong Limited to institutional/ corporate professional investors only. **In Australia:** Provided by Natixis Investment Managers Australia Pty Limited (ABN 60 088 786 289) (AFSL No. 246830) and is intended for the general information of financial advisers and wholesale clients only. **In New Zealand:** This document is intended for the general information of New Zealand wholesale investors only and does not constitute financial advice. This is not a regulated offer for the purposes of the Financial Markets Conduct Act 2013 (FMCA) and is only available to New Zealand investors who have certified that they meet the requirements in the FMCA for wholesale investors. Natixis Investment Managers Australia Pty Limited is not a registered financial service provider in New Zealand. **In Latin America:** Provided by Natixis Investment Managers S.A. **In Uruguay:** Provided by Natixis Investment Managers Uruguay S.A., a duly registered investment advisor, authorised and supervised by the Central Bank of Uruguay. Office: San Lucar 1491, oficina 102B, Montevideo, Uruguay, CP 11500. The sale or offer of any units of a fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627. **In Colombia:** Provided by Natixis Investment Managers S.A. Oficina de Representación (Colombia) to professional clients for informational purposes only as permitted under Decree 2555 of 2010. Any products, services or investments referred to herein are rendered exclusively outside of Colombia. This material does not constitute a public offering in Colombia and is addressed to less than 100 specifically identified investors. **In Mexico:** Provided by Natixis IM Mexico, S. de R.L. de C.V., which is not a regulated financial entity, securities intermediary, or an investment manager in terms of the Mexican Securities Market Law (Ley del Mercado de Valores) and is not registered with the Comisión Nacional Bancaria y de Valores (CNBV) or any other Mexican authority. Any products, services or investments referred to herein that require authorization or license are rendered exclusively outside of Mexico. While shares of certain ETFs may be listed in the Sistema Internacional de Cotizaciones (SIC), such listing does not represent a public offering of securities in Mexico, and therefore the accuracy of this information has not been confirmed by the CNBV. Natixis Investment Managers is an entity organized under the laws of France and is not authorized by or registered with the CNBV or any other Mexican authority. Any reference contained herein to "Investment Managers" is made to Natixis Investment Managers and/or any of its investment management subsidiaries, which are also not authorized by or registered with the CNBV or any other Mexican authority.

The above referenced entities are business development units of Natixis Investment Managers, the holding company of a diverse line-up of specialised investment management and distribution entities worldwide. The investment management subsidiaries of Natixis Investment Managers conduct any regulated activities only in and from the jurisdictions in which they are licensed or authorized. Their services and the products they manage are not available to all investors in all jurisdictions. It is the responsibility of each investment service provider to ensure that the offering or sale of fund shares or third party investment services to its clients complies with the relevant national law.

The provision of this material and/or reference to specific securities, sectors, or markets within this material does not constitute investment advice, or a recommendation or an offer to buy or to sell any security, or an offer of any regulated financial activity. Investors should consider the investment objectives, risks and expenses of any investment carefully before investing. The analyses, opinions, and certain of the investment themes and processes referenced herein represent the views of the portfolio manager(s) as of the date indicated. These, as well as the portfolio holdings and characteristics shown, are subject to change. There can be no assurance that developments will transpire as may be forecasted in this material. Past performance information presented is not indicative of future performance.

Although Natixis Investment Managers believes the information provided in this material to be reliable, including that from third party sources, it does not guarantee the accuracy, adequacy, or completeness of such information. This material may not be distributed, published, or reproduced, in whole or in part.

All amounts shown are expressed in USD unless otherwise indicated.

## Ostrum Asset Management

An affiliate of Natixis Investment Managers  
French Public Limited liability company with board of Directors  
Share capital €27 772 359  
Regulated by the Autorité des Marchés Financiers (AMF) under  
no. GP 18000014  
RCS Paris n° 525 192 753  
43 avenue Pierre Mendès-France - 75013 Paris  
www.ostrum.com

## Natixis Investment Managers

RCS Paris 453 952 681  
Capital: €178 251 690  
43 avenue Pierre Mendès-France  
75013 Paris  
www.im.natixis.com

INT477-0319

## MARKET INSIGHTS

DOCUMENT INTENDED EXCLUSIVELY FOR PROFESSIONAL CLIENTS (IN ACCORDANCE WITH MIFID)