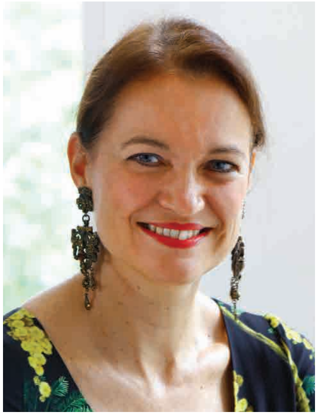
KEYNOTE INTERVIEW

A core comeback



Appetite for core infrastructure is soaring as investors seek a safe harbour in a storm, says Vauban Infrastructure Partners chief executive and founder Gwenola Chambon

Q Why do you believe that infrastructure, as an asset class, is well suited to the current macroeconomic environment?

Infrastructure has a proven track record of weathering storms. In fact, it was during the global financial crisis that people started to recognise infrastructure as a safe haven.

Now, as we face significant macroeconomic challenges once again with high inflation and rising interest rates, infrastructure's resilience is coming to the fore, as is its decorrelation from broader equities. That is reviving interest in the asset class among investors, who are seeking out infrastructure's stable and predictable cashflows, as well as its natural hedge to inflation.

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Q Why is core infrastructure particularly well positioned and how is investor appetite evolving relative to other risk categories?

Core is the very definition of infrastructure when it comes to fundamental characteristics of being highly regulated or contracted; it is the lowest risk branch of the asset class. That is why we see the appeal of core growing and allocations rising. Investors that have committed heavily to value-add strategies are starting to be concerned that rising interest rates are going to impact the ability to put appropriate financing in place and about the level of risk these assets carry.

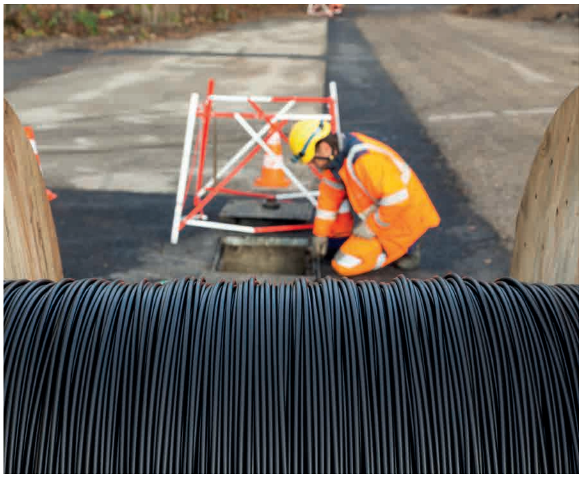
Increased interest rates are impacting valuations, and a shortage of liquidity and increased cost of debt are causing the performance of historical vintages to deteriorate. Value-add strategies remain interesting, but the feedback we are getting from investors is that there has been a natural move towards playing it safe. Therefore, allocations to core are taking a more important role in roadmaps for 2023.

Q The terminology around core infrastructure has evolved in recent years with super-core and core-plus creeping into the lexicon. How meaningful do you believe these definitions are and where

There is sometimes a perception that core infrastructure does not need managing – that these assets look after themselves. Would you refute that claim and what does asset management look like for you?

The asset management of core infrastructure is incredibly demanding. We are taking care of infrastructure that provides essential services to communities, so the responsibility is huge. You need to be sure you can provide those services seamlessly, which was a real challenge during the pandemic. You also have to work with the public entities that are entrusting you to take care of the infrastructure.

In addition, you must meet the rapidly evolving needs of communities. Only by meeting shifting stakeholder demands can you ensure contracts are renewed and evolve over time. For example, we have been operating fibre-to-the-home networks in Northern France. The concession initially involved a particular region but now, not only is the territory expanding, but additional layers are being placed on top of the original operation and maintenance of the network. It started with the connection of security cameras and now encompasses all kinds of IoT [internet-of-things] applications, including connected rubbish bins that signal when they are full and ready for collection. In this way, connectivity is allowing municipalities to provide better services in a more efficient and economic way.



Increasing connectivity: Vauban has been operating fibre-to-the-home networks in Northern France

Of course, as asset managers, we also must ensure our assets are fit for a net-zero future, which involves a lot of work. Our approach to asset management is stakeholder-centric, whether that stakeholder involves our customers, public entities or the planet. If users are unhappy with the service they receive, then regulators and public entities will be unhappy as well. But no-one will challenge you on making money from infrastructure if it is performing well and meeting the needs of its different constituents.

should investors be focusing their attention?

I think super-core is marketing terminology that has been created by big brand asset managers to reflect growing interest among investors for these strategies. There is not any real difference between core and super-core except that super-core is typically used to describe very large funds that have been raised over the past two years. These funds are so big that they need to identify opportunities of serious magnitude, which means many are targeting large utilities. At the end of the day, these are corporates, which means they are not as low risk as originally may have been promised.

The sheer size of these funds also means it can be challenging for managers to deliver on the co-investment opportunities that investors are eager to access. Despite this, the infrastructure space is so large and the capex needs so great, that there is room for everyone.

While the opportunity set is clearly expansive, have you seen competitive dynamics evolve within the core infrastructure market?

We have seen an increased amount of direct investment over the years, with the large insurance companies in particular targeting core investments by themselves. These insurers typically rely on a relatively limited number of people on the ground to deliver their strategies, which means they focus only on the most neatly packaged transactions.

We have also seen those very large super-core funds, of course, but a majority of core infrastructure assets out there are not that large. I believe infrastructure is a very local business; it is necessary to stick to markets where you have people on the ground.

Appetite for infrastructure has grown so significantly over the past five years that a lot of players have either moved away from core into value-add or have been pushed up the size spectrum. This means that for a mid-market investor like us, the market is relatively uncrowded.

Where do you see the most interesting investment opportunities in 2023?

Decarbonisation is keeping everyone

incredibly busy. I have never seen so much activity in the market. There is huge capex required to address the adaptation of existing infrastructure that was not built to cope with skyrocketing energy prices or the need to mitigate climate change. There is also significant need for new infrastructure.

The energy transition is creating opportunities ranging from district heating to smart meters. We are also seeing opportunities in the rail sector, encouraged by EU policies designed to encourage more movement of goods to shift from road to rail.

Digitalisation also remains an important mega-trend, with a lot of work still ongoing deploying fibre-to-the-home networks to ensure everyone has access to the internet. That opportunity is also being driven by the fact that incumbent operators do not have the financial firepower to cope with the scale of capex needs.

There has been a huge shift in what investors are looking for, with increased demand for green infrastructure, in particular, in contrast to a pipeline heavily dominated by mobility, oil and gas just five years ago. That will create challenges for the more traditional industries, which face disruption when accessing finance. In fact, that is a challenge for all of us in society, because we cannot transition to an entirely green economy overnight.

"We have moved from an era of cheap money and cheap energy with zero inflation, into an era where money is no longer cheap, interest rates are rising and inflation is at a 25-year high"

Q Are you seeing opportunities in social infrastructure given how cash-constrained governments are today?

Cash constraints are certainly an issue, but that doesn't only impact social infrastructure. It is the reason that the public sector is increasingly inclined to work hand-in-hand with the private sector in many spheres. Social infrastructure, however, is a less active sector because the public-private partnership frameworks that once dominated have become far less prevalent in Europe. At Vauban, we will only look at social infrastructure in a PPP context because we want to ensure we are not exposed to social services. We will build and manage hospital and university buildings, for example, but we do not wish to be responsible for providing the health or educational services themselves.

Q Is the concept of making money from infrastructure becoming more challenging during the cost of living crisis?

It is a question of balance. There are situations where we have the contractual right to increase prices beyond even the current high inflation rates, but you must consider whether that is sustainable. Part of our job is to balance what is achievable, what is acceptable and what we need to deliver for our investors. It is an equation that must constantly be revisited over time.

Q What do you see as the biggest challenges and opportunities over the next year as a core infrastructure investor?

We have moved from an era of cheap money and cheap energy with zero inflation, into an era where money is no longer cheap, interest rates are rising, and inflation is at a 25-year high. My hope is that this will bring some rationality back into the market in terms of purchase prices, appropriate financing and appropriate structuring.

Then there is the huge responsibility and the huge opportunity that falls on all of us in the infrastructure industry – delivering the climate change agenda. The timeframe is tight and we are all going to be kept incredibly busy trying to achieve these goals. That is undoubtedly the biggest challenge facing our entire generation. ■

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