SEEING SUCCESS IN A COMPETITIVE MARKET

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As infrastructure continues to meet and exceed investors' expectations, the market is becoming increasingly overcrowded as GPs and LPs clamour in. Is this bad news for players in the space?
We believe an overcrowded infrastructure market is not necessarily a bad thing for players in the space. Over the past decade, infrastructure has gained popularity as a key asset class. Capital raised for infrastructure funds has increased remarkably from $44bn in 2007 to $90bn in 2018, according to Preqin. The growth in the infrastructure market is driven by both demand and supply perspectives.

On the demand side, with more capital to deploy driven by both existing programs and new pension programs, LPs are looking for investment opportunities that meet their target returns. Infrastructure is often a common asset class for LPs that look for stable returns, low volatility and low risk on a relative basis.

On the supply side, infrastructure opportunities are continuously available, primarily driven by opportunities arising from the ageing of existing infrastructures, which require improvements, and the increasing population and middle class in emerging markets such as China, India and Brazil, which require strong infrastructure platforms to support their developments and connectivity.

From a macroeconomic standpoint, infrastructure investment is also a very useful tool for macroeconomic stabilization as these long-term projects create a large amount of job opportunities and thus improve employment rates in associated countries. The completed infrastructures will eventually create synergies in supporting a sustainable macroeconomic development in the long run, which ultimately benefits stakeholders in the market including GPs and LPs.

With a positive outlook for infrastructure and the economic benefits it can bring, it is believed that infrastructure-related commitments can be efficiently deployed by funds and other vehicles, leading to sustainable business partnerships and promising long-term returns.

Fund managers are competing for fundraising capital more intensely than ever before and capital is becoming increasingly concentrated among a select few. Who would you say are the winners and losers in this situation?
Fundraising has become more and more competitive and LPs have become increasingly selective. According to Preqin, 54% of infrastructure capital raised in 2018 was secured by the 10 largest funds closed.

Larger GPs often require less fundraising effort due to brand recognition, proven team capability and track record. LPs are keen on investing with larger GPs such as Global Infrastructure Partners given their better deal-sourcing and portfolio management capabilities. The potential downside of these large GPs with huge amounts of capital to deploy is that they may be forced into looking at various trophy assets, which are typically sold in a competitive auction process, hence the higher price-tag.

On the other hand, smaller GPs are slightly less well positioned as they tend to encounter more challenges during fundraising. Hence, smaller GPs try to attract LPs with a different angle, i.e. through bespoke return profiles or innovative fund structures, or by investing in unique asset types. With a smaller scale of operations, smaller GPs will

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have greater flexibility to explore new infrastructure opportunities, such as natural resources and renewable energy, instead of traditional infrastructure assets such as roads, powerplants and airports. Other trends occurring in the market with smaller GPs include consolidation, whereby firms acquire a small infrastructure GP to enhance their capability in a particular market, and additional product offerings.

In the current fundraising situation, we do not think it is appropriate to identify the winners and losers. As the market keeps evolving, we believe that more products with different niches will be launched and new partnerships will be developed. GPs are getting more creative in designing their products to compete with their peers to secure commitments and tailor to the needs of investors. Over the past few years, we have seen GPs breaking through the 'fixed fund life' limitation by launching open-ended, evergreen funds to consistently attract incremental commitments as the infrastructure projects develop. Other observations include some GPs launching joint venture funds with sovereign wealth funds, pension funds or insurance companies. All stakeholders should be ready to take on new opportunities that emerge.

What are the biggest concerns for investors today? How can they mitigate these concerns?
For most investors, not specifically for infrastructure investors, risks arising from political uncertainty seem to be at the top of their agenda, followed by high valuations across different asset classes.

With Brexit taking place in 2019 and most recently the trade war between the US and China, the market is filled with uncertainty and investors are skeptical about making investments in regions with high levels of risk. Political shocks can lead to shifts in interest rates and taxation policies that can severely impact investors' returns and capital allocation strategies. Depreciation is another potential risk that infrastructure investors may face, as their asset values will become volatile as currencies fluctuate with economic shocks.

There are various measures available for investors to mitigate the risks. One key measure to reduce impact from political uncertainty is to avoid over-investing in one jurisdiction. Investors can also obtain political risk insurance to cover potential impact on the business caused by political risks. Most importantly, it is recommended that investors should undergo proper due diligence and compliance checks on their investment targets before committing and structure their investments to ensure currency risks caused by political and economic fluctuations are efficiently diversified.

On the valuation side, given the high level of capital secured by infrastructure funds in the past couple of years, dry powder is at record highs. Therefore, is not surprising to hear competition for assets has been growing. Adding to this, the largest institutional investors are increasing their direct investment activity and, more often, are competing with infrastructure funds for assets, which leads to high and rising valuations.

What areas do you feel are presenting the best opportunities in infrastructure today and why?
There are some spaces in which we can see potential opportunities in the infrastructure markets; they are opportunities from China and neighbouring regions, education-driven infrastructure and renewable energy:

- **China and neighbouring regions**
  Under the Chinese Government's One Belt One Road (OBOR) initiative, more trades and businesses are expected in China and neighbouring countries and hence drive a high demand for infrastructure. The Chinese Government has been very active in building and improving infrastructure such as airports and road systems throughout the region to support the logistics required in realizing the OBOR initiative. Investing in associated infrastructure is expected to generate promising returns as it is believed that China will become one of the strongest economies in the world in the next 2-3 decades. Research predicts over 70% of the Chinese population is expected to be middle class in 2022 and will therefore have the ability to spend more on international travel. Investing in travel-related infrastructure like airports and cruise terminals also presents a profitable opportunity.
- **Education-driven infrastructure**
  Education-related infrastructure is also an area that has grabbed more attention recently. Studying abroad has become a trend in recent years, particularly in English-speaking countries such as the UK, the US and Australia. Therefore, education-linked infrastructure including student housing, university campuses and related amenities will be an opportunistic space for infrastructure investments.
- **Technology and renewable energy**
  As part of the UN's global Sustainable

Development Goals, the future investment thesis is moving towards the topic of sustainability. We believe construction projects to build photovoltaic power stations, wind farms and power plants using other renewable power sources will retain their important role in the power infrastructure market and will continue to generate good investment returns. Moreover, the shift towards automation and decentralization in lifestyle and working culture means that demands in network infrastructure are increasing to improve efficiency and connectivity. In addition, recent trends in hybrid and electric vehicles also create opportunities in ventures focusing on renewable-energy-associated technology such as super batteries and artificial intelligence.

With increasing amounts of capital coming into the asset class and limited numbers of proceedable projects available, how are different jurisdictions looking to encourage greenfield investments in projects requiring private capital?
In developed countries such as the US, to incentivize greenfield investments the Federal Government offers an investment tax credit (ITC) up to 30% for commercial, utility and residential solar and wind technology projects. In addition, the tax incentive period has also extended the ITC period for an additional five years to further encourage investors to participate in greenfield infrastructure investments. Across the pond, the UK Government provides a comprehensive financial incentive scheme, including an R&D relief of up to 230% deduction of costs and 12% tax credit, to encourage research and development in the clean energy space. In addition to tax relief, exemptions in climate change levy and feed-in tariffs are also available for investments in renewable power sources.

Asian countries are also actively promoting greenfield investments to both domestic and international investors. China has set policies and incentives including tax credits and fiscal support such as 'green credits' for the development of infrastructure projects, leading to a more sustainable and cleaner environment. In Japan, the government provides 'feed-in tariffs' and tax deduction (up to 7%) to stimulate investment in renewable energy.

Infrastructure assets under management (AUM) are set to increase over 2019 according to fund managers. What will be the key drivers of this?
We can look at the key drivers from three perspectives: demographics, energy efficiency and consumer behaviour.

From the demographic perspective, the rise of the Asian emerging markets will be the main driver of the projected AUM increase. We expect the increasing population and expanding middle class across emerging markets will drive the demand for infrastructure assets and hence the AUM. We believe urbanization of second-tier cities, particularly in China, will take off in the next 20 years and projects for the construction of commercial districts and transportation links will be very active.

On energy efficiency, the shift in global climate encourages the use of clean energy, and investing in infrastructure assets leveraging the use of renewable power sources will become a key trend in the infrastructure investment space.

Lastly, from a consumer behaviour point of view, electric vehicles and technologies powered by renewable energy are becoming consumer trends. R&D efforts and associated infrastructure will be required to cater to consumers' needs on related products.

ABOUT MVISION

Founded in 2001, MVision is widely recognized as one of the world's leading independent international advisory firms, focusing on raising capital for Private Equity, Real Estate, Real Assets, Credit and Direct transactions in both the developed and emerging markets.

Operating out of offices in London, New York, San Francisco, Hong Kong and Sydney, MVision has a long-standing reputation for working with current and future market leaders across the globe. MVision firmly believes that fundraising is far more than a one-time event; it continues to assist clients with the ongoing task of funding and growing their businesses effectively, managing issues such as positioning, growth and performance.

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