The Rise of Infrastructure Debt: New Opportunities and Investor Interest

A decrease in debt financing available from large banks has driven a rise in the prominence of infrastructure debt investment in recent years. Paul Bishop explores this growth and current investor interest in the sector.

Infrastructure debt has traditionally been a space within the infrastructure asset class occupied by large banks with sizeable balance sheets able to cope with the long-term nature and cost of such investments. However, in recent years non-traditional debt providers such as unlisted infrastructure fund managers and institutional investors have begun to populate the infrastructure debt financing market.

This shift is partially being driven by incoming capital adequacy requirements for banks (Basel III), which are making new debt investments in illiquid infrastructure assets a more difficult prospect and are forcing banks out of the space. This is creating a gap in the infrastructure debt market for non-traditional lenders that are attracted to the stable revenue streams and the long-term liability matching characteristics of infrastructure debt. In addition, historically low interest rates, volatile equities, and depressed fixed income yields are driving investors to look for predictable and stable yields in other low-risk investments such as infrastructure debt.

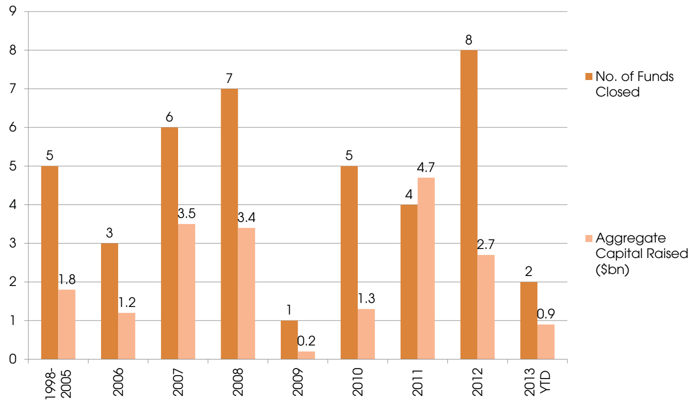
This feature article examines how the GP side of the infrastructure debt market is evolving through the creation of unlisted debt funds and separate account platforms, and will also analyze the characteristics of those investors actively looking to invest in this emerging sector.

The Evolution of the Infrastructure Debt Fund Market

In the past, the infrastructure debt fund market has been a fairly niche part of the asset class, but it is growing in prominence, and there are now various ways for LPs to gain exposure to infrastructure debt. Traditionally, these debt funds have made both equity and debt/mezzanine investments. However, with changing investor demand fund managers are increasingly launching vehicles focused solely on debt investments as well as separate accounts and mandated arrangements to satisfy investor appetite.

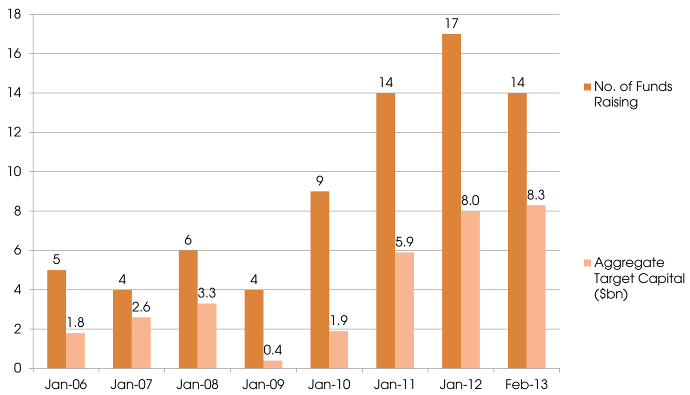
As shown in Fig. 1, the unlisted infrastructure debt fund market reached its peak in 2011 in terms of aggregate capital raised when four funds reached a final close on an aggregate $4.7bn. Although the aggregate capital raised by debt funds in 2012 was lower at $2.7bn, it was a record year in terms of the number of debt funds reaching a final close. Fig. 2 further illustrates the growth of the infrastructure debt fund market; as of February 2013, 14 unlisted infrastructure debt funds were on the road seeking a record aggregate $8.3bn in capital commitments. These vehicles account for 10% of the $81bn being sought globally by all unlisted infrastructure GPs.

Fig. 1: Annual Infrastructure Debt Fundraising, 2004 - 2013 YTD*



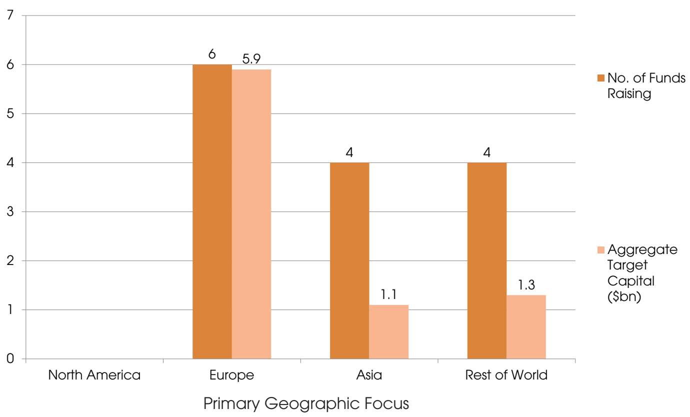
Source: Preqin Infrastructure Online *As of February 2013.

Fig. 2: Unlisted Infrastructure Debt Funds on the Road over Time, January 2006 - February 2013



Source: Preqin Infrastructure Online

Fig. 3: Current Infrastructure Debt Funds in Market by Primary Geographic Focus*



Source: Preqin Infrastructure Online *As of February 2013.

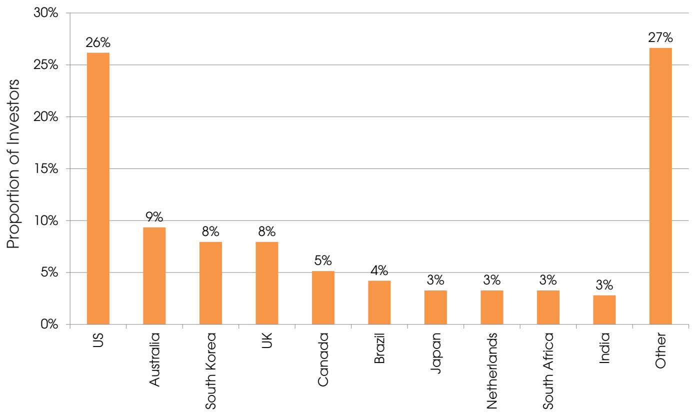
Europe is at the centre of the infrastructure debt fund market, with six funds on the road focused primarily on investments within this region as of February 2013 (Fig. 3). These Europe-focused debt funds are seeking an aggregate $5.9bn or 71% of the total capital being sought globally by unlisted infrastructure debt funds. Asia- and Rest of World-focused vehicles account for four funds in market each, targeting $1.1bn and $1.3bn respectively. There are no infrastructure debt funds currently on the road targeting investments primarily in North America.

Although the investment strategy of infrastructure debt funds remains diversified, many new funds coming to market are now primarily focused on debt as opposed to a mix of debt and equity. For example, Allianz Global Investors has recently begun structuring a debt fund that will focus solely on UK infrastructure debt and will have no equity exposure. Allianz will seek to raise £1bn for senior debt investments in both economic and social infrastructure assets, and it also has plans to raise a similar fund focused on Europe in 2013.

Separate Accounts and Mandates

Aside from the emerging infrastructure debt fund universe, investors and GPs are also examining alternative routes to market in the infrastructure debt space. Separate accounts and bespoke mandates offer a much more tailored way to invest in infrastructure debt. These mandates lend themselves well to the

Fig. 4: Breakdown of Investors in Infrastructure Debt by Location

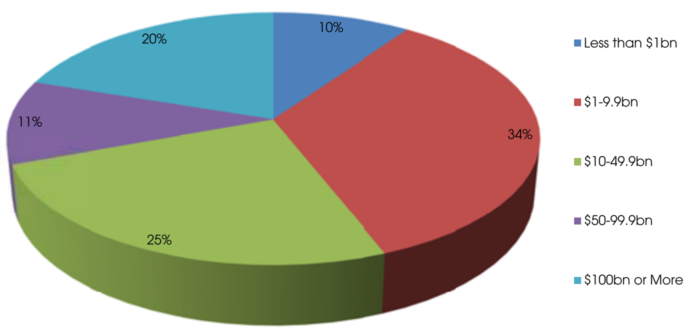


Source: Preqin Infrastructure Online

highly structured and technical nature of infrastructure financing and can help to create a closer alignment of GP and LP interests. However, separate accounts are often the preserve of large institutional investors with sizeable allocations to infrastructure and good relationships with fund managers.

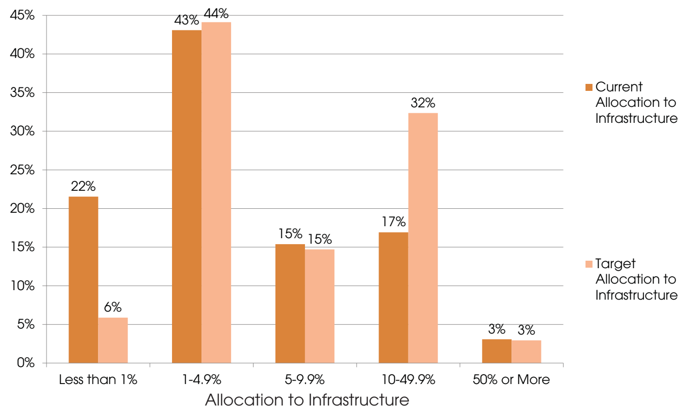
In recent months there have been a number of high-profile infrastructure fund managers establishing infrastructure debt platforms on behalf of institutional clients. Macquarie Funds Group established Macquarie Infrastructure Debt Solutions (MIDIS), which is handling a $500mn mandate on behalf of Swiss Re. The

Fig. 5: Breakdown of Investors in Infrastructure Debt by Assets under Management ($bn)



Source: Preqin Infrastructure Online

Fig. 6: Investors in Infrastructure Debt by Current and Target Allocations to Infrastructure (As a Proportion of AUM)*



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mandate will focus on economic and social infrastructure debt in assets located in Europe and North America. Natixis Environnement & Infrastructures has also teamed with Ageas, a Belgium-based insurer, to provide €2bn of infrastructure debt finance to be invested into a variety of European infrastructure assets.

Investors in Infrastructure Debt

Investors are now presented with a number of ways to access the infrastructure debt market and many infrastructure GPs are beginning to establish debt teams to satisfy institutional investor demand. Preqin tracks over 1,700 active investors in the asset class, 12% of which will consider infrastructure debt investments. This excludes banks which are focused on project financing arrangements as part of their general business strategy.

As shown in Fig. 4, a significant proportion of investors in infrastructure debt (26%) are based in the US. Australia, South Korea, the UK, and Canada are also key centres for infrastructure debt investors. This is unsurprising given the experienced nature of infrastructure investors in these countries which are practised enough to examine unconventional routes to market. The bulk of investors in infrastructure debt are public pension funds (20%), insurance companies (17%) and private sector pension funds (11%). Due to the long-term nature of infrastructure debt, many institutions that consider debt exposure are those seeking stable, long-term returns as a match to their own long-term liabilities.

Infrastructure debt LPs also typically have larger total assets under management (AUM). The mean AUM for all active investors in infrastructure is $39.7bn, whereas the mean AUM for investors in infrastructure debt is $66.7bn. As shown in Fig. 5, 59% of debt investors have between $1bn and $49.9bn in total assets under management, while a significant 20% have assets of $100bn or more. Larger investors are more able to access alternate methods of investment aside from traditional infrastructure debt funds, which may help drive a growth in separate accounts within the space.

In terms of preferred strategy, 83% of investors in infrastructure debt will make commitments to unlisted infrastructure funds and 50% will invest directly. This suggests that infrastructure debt funds and separate debt accounts will both continue to grow in prominence. Separate accounts also occupy a middle ground between fund commitments and an all-out direct investment strategy, which could be attractive to less experienced investors.

Outlook

When interviewed for the new 2013 Preqin Global Infrastructure Review, Boe Pahari of AMP Capital Investors outlined a positive future for infrastructure debt. He commented, “Banks have a changed appetite in terms of leveraged ratios and tenders after the credit crunch. As a result, there is a space where pension funds can participate on the debt side, particularly in mezzanine.” As traditional lenders continue to pull away from the infrastructure debt market, investor appetite for the sector is likely to remain strong in 2013. Fig. 6 shows that a significant proportion of investors in infrastructure debt have yet to reach their target allocations to the asset class, again suggesting the potential for further investment in the space.

Infrastructure debt is often seen as a particularly attractive opportunity for investors that favour stable, long-term, predictable yields over capital growth. The potential stable revenue streams generated by infrastructure debt are also a good match for those investors with long-term liabilities. Although barriers to entry exist, this interest in debt is likely to continue in future as investors seek to take advantage of the favourable investment characteristics of infrastructure debt, and unlisted infrastructure debt fund managers will be at the centre of this activity.

Only includes investors that have a specific allocation to infrastructure. A significant proportion of investors choose to invest opportunistically in infrastructure and do not operate under set allocation guidelines.

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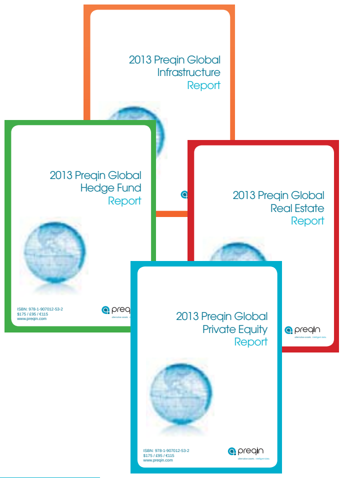

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