INVESTMENT

Infrastructure: An investment powerhouse

Francesca Fabrizi looks at why infrastructure is continually ticking all the boxes for European pension fund investors

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In September, pensions giant APG announced it had invested, on behalf of its pension fund clients, USD 500 million in the deployment of fibre glass in the United States, taking a 16.7 per cent interest in US fibre glass production company SiFi Networks America.

In the same month, it announced a €500 million investment in the Smart City Infrastructure Fund, which focuses on investments that aim to make cities more energy efficient.

In May, a consortium comprising APG, PGGM, Alecta, Keva and AXA Investment Managers announced their acquisition of a 50 per cent interest in Stockholm Exergi Holding AB – the largest supplier of district heating in Sweden.

These are just several examples of how the European pension fund sector is reinforcing its commitment to infrastructure – the reasons being that, as an asset class, it not only hits the spot on the risk/return front, but is also favourable against rising inflation, has cash-flow generative characteristics, and is increasingly helping pension funds meet their sustainability needs.

"There has been a noticeable pick-up in interest from European pensions funds around infrastructure over the past few years," says BNP Paribas Asset Management head of infrastructure debt, Karen Azoulay. "This growing interest has been largely driven by pension funds wanting to diversify their income sources away from traditional asset classes, such as equities and fixed income, and into alternatives."

Specifically for infrastructure debt, she adds, pension funds, like many institutional investors, are developing a better understanding and appreciation of the asset class, particularly the stable additional income and security compared to equivalently rated corporate bonds.

Furthermore, environmental, social and governance (ESG) considerations are playing a major role in building interest, she says, and to their credit, pension funds have added ESG factors to their investment focus. "This has really brought infrastructure investing to the forefront, as ESG factors are very visible and palpable in this asset class, with the financing of solar power and wind turbine projects as examples."

KGAL Investment Management head of international institutional business, Christian Schulte Eistrup, concurs that, in their experience, European pension funds are increasingly discovering infrastructure as an interesting investment, and are also understanding the asset class better, with the firm seeing strong and growing interest, particularly in renewable energy. "We are also observing that quite a few pension funds have developed strong expertise in the area and are bringing a high degree of sophistication to the asset class as they continue to build out their infrastructure allocations."

One other major factor nudging allocations towards infrastructure is the fear of rising inflation – Alecta, for example, has been reducing its holdings of stocks and bonds in favour of alternatives for a number of years, in response to potential inflation increases.

"Inflation fears are impacting this trend quite heavily," argues Alecta head of real assets, Axel Brändström. "From our perspective, we began to raise our allocation towards real/alternative assets, which includes real estate, infrastructure and alternative credits, from equity and bonds in 2016, and will continue to do this in the coming years. This is a part of our strategy to create a portfolio that is more resilient to rising inflation, but also will give our customers equal expected returns, with lower risk."

Addtionally, the stability of cash flows and access to exposure to corporate activity that is not heavily correlated to GDP growth are also key factors influencing Alecta's asset allocation decisions. "Private markets tend to be more long-term focused, which is something that pension money appreciates. There is also a complexity premium in some of the opportunities that large pension institutions can invest in due to their scale," adds Brändström.

The ability to access assets that are contractually linked to inflation is also one of the many attractive features of infrastructure, agrees Willis Towers Watson portfolio manager, Duncan Hale: "This is particularly important for those investors that have inflation-linked liabilities, because increasingly investors are looking at assets like infrastructure (and particularly lower risk infrastructure) and real estate as assets that can help them manage their liabilities."

Willis Towers Watson is indeed seeing lots of investors looking to invest into low-risk infrastructure (alongside other similar assets like certain types of real estate) for its cashflow generative properties.

"In a world where traditional cash yielding assets (like traditional sovereign and corporate bonds) offer very low income, many investors are looking at certain types of infrastructure and real estate that deliver long-term, inflation-linked, predictable yield as a way of generating income to supplement the low yield received from those traditional assets."

Similarly, he adds, the focus on sustainable investment is also making investors look closely at their infrastructure portfolios, as infrastructure is a sector where there are assets that will benefit from the transition economy and those that will not. "In terms of those assets that will benefit from the transition economy, this includes the obvious – things like renewable energy are at the forefront of the decarbonisation agenda; but also things that are less obvious. Utilities and certain transport assets are just two examples of areas where additional capital will be required as we move to a net-zero world, and this potentially offers opportunities for investors in these areas. At present, we are seeing more capital being allocated to investments and strategies that are positively skewed to this type of risk, versus those that are not."

Infrastructure in a post-covid setting

Infrastructure also boasts key attributes pension funds are looking for given the current economic environment and the long-term impact of a turbulent eighteen months since Covid-19 first started to make a real impact. "In a post-Covid world, pension fund investors, like many others, are seeking investments that provide meaningful income without taking on too much added risk," comments Azoulay.

"During the height of the Covid pandemic (March to May 2020), we experienced elevated volatility in most markets, which drove up credit spreads and hampered equity prices. Whilst we have experienced a strong recovery across most major markets since then, investors are keen to avoid such levels of volatility and uncertainty. For this reason, infrastructure debt is a particularly compelling investment option, given its key attributes are long-term stable income, security and diversification."

Notably, she affirms, these key attributes were on full display during the height of the pandemic, with the asset class as a whole delivering resilient performance. "Due to the essential nature of the services provided by infrastructure projects, such as power generation and telecommunications, operations of these infrastructure projects continued," she adds. "Importantly for infrastructure debt investors, this continuing operation meant that cash flows were maintained throughout the year."

Furthermore, in a post-Covid world, investors are re-focussing on ESG and sustainability, says Azoulay, and are more and more looking for assets with a "positive/strong net environmental contribution; and they expect managers to report on the investment impact".

KGAL head of portfolio management and sustainable infrastructure, Andreas Ochsenkühn, agrees that infrastructure investments have proven to be particularly resilient to the external shocks that occurred during the Covid-19 crisis, which has led to even more interest from institutional investors in the whole sector, while Eistrup adds that diversification and attractive relative returns versus traditional asset classes remain centrally important attributes of infrastructure investment. Additionally, he echoes the importance of infrastructure's sustainability attributes. "We see clearly that pension funds are increasingly looking beyond those financial attributes toward the important goal of genuinely sustainable investment.

"Particularly in today's climate and Covid context, many pension funds are seeking to simultaneously pursue their financial goals and create a positive impact on the global environment. This dual goal is leading to increased interest in investing in renewable energy generation and the broader energy transition." ■