# Why infra is ripe for disruption

*Simon Gordon*, *Philip Hendy*, *Fèmy Mouftaou* and *Wouter Plantenga* of JTC look at the opportunities available as the infrastructure market evolves

From a greater emphasis on specialist funds to the emergence of new investment areas such as mobile phone masts and social housing, the infrastructure sector is changing fast. Four senior executives from fund services provider JTC – Simon Gordon, director of fund and corporate services, UK; Philip Hendy, head of real assets, Jersey; Fèmy Mouftaou, head of business development, Luxembourg; and Wouter Plantenga, head of group client services, US – gathered to discuss how managers and investors are reacting.

**Hendy:** income remains infra's base attraction

**Q Real asset funds, including infrastructure, can be an incredibly broad area of expertise – how have you seen infrastructure, and areas such as real estate, change in recent years?**

**Simon Gordon:** The underlying trend across real asset and infrastructure funds has been investors seeking 'alternative' assets to the core. The attractions are diversification, the exploitation of inefficiencies in the market and generating returns.

The common driver across real estate, real assets and infrastructure is the desire for investors to drive higher levels of both capital and income return through active management with transferable skills between the asset classes. From JTC's perspective, having administered real estate and private equity funds of varying sizes for many years, we are able to utilize the skills and knowledge we have collectively built up to assist both at holding company and fund level.

**Philip Hendy:** In real estate we have seen the emergence of healthcare, logistics, data centers, student accommodation and private rented residential as markets in their own right. Last year, based on JLL figures, transactions in the alternative real estate market in the UK totaled £15.7 billion ($20.67 billion; €17.98 billion). Real estate investors have become real asset investors and are moving ever closer to infrastructure investors.

The number of specialist funds with a specific asset focus has grown in real estate and can now be seen in real assets and increasingly in infrastructure. The days of the generalist real estate fund appear to have gone with the trend for smaller dedicated funds for diverse areas such as supermarkets, healthcare, automotive real estate. We've also seen specific clean energy infrastructure funds come to market, and we expect this trend to continue.

**Wouter Plantenga:** The emergence of environmental, social and governance is also impacting managers and investors. The investor base is increasingly critical of managers with insufficient ESG policies and places greater emphasis on ESG factors as part of investment decisions and manager operations. This is pertinent in the real asset space with the nature of the asset class meaning that ESG factors have a high impact on investment strategies and the corporate governance of investment structures.

ESG is one area where infrastructure has a competitive advantage as many of the assets can have a positive impact on the environment and society. Renewable energy such as solar, wind and tidal power are obvious positive examples. The International Energy Agency estimates, for example, that there are still 2.8 billion people in developing countries depending on 'dirty energy' – there's both a real need and an opportunity for ESG.

Investment managers, functionaries and fund administrators need to be alive to the impact ESG has on investors. At JTC we are used to investor reporting asset benchmark comparisons, and I suspect that soon we will need to provide ESG data and comparisons, particularly for larger and sovereign investors.

**Q Infrastructure, in itself, is an evolving area – what does infrastructure mean to your client network, and how are you adapting your services to meet these changes?**

**Fèmy Mouftaou:** Infrastructure investment over the last 10 years has established a strong track record in providing stable forecastable cashflows which are often immune to economic cycles. This has meant increased allocations but there are other attractions as the sector evolves.

To many people infrastructure means utilities, airports, ports toll roads and bridges but, like every asset class, investors have sought diversification and higher returns, meaning that this view has become somewhat outdated. The focus for infrastructure investors now includes communication networks including masts, 5G and fiber, renewable energy, social housing, public/private partnerships providing healthcare and educational facilities, and refuse treatment to name a few. This has also meant that the lines between real estate, private equity and infrastructure have become blurred.

**PH:** The traditional view of infrastructure is still seen as 'core', but the growth areas are the non-core markets. These often have a lower entry price opening up opportunities to smaller funds and investors and providing diversification to larger players. We are witnessing, for instance, the launch of specialist funds in areas such as solar energy, giving investors more allocation precision.

These focused funds are often smaller with the manager having less in-house resources. As a result, more reliance is placed on an efficient outsourced administrator to flex around intensive periods such as closes and deployments without the manager incurring additional costs.

**SG:** Disruption of established markets has become part of modern life and infrastructure is not immune to that. There's no doubt that disruption in the infrastructure market will create new opportunities as well as detrimentally impacting some existing platforms. At JTC, for instance, we have been involved with the emergence of stable asset-backed crypto currencies and our expectation is that it will not be long before the long stable income stream of an infrastructure project is used for an ICO or tokenized event.

**WP:** Overall, with the weight of capital looking to deploy into infrastructure, we are seeing more and more managers looking to raise funds, and those with positive ESG credentials, an established track record and reduced capital requirements for non-core are finding that investors are ready, willing and able to sign up.

Meanwhile, with investors seeking returns over benchmarks, we are also very conscious that there is a real need for proactive administration and accountancy services and a demand for accurate and timely reporting for management at both holding company and fund level.

**Plantenga:** ESG is impacting on managers and investors alike

**Q Infrastructure funds have traditionally been chosen as income vehicles. How has the interest rate increase in the UK affected the popularity of these type of funds, as opposed to more traditional alternatives?**

**PH:** The base attraction of infrastructure has been the income and this is unlikely to change. After a decade of low interest rates across much of the world, acceptable rates of return have been set more by the internal cost of capital for investors than central banks. That said, should rates continue to rise, the risk-free return will clearly impact on investor requirements.

**Q What are the most popular structures for infrastructure funds, and what's the reasoning from both a client choice and manager recommendation perspective?**

**WP:** Whilst managers are imaginative in searching out new infrastructure style income streams, there remains a conservative approach to fund structures. The traditional general partner run limited partnership, with individual hold companies holding assets beneath, remains the default choice. With some investors making their first foray into infrastructure, familiarity with the fund structure can provide a degree of comfort.

**Q What trends are you noticing when investors choose a domicile? Has the raft of regulatory changes had an impact on investors' thinking?**

**FM:** The jurisdiction of the fund vehicle is invariably influenced by the location of targeted assets and investors but increasingly we find investors and managers looking for efficiency, flexibility and speed of action in jurisdictions such as Guernsey, Jersey and Luxembourg, Also important is to select a jurisdiction that will remain stable during the long life cycle of the infrastructure project.

**SG:** Investors, given the tangible asset base, appear to view the regulatory oversight of infrastructure funds as a cost impairing returns without material benefit. The focus of funds is on transparent reporting and good governance, which echo the regulatory framework. That's what investors really want. With further regulatory changes always on the horizon irrespective of domicile, investors want the least amount of change and the smallest impact on returns.

**Q To what extent are Brexit and other political instabilities driving these trends?**

**PH:** Brexit is not impacting infrastructure as it has, say, the real estate and equity markets. The risks in the infrastructure market are regulatory change, with investors more concerned about the potential of a general election leading to a hard-left government imposing price controls and embarking on a nationalization of infrastructure assets. Outside of the UK and EU, the political changes in South America are leading to a more positive environment for infrastructure investors whilst Africa remains an enormous opportunity with over 600 million people still without access to electricity. ■

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