

FINANCIAL SPONSORS LEAD THE WAY

AN OFT-HEARD REFRAIN IN OUR WORLD IS THAT THERE IS TOO MUCH CAPITAL CHASING TOO FEW DEALS. IT IS TRUE THAT THERE IS A LOT OF CAPITAL, BOTH DEBT AND EQUITY, THAT IS AVAILABLE TO INVEST IN INFRASTRUCTURE PROJECTS AND COMPANIES. BY **NASIR KHAN**, MANAGING DIRECTOR, HEAD OF INFRASTRUCTURE FINANCE, AMERICAS, **NATIXIS CIB**.

According to industry estimates, infrastructure fund managers have raised more than US\$500bn of equity capital over the last five years. At a 75/25 debt/equity ratio, this equates to US\$2trn in total private capital available to invest in infrastructure projects and companies.

But it is equally true that there is an even larger need for infrastructure investment. McKinsey estimates that the worldwide need for such investment over the next 15 years is approximately US\$57trn. Why then this mismatch between supply and demand?

Are there exogenous factors limiting the pool of investable assets despite the urgent need for investment, or is it because investors are all chasing the same limited pool of assets that meet a certain geographic and risk profile?

In the early years of infrastructure investing, it was a little bit of both. With respect to the first point, in the US, P3s once showed tremendous promise and when President Trump announced his US\$1.5trn infrastructure plan there was excitement that the promise might be realised. This has not happened.

Plans similar to Australia's highly successful asset recycling programme have been floated but have gone nowhere. Americans are comfortable having electricity infrastructure being owned and operated by the private sector but this does not appear to apply to core infrastructure such as transportation and water.

Lack of sufficient public funding, regulatory hurdles, political considerations, and other factors prevent critically important infrastructure investments from happening, even though private investors – debt and equity – are eager to invest. The critically important Amtrak Gateway project is an example of this.

With regard to the second point, first, by definition, infrastructure investors will only provide a fraction of the total investment dollars required for investment in infrastructure because they need to earn a return on their investment. They therefore need a visible source of revenues from user fees or contractual revenues from offtake contracts or availability payments.

But in addition to this, in the early days of infrastructure investing in the US, infrastructure funds were primarily focused

on transportation infrastructure – toll roads, ports, airports, and parking. This is because it was in the transportation sector where most of the early activity was, with large privatisations making headlines.

Macquarie did the first two high-profile infrastructure deals when it invested, along with Cintra, first in the Chicago Skyway in 2005 and then in the Indiana Toll Road in 2006.

Bank-sponsored infrastructure funds such as Goldman Sachs Infrastructure Partners (GSIP), Morgan Stanley Infrastructure Partners (MSIP), Citi Infrastructure Investors (CII), and the Canadian pension funds, including OTTP, OMERS, CPPIB, PSP and CDPQ, were early to the game and made significant investments in Carrix (GSIP), Montreal Gateway (MSIP), Chicago Parking Meters (MSIP), and Global Container Terminals (OTTP).

CII was the successful bidder on the Midway Airport and Pennsylvania Turnpike but was unable to close on either. Pennsylvania Turnpike, which would have been the largest privatisation in US history, did not make it through the Pennsylvania General Assembly.

Talk about privatising the New Jersey Turnpike and Ohio Turnpike emerged in the years after but public sentiment had turned against privatisations. In retrospect, the term privatisation, which was a misnomer anyway, was not the right label to put on these long-term leases, but that is a topic for another story.

A major potential source of potential opportunities had been blocked. Some funds such as CII did not survive. Port deals continued to happen because they were generally transfers from one private operator to another, and as such were not subject to the same political risk associated with public infrastructure.

Two significant rail deals closed – Rail America in (2007) and Florida East Coast Rail in (2008), both acquired by Fortress, but the assets were not considered infrastructure.

Despite the lack of obvious investment opportunities, investors continued to view the US as a key market given its sheer size and need for infrastructure investment, and continued to enter the market.

Macquarie and GIP were the largest players, along with Brookfield, which with its

international platform and expertise across multiple sectors had become a major player.

The Canadian pension funds, IFM, Alinda, Stonepeak, EQT, Carlyle and others had raised or targeted funds dedicated to infrastructure. Because of the lessons learned during the global financial crisis, valuations and leverage levels remained under control but the pool of available capital vastly exceeded available opportunities.

Infrastructure funds were quick to note this trend and adapted in three different ways. First, they turned their focus to power. This made sense and was relatively easy to do. It made sense because there were more opportunities – power had historically been the largest project finance segment – and because electricity infrastructure was largely private infrastructure already owned and operated by private investors, deal certainty was higher than in privatising public infrastructure, which was subject to public opinion and political considerations.

Second, they gravitated toward negotiated deals rather than participate in auction processes, and third, they turned their attention to non-core infrastructure or core-plus infrastructure. Often, but not always, these went hand in hand.

So, for example, Alinda bought a water heaters company in Canada called Reliance Home Comfort, Carlyle bought a Midwestern school bus business called Illinois Central School Bus and won the concession to operate travel plazas in Connecticut, and EQT acquired a cooking oil and waste management company.

While these were smart moves adapting to the shifting opportunity set and competitive landscape, none of them represented a broad shift in strategy – they were more tactical than strategic – or capitalised upon industry trends that would present a long-term, sustainable flow of deals.

Then came the shale boom ... and the boom in data usage from consumers and companies alike. Both would require large amounts of investment in infrastructure and the infrastructure funds saw an opportunity. They have capitalised upon these twin booms and have stepped in to the lead the way in funding the expansion of critical energy and telecommunications infrastructure.

The shale boom had resulted in the US becoming the world's largest hydrocarbon producer. This immediately

led to a corresponding need for midstream infrastructure to transport and export gas production from supply basins to end markets – pipelines, LNG facilities, and other infrastructure – and the infrastructure funds jumped in.

Both IFM and GIP have invested in Freeport LNG, Stonepeak in Venture Global's Calcasieu Pass project, Blackstone is the largest shareholder in Cheniere Energy Partners, and Brookfield has invested in Dominion Energy Cove Point LNG.

They have also bought stakes in pipelines, with Alinda acquiring a 49% stake in SemGroup's Maurepas pipeline in Louisiana and Blackstone a 32.4% interest in the Rover pipeline, which transports gas from the Marcellus and Utica Shale production areas to markets across the US.

But Blackstone has gone much further than that. With its acquisition of EagleClaw and Tallgrass Energy it has moved beyond investing in single assets and invested in large-scale midstream infrastructure platforms.

Blackstone is not alone in this. IFM recently completed its US\$10.3bn purchase of Buckeye Partners, Stonepeak has acquired crude oil midstream company Oryx Midstream, and Arclight has acquired American Midstream.

With these investments, the infrastructure funds have established themselves as central players in the midstream space and will use these platforms to continue to invest in critical midstream infrastructure for years to come.

They have established themselves as the principal source of capital for midstream infrastructure, more so even possibly than the MLPs that had long occupied this position. In so doing, the infrastructure funds and private equity firms that invest in the space have hit upon a long-term, sustainable source of investment opportunities consistent with their investors' risk and return requirements while fulfilling an important need for the funding of critical energy infrastructure.

The infrastructure funds play a comparably important role in the funding of telecommunications infrastructure. Data usage by consumers and companies alike has exploded exponentially. This is expected to continue with the advent of 5G and greater adoption of IoT. Monthly global mobile traffic is expected to increase sevenfold between 2017 and 2022 to 77 Exabytes per month.

This has resulted in the need for infrastructure to support this growth. At the same time, while consumers are demanding ever more bandwidth as they consume more data, they are not willing to pay more for this privilege. So, while data usage increases exponentially, the average revenue per user (ARPU) is not expected to increase.

Under the traditional business model telecom service providers would have invested in the required infrastructure – towers, fibre, subsea

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cable, and data centres – required to support the increased traffic. However, with ARPU expected to remain flat, service providers began to look elsewhere for capital.

There were other reasons why it made sense for third parties to own and operate telecommunications infrastructure. By having multiple tenants on their towers and in their data centres, third-party owners can make more efficient use of telecommunications assets. This pointed to a need for change in the business model and towards third-party ownership of telecommunications infrastructure. Again, infrastructure funds and private equity stepped in.

Last year, AT&T, sold 31 data centres to Brookfield for US\$1.1bn. They were not the first telecom service provider to divest their assets. Verizon had sold a large data centre portfolio across the US and Latin America to Equinix in 2016. Brookfield, along with Digital Realty also acquired Ascenty, a Brazilian data centre business, Latin America's largest, from another private equity firm, Great Hill Partners.

Macquarie has invested in two data centre platforms in the US, Aligned Energy and Netrality, and Alinda has formed a JV with QTS to be able to support its hyperscale data centre development strategy. We have seen infrastructure funds invest in fibre companies, too. In 2018, Antin acquired FirstLight, a leading fibre-optic bandwidth provider with operations in the Northeastern US.

Again, as is the case with their midstream investments, infrastructure funds are investing

in telecom businesses, not just assets, and in doing so are going to be central players in the telecom boom, too.

The largest transaction to-date involving an infrastructure fund is EQT's US\$14.3bn purchase, along with Digital Colony, of Zayo Group, a bandwidth infrastructure company with a 133,000 mile network in North America and Europe, providing mission-critical bandwidth to thousands of enterprise buildings and data centres.

It is quite remarkable to see how infrastructure funds have been able to assume leadership positions in midstream and telecommunications infrastructure. It was not always so. They have done this by being agile, many of them adjusting their sector focus from transportation to midstream and telecommunications, spotting opportunities and trends, and bringing large amounts of capital to where it was most needed.

Many of the early infrastructure funds were formed with the idea of investing in boring infrastructure, existing assets with monopoly-type profiles and predictable long-term cashflow.

Instead, today's infrastructure funds are investing in next generation infrastructure, assets and companies underpinning America's growth into the world's leader in energy and supporting the exponential increase in data usage by consumers and companies. Even in power, infrastructure funds and private equity firms such as Macquarie and Goldman, among others, are investing in emerging technologies such as battery storage. ■



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