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What is driving investor interest in infrastructure?

Over the past few years there has been growing interest from investors in infrastructure as the sector has proven to be a reliable source of returns. There are now a number of investment vehicles available to UK retail investors – a sign, perhaps, the sector is becoming more mainstream.
It helps that infrastructure has become rather more high profile, thanks to promises by governments in developed markets to increase infrastructure spending as thoughts turn to fiscal spending as a way of boosting economic growth.
One of President Trump's pledges during his campaign trail was to start building more infrastructure developments (and not just the Mexican wall) to help generate growth and jobs.

Structural, not cyclical

Peter Meany, portfolio manager for the First State Global Listed Infrastructure fund, believes investors have been attracted to the asset class for its defensive qualities.
"The underlying assets provide essential services and the business models are simple to understand. Infrastructure also offers growth which is more structural than cyclical, and strong pricing power which can provide a hedge to inflation," he notes.
"Investors' use of global listed infrastructure has evolved over time. Initially it was used as a defensive, low volatility equity. This expanded to see it used as a source of income, as declining bond yields increased the relative appeal of its growing and relatively secure dividend streams."
Like property, infrastructure benefits from being a tangible asset for investors to hold and, as Mr Meany observes, this makes it an easy investment to understand.
>As investor interest in infrastructure as an asset class has grown in the UK, the range of listed investment vehicles providing exposure to infrastructure-related projects has also increased.---William Argent
According to the Association of Investment Companies (AIC), HICL Infrastructure was the first infrastructure investment trust to launch in March 2006, raising £250m.
The AIC infrastructure sector is now the fourth largest investment trust sector, showing just how keen investors have been to get exposure to these projects. The uncertainty which has dominated markets and politics over the past few years may also be a factor behind investor interest.

Strong and stable

William Argent of Gravis Capital Management, fund adviser to the VT UK Infrastructure Income fund, says investors are drawn to the dependability of infrastructure, which is often able to generate inflation-protected income streams.
"The visibility of future cash flows provides a level of certainty and is a key reason for asset values having demonstrated considerable stability.
"In addition, the discount rates used by investment companies to value their assets have proved conservative and so in many instances investors have

experienced gradual accretion in capital values," he explains.
"These characteristics have prompted many investors to view the asset class as a viable alternative to investing in government or corporate debt, where returns are considerably less attractive."
The CPI rate of inflation spiked at 2.9 per cent in May this year, falling to 2.6 per cent in June, rebounding to 2.9 per cent in August.
Some investors have forecast the UK inflation rate has already peaked in 2017, but others warn it may still resume its climb.
Either way, inflation has a nasty habit of eating into savings and investments, so any assets which can provide some form of protection are likely to be in high demand at the moment.
Having confirmed investor interest, a number of fund houses have launched open-ended funds offering exposure to the sector, while several investment trusts have joined HICL since 2006.
Mr Argent observes: "As investor interest in infrastructure as an asset class has grown in the UK, the range of listed investment vehicles providing exposure to infrastructure-related projects has also increased."
This means investors can now access the returns linked to a broader range of social and economic infrastructure projects.

Government goals

"Continued infrastructure investment is critical to the government's ambition to address the UK's productivity gap and this underpins over £500bn of planned future spend. This pipeline of opportunities is likely to support continued investor interest in the sector," he claims.

What is a PFI or PPI project?

Simon Moore, senior investment manager at 7IM, explains how PFIs and PPPs work:
"There are infrastructure projects funded under PPP/PFI regimes around the world. These are large, critical assets where the national government has a formal and legally binding guarantee to fund payments to the project. The project is typically 90 per cent financed by infrastructure loans and 10 per cent by equity investors. The life of the project is in the order of 25 years, at the end of which the project reverts to government ownership. The projects can be availability based (hospital, school, prison) where the government pays simply for the asset to be open for business; or demand-based where payments depend on usage (toll roads).These are not listed projects nor are they easily tradable so tend best to sit in closed-ended investment companies.
"These are fully operational projects, so beyond the construction stage, and have gone through the one-year post construction 'snagging' period. All day-to-day running of these projects is outsourced to contractors with strict contracts in place such that any problems at the asset level are borne by the contractor."
Has the government guarantee been tested?
Yes. In 2012 the South London Healthcare NHS Trust, which runs three hospitals under the PFI regime, including the Queen Elizabeth hospital in Woolwich, went into financial difficulties. The government stepped in to meet its trust's PFI obligations and there were no payment defaults."
Mr Haynes also sees the potential for increased government expenditure to provide ongoing opportunities to those interested in being invested in infrastructure assets.

“As central banks’ monetary policies have become less effective, there has been a shift towards talk of increasing fiscal policies to support the global economy.

“Through an increase in government spending, the authorities attempt to improve unemployment rates, fight against deflation, stabilise business cycles and influence interest rates. One way of achieving this economic ‘holy grail’ is through investing in long-term infrastructure projects,” he asserts.

But this is not just confined to the UK, meaning investor interest in infrastructure may be boosted by overseas infrastructure projects.

Mr Haynes adds: “In Europe and Japan, the European Central Bank and the Bank of Japan have both mentioned that looser fiscal policy may be required to boost economic growth.

“However, the election of Donald Trump generated the most interest, with one of his biggest undertakings to ‘make America great again’ being to spend big to regenerate the country’s dilapidated infrastructure (although like many of his pre-election promises we are still to see the evidence emerge).”

Alex Scott, deputy chief investment officer at Seven Investment Management, sums up: “There is clear appeal for investors in the cashflow profile of infrastructure assets: long-term, highly predictable cashflows, with a significant degree of inflation-linking and generally backed by public sector counterparties.”

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