Creating new infra 'is far more about value-added, active management'

Mark McComiskey, head of infrastructure at AVAIO, talks about the opportunities and challenges presented by investing in new infrastructure assets

Greenfield: Creating new assets requires a completely different skill set

Q How significant is the infrastructure funding gap, specifically for the creation of new assets?

MM: Estimates are in the trillions on a global basis over the next 15 to 20 years. There is a clear consensus that we face a huge challenge funding the construction of the infrastructure required to support the growth and development of societies around the world.

And it is clear much of that funding will need to come from the private sector. Demographic changes, social costs and rising debt levels are all increasing the draw on the public purse, limiting capacity for spending on other projects.

Europe and Canada have done a good job with public-private partnerships, but those models in themselves have limitations and gained less purchase in the US. We are certainly seeing some of the burden of responsibility for creating new infrastructure moving out of the public sphere and into private hands.

Q Why do you believe the creation of new infrastructure represents an attractive investment strategy?

MM: The vast majority of funds raised to invest in infrastructure are focused on the purchase of existing assets. Everyone talks about the funding gap to create the infrastructure the world needs, but most investment funds have a small allocation for construction and development. The combination of the massive need for capital and relatively less competition makes this an attractive place to look for interesting opportunities that offer good risk-adjusted returns.

Q What are the challenges involved with investing in new infrastructure?

MM: The modern take on the infrastructure asset class emerged from the realisation, 20-plus years ago, that infrastructure assets can offer stable cashflows at a reasonable price, in part due to their uniquely high barriers to competition. A bridge over a river is not going to have much competition. A major airport is almost assured of a certain volume of traffic. The protected positions and attractive yields led to a focus on buying established infrastructure that could be readily due-diligenced. The result has been a sector that has seen investment success, rapid growth in capital supply, and increasing levels of competition.

Creating new infrastructure assets requires a completely different skill set.

Rather than a project finance-style underwriting ability, it is far more about value-added, active management.

If you go through the list of activities required to bring a project to the point that it becomes investible, it's substantial: you need to secure land and the permits; you need to complete the environmental work; create some form of revenue model or offtake that underpins the economics of the project; you need to secure a cost-effective, risk-minimising approach to constructing and operating the infrastructure, and then you need to finance it. Each of these activities involves different kinds of knowledge and expertise, and presents its own risks and challenges. To successfully pursue investing in new infrastructure, it is necessary to marshal skills in all of those activities in one organisation.

Q What needs to happen to encourage more private capital investment in new infrastructure?

MM: There are two issues. The first is that there are classes of infrastructure that are just not amenable to the injection of private capital for non-economic reasons. Water utilities in the US are a prime example of a sector where capital is desperately needed, where the private sector has long had an interest in investing, but has struggled to achieve meaningful penetration.

The second issue is that even where there is no resistance, investors are reluctant to participate because of the real and perceived difficulties of the process of developing new assets. Some of those concerns are valid. Look at the challenges faced by Kinder Morgan with the Trans Mountain Pipeline System. That ultimately led to the Canadian government nationalising the project as a way to preserve its reputation among private-capital providers and advance it.

But a lot of this is really just a question of expertise. The infrastructure-investment world is evolving. It takes time to develop new skills. If you develop the capability to filter a pipeline of projects, to identify those likely to succeed and where your skill set can allow you to contribute to that success – accelerating the permitting, achieving the offtake, managing the engineering and construction process – then you can make a difference, reduce the risks and invest successfully. But it is taking time, as an industry, to get to that point.

Q How do you approach long-term dynamics such as climate change?

MM: We are creating assets that we expect to be around for, perhaps, 100 years. Looking at those timescales, you have to assume that climate change will have both regulatory and economic implications for society, as well as physical implications for infrastructure.

Just as the FSB's Task Force on Climate-Related Financial Disclosures has recommended investors quantify the impact of climate change on their portfolios, we have integrated climate scenarios into our underwriting process. We run models analysing the economic exposure of assets to these scenarios so that we can think about this issue in a quantitative way.

The flip side of that is physical underwriting. We run climate-severity analysis on infrastructure we are considering building. For example, if you are looking at building a desalination plant in Florida, you want to understand whether there is likely to be an increase in severe-weather activity and what that means for how the facility is designed, built, and reinforced, as well as implications for the frequency of interruptions to operations. You want to understand how the trend of rising sea levels will affect the asset if it continues into the future.

Q What about technological advancements? How do you future-proof new projects against obsolescence?

MM: The impact of technological change is not always clear. Some forecast that self-driving cars will reduce traffic. Others argue that because people will be able to eat, sleep and do other things while travelling, they won't mind commuting longer distances and traffic will increase. Making these judgments is a perpetually difficult problem.

There are areas where it is clear technology will be disruptive – specifically in the energy transition – although highly-specific forecasts should be suspect. There are many different approaches to risk management in this space. In our case, while we always try to find projects that will benefit from, or at worst be neutral to, technological change, we recognise our limits and also look for reliable, creditworthy counterparties to underwrite the revenue needed to generate investment returns over the life of a project. The aim is to position well but also to minimise the exposure to technological and regulatory change in a contractual sense.

Q How do you believe private sector involvement in building new infrastructure will evolve over the next few decades?

MM: I am an optimist and believe that any area showing massive demand for capital – in particular where that demand is to create vital, societal infrastructure – will find a way to attract that capital. Governments and NGOs across the globe are very focused on this and are actively trying to ease the flow of private capital into infrastructure.

So, as has happened in other asset classes such as real estate, I think we will see an increasing diversification of infrastructure investing. Investors focused on purchasing core infrastructure assets will continue to be major players in the market, but more groups will emerge with the skills to pursue value-added and opportunistic approaches. That will breed far greater differentiation than currently exists, allowing capital providers to pick where on the risk-return spectrum they wish to participate in the infrastructure sector. That will ultimately encourage more capital to move right across the infrastructure life-cycle, a trend that is already well under way. ■