KEYNOTE ADDRESS

- Dennis Kwan, **MVision**

What have been the key trends in infrastructure fundraising in 2016?
In 2016, the infrastructure fundraising market was dominated by a couple of mega funds (i.e. GIP and Brookfield) and a number of large funds (especially European infrastructure funds) that received unprecedented levels of capital. This favourable fundraising environment was helped by record distributions and a large proportion of investors underweighted to the asset class, which we expect to continue in years to come.

We continued to witnessed some of the largest and most sophisticated institutions moving away from fund investments to operate direct infrastructure investment programs instead, where the benefits include greater control over the direction of the assets, avoiding or minimizing fees and other terms, and the ability to select assets that fit with their investment program.

Lastly, emerging markets infrastructure funds have attracted investors' attention owing to increased population growth and urbanization needs, where much of this growth will be channelled into the infrastructure of these emerging countries to accommodate the increased demand on essential infrastructure services such as power, water and transportation.

Are you seeing increased interest in infrastructure from investors currently?
Infrastructure is seeing a solid increase in interest among pension funds, insurance companies and other institutions. We see existing infrastructure investors increasing their investments in energy, water, transportation and social projects around the globe. Under the current economic environment, investors are looking at infrastructure as part of their efforts to find investments that have low correlation to equities and bonds, underpinned by reasonable yields and inflation-linked revenues. Moreover, many investors have had a positive experience of the asset class during recent years, with performance exceeding their expectations, and record distributions, which translates into larger allocations to infrastructure in future.

New investors are finding infrastructure a diversifier to their traditional investments. We see an increasing number of new investors entering the asset class across the world. The long investment horizon and inflation-hedging characteristics of the assets are well suited to large institutional investors with long-term liabilities.

Are there any particular trends you are seeing in infrastructure today?
From our engagement with investors globally, a number of key trends have emerged in the infrastructure landscape:

1. In 2016, infrastructure proved to be very resilient, particularly in the case of more traditional infrastructure assets such as airports, midstream energy assets and water.
2. Renewables is now an investable sector within infrastructure, and returns are proving to be attractive.
3. Increased competition in traditional infrastructure markets has pushed investors to look at emerging markets (i.e. India and Southeast Asia).
4. Driven by the increasing competition, targeted returns have moved 200-400bps lower in developed markets.
5. Debt markets remain favourable – low spreads and fees with reasonable covenants.
6. Increasing number of investors are making direct or co-investments Funds have been able to generate good exits around the globe; expect strong exits to continue for the next couple of years.
7. A number of established infrastructure funds are raising a dedicated infrastructure debt fund.

In light of struggling commodity prices, have you seen demand for renewable energy infrastructure growing?
Renewable energy, most notably wind and solar, is clearly playing a big role in meeting the global demand for electricity. The increasing cost competitiveness of wind and solar technology, making them less reliant on subsidies, has become the main attraction of new energy. The cost of solar photovoltaic power halved between 2010 and the end of 2014, while the cost of onshore wind power is now competitive with electricity from fossil fuels, according to a report from the International Renewable Energy Agency. Further supporting the growth of renewables are the government-led renewable power targets set by various countries to address climate change (i.e. Clean Power Plan in the US and the EU's 2030 Energy Strategy).

The increased demand from corporate power users for renewable energy and replacing their ageing power generation fleet or adding capacity to existing plants are all drivers for the growth of renewable energy infrastructure. Based on the fundamental change under way in the global energy industry, we believe the renewables sector will continue to develop and investors will keep improving their ability to gauge risk and reward across the spectrum.

Do you believe the increased interest in emerging markets is a result of the high prices of assets in developed markets?
The developed markets continue to attract strong interest from investors globally, leading to a significant rise in valuations and a related investment return compression. We have seen returns decline by almost 5% on average across key infrastructure segments in the past five years as asset prices were bid up. This is backed by relatively benign economic and political conditions in these markets, while a prolonged period of low interest rates is forcing investors to consider alternatives – i.e. emerging markets.

The majority of investors understand that the investment gap presented by emerging markets is too big to fill in the near term. However, the perceived risks associated with investing in emerging markets are still high. The biggest issue is the 'trust' factor, where investors' perception over whether the rule of law holds in the same way it does in developed markets (i.e. governments making unilateral changes to contract terms). This is, however, making good progress. As the trust factor improves, this will reduce the perceived risk of the asset. Investors with a slightly larger portfolio of infrastructure funds/assets are now putting money to work in the new markets through both funds, as demonstrated by some successful fundraises during the past one or two years, and in direct investing.

Over recent years, capital has been increasingly concentrated among a small number of large funds. What can smaller managers do to attract investor interest?
Large sovereign wealth funds and GPs with large fund sizes are muscling into the big-ticket core infrastructure space. The heightened competition for large and trophy assets is probably helping to broaden the thinking of investors in order to avoid the influx of competition. Investors continue to share concerns over rising valuations of assets and the limited availability of attractive investment opportunities, which potentially impact on the deployment rate and returns.

One way to navigate the increased competition is to select an experienced mid-market manager. The perception is that mid-market transactions can be a bit more sophisticated but with the potential of awarding investors with an additional 200-300 basis points in return. The 'sophisticated' part is that oftentimes a GP needs to have the ability to support the management in seeking to improve the business and to put in place an efficient long-term capital structure etc. Moreover, mid-market transactions are typically sourced through existing relationships, enabling acquirers to compete on factors other than price.

To successfully raise capital, fund managers will need to be able to effectively communicate how they can find and create value in the current market in order to successfully secure investor commitments.

Are you seeing investors pay greater attention to ESG considerations?
Responsible investment is rapidly becoming a mainstream concern within the infrastructure sector. The significant growth in the number of investors that have adopted the Principles for Responsible Investment (PRI) is only the latest indicator of the increase in the prominence and consideration of environmental, social and governance (ESG) factors within investment management. ESG data and policy spans a range of issues, including measures of company carbon emissions, labour and human rights policies, and corporate governance structures. Policy makers, asset owners and the public at large are focused on ESG factors as a means to promote sustainable business practices and products. Many studies try to identify the potential links associated with company operational strength, efficiency and the management of long-term financial risks.

ESG is a relatively new area, though, that is still finding its way. It is clear that LPs and GPs are looking at how to achieve their responsible investment objectives, and that their expectations and approaches are yet to align. From our engagement with LPs, it is quite clear that ESG plays a significant role in their investment decisions. We have seen LPs decline to participate in a fund, withdraw from an investment or withhold capital on ESG grounds. We anticipate ESG will gain further importance in the foreseeable future. For GPs then, it is critical to get this right to satisfy the growing expectations of LPs.

There is obviously a gap that needs to be bridged. Stakeholders and market participants should focus on establishing a framework that enables them to develop ESG standards and best-practice guidelines.

What are your predictions for the infrastructure market in 2017?
We see 2017 as a year of growing momentum for the infrastructure sector:

Increased interest in infrastructure from institutional investors: increased flows are being driven by the institutional investors eager to put capital to work. Institutional investors, such as insurance companies and pension funds, have shown increased interest in infrastructure as the prolonged low interest rate environment and large and growing long-term liabilities encourage them to seek alternative sources of returns. Infrastructure continues to play a key role in reaching these objectives.

Increasing demand for emerging markets: it is clear that the center of gravity in the infrastructure market is shifting towards the emerging markets, especially Asia. For example, China is showing signs of opening the domestic market to international investors and published a pipeline of 2,000 PPP projects.

Favourable government initiatives to support infrastructure investments: governments and supranational bodies around the world are promoting infrastructure investment in an effort to foster long-term growth and jobs. This has resulted in a proliferation of initiatives and legislation calling for greater funding of infrastructure projects. For example, China's 'One Belt, One Road' project and the Asian Infrastructure Investment Bank (AIIB) are initiatives to improve prospects for economic growth in the region.

With ultra-low bond yields and shares constrained, and the likelihood that we will see continued higher-than-normal volatility in equity markets, infrastructure, particularly unlisted infrastructure, is likely to play an increasingly important role in investors' portfolios.

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