InstarAGF Asset Management

Building North America's cities through midmarket investments

Gregory Smith is president and CEO of InstarAGF, where he brings more than 20 years of experience in the investment, operation, acquisition and financing of private equity investments, including public and private infrastructure, real estate, power and utility businesses. Gregory was previously managing partner and head of Brookfield Financial's Global Infrastructure Advisory Group. He also previously served as the president of Macquarie Capital Funds Canada Ltd., where he was responsible for the establishment, growth and operations of Macquarie's unlisted and listed funds business in Canada along with the active management of Macquarie's Canadian assets owned by offshore funds.

Recently, **Salika Khizer**, managing director of infrastructure at Institutional Real Estate, Inc., spoke with **Gregory Smith** of InstarAGF. The following is an excerpt of that conversation.

You have been involved with the infrastructure world for quite some time. Where are we now in its evolution?

You're right — I've been working with infrastructure for the past two decades. During that time, infrastructure has gone from individual, one-off acquisitions to a fully formed asset class. It is now not only sought after by institutional investors, but on the front page of the paper almost daily. This maturing of the asset class is providing a myriad of opportunities for investors.

Are there some opportunities that are better than others?

While the right investment for any particular investor will depend on their risk/return profile, we believe midmarket assets are the most compelling. The assets in this segment tend to range from $100 million to $1 billion, and there is much less competition for them than for the mega-assets everyone hears about. Although there is a lot of capital chasing mega projects, the need for infrastructure is greatest at the local level — where midmarket assets tend to be concentrated. Municipalities are responsible for about 70 percent to 80 percent of infrastructure activity, but collect 10 cents or less of every tax dollar. So there is a lot of need for infrastructure at that level, but there is less capital and competition. Investors have been realizing an additional 100 to 150 basis points on these midmarket investments compared to the larger-scale transactions. You're able to create alpha by focusing on a segment of the market that's not well represented, but where there is a definite need. Because of that advantage, this segment is where InstarAGF has decided to focus.

Why is there less competition for assets in this segment?

The infrastructure asset class has been dominated by mega-funds and very large institutions that have a huge amount of capital to allocate to infrastructure. Their investments need to go out in large bites — $300 million or $500 million or more. Midmarket assets are simply too small for the amount of capital they need to deploy.

Will opportunities continue to grow in the midmarket?

We are confident that they will. Although about 80 percent of the North American population already lives in cities, urbanization is expected to remain a defining trend for the 21st century. Continued urbanization will drive midmarket infrastructure to meet rapidly growing and shifting municipal needs.

What specifically are some of the midmarket opportunities in North America?

Everyone knows that energy is an active infrastructure sector in North America, but there is also a lot of activity around civil assets — roads, bridges and connectivity. Specifically, there is significant interest in light rail transit and urban mobility with an increasing focus on airports. In addition, local scalable solutions are being introduced for water and energy distribution. We are starting to see technology in areas such as energy storage, which has become a nice investment complement to the traditional power plant. One of the most interesting trends is on the social infrastructure side, where we are seeing a lot of new universities, schools, hospitals and municipal buildings being built, as well as old ones being refurbished or repurposed. As you can see, despite the perception that infrastructure investment is struggling in North America, there is a lot of activity.

What else are you seeing?

Energy localization is certainly one of the major trends. In the 1990s, we were doing gas-powered facilities that combined heat and power generation. Then there was a big wave of wind projects, and now there is the big wave of solar projects. I think the next big trend around energy is going to be district energy and micro-grids, where you generate and deliver power on a localized basis. We are seeing this trend really emerging in municipalities and on higher-education and health-care campuses across North America. People are looking to future proof our infrastructure, so they look at more sustainable and technologically advanced systems, which are easier to implement on a district basis.

Is infrastructure a growth investment, as well as an income investment?

It is when you look at it from a portfolio construction standpoint. Infrastructure is still one of the additions to a portfolio that can increase returns and reduce the per unit measure of

risk. It is obviously outperforming fixed income in terms of yield and total return, and has lower volatility than private or public equity. It fits nicely into a multi-asset portfolio, especially when you've got long-dated assets and obligations. Infrastructure also provides an inflation hedge, so if you think we are entering an area of increasing interest rates, it is helpful in mitigating some of that risk. The problem most investors are having right now isn't where infrastructure fits in their portfolio, it's how to find well-priced assets. The class has become very competitive.

Is there a way to increase the amount of available infrastructure?

Our cities are growing — making them more sustainable and livable will be key to the growth of infrastructure. You can look at ground-up development, like transit-oriented development with smarter designs, or you can make existing infrastructure better. You can repurpose existing buildings and use them in much better ways, which is a great area of value creation. Repurposing and renovating existing infrastructure drives innovation and, at the same time, improves social conditions, reduces inequality and creates what we always say is a distinctive sense of place. Taking advantage of the infrastructure needs of a growing city has a unique kind of social benefit as well as economic benefit for the city.

What types of economic benefits does infrastructure have?

Investing in infrastructure, particularly in urban areas, improves productivity. A dollar invested in infrastructure has an economic multiplier effect of about 1.7 times in North America. One of the major worldwide trends is urbanization. This is being played out in the U.S. by the densification of cities. From an investment standpoint, this trend is driving a whole host of changes in the types of infrastructure that we build. We begin to look at transit-oriented development, which leads to urban mobility centers. We look at distributed water treatment plants, local distribution companies, district energy centers and micro-grids. When you add technology, sustainability and data analytics, it changes the way we look at infrastructure investment and the potential it can have for our investors as well as the communities in which we invest.

What are some of the challenges to building new infrastructure, as well as renovating existing assets?

We need to future proof our infrastructure. What we build today needs to withstand climate-change events and be adaptive to future technologies over a number of decades. We are not just talking a few years. Infrastructure lasts for decades. Research indicates that the global demand for new infrastructure amounts to more than $90 trillion, which is almost double the estimated $50 trillion dollars of the world's existing stock. We effectively need to rebuild our infrastructure around the world over the next two decades, a huge challenge that is really mounted at the local level.

There is so much interest from investors to invest in infrastructure, and there is so much need in the U.S., why aren't the two finding each other?

It has to do with processes. You need agencies that are able to bring projects to market in a predictable and transparent way. When we look at public policy, whether it is at the state or federal level, you need to have the agencies, policies and programs that bring projects to market working together in an efficient, productive way. We simply aren't quite there yet. Investing in infrastructure can be much more complex than other investments because of the various stakeholders and the need to collaborate with them all.

Who are these stakeholders, and how do you approach the needed collaboration?

We have learned that building quality infrastructure is fundamentally about empowering people and setting the stage for communities to grow and prosper. I remember back when I was starting to engage in infrastructure, somebody said, "We love infrastructure because it is big physical assets, and we don't have to deal with people." In reality, the opposite is true — infrastructure is all about people. Building community support leads to public support. That public support leads to government support. Only then do you get proper regulation and policies that drive optimal outcomes for communities as well as investors. Allowing citizens to have their say in the planning and designing of infrastructure lowers the risk of infrastructure projects and is vital to their overall success. Infrastructure requires transparent communication between the government, the private sector and the citizens that are actually using that infrastructure. Our commitment to stakeholder engagement is a key differentiator for InstarAGF.

What else differentiates InstarAGF?

Our focus on the middle market. We have a team of professionals with over 100 years of combined infrastructure investing experience that is now focused on working with cities and communities to build their critical infrastructure. We are investing in things like distributed generation, airports and urban mobility centers. We are investing in those district energy centers and micro-grids that are so important to higher-education and health-care campuses, and municipalities. Our goal is to invest in areas that are emerging, and that are actually helping to build communities.

CORPORATE OVERVIEW

InstarAGF is building a North American investment platform focused on infrastructure, real assets and private-equity investments in the middle market. Our team's significant depth of sector and investment expertise, relationships and global reach empower InstarAGF to help investors meet their investment goals.

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