Broadening the infrastructure investment framework

GREGORY SMITH OF INSTARAGF LOOKS AT HOW INNOVATION IN PARTNERSHIPS CREATES A COMPELLING VALUE PROPOSITION FOR INSTITUTIONAL INVESTORS

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Developing and modernising our communities' essential infrastructure buildings and services for the 21st century is a critical economic and social imperative. Every 1% increase in infrastructure spending in North America is estimated to have a multiplier effect of up to 1.7 times, increasing our productive capacity, creating jobs and enabling new economic opportunities.

While infrastructure investment strengthens a community's and nation's economic prospects, it also offers an attractive value proposition to investors: infrastructure has been shown to be resilient to economic cycles and to have lower correlations with traditional asset classes.

In particular, the North American landscape features relative economic stability, business efficiency and predictable regulatory and legal frameworks, combining growth potential with high levels of investment and a lower risk environment. These characteristics all work to drive increasing investor interest in infrastructure opportunities in Canada and the United States. According to Preqin, 60% of institutional investors globally favour the region for infrastructure investment in the coming year. Further, the North American market has experienced a robust and growing deal flow in the last few years across infrastructure categories, including the energy, utilities and transportation sectors, which account for 87% of infrastructure deals completed since 2009.

The need for infrastructure investment in Canada and the US is significant after years of declining or stagnant government funding. While the Canadian and US governments have tabled new infrastructure spending programmes and legislation in recent years, the infrastructure deficit for public buildings, roads, bridges, sewers, electrical grids, and water purification plants remains massive: up to $570 billion in Canada and into the trillions in the United States. Given the age and condition of

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much of the continent's critical infrastructure and strained and limited sources of traditional financing, our collective approach to infrastructure can no longer be "business as usual".

Partnering for innovation

With North American communities experiencing the myriad challenges – and opportunities – of urbanisation, technology shifts and climate change, governments increasingly recognise the need to bring innovation to infrastructure financing, development and delivery, and the value of attracting greater levels of private sector capital and expertise in this pursuit. An example is the Canada Infrastructure Bank (CIB), which presents a unique opportunity to approach infrastructure renewal more strategically. Proposed by the federal government in 2016 and expected to commence operations by the end of 2017, the bank is an important step towards enabling greater private sector investment in local infrastructure. With its focus on economic infrastructure and openness to exploring innovative approaches for financing and development, the CIB is intended to create a pipeline of larger, economically viable projects accompanied by clear procurement processes, offering new partnership possibilities for investors and communities alike.

For years, a number of local infrastructure fund managers and institutional investors have stepped up to supply capital to mid-sized domestic projects and assets, including partnering with municipalities, which are responsible for 60% of public infrastructure assets. Initiatives such as the CIB will help to deepen and extend such relationships, focusing private capital and operational expertise towards strategic national infrastructure projects and setting out a clear procurement process to match the supply of capital to demand for infrastructure. By bringing innovation to infrastructure partnerships, the CIB should help to further enhance the reliability of Canada's investment environment for institutional investors.

Partnering effectively for the future

In my view, governments, municipalities, universities, schools and hospitals (together, the "MUSH" sector) have a real opportunity to more effectively tap the growing, global pool of institutional capital seeking infrastructure investments. By partnering with the private sector, MUSH institutions can build higher quality infrastructure more efficiently and at a substantially lower cost – or no cost at all, in some cases – to taxpayers.

Using a Canadian example, Billy Bishop Toronto City Airport, located on an island just south of Toronto's downtown core and owned and operated by PortsToronto, is a unique collaboration between federal and municipal levels of government and the private sector. Billy Bishop Airport is a critical transportation hub for Toronto, hosting 2.7 million passengers in 2016 and delivering more than $2 billion in economic output to Toronto and the surrounding region. It is also a great example of how infrastructure, innovation and public-private cooperation work in tandem.

The airport's terminal building is owned and operated by Nieuport Aviation Infrastructure Partners, a consortium of local and international private investors with deep aviation infrastructure expertise, under a long-term lease with PortsToronto. In addition, in 2015 PortsToronto successfully completed a pedestrian tunnel underneath Lake Ontario, the first public-private partnership (P3) in Canada to be procured without a government guarantee. In both partnership models, the private sector bears responsibility for operating and maintaining this critical infrastructure according to stringent requirements, thereby preserving the value of the asset and enabling its significant community and economic contribution.

Overall, projects delivered through public-private partnerships consistently outperform traditional models of financing, reduce the risks of infrastructure delivery, and amplify the economic benefits generated by infrastructure investments. In Canada, over a 10-year period, P3s have generated $92.1 billion in total economic output and more than 500,000 full-time equivalent jobs, and saved taxpayers a total of nearly $10 billion in costs, according to the Canadian Council for Public-Private Partnerships. These statistics, and the success of infrastructure assets such as Billy Bishop Airport, clearly demonstrate how innovative partnerships can – and must – play a role in addressing our trillion dollar infrastructure deficit and accelerating infrastructure renewal.

As critical regional infrastructure, Billy Bishop Airport also points to an emerging trend: the “localisation” of infrastructure towards community-centred projects based on partnerships and alignment of interests between investors and stakeholders. A number of interesting infrastructure investment opportunities in Canada are arising from urbanisation, technological change and sustainability imperatives, including community demand for more local solutions in many infrastructure subsectors: district energy systems and scalable water facilities instead of large utilities; renewable energy and energy storage; urban light rail transit; and retrofit and refurbishment projects. Overall, there is an increasing emphasis on "future-proofing" our critical infrastructure and bringing innovation to the table.

Partnering for value growth

Appetite for the infrastructure asset class is increasing as investors seek real alternatives that are more resilient to economic cycles and have a lower correlation with other asset classes, including private equity. Infrastructure investments also typically provide some inflation protection, making them a good match for long-dated liabilities, and deliver current yield. In addition, the infrastructure asset class has generally demonstrated a stable return profile throughout the economic cycle, and adding infrastructure to a portfolio typically delivers diversification benefits and improves return per unit of risk. Globally, equity assets under management for unlisted infrastructure managers reached USD $373 billion in 2016, a 15% compound annual growth rate (CAGR) over the past five years. Infrastructure meets many institutional investor needs, and more than half of investors polled by Preqin are planning to increase their allocation to this asset class over the long term.

As a result, there is more than enough capital available from private investors to fund the staggering cost of upgrading our infrastructure, with unlisted infrastructure funds holding $137 billion of dry powder in 2016. Rather, the challenge lies in better matching private capital to infrastructure investment need, and in recognising the vital role of community partnerships in bringing infrastructure projects to successful fruition.

Embracing new partnerships and approaches to delivering quality infrastructure offers a compelling value proposition for institutional investors. Innovation in infrastructure financing and delivery also positions investors to have a direct impact and role in creating more vibrant and sustainable communities, which leads to reduced income inequality and greater opportunities for all. As Thomas Edison said, *there’s a way to do it better – find it.*