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Momentum continues to build for infrastructure

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During the past 15 years, infrastructure as an asset class has become increasingly accessible to retail investors. Traditionally the domain of institutional investors, innovative providers have packaged infrastructure assets into a variety of vehicles that retail investors can access, including specialist renewable energy funds, large listed investment trusts and funds of funds.

Against a protracted backdrop of low interest rates and the corresponding low bond rates, the yields generated by infrastructure assets have become increasingly attractive.

The nature of many infrastructure projects means that they typically carry stable and predictable demand, high barriers to entry and long-term, often government-backed, contracted revenue streams.

This lack of correlation with the capital markets can make investments in the sector especially resilient to volatility in the wider market. In addition, because a significant proportion of the underlying revenue streams can be linked to inflation, this provides added protection against interest rate rises.

A recent study conducted by Foresight Group found that protection against inflation and long-term positive stable cashflows were ranked as the most important factors for advisers considering infrastructure investment, followed by attractive yield and low correlation to traditional assets such as equities and bonds.

Compelling picture

The future for the sector looks bright. As volatility returns to global markets and interest rate rises begin to kick in, investors are finding the predictable revenue streams and stable returns particularly compelling.

Furthermore, the global and UK energy market is undergoing a once-in-a-lifetime up-

Wheels of industry: infrastructure investment is rising

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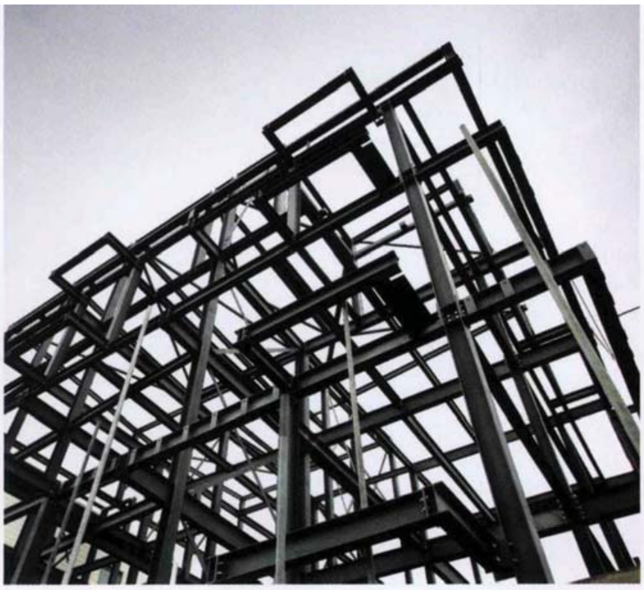

heaval, presenting new opportunities across generation and flexible grid infrastructure such as energy storage, transmission and distribution.

As a result, infrastructure investment among retail investor: is predicted to continue growing, with our research finding that advisers expect average cli-

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ent allocations to infrastructure to reach 7% by 2023.

Fake news

However, not all listed infrastructure opportunities are created equal. Critics claim, and we would agree, that some listed infrastructure offerings have under-delivered on their promises, often having been inappropriately badged as infrastructure in the first place.

These quasi-infrastructure assets, a recent cautionary example being Carillion, offer similar risk/reward characteristics to traditional equities and while they may operate within the infrastructure sector, they do not have access to the underlying project cashflows.

As a result, they potentially undermine the overall credibility of the sector. Indeed, our research revealed 58% of advisers believe the rise of the phenomenon has the potential to put investors off infrastructure funds that provide genuine exposure to a diverse mix of cash-generative projects.

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It is our view that debating the issue should be welcomed because it can only help guide investors and their financial advisers more clearly as to what to avoid in the sector.

Three questions

Now is an exciting time to be investing in infrastructure. The energy markets are undergoing rapid transformational change and this, combined with favourable macroeconomic fundamentals, presents compelling opportunities for investors.

However, advisers have a key role to play to ensure their clients avoid the dangers of quasi-infrastructure. To pick a quality infrastructure fund, it's helpful to ask three key questions.

First, to what extent are the underlying cashflows guaranteed? This addresses how resilient an investment will be in case of a downturn or change in demand. The most resilient projects will have long-term contracted cashflows, eg government purchase of energy, delivering a guaranteed income stream for investors.

Second, are cashflows inflation protected? As developed nations begin to unwind their quantitative easing programmes, investment income will come under pressure from rising interest rates. Quality infrastructure investments are those where cashflows are at least partially tied to inflation, ensuring value will be better mitigated compared with other asset classes.

Third, are the cashflows long term? Attractive infrastructure investments focus on sectors with high barriers to entry and long-term stable demand such as energy or utilities.

Asking these three questions will ensure advisers can guide their clients towards quality infrastructure investments that achieve the portfolio diversification, reduced volatility and inflation protection that they are hoping for.

As such, we believe that the challenge of quasi-infrastructure is surmountable and rather than undermining the sector, it will lead to a flight to quality. **LW**

IN NUMBERS

£1BN

Amount Network Rail has been told to spend on UK's railways

£148M

Cost of Carillion collapse to UK taxpayer

£8M

Amount offered by Innovate UK to 13 businesses developing solutions for UK urban infrastructure

Source: FT/NAO/Innovate UK