Roundtable

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Backing the future

Amid uncertainty in many other markets around the world, Australia's infrastructure pipeline remains strong, despite the end approaching for big-ticket privatisations, a group of industry experts tell **Daniel Kemp**

Our roundtable discusses why the country remains attractive for investors and what the future is likely to hold.

The Australian infrastructure market sits in an interesting place in 2018.

On the one hand, the recent spate of high-profile, big-ticket privatisations seems to be coming to an end, with the A$16.8 billion ($12.78 billion; €10.87 billion) WestConnex road project in Sydney (the largest of its type in the country) and Victoria's land registry the only assets currently on the slate that fit that definition. All assets of this type have either been privatised already or are in states where there is little political will to do so.

But on the other hand, this slowing down has not dampened enthusiasm among investors. While there is a recognition that the pace of activity in brownfield investments cannot remain the same as in recent years, most are still reasonably optimistic about the prospects for Australia's infrastructure.

"There's clearly a slowdown in the number of privatisations to come, at least of the core assets that are on the government's

balance sheet," says Marko Kremer, managing director of DIF, which closed its largest-ever fund on €1.9 billion in May, with plans to make investments in Australia.

"They'll now go to the second order of infra-like assets, like what we're seeing now in terms of registry businesses, and there is also talk of the visa application business being privatised."

POSITIVE PIPELINE

The move towards assets that have not traditionally been classed as infrastructure – such as land registries, crematoriums and lotteries – is not a new trend in Australia but is one that investors do not expect to stop any time soon.

Prior to last year's Australia infrastructure roundtable, New South Wales had finished leasing its land registry for A$2.6 billion to a consortium consisting of Hastings Funds Management and First State Super. South Australia then followed a month after our discussion, reaping A$1.6 billion from a consortium of Macquarie Infrastructure and Real Assets and the Public Sector Pension Investment Board.

Victoria is now set to follow suit this year, with numerous superfunds and GPs rumoured to be interested, with Western Australia exploring the possibility of following suit.

"While the conversation we have with most LPs is that they're not very likely to bid for land registry assets, it's an evolving debate and that may change," Kremer says. "Investors are getting more comfortable that these essential services are part of the infrastructure asset class. You have some who are pioneering the landscape right now, and I think the infrastructure community will probably follow them in the end."

Each LP views these kinds of assets differently, with some possessing more appetite to take them on than others.

"Cbus's infrastructure asset class exposure includes a core and core-plus allocation. Opportunities are assessed according to their underlying characteristics and fit within the parameters of these allocations," says Diana Callebaut, head of infrastructure at Cbus.

"Among other characteristics, our current view is that core infrastructure is a physical asset. Therefore, opportunities such as land registry businesses would not fit within our core definition but may – depending on the characteristics of the opportunity – fit within our core-plus allocation."

Without needing to think outside the box, though, investment opportunities in Australia still look promising.

David Stegehuis, investment director for infrastructure at IFM Investors, says the need to upgrade existing assets will lead to investment. "Within our portfolio, we have about A$11 billion of investments to either extend or add to existing assets, such as new runways, or the new cruise terminal at Port of Brisbane, for example. We're seeing increased patronage and increased demand for the services our assets provide, and that will provide a lot of investment flow into the sector," he says.

The increasing imperative for sustainable investment could create further investment flow, too, with the need for capital to

AROUND THE TABLE

Diana Callebaut, head of infrastructure, Cbus
Callebaut is head of infrastructure at Cbus, where she is responsible for developing and implementing the superfund's infrastructure investment strategy. She joined the organisation in February 2016 and was previously a director in KPMG's corporate finance division. Prior to that she held roles at Credit Suisse Investment Banking in London where she gained global PPP/greenfield and secondary market infrastructure transaction and advisory experience.
Callebaut is also on the supervisory committee of the Women's Infrastructure Network in Australia.

Robin Dutta, head of infrastructure & PPP, institutional, ANZ
Dutta runs the infrastructure and PPP team within the project finance division of ANZ, including a recent focus on transport and social infrastructure PPPs, and on the transition to a low-carbon economy. Dutta joined ANZ in 2009 and was previously head of loan syndications. Prior to this, he was a director at Citibank.

Marko Kremer, managing director, DIF
Kremer is a managing director of DIF and head of DIF's operations in Australia. He joined DIF in 2008 and since 2015 has headed the Australian office where he is responsible for the origination and execution of infrastructure and renewable transactions. Prior to joining DIF he was an executive director in the leveraged finance team at ABN AMRO, and spent five years at ING Wholesale Banking.

David Stegehuis, investment director, infrastructure, IFM Investors
Stegehuis joined IFM Investors in 2014, and in his role as investment director, infrastructure, he supports the origination, analysis, structure and execution of infrastructure investments, along with ongoing asset monitoring and management. His other recent roles before joining IFM include director of project finance at the Clean Energy Finance Corporation, associate director commercial and strategy at Acciona Energy, and general manager and M&A lead at Infigen Energy.

make assets greener. "We're also thinking about the Scope 3 emissions our assets are linked to," Stegehuis says. "For example, an airport has its own emissions through its buildings and construction activities, but [we also need to consider] the emissions of visiting aircraft. The design and operation of the airport can help the partners operating those aircraft, or other parts of the supply chain, reduce their emissions."

In addition, the upcoming WestConnex deal highlights a slightly different type of privatisation, where the government has built up the asset themselves with a view to selling it off midway through construction, or shortly before it becomes fully operational.

"I think we'll see the same on the North East Link project in Victoria – it's being developed to eventually be privatised. The same probably will happen with Western Sydney Airport once that's built," Kremer says.

All of this means the infrastructure pipeline in Australia is evolving quite predictably, once you take the political situations in states other than NSW and Victoria into account, argues Robin Dutta, head of PPP and infrastructure, institutional, at ANZ. "The theme is not so much privatisation of existing assets, but rather adding new capacity in all forms of infrastructure. Hence, we're expecting a marked shift from brownfields to greenfields," he says.

An interesting development within this context has been the move by some Australian superfunds to pursue direct infrastructure investment strategies, with Callebaut's Cbus among them. She says this decision, coupled with maintaining Cbus's existing commitments with GPs (as well as keeping the door open for new relationships) in what she calls a "hybrid infrastructure investment strategy", was designed to provide the fund with more options.

"This enables us to enhance our ability to drive portfolio construction and provides greater flexibility to access opportunities and manage investments. We intend to continue leveraging our GPs for large transactions and focus our direct opportunity pursuits on complementary opportunities where we partner with like-minded investors and/or strategic partners – this includes GPs."

Where do those GPs fit into this strategy, then, and is their role more broadly likely to change? "GPs will continue to have a role in our strategy to the extent there is an ongoing mutually beneficial partnership," she says. "Like any relationship, this will continue to evolve as circumstances and the market evolve."

Kremer echoes this from the GP side, saying that both models sit "perfectly" alongside each other.

"The larger funds who prefer to do direct investments may still allocate pools to GPs, for example in specific niches where they prefer to have exposure and where deals are too small for them to target themselves.

"Direct investment will also not be the preferred route for every superfund given the required size of teams, deal experience, relationships and the need for efficient decision processes. I think the models sit well together and have done for some time in Europe and North America."

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ENERGY UNCERTAINTY

One sector that continues to be hotly debated in Australia is energy generation and transmission. The federal government is currently in the process of developing a new policy called the National Energy Guarantee, which promises to guarantee a certain level of reliability while reducing costs for customers, with targets for lower emissions thrown in for good measure.

"There's a lot of detail to come so we don't actually know what the policy is yet," Stegehuis says. "But it does seem as though it will further entrench the role of the big, integrated utilities and make them the natural investment vehicle into the sector. It's going to make private investment from an independent investor even harder."

There's also concern that the emissions target has been set too low, at a level that won't encourage significant investment in renewables projects in and of itself.

"I don't think it'll push a lot of renewable energy into the system," Kremer says. "The generation mix is at the level already [proposed for the NEG], so unless we get maybe a Labor government who will sharpen the pencil in relation to that target, it won't lead to a major push for renewable energy. Renewable energy will come from its own merits because it's more economical to develop it [than fossil-fuel generation]."

So, is it frustrating that the NEG is in danger of missing the mark when it comes to renewables?

"It's more the uncertainty as there remain important details of the NEG which still need to be formulated or finalised," Dutta says. "Overlay the fact that certain states are procuring incremental renewable capacity independently and look at the role of corporates themselves underwriting PPAs, though this is at a far earlier stage, then the impact of these trends will outweigh the policy uncertainty."

How those individual state projects will link up with the NEG is up for debate, but there is a feeling the federal government has recognised the momentum that has already built up among the individual states.

"There are some questions about how those state schemes will integrate with the NEG, and that's one of the unknowns," Stegehuis says. "But at least the architecture will be there, it'll probably be good enough, and then it should be open to the government of the day to adjust the dial [on emissions reduction targets] according to their philosophy and circumstances."

The fact that the thresholds will not be set in stone is good in one sense, because these can be tightened by future governments, but could lead to short-term volatility if investors are less certain about future market conditions. Kremer says: "There will be ongoing uncertainty because the thresholds may be revised in the future, which may drive different behaviour in terms of renewables."

Above all, the shared feeling among our participants of is that something had to be done, so even an imperfect policy is better than no policy.

"It's all relative – it's an improvement from where we were," Callebaut says. "But is there more to be done? Certainly."

TRANSPORT CAPACITY CHALLENGE

Another area with plenty of work to do is transport, with Australia's capital cities are all suffering under capacity constraints, particularly Sydney and Melbourne.

"The outlook for transport is positive," Dutta says. "We're addressing capacity constraints that have accumulated over a long period of time, and the challenge is less around the transaction volumes than the timing."

The capacity of the contracting market to deliver the large pipeline of transport projects was of concern to all our participants, with Western Sydney Airport, Melbourne Airport Rail Link, North East Link in Melbourne and Inland Rail all in various stages of development, alongside the mega-projects of Sydney Metro, Melbourne Metro, WestConnex, Sydney Light Rail, and many more which are already under way.

"We always like to see more projects coming to market from government more quickly, but to be honest, what needs particularly careful consideration is the contracting strategy around them and how they are going to be brought to market in the next 18 months," Dutta says. "If there's a bottleneck, it's not availability of capital per se, as there's a lot of money around the world chasing infrastructure investment opportunities, but the resourcing to attend to all concurrently is front of mind for us."

Callebaut agrees: "With such a strong pipeline of projects a critical constraint is contractor capability and capacity to consistently perform on all facets of project delivery."

It's striking that so many of these projects now appear to be coming to fruition all at once, many of which have been years and years in the planning. Is it capacity constraints, coupled with a strong fiscal environment, forcing the hands of state governments? Or are there other factors at play?

"One thing I'd observe is that there seems to be quite a lot of rail activity both under way already and in the pipeline, relative to roads [and] compared with the relative balance between the two in the past," Dutta says. "Rail is seen as a necessary solution, as you're not going to solve future transportation needs solely with more road capacity – although there is a material volume of road projects on the way as well. It's about finding a balance between both, although that in itself doesn't explains the current volume of projects."

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>
> Callebaut

EXTERNAL RISKS

Resourcing is not the only risk facing Australian investors, though.

Cyber-attacks are of increasing concern, both in terms of protecting existing assets and when considering how to deploy capital into new assets.

"We're getting advice that says the risk of cyber-attacks on our assets – whether targeted directly or not targeted but still affecting the asset inadvertently – is increasing, from both foreign states and pirates. There is a need for all investors, whether domestic or foreign, to think more about their cyber security in terms of IT, people, and physical controls," Stegehuis says.

The offensive capabilities of cyber attackers are often running ahead of the

defensive capabilities of organisations, he adds. "We need better co-ordination between industry peers, but also with governments."

On the other hand, the potential rise in interest rates did not unduly concern our participants.

"If interest rates rise, LPs won't necessarily move suddenly to the bond market. Infrastructure is becoming a well-defined and well-respected asset class. A lot of funds want to have exposure to infrastructure, so I don't think interest rates will play a big role there," Kremer says.

Callebaut echoes this, arguing that LPs like Cbus are "long-term, patient investors", in it for the long haul. "We look through the cycle to evaluate the impact of interest rate movements. In terms of the short- to medium-term outlook we expect valuation compression on our current investments and potentially some relief from the recent pricing competition on traded assets."

The low-interest-rate environment, though, has led to greater refinancing activity, Dutta points out.

"It's triggering a lot of refinancing activity in the underlying businesses and concessions that investors have interests in."

The prospect of those rates rising also does not concern Dutta, due to the amount of undeployed capital that remains out there.

"There's that much uninvested capital looking to deploy and, as discussed, we've got such a healthy pipeline of projects in Australia and globally, that I think it probably mitigates what otherwise would be concerns about what impact that might have on the forward calendar of deals."

FAST-CHANGING MARKET

The outlook is positive, then, despite the hiatus in big-ticket brownfield privatisations, with dealflow set to come from non-traditional assets and upgrades to existing assets, coupled with a still-strong pipeline of greenfield transportation projects that look set to be built by government with an eye on privatisation down the track. Australia's infrastructure market is fast-moving and there are still many deals to be done – even in the context of policy uncertainty, higher interest rates and a strained contractor market.

As Stegehuis puts it, things can change quickly.

"We look five years ahead now and don't see a large pipeline of brownfield privatisations. But say, suddenly, China turns off the acceptance of recycling materials, and we have to start thinking about recycling plants here," he says, highlighting a new sector for capital to consider.

"As another example, Melbourne Airport Rail Link was, a couple of years ago, very hard to contemplate – now, it looks like a real possibility. Things can go quickly from being unlikely to becoming active transactions."

With this in mind, investors still have a lot to be positive about when it comes to Australia. As Dutta concludes: "With a pretty healthy pipeline and what are still significant amounts of uninvested capital, I don't see a real reversal of current levels of appetite and existing trends." ■

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