AMP CAPITAL

# The Case for Investing in Infrastructure

### Infrastructure assets provide vital services that support economic growth, generate productivity and underpin the operation of society. This includes assets such as roads, rail and airports, as well as social assets like schools and hospitals. It's a wide-ranging asset class comprising investments with many different risk and return profiles.

The Global Infrastructure Hub projects that global infrastructure investment needs to reach $94 trillion by 2040 to keep pace with economic and demographic changes, and to close infrastructure gaps.It also forecasts a global infrastructure investment gap of about $15 trillion by 2040[1]. For investors seeking sustainable income and capital growth over the long term, this offers a significant opportunity. This paper will discuss why investors should consider infrastructure as part of a diversified portfolio, how to gain exposure to this asset class, the benefits of a blended approach and some key risks of investing in infrastructure.

1. The Global Infrastructure Hub's Global Infrastructure Outlook 2018.

Image: Mark Oliphant College, Adelaide

## The world's increasing hunger for infrastructure funded by private capital

Portfolio allocations to infrastructure have grown significantly in recent years and this trend is expected to continue. The infrastructure opportunity is being driven by themes such as:

- global population growth
- urbanization and development in emerging markets
- the need to renew or replace ageing infrastructure in developed markets

With governments across the globe burdened with high levels of debt and, at the same time, looking to infrastructure investment to re-start economies, the need for private capital to fund projects will consequently persist over the long term. This will support a broad and growing range of infrastructure investment opportunities.

# Why invest in infrastructure?

Infrastructure assets can offer investors a strongly differentiated set of characteristics. This includes:

### 1. A buffer against economic downturns

Infrastructure assets generally provide essential services, as communities must use or rely on them on a day-in and day-out basis. For some types of infrastructure assets (e.g. schools, availability-style roads etc) the revenues come directly from the government or government entities, providing a relatively high degree of security. As a result, we believe that they are often less influenced by economic factors than many other businesses, meaning they are more likely to deliver steady returns through economic cycles.

### 2. Stable, long-term income

In our view, infrastructure assets can offer long-term stable revenue streams because asset revenues are often underpinned by regulatory frameworks (for instance electricity distribution grids) or long-term contracts which may be with governments (for instance social infrastructure assets such as schools and hospitals). Infrastructure assets often have a lengthy life span, which can be 30+ years. These revenues are also often linked to inflation, helping protect investors against the erosion of the value of their investment. The more predictable nature of the income that infrastructure provides may allow investors to match their long-term liabilities to the returns provided by the infrastructure assets.

### 3. Significant barriers to entry

Infrastructure assets often benefit from significant barriers to entry. For example, they can have contractual protection from competition by government; alternatively, high costs and long lead times for construction of these assets can provide natural monopolies. This means they are typically less exposed to new competition and threats to their profitability.

### 4. Uncorrelated to traditional asset classes

Infrastructure assets can also be a source of diversification for investors. Returns are generally uncorrelated to other popular asset classes such as shares and fixed interest investments. This means they bring diversification benefits to a portfolio and can help reduce overall portfolio risk.

For these reasons, we believe that the infrastructure asset class can provide steady returns through market cycles with lower volatility, stable long-term yields, and diversification benefits. It also offers long term growth potential, as these assets typically benefit from growth in population and economic activity.

# Gaining exposure to infrastructure

There are several different ways investors can gain exposure to infrastructure as an asset class.

Each of these ways have different characteristics, and it's vital to understand what these are before making a decision to invest.

### Listed infrastructure

#### Individual listed stocks

There are a number of infrastructure companies listed on the Australian stock exchange, and on share markets around the world. Toll road operators are an example in Australia, and regulated utilities are an example in the US. In our view, it's imperative when investing in individual infrastructure stocks to do proper due diligence to ensure the management of the business has a good track record profitably managing infrastructure assets.

While many of these investments may generate good income, investors are also exposed to share market movements. Additionally, we believe that unless investors invest in a reasonable number of individual stocks around the world, investors are unlikely to achieve a well-diversified infrastructure exposure.

#### Listed infrastructure funds

Listed infrastructure funds invest in a range of different listed infrastructure stocks, often across different jurisdictions. This allows them to diversify their portfolio, and smooth out the portfolio's returns and manage its risk.

These funds are typically highly liquid because they invest in listed securities that can be quickly and easily bought and sold on major share markets. But they also expose individual investors to the ups and downs of equities markets, which is something for investors to take into account.

### Unlisted infrastructure

Traditionally only accessible by large institutional investors, unlisted infrastructure funds give individual investors the ability to get direct exposure to unlisted infrastructure assets. Unlisted infrastructure assets offer several benefits including stability of valuation (or low volatility), because unlisted assets are not subject to the market speculation and sentiment that impacts listed investments.

The trade-off is a reduction in liquidity, as unlisted infrastructure assets are typically large and have a high capital value, meaning there is a risk that investors won't quickly or easily be able to sell such an investment. So unlisted infrastructure is generally considered to be a longer-term investment in a portfolio.

## Listed vs. Unlisted infrastructure

The key differences between listed and unlisted infrastructure investments are:

**1.** How often and the way that they are priced

**2.** The way in which they are bought and sold (converted to cash), known as liquidity

**3.** The size of the individual investment required

**4.** Access to some types of infrastructure assets

| | Listed | Unlisted |
|---|---|---|
| **Pricing** | Priced every day that share markets are open and therefore subject to short term sentiment swings resulting in more price volatility than unlisted. | Independent valuations by expert valuers are conducted at regular intervals, and are based on commercial fundamentals.<br>Valuation frequency may be increased if these fundamentals change materially. |
| **Liquidity** | Bought and sold readily (and converted to cash) on public share markets – highly liquid. | Process of buying or selling assets more complex and takes longer. |
| **Investment size** | Ability to access with relatively small investment amount. | Large asset sizes typically require a significant capital investment, meaning unlisted infrastructure traditionally tends to only be accessible to institutional investors. |

## Benefits of a blended approach

For individual investors, we believe that a blend of listed and unlisted infrastructure assets can maximise the benefits of both investment approaches.

## A blended infrastructure portfolio has the potential to provide:

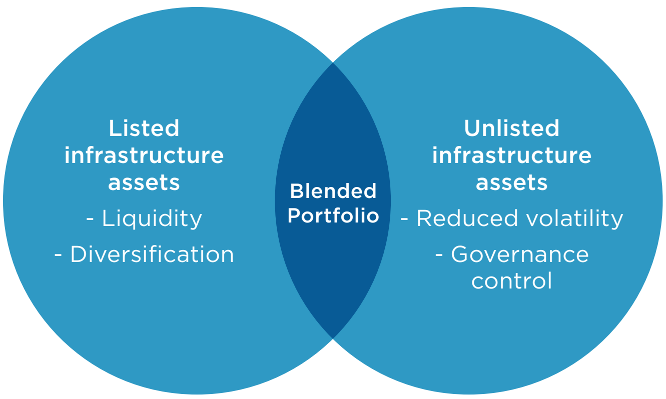
Exposure to unlisted infrastructure assets, typically only accessible to very large institutional investors, without the large capital outlay generally associated.

**1.** Governance control through methods such as representation on the board of unlisted infrastructure assets.

**2.** A lower level of volatility than purely listed infrastructure stocks.

**3.** Flexibility to diversify exposures globally and across sectors more broadly than a purely unlisted infrastructure portfolio.

**4.** A higher level of liquidity than is typically associated with unlisted infrastructure.




## Key risks of investing in infrastructure

Investments in the infrastructure sector involve risks which broadly stem from issues of geographic or market concentration, the financial instability of third-party sub-contractors, government regulation, technical failings, management capability and the economic climate including interest rate fluctuation. Liquidity risks also exist when investing in unlisted infrastructure. Assets subject to liquidity risk may be difficult to trade and it may take longer for their full value to be realised, and in circumstances where the Fund's portfolio ceases to be 'liquid' for Corporations Act purposes, there may be significant delays or a freeze on withdrawal requests. Infrastructure investments are vulnerable to adverse change in the economic conditions of the jurisdiction in which they are situated, as well as to global economic declines. Since projects in this sector tend to be of a long-term nature, projects which were conceived at a time when conditions were favourable may subsequently be adversely affected by changes in the financial markets, investor sentiment or a more general economic downturn.

## Our approach to global infrastructure investing

The AMP Capital Core Infrastructure Fund (CIF or the Fund) provides an example of a blended infrastructure portfolio. Established in 2007, CIF gives investors access to a portfolio of Australian and global listed and unlisted infrastructure assets which are diversified by asset type, sector and location. It offers strong total return (income and capital growth) potential and is expected to have a low correlation to other asset classes, such as equities and bonds.

By investing in the Fund, investors have access to infrastructure assets across the airport, power transmission, rail, telecommunications, renewables and education sectors.

To learn more about the Fund, please go to:
**www.ampcapital.com/core-infrastructure-fund**

## Contact Us

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