GLOBAL LISTED INFRASTRUCTURE ORGANISATION

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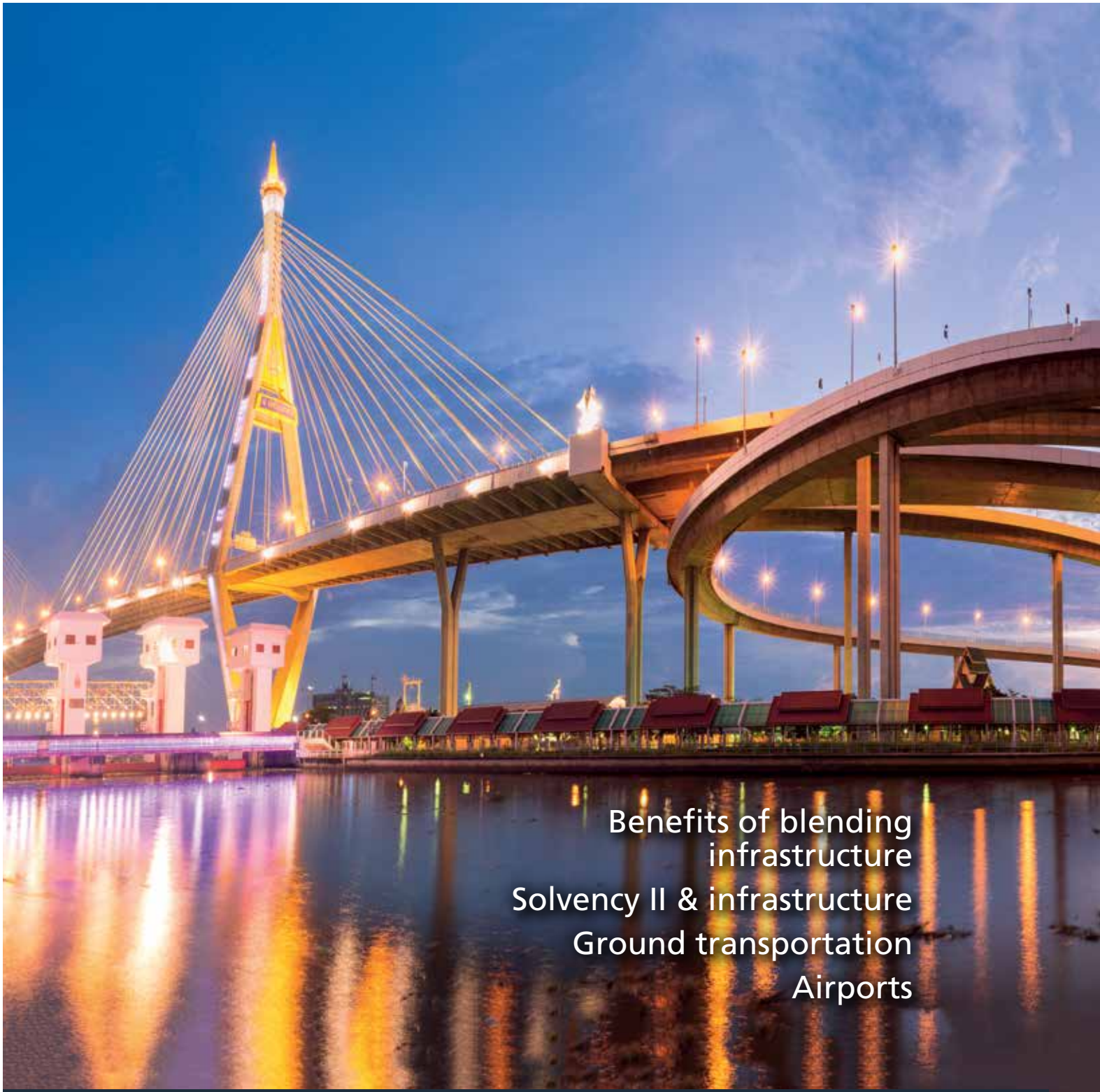


Benefits of blending infrastructure

Solvency II & infrastructure

Ground transportation

Airports

Stars aligning for the UK infrastructure investment companies

From the complex mix of investment options, their influencers and long-term economic essentials, a sure pattern is emerging in the UK infra-structure world.

The UK closed-end listed infrastructure investment company sector is still relatively new. Currently there are 11 companies with equity investments in a diverse range of private infrastructure assets, from social infrastructure like schools and hospitals, to renewable energy such as solar parks and wind farms, with a total market capitalization of just under £15bn.

The geographic spread of the assets is focused on the main developed markets across the globe (i.e. the UK, Continental Europe, North America and Australia). The closed-ended structure is more suitable for investment in such illiquid assets, as the corporate vehicle is not forced into asset sales or purchases determined by investment flows in, or out, of the vehicle as is the case with open-ended funds.

For the purposes of this article, we have calculated the market capitalization weighted performance of 11 UK listed infrastructure companies (highlighted in Table 1.) and called it the GLIO UK Infrastructure Index (GLIO UKI). At an individual stock level, Table 1. highlights the 11 individual investment companies, detailing IPO year, full market capitalization, current yield, and annualized Total Return performance over a number of investment horizons, where available. The top six companies are constituents of the FTSE Mid 250 Index.

Table 1: Size, yield and performance of UK investment companies

Company	IPO	Sector	MC $bn	Yield	1 Year	3 Yrs	5 Yrs	7.5 Yrs	10 Yrs
HICL Infrastructure	2006	Diversified	3,430	4.5%	11.3%	13.4%	13.0%	11.4%	10.4%
INPP	2006	Diversified	2,199	4.3%	13.4%	11.8%	10.5%	10.3%	9.1%
3i Infrastructure	2007	Diversified	2,426	3.9%	14.1%	17.1%	13.9%	14.0%	11.4%
JLIF	2010	Diversified	1,656	5.2%	16.8%	11.3%	10.6%		
Greencoat	2013	Renewable Energy	1,090	5.4%	18.1%	10.2%			
TRIG	2013	Renewable Energy	1,122	5.8%	11.9%	8.2%			
BBGI	2011	Diversified	754	4.4%	10.5%	10.8%	10.3%		
Foresight Solar	2013	Renewable Energy	556	5.8%	16.3%	9.2%			
Nextenergy	2014	Renewable Energy	631	5.7%	21.9%				
Bluefield Solar	2013	Renewable Energy	514	6.5%	18.1%	9.5%			
JL Environment	2014	Renewable Energy	463	5.6%	16.5%	8.4%			
Grand Total			**14,841**	**4.9%**					

Source: Reuters, as at March 31, 2017

Index Performance and Comparison

Chart 1. illustrates the ten-year performance of the GLIO UKI vs the FTSE equity indices. The GLIO UKI outperforms all the FTSE equity indices for the majority of the timescale (with the exception of the FTSE 250 for a few months in 2014). Table 2. shows that the annualized performance of the GLIO UKI looks very attractive over the 3, 5, 7.5 and 10-year annualized investment horizons, compared against the FTSE 100 and the FTSE UK Financials. (An explanation of why we use FTSE UK Financials is contained in the classification issues section later in this article.)

The GLIO UKI outperforms both indices over all investment horizons. The GLIO UKI also beats the FTSE 250 over the shorter and longer term.

The volatility of the FTSE 100 & 250 is considerably higher compared against GLIO UKI. Moreover, the FTSE UK Financials experienced volatility on average three times higher than the GLIO UKI. Combining attractive annualized total returns with low volatility provides outstanding Sharpe ratios for the GLIO UKI over all investment horizons, resulting in considerable risk/return outperformance relative to the three FTSE equity indices.

Benefits of Listed Infrastructure Investment

The low short-term interest rates prevalent since 2009 and the decline in bond yields, have meant investors have looked to higher cash-yielding sectors like real estate and infrastructure to bolster income for portfolios. Currently the GLIO UKI offers a market-cap weighted average yield of 4.9%. This compares against 3.5% for the FTSE 100, 2.7% for the FTSE 250 and 3.8% for the FTSE UK Financials.

"Combining attractive annualized total returns with low volatility provides outstanding Sharpe ratios for the GLIO UK, over all investment horizons"

In terms of diversification of assets, these 11 companies have stakes in almost 500 different underlying assets, across a variety of sub-sectors and locations. In a geographic sense, investments are located almost exclusively in the developed markets of the UK, Continental Europe, the USA, Canada and Australia.

The sub-sectors range from social infrastructure, such as schools, healthcare, justice and emergency services, social-housing and government buildings, to transportation, and renewable energy in the form of solar parks and wind farms.

At a financial level, diversification can be highlighted compared against the FTSE equity indices. Chart 2. highlights the 36-month correlations of the GLIO UKI versus the three FTSE indices. In all cases, correlations have dropped materially as the GFC unwinds from the correlation figures, as you would expect, the correlation with the FTSE 250 hitting an average range of 0.2, and the FTSE 100 0.1 until recently.

The vast majority of the investments are long-term contracts with the public sector, or with high-quality private sector corporates, to operate a specific asset and/or generate power. With very predictable costs, which can also be locked in via largely matching sub-contracts, this structure provides the right conditions to achieve very stable income streams. In addition, many assets will be protected against inflation either explicitly, such as the case with most PFI/PPP concessions, or indirectly through the inflationary link built into power prices.

Finally, all of these benefits can easily be accessed by retail and institutional investors alike through the liquidity of the investment company shares which are all traded on the LSE, coupled with the advantage of the transparency of the public markets.

Other considerations

Solvency II

The majority of the GLIO UKI investment companies should be able to take advantage of EIOPA recommendations >

1 The GLIO UK Infrastructure Index (GLIO UKI) is an unofficial index, and is calculated for illustrative purposes for this article only. The index is calculated using monthly Reuters total returns for the individual stocks, and weighted by full market capitalization.

Table 2: Index performance, risk and comparison

Horizon	FTSE 100	FTSE 250	GLIO UK Infra	FTSE UK Fncls
3 Years	2.4%	9.6%	10.2%	-1.7%
5 years	4.7%	10.9%	10.5%	1.8%
7.5 Years	7.0%	13.8%	9.9%	-0.2%
10 Years	4.1%	8.5%	9.3%	-3.9%

Risk	FTSE 100	FTSE 250	GLIO UK Infra	FTSE UK Fncls
3 Years	10.4%	9.9%	4.5%	12.9%
5 years	11.4%	11.7%	4.1%	16.8%
7.5 Yrs	13.0%	14.9%	6.4%	21.5%
10 Yrs	14.2%	17.1%	9.8%	23.4%

Sharpe Ratio	FTSE 100	FTSE 250	GLIO UK Infra	FTSE UK Fncls
3 Years	0.23	0.97	2.27	-0.14
5 years	0.41	0.93	2.55	0.11
7.5 Yrs	0.54	0.93	1.56	-0.01
10 Yrs	0.29	0.50	0.94	-0.17

Source: GLIO & Reuters, as at March 31, 2017

"Many of the UK infrastructure investment companies are classified under the 'Financials' sector, but the companies within the GLIO UKI offer completely different investment characteristics."

to the European Commission on Solvency II capital requirements. In practice, this would mean that the current risk charge of 39% for insurers would be reduced to 30% for their investments in the majority of the GLIO UKI companies. Of the 11 companies, analysis shows that eight would most likely qualify for the lower 30%, with two classified as 'maybe' and one requiring further investigation as it holds assets outside of the OECD or EEA, a key requirement of Article 164a.

The full analysis is available upon request from GLIO. Going forward, this may be the tipping-point for the insurers to invest in the sector in a more significant way.

Global Classification Issues

Currently, many of the UK infrastructure investment companies are classified under the 'Financials' sector of the global classification systems governed by FTSE and MSCI. This means that the infrastructure investment companies are being bundled with global banks and insurance companies such as HSBC, Prudential, Lloyds Bank and Aviva.

From the performance Chart 1, plus Table 2. and correlations Chart 2, the companies within the GLIO UKI offer completely different investment characteristics. 36-month correlations following the global financial crisis fall into the zero to 0.2 range, and looking at the medium to long-term total return performance versus UK Financials, the difference is huge. Perhaps it is time the index providers looked at this issue?

Shareholders

Currently, the shareholder base of the GLIO UKI companies is predominately UK-based. In conversations with the UK infrastructure investment companies, this could be more than 90% in many cases. Looking forward, as the sector continues to develop and mature, and a broader range of global investors understand the opportunities the sector offers, this figure should lower as

UK infrastructure investment companies: Geography & Sector Summary

Fund	Managed by	Geographic Focus	Sectors
HICL	InfraRed Capital Partners	UK, Europe, Canada & Australia	Education, health, justice & emergency services, transport
3i Infrastructure	3i Investments	UK & Europe	Transport, power, utilities, energy & healthcare
INPP	Amber Infrastructure	UK, Europe, Canada & Australia	Schools, courthouses, health, police stations, transportation, utilities and energy
JLIF	John Laing Capital Management	UK, North America & Cont. Europe	Health, educations, justice & emergency services, transport, regeneration and social housing, government buildings and street lighting.
TRIG	InfraRed Capital Partners	UK & Cont. Europe	Renewable energy – wind & solar
Greencoat UK Wind	Greencoat Capital	UK	On & offshore wind farms
BBGI	BBGI SICAV	UK, Cont. Europe, Australia, & North America	Transport, healthcare, education, justice & other service sectors
NextEnergy Solar	NextEnergy Capital	UK	Solar Energy
Bluefield Solar	Bluefield Partners	UK	Solar Energy
Foresight Solar	Foresight Group	UK	Solar Energy
John Laing Environmental	John Laing Capital	UK	Onshore wind, solar & water utilities

Source: Reuters & company websites

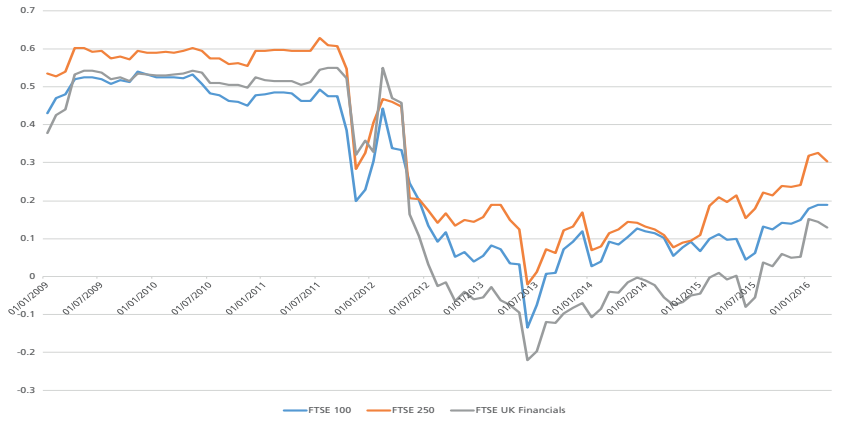
Chart 1: GLIO UK Infrastructure vs FTSE 100, 250 & UK Financials

Source: Reuters & GLIO, as at March 31, 2017

Chart 2: 10 FTSE 100, FTSE 250, FTSE All-Share Financials vs GLIO UK Infrastructure

36 months Correlations

Source: Reuters & GLIO, as at March 31, 2017



Robin **HUBBARD**

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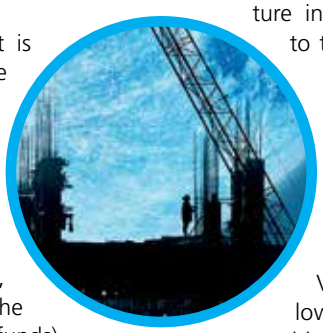
Fraser **HUGHES**

non-UK investors start making larger investments.

Knowing the Risks

Of course, no investment is without risk, and there are a number of elements to consider when investing in infrastructure, which include: political and regulatory risks, exposure to development (greenfield investment), counterparty risk, and (in the case of the renewables funds) weather and power price risks.



Of course, the benefits of liquidity mean investors can mitigate these negative shocks effectively, if unforeseen situations develop. Furthermore, the redemption issues which caused major headaches for the open-ended UK property funds will not be a distraction for the UK infrastructure investment companies due to their closed-end structure.

Impressive Record

Although a relatively young sector, UK infrastructure investment companies have an impressive track-record. Very attractive yields in a low-yield world, backed by stable income streams – low volatility has formed the backbone of the investment case. In addition, the sheer weight of capital required to maintain and develop infrastructure at a global level means that investment in infrastructure, both private and listed, should continue to grow going forward.

With regulation aimed at attracting more investment into infrastructure in order to support economic growth, as in our Solvency II example, we believe the options for institutional and retail investors will also grow tremendously over the mid to long term. With investors targeting increased allocations to real assets, the stars are aligning for the UK listed infrastructure investment companies.