IITs an opportunity to expand the universe

By Fraser **HUGHES**

Recent M&A activity in Australia puts IITs in the spotlight as a way of expanding the listed infrastructure universe in the future.

2021 saw private bidders enter the Australian listed market, snapping up long-standing essential infrastructure companies. AusNet Services, Spark Infrastructure and Sydney Airport headed into the confines of private hands and out of the larger public domain.

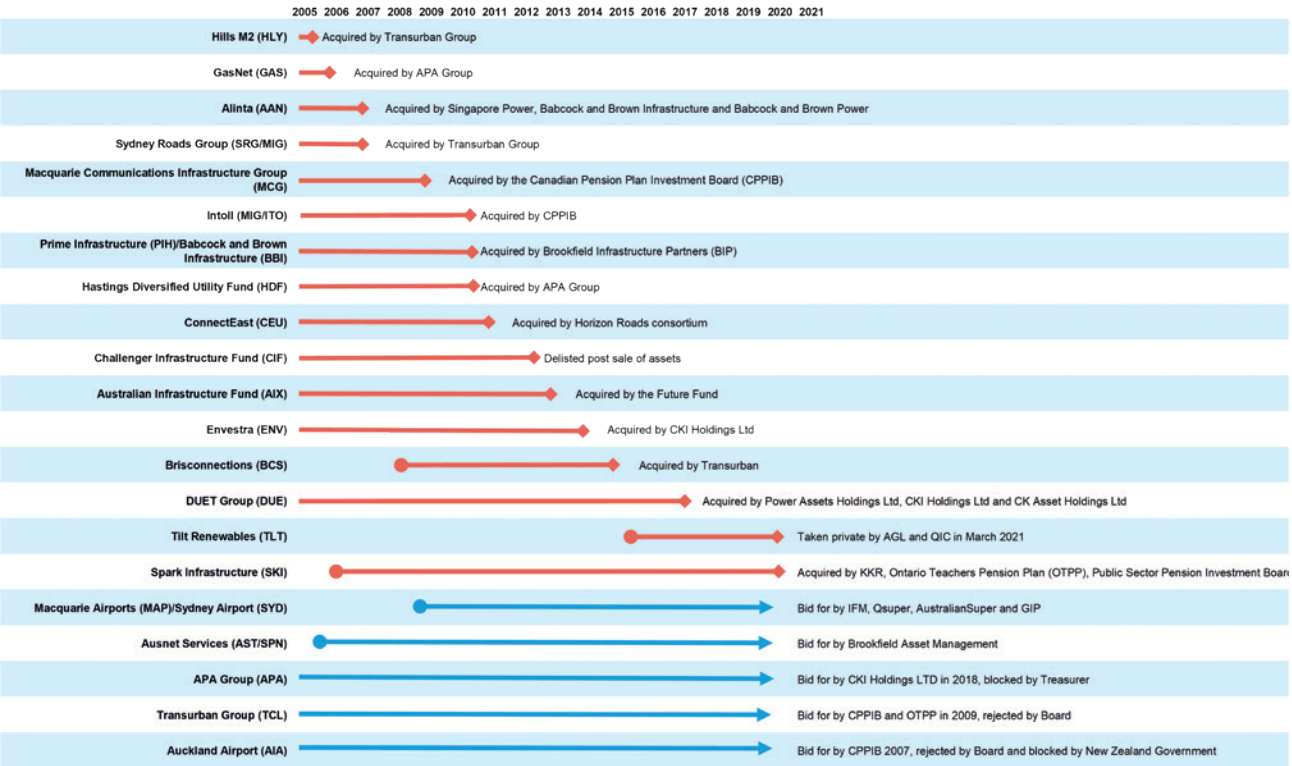
In a way, it's not surprising; asset owners such as pension funds and sovereign wealth funds are looking to increase allocations to infrastructure, but lack quality assets in the private market. Private market participants can easily pay 40% premiums over listed multiples, so lifting out a listed company can offer better value for money.

"Listed airports, including Sydney Airport, lost anywhere between 35% and 50% of value when the share market corrected in 2020," notes Sarah Shaw, founder and chief investment officer of 4D Infrastructure. "So you can understand why unlisted investors with long-term horizons and cash are taking the opportunity to scoop up such under-valued listed assets."

Many Australian super funds have infrastructure allocations of around 7%, according to Ausbil calculations. Even so, they are well ahead of similar kinds of pension funds in Europe, with average allocations of less than 1%. The result is that domestic investors have now very limited opportunities to invest in Australian essential infrastructure as the supers pounce.

"If you are an actuary in a superfund and you can see your liabilities growing at 5% over the next 30 years, then you look at an infrastructure >

Figure 1: Shrinking listed infrastructure sector in Australia



Source: Ausbil

asset that has a net highly certain return of 7% over the same period," says Tim Humphreys, head of global listed infrastructure at Ausbil. "Infrastructure looks extremely attractive from an asset-liability-matching perspective."

A shrinking listed infrastructure sector is not an ideal situation (Figure 1), in fact, we believe a diverse listed infrastructure in Australia would offer benefits to a far deeper pool of local and non-domestic investors. It would also help state and local governments bolster their finances at a broader level.

It is also worth reminding ourselves of some of the benefits of listing infrastructure assets:

- Transparency and accountability – regular news and results released to the market, plus the subsequent public scrutiny.
- Increased efficiency – driven by addition transparency, public scrutiny and investor engagement.[1]
- Customers can become shareholders in the services they use.
- Raised corporate profile and access to capital markets, to raise capital and invest in assets.
- Less ownership risk – democratized ownership means no one shareholder controls the direction of the company.
- Private owners are more likely to trade assets, especially if a fund has a finite life.

Humphreys adds that there is "wide debate" going on in Australia on ownership, that is, whether such assets are better left listed or whether consumers get better service under unlisted structures.

"As long as the regulatory regime is secure and strong enough, there should be no impact on the consumer." Humphreys does point out, however, that in the UK water market there is now evidence that listed companies perform better than privately owned ones. This is an important issue picked up by Steven Kempler of Maple-Brown Abbott in issue 9 of the *GLIO Journal*.

Along similar lines, Shaw says: "The asset's contractual or regulatory structure remains the same whether it is held in listed or private hands – we are talking the exact same assets, just with different owners. The user experience should not change, but failing these standards means repercussions and could damage their return profiles."

When your superfund liabilities grow at 5% over 30 years, versus an infrastructure asset with a 7% net return over the same period, infrastructure looks extremely attractive.

1 Take the UK water companies example from Issue 9 of the GLIO Journal. See: https://en.calameo.com/read/005185466d83293b468ac?page=38

IITs help by offering a broader range of investors access to the infrastructure assets they crave in a coherent, tax-transparent and regulated vehicle, while citizens get to use higher-quality, better-funded assets and services than they would do otherwise.

Could Infrastructure Investment Trusts (IITs) reverse the trend?

Globally, we face a massive bill to maintain our current infrastructure and fund the infrastructure of future generations. The Sydney-based GI Hub put this figure at $94tn. As governments around the world remain strapped for cash, exacerbated by COVID-19, they need to think innovatively so as to fund essential assets in lockstep with their public.

The answer could be obvious; Australia already has one of the most successful Real Estate Investment Trust (REIT) markets in the world. There are approximately 50 A-REITs listed on the Australian Stock Exchange, and PricewaterhouseCoopers estimates that around 70% of investment-grade property is listed. Institutional and retail investors have many choices to gain exposure to a diverse array of property sectors, plus they benefit from attractive yields as A-REITs pay out a vast majority of taxable income to shareholders.

In the USA, the birthplace of REITs, the National Association of Real Estate Investment Trusts (NAREIT) eestimates that 80 million Americans own REITs through retirement savings and other investment funds. Most major economies in the world now have a REIT structure in play. It's a true global success story.

As we have discussed in previous issues of the *GLIO Journal*,[2] we believe infrastructure can learn from the successes of REITs. Imagine a listed tax-efficient structure for infrastructure to stand side-by-side with the REIT sector.

Seizing the opportunity for innovation with IITs

A G20/OECD report[3] published in July 2020 presents multiple proposals from the private sector on mobilizing investment in infrastructure, including a proposal on a clearly defined financial vehicle for infrastructure – a tax-efficient IIT. In simple terms, the IIT structure could emulate the legal and financial blueprint set by REITs.

IITs help by offering a broader range of investors access to the infrastructure assets they crave in a coherent, tax-transparent and regulated vehicle. Put simply, the population can own a stake in the essential assets they use on a daily basis. Citizens get to use higher-quality, better-funded assets and services than they would otherwise have access to. This is particularly pertinent in a post-COVID world, where global government finances are already stretched by the attempt to reboot the economy.

Factoring environmental considerations into the development and maintenance of assets is critical to receive funding from public markets; investors must be convinced that those managing the assets are doing the right thing and heading in the right direction. There is a clear opportunity to ring-fence essential new clean energy development and accelerate the wind-down of fossil-fuel generation and consumption.

In many ways, the deficit is not one of capital, but of governments' willingness to work with the private sector and create a suitable asset vehicle, such as a listed IIT. Getting state and local lawmakers to release ownership and control of critical assets to publicly owned companies can be challenging, but we've seen many cases where state or local owners maintain majority stakes in a newly listed vehicle.

As we know, well maintained and updated infrastructure fuels an economy's long-run potential growth rate and competitiveness. A transparent, diverse, liquid listed IIT market could be the gateway for investors to get exposure to the assets they crave, help relieve the financial burden on state and local governments and create the conditions to move toward climate-related goals.

An open, broad and tax-transparent listed infrastructure sector needs to be a long-term goal, where governments finance infrastructure assets hand-in-hand with its population. Now is the time for governments to approach essential infrastructure financing innovatively. Failing to do so would be a huge missed opportunity.

Fraser **HUGHES**

Founder & CEO of the Global Listed Infrastructure Oganisation (GLIO).

2 See: https://en.calameo.com/read/005185466d83293b468ac?page=14

3 The G20/OECD Report on the Collaboration with Institutional Investors and Asset Managers on Infrastructure: Investor Proposals, released in July 2020 at the G20 Finance Ministers and Central Bank Governors meeting.