Insights into investment and M&A trends in the infrastructure space

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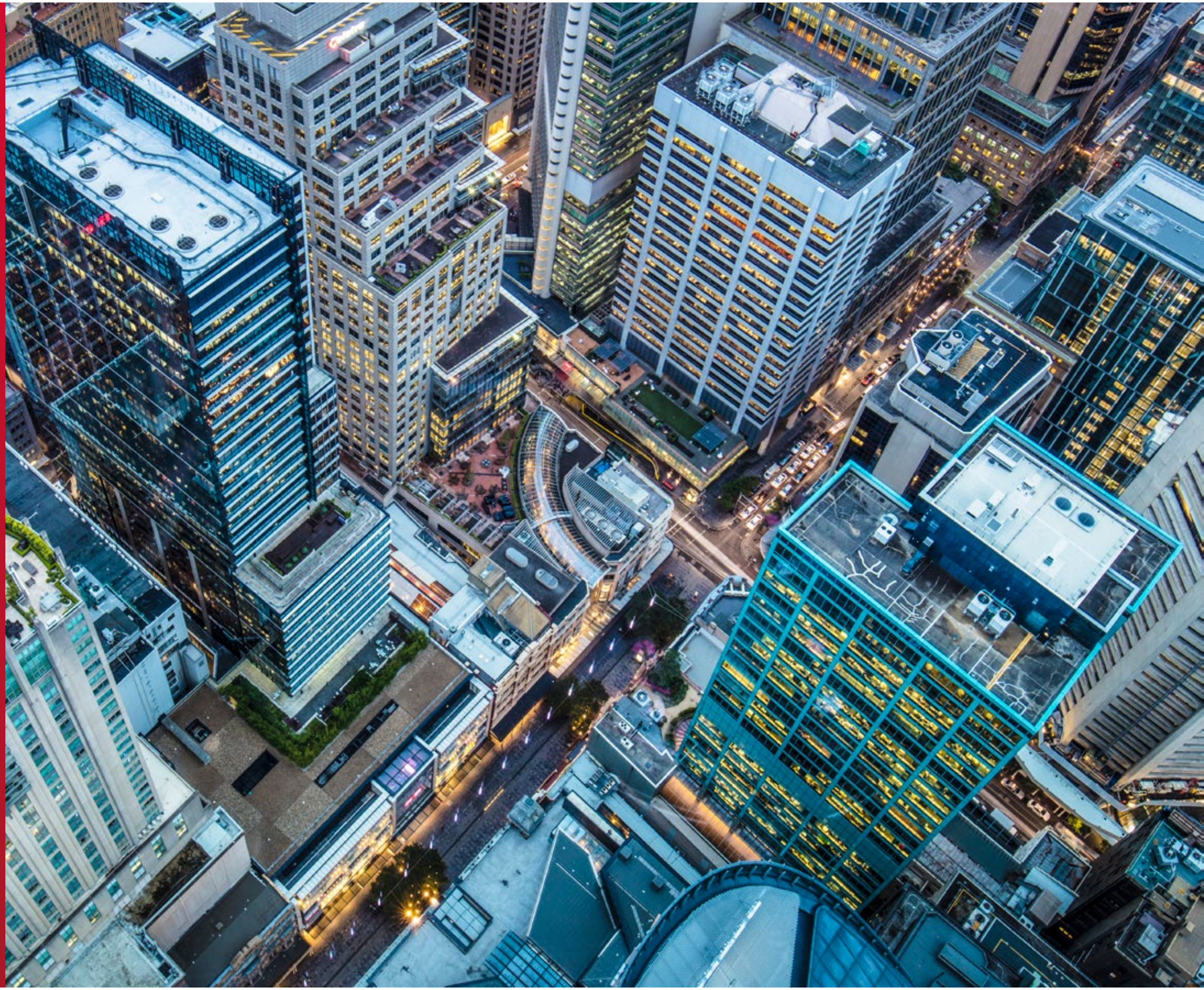
2022 has been a volatile year for global markets with the continuation of the COVID-19 pandemic, the war in Ukraine, tensions in the East China Sea and rising interest rates to combat inflation. Not surprisingly, these factors have created a significant degree of uncertainty and misalignment of valuation expectations between investors and vendors. Despite this, as an asset class, infrastructure has continued to demonstrate it is a reliable, long-term, stable investment.

In this article we explore six key thematics as follows:

- the fluctuations in transaction values and volumes;
- the increased risk profile of infrastructure portfolios;
- the changing model of commercialisation transactions;
- the rise of digital infrastructure as an asset class;
- the transition to renewables; and
- the increasing presence of superannuation funds in infrastructure.



Transaction value increasing and volume decreasing

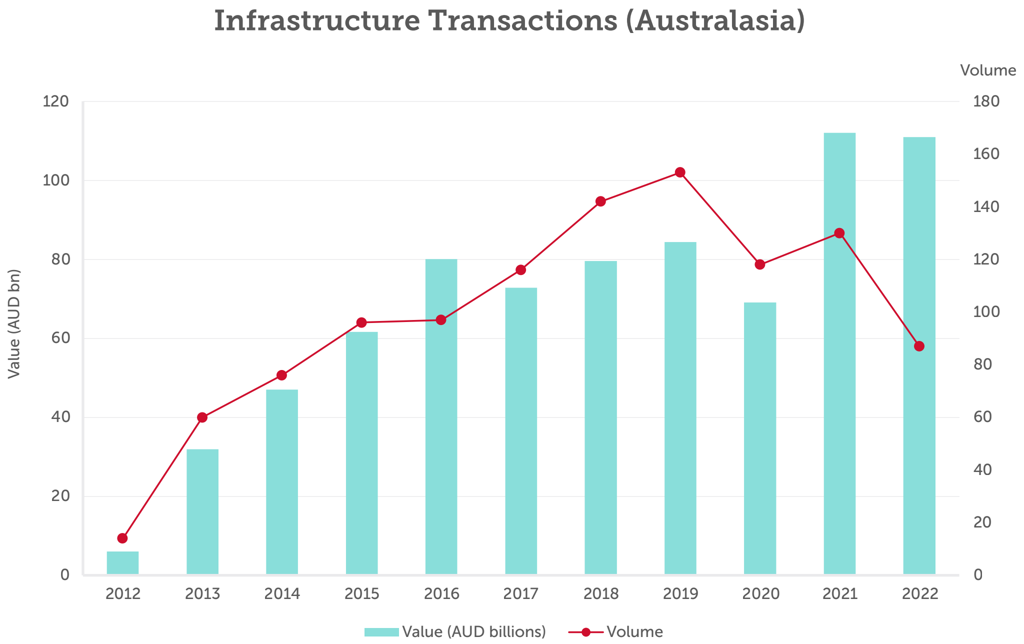
Given the number of high value transactions, the total value of infrastructure transactions in Australasia in 2022, being approximately $111 billion, is on track to surpass the previous record set in 2021 of $112 billion. This alone would indicate that infrastructure investment and M&A activity has flourished in 2022, irrespective of the market volatility.

However, the volume of transactions in 2022 to date is down by approximately 33% on 2021 volumes, consistent with the general downward trend in infrastructure transaction volumes since the record year in 2021.

Globally, both the volume and value of infrastructure transactions are on track to be significantly lower than 2021. Interestingly, it will be the first time in the last 10 years that the volume of infrastructure transactions has not increased year on year.

While the geopolitical and economic uncertainty remains, we anticipate that Australian deal activity in the infrastructure space will, in line with the global trend, continue to remain the same or decrease over the next 12 to 18 months. Nevertheless, we expect that infrastructure as an asset class will continue to perform well relative to other investments and will remain attractive to investors and processes will continue to be very competitive driving value for deal originators and vendors.

There is a long held theory amongst investors that infrastructure assets provide a hedge against inflation. Lending support to this theory, since 2002, when inflation has been greater than 3%, listed global infrastructure has outperformed equities by 4%. This theory will be put to the test over the next 12 months.



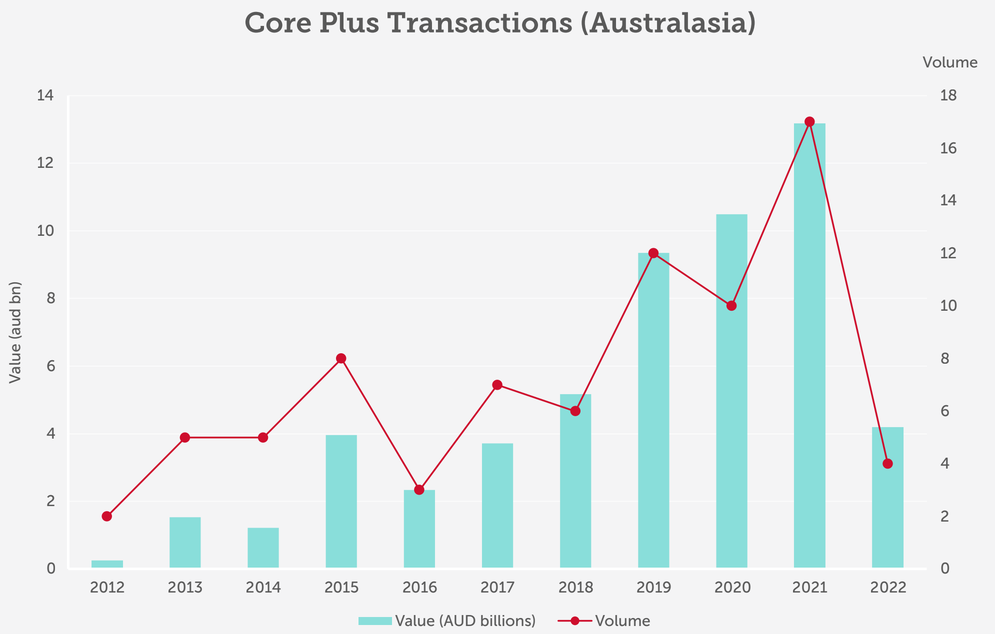
Source: Inframation

Moving up the risk curve

In recent times, we have seen a number of deals in core-plus sectors, such as waste, health and logistics. We are continuing to see investors who would have traditionally invested in lower risk core infrastructure assets (such as airports, seaports and toll roads) move up the risk curve in search of higher returns. A significant reason behind this trend is the introduction of the *Your Future, Your Super* reforms that came into effect on 1 July 2021. Under these reforms, Australian super funds are grappling with the new returns benchmark, which requires them to invest in higher risk assets that otherwise would not have been contemplated by their investment committees.

Transaction volume and value was on a steady upward trajectory between 2016 and 2021. Interestingly, 2021 saw record levels in both the volume and value of core-plus transactions, coinciding with the introduction of the *Your Future, Your Super* reforms. However, the volume and value of core-plus deals in 2022 have fallen back to 2018 levels.

In times of great uncertainty, conventional wisdom would suggest that investors will turn towards lower risk and lower return investments. Accordingly, we query whether investors are slightly more reticent to invest in core-plus assets in 2022, opting to instead invest in lower risk traditional infrastructure assets.



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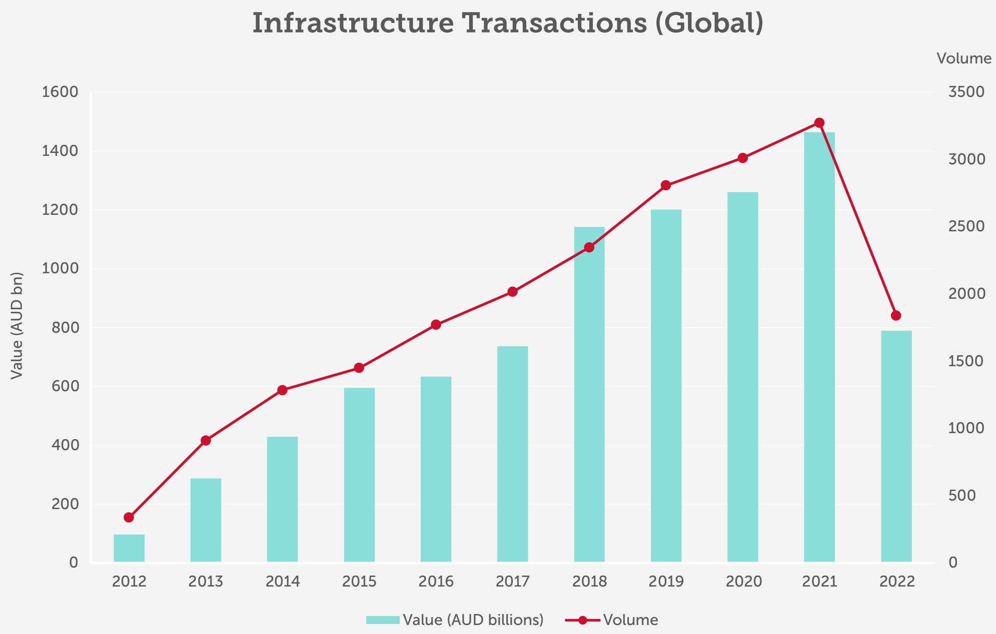


Source: Inframation

Emergence of partial privatisations and joint ventures

In an attempt to minimise the economic impact of the COVID-19 pandemic, governments across the country increased both borrowing and spending. In the 2021 Federal Budget, the Commonwealth Government committed to $311 billion to fight COVID-19. As we begin to emerge from the COVID-19 pandemic, governments across the country are faced with increasing balance sheet pressure, which is exacerbated by rising interest rates.

In order to relieve this pressure, one option for governments is to sell State assets to private investors. However, this presents its own set of challenges. Scrutiny of government decisions, past and present, to privatise infrastructure assets continues increase. One needs to look no further than the commentary surrounding the decision not to have a national carrier following the privatisation of Qantas or to lease the Port of Darwin under a long-term concession arrangement for examples of criticism of Government.

In part to ameliorate the risk of public criticism levelled at traditional privatisations, we are seeing governments enter into collaborative arrangements with the private sector, such as joint ventures and outsourcings rather than pure privatisations.

These arrangements allow governments to retain an interest in the infrastructure assets from an equity perspective and a seat at the Board table, while generating significant upfront proceeds for the State. By way of example, in recent times we have seen:

- the NSW Government's original concession of 50.4% of Endeavour Energy to a Macquarie Group led consortium for $7.6 billion in 2017;
- the NSW Government's initial sale of 51% stake in Sydney Motorway Corporation, the holding company for the WestConnex project, to the Sydney Transport Partners consortium for A$9.3 billion in 2019. The NSW Government sold its remaining 49% interest to Sydney Transport Partners in late 2021; and
- the recently announced 40-year joint venture between VicRoads and a consortium of Aware Super, Australian Retirement Trust and Macquarie Asset Management, generating $7.9 billion in upfront proceeds for Victoria.

These arrangements, particularly the Endeavour Energy and VicRoads models, are more palatable to taxpayers than the traditional form of privatisation that would see governments completely exit their ownership interests in infrastructure assets from day one. The ability to sell-down in stages provides for a smoother transition of the asset private sector controls and allows Governments the flexibility to retain ownership in the asset over the long-term. We anticipate future commercialisation will follow the joint venture model.

The NSW Government's Renewable Energy Zone (**REZ**) will provide the opportunity for private investors to invest in state assets. The Energy Corporation of NSW is currently leading the delivery of NSW's first REZ in the Central-West Orana region, which includes the appointment of a network operator to design, build, finance, operate and maintain the REZ network infrastructure. With other REZs planned in NSW and elsewhere in Australia, this presents a significant investment opportunity for infrastructure investors.

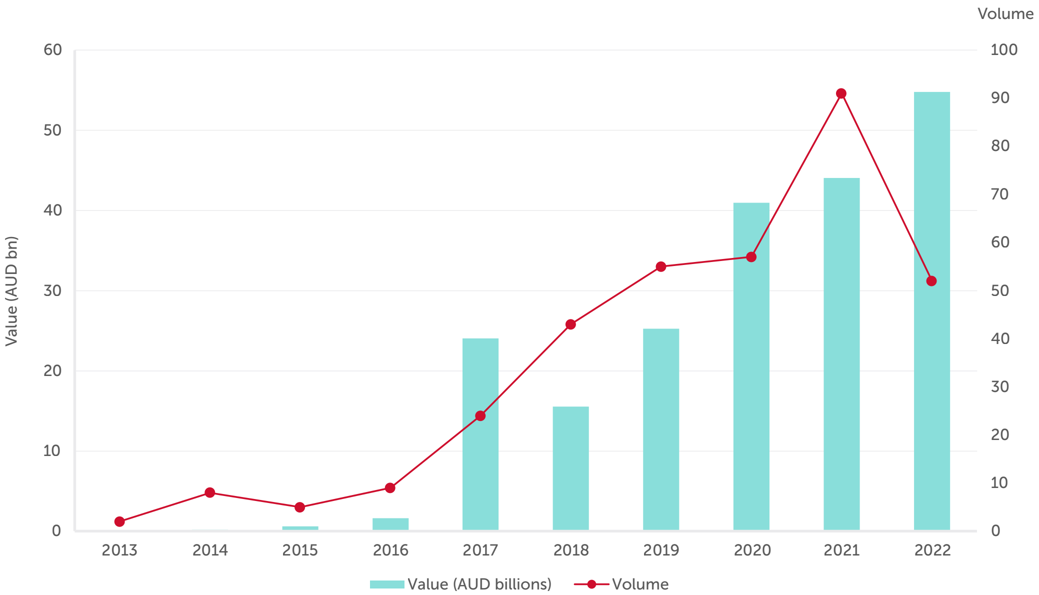
Separately, as a consequence of previous divestments to the private sector, the portfolio of traditional infrastructure assets held by governments is quite limited. Accordingly, it would not be surprising to see creativity from governments when it comes to identifying infrastructure assets to make available to private sector investors.

Continued growth of digital infrastructure

Digital infrastructure has cemented its place during the COVID-19 pandemic and we have continued to see growth in the volume and value of digital infrastructure transactions. The VicRoads Modernisation Project is a good example of this, being the world's first partial commercialisation of a motor vehicle registry business.

Using global data centres transactions as an example, we have seen a significant growth in both the total volume and value of transactions. Investment and M&A activity involving data centres was virtually non-existent prior to 2013. However, since then, we have seen strong growth in these transactions and we expect this trend to continue.

Data Centre Transactions (Global)



Source: Inframation

Transition to renewables

Looking forward, the long anticipated transition to renewables presents one of the key opportunities in the Australian infrastructure market. As a sign that the energy transition is beginning to accelerate, solar power outpaced coal as the number one fuel source in the power grid in August for the first time.

The electorate's desire for change, with the election of the Albanese Government and independent candidates with a focus on climate action, has been seen by many as a positive result for the transition to renewable energy. On 4 August 2022, the Climate Change Bill 2022 was passed by the House of Representatives, which would see an emissions reductions target of 43% from 2005 levels by 2030 and net zero emissions by 2050. Further, at the 2022 Superannuation Lending Roundtable, Federal Treasurer Jim Chalmers laid down a new agenda for the nearly $3.4 trillion superannuation sector that he hopes will steer part of the vast capital pool toward investments in clean energy.

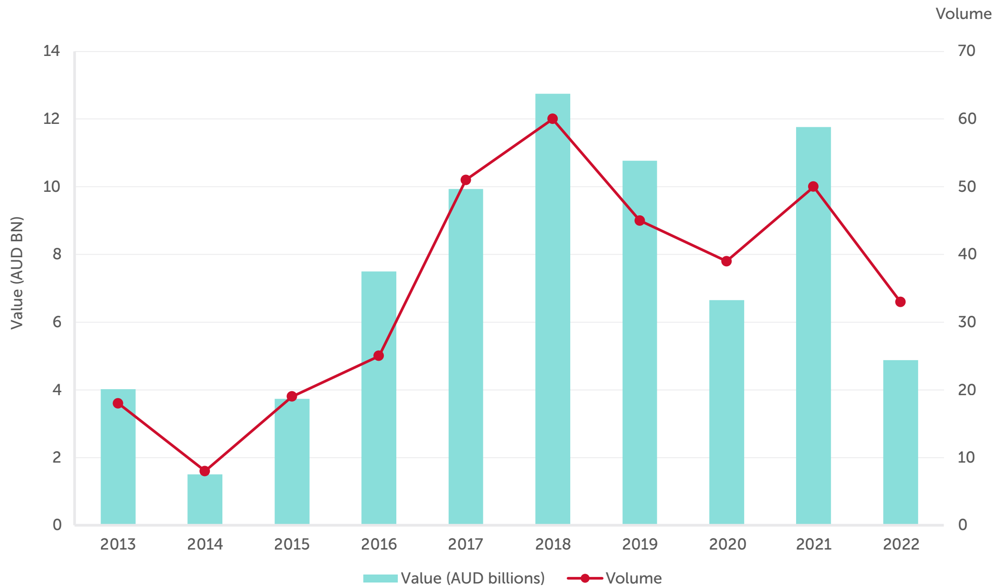
The ALP has also announced its plan to rebuild and modernise the electricity grid, referred to as Rewiring the Nation. The plan will see $20 billion invested into transmission assets in order to facilitate greater investment in renewables, with the intent of turning Australia into a 'renewable energy superpower'.

Notwithstanding the impetus for change, there remains a need for a gradual, rather than immediate, transition to renewables. The recent energy crisis, described as being the worst Australia has ever experienced, exemplifies the risks of leaving behind traditional forms of energy prematurely. Consistent with a gradual transition, Mr Albanese has rejected calls to ban fossil fuel projects in the immediate future.

In terms of deal activity, between 2013 and 2018, there was a doubling in both the volume and value of transactions in the renewables space. However, since then, there has not been any marked difference. One explanation for this is that renewables have not traditionally been good investments. As an indication of this, John Laing Group announced in 2020 that it would no longer invest in standalone wind and solar following a re-assessment of the risk-return profile of the sector. Consistent with this new approach, the Group sold its Australian wind farm assets for $285 million in late 2020.

Nevertheless, in order to achieve global emissions reduction goals and slow the pace of global warming, investment in renewables must increase significantly on current levels in the near future. However, whether this uptick in renewables investments occurs in the next 12 to 24 months remains to be seen.

Renewables Transactions (Australia)



Source: Inframation

Superfund investment in infrastructure

Investment in infrastructure assets by the superannuation sector remains strong.

As at 30 June 2022, Australian superannuation assets totalled $3.3 trillion. For superfunds with more than four members, 8% of total funds are allocated to infrastructure, amounting to $160 billion. In the last two years, we have seen superfund involvement in major infrastructure transactions. For example, we have seen:

- the purchase of Axicom by the AustralianSuper and Singtel owned Australian Tower Network for an estimated $3.5 billion;
- the acquisition of Sydney Airport for $23.6 billion by a consortium that included the Australian Retirement Trust, AustralianSuper and UniSuper; and
- as noted above, the joint venture between VicRoads and a consortium including Aware Super and Australian Retirement Trust, generating $7.9 billion in upfront proceeds for Victoria.

Moving forward, superfund investment in infrastructure looks set to increase. As discussed earlier, Mr Chalmer's decision has signalled the Commonwealth Government's intent to direct a greater amount of the superannuation sector's funds into infrastructure assets in the form of renewables. Further forecasts predict that total superannuation assets will grow to $5-$6.5 trillion by 2030 and to $9-$10.5 trillion by 2040.

As natural consequence, we expect that the superannuation sector's investment in infrastructure assets will continue to grow in the future. Accordingly, we anticipate an increase in both the volume and value of infrastructure asset transactions involving superfunds.

Interested in infrastructure?

If you are interested in infrastructure investment in Australia, please reach out to our dedicated infrastructure specialists.

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