Roundtable

Debt

SPONSORED BY
- DC ADVISORY
- WHITEHELM CAPITAL
- BROOKFIELD ASSET MANAGEMENT
- MIZUHO GLOBAL ALTERNATIVE INVESTMENTS
- LLOYDS BANK

PHOTOGRAPHY: PETER SEARLE

Life in the fast lane

With infrastructure debt now experiencing a flood of liquidity, five industry experts tell **Zak Bentley** what sets funds apart, the relationship between institutional investors and banks and how to manage risk in a concentrated market

Sitting for years in the shadows, it's likely people will look back on 2017 as the year infrastructure debt finally caught up with its equity cousin. AMP Capital's $2.5 billion fundraising for its third global mezzanine strategy was a record for a debt fund, but also the fourth-largest infrastructure fund raised overall last year, according to *Infrastructure Investor* data. The close of AMP's fund marked a high point for the market and provided further proof of the substantial progress made by infrastructure debt in such a relatively short space of time.

Indeed, as Alexander Waller, head of infrastructure debt at Whitehelm Capital tells us, a high-yield strategy four or five years ago would have received "maybe enthusiastic nods" without getting investors over the line. While the commitments have now changed significantly, the enthusiasm certainly remains, as exhibited by our other roundtable panellists Phillip Hyman of DC Advisory, Lloyds Bank's Guillaume Fleuti, Hadley Peer Marshall from Brookfield Asset Management and

> "The US has more going on when it comes to the energy sector and that has been a big driver of opportunity" Peer Marshall

Mizuho Global Alternative Investments' Go Taniguchi.

"Japanese institutional investors are hungry to invest in infrastructure debt," says Taniguchi. "Japanese government bonds are almost negative. They need to diversify their fixed-income portfolio, so insurance companies and pension funds are very keen to invest in infrastructure debt funds. In terms of the fundraising environment, especially in Tokyo, this is a very good opportunity for the debt market."

The nature of how the market works has also changed, according to Waller. "Bigger players have traditionally invested on a direct basis or via mandates but there wasn't really a pool of investors that could each write a €30 million ticket and be part of a co-mingled fund," he explains. "That's really changed and changed extremely quickly over the last three or four years."

That has also led to a huge increase in the number of debt funds in the market, a potential problem for the table's banking representative.

"An investor has a choice of between 40 or 50 funds, so I wonder how you differentiate yourselves?" asks Fleuti. "Do we

AROUND THE TABLE

Guillaume Fleuti, head of infrastructure and corporate debt capital markets, Lloyds Bank
Fleuti initially joined Lloyds in 2009 as a senior director for the group's debt capital markets division, before becoming head of infrastructure and energy in 2013 and managing director of both in 2015. He has executed major transactions in the utility, natural resources and telecoms sectors.

Phillip Hyman, director, DC Advisory
Hyman joined DC Advisory in 2016 from HSBC and advises investors across the infrastructure spectrum on both debt and M&A transactions internationally. Prior to joining HSBC, Hyman spent six years with Royal Bank of Scotland, working on investment-grade and non-investment-grade infrastructure loan origination.

Hadley Peer Marshall, senior vice-president, Brookfield Asset Management
Marshall has led Brookfield's infrastructure credit investments in the Americas since her arrival in 2015 and her role includes origination, execution, and asset management. She had previously spent eight years at Goldman Sachs where she had co-headed the project finance and infrastructure group, following a four-year tenure at Citi.

Go Taniguchi, fund manager, infrastructure, Mizuho Global Alternative Investments
Taniguchi joined MGAI last year and led the group's first investment in European offshore wind. He had spent the previous two years at Bank of Tokyo-Mitsubishi UFJ, doing deals in Indonesia's power and Japan's toll road and renewable energy sectors. Taniguchi also worked for seven years at the Japan Bank for International Cooperation.

Alexander Waller, head of infrastructure debt, Whitehelm Capital
Waller has headed Whitehelm's infrastructure debt group since 2014, following a seven-year spell at Challenger Group, where he was responsible for both debt and equity investments. He also had a three-year stint at RBS and has worked on numerous deals across the UK water, transport and renewables sectors.

> Are there sectors where we would not transact because [institutional players] are more competitive and going to be taking over from the banks? Not yet" Fleuti

have too much and too many and will you be able to deploy it at pace?"

The first line of defence comes from Waller, who maintains that, while the market is concentrated, there are many spaces to fill. "There is a myriad of managers apparently active at the moment but the picture looks a little different when you're close up," he states. "We think there are three or four players who can deliver a meaningful cheque in our space, which is a BB-type space where we want 400 to 600 basis point returns. We're motivated by risk/reward more than anything else. Looking at the long list of investors, it feels like an overbanked, overfunded market, but actually the manager strategies are quite different."

Hyman agrees and finds an "abundance of liquidity" in the European investment-grade BB+ space. "The market has been very good at keeping control of leverage creep and the amount of supply has been limited to having an impact on pricing," he believes. "However, the 'infra premium' is starting to diminish and lenders are looking at ways to sustain their returns. Some are looking to the UK, given the supply in sterling is less than euros and there is more pricing protection, others with senior mandates are looking at degrees of subordination to try to retain a premium."

The picture is slightly different outside the continent. "Relative to Europe, the US has more going on when it comes to the energy sector and that has been a big driver of opportunity," says Peer Marshall. "From the investor perspective, the US lacks the same depth of experience the European market has, but infrastructure mezz is slowly becoming an asset class that investors are looking at and thinking about with regard to the allocations in the fixed-income bucket. As we were marketing our fund, investors were getting better educated about this asset class and the attributes it could bring to the portfolio, including attractive risk-adjusted returns."

As Waller alluded to earlier, this sits among the numerous strategies available to investors, although he is content with Whitehelm's current position.

"We don't want to move into areas that are well-trodden by specialist US energy mezzanine firms," he argues. "It's a different risk profile, a different geography and it has a specialist market of its own. We're sitting happily in our own specialist area, earning 400 to 600 [basis points], not 200 to 300 for allegedly crossover credits because I don't think that's necessarily a fair return on capital and not 600 to 800 because I think then you're not really investing in bona fide infrastructure."

BANKING ON SUCCESS

The increased activity in the institutional debt market, together with regulatory restrictions, has led to banks becoming more reticent in infrastructure lending. However, Fleuti claims reports of banks' deaths have been exaggerated.

"Are there sectors where we would not transact because [institutional players] are more competitive and going to be taking over from the banks? Not yet," he

maintains. "We see a number of advisors thinking how to save costs for clients and one way is to go straight to the institutional investors. The banks cannot be completely replaced yet."

Fleuti is backed by Hyman, the advisor at the table, who has noted how institutional investors are still lacking the sophistication banks bring to deals.

"In an acquisition scenario, banks have all the systems in place to support multiple bids, can move quickly, are transparent and bankers know their institutions," he says. "There are a lot of funds that can also move quickly and managers that are able to deliver their institutions but there are also a lot that are not yet set up to take the place of banks just yet. Even the junior funds that are very deliverable (partly as a result of banks unwilling to lend into true junior structures), usually cannot support multiple bidders on acquisitions."

For better or worse, institutional investors can deploy capital to a deal in a much quicker fashion than banks – "in theory" an advantage, according to Fleuti. "The advantage the infrastructure debt manager has is the speed," adds Taniguchi. "I think speed is important for us as we teamed up with selected investment professionals."

However, Hyman sees the smaller teams, and more importantly the way in which they are run, as part of the problem.

"The market is still pretty immature and these funds don't have the team depth to run multiple competitive auction processes," he asserts. "Some of them also don't want to put the time, effort and management into a competitive process because they're not sure of a certainty of financing opportunity at the end."

Peer Marshall agrees that the speed factor is significant but believes fund managers have to add a greater reliability to their game. "When I was on the banking side, I felt you had some private credit funds that were quite efficient, but at the same time, depending on how they're structured and their LP base, it could be unpredictable if they were going to come into the deal," she explains. "In the bank market, there is a pretty good sense of who can make it into the deal and who can't. When you look at the private credit market, it is harder to have a concept of who that was and who would be able to deliver and how quickly they could do it. Hopefully, time will be able to fix that problem and I think it has to an extent."

For Fleuti, he will continue to work on the deals where the banks are needed, while keeping an eye on market developments. "Institutional investors are wanting to do everything themselves but can't. I fundamentally believe there's room for everyone and the banks will reinvent themselves and the institutional guys will continue to evolve. Right now, we have a tension between the two, which is quite fascinating to watch."

> "Ultimately, leverage creep is the next big thing. People are very disciplined at the moment but as lenders get more comfortable, they are comfortable taking more leverage" **Hyman**

> We're very happy evaluating refinancing or financial risk, but much less comfortable ground betting on scientific or technological risk"
>
> Waller

RISK ASSESSMENT

While the tension between the banking sector and the institutional players does not truly manifest itself around our table, there are differences of opinion over what to invest in and how to address market risks. For example, Mizuho's willingness to invest in assets such as car parks raises Fleuti's eyebrows.

"There are probably sectors that are going to disappear," he states. "Would you deploy 20-year money into car parks? Do we need car parks in 15 years?"

The view is somewhat shared by Waller, who at Whitehelm tends to deploy five- or 10-year money. "We're very happy evaluating refinancing or financial risk, but much less comfortable betting on scientific or technological risk," he says. "We prefer to deal with the known and that might involve taking on significant financial risk on core infrastructure assets to earn the right return.We would be disinclined to take a bullish view on car parks and face the prospect that in 12 years' time everyone is on hoverboards."

Taniguchi, however, defends his approach and backs investing in nascent sectors. "Technology risk is not a burden," he maintains. "Before we invest in such an asset we need to do substantial due diligence from a technical perspective." He continues: "I'm interested in battery storage and smart meters. We invest across the power space but to enhance this kind of return, we need to look closer at embracing new areas."

Again, this sparks debate among the participants, coming a few weeks after Santander became one of the first senior debt lenders to back battery storage in the UK.

"Battery storage has come up several times as a potentially interesting sector." says Waller, who remains intrigued. "From a debt financier's perspective, if there's a guarantee from a BBB-rated counterparty of 15 years, that's suited to conventional asset or project finance. The question for me is, what's going to happen when

> "Japanese government bonds are almost negative. They need to diversify their fixed-income portfolio, so insurance companies and pension funds are very keen to invest in infrastructure debt funds" Taniguchi

new batteries come to market? What's the structure? Is this something we should be getting excited about or is it just going to be traditional asset-backed finance?"

Fleuti is more definitive. "I think what people mix sometimes is the opportunity in terms of the revolution of the energy market for us as consumers. Yes, it's fascinating and I do expect a lot coming from storage, but not as a Lloyds' employee. From a debt financing point of view, it's not going to be very exciting, it's going to be very binary and for the time being, it's an equity story."

The conversation on risk also extends to the sort of currency and market risks taken on by our managers. "I don't think there's a good-enough reward for going into emerging markets," believes Waller. "We have enough investment opportunities and focus on the markets we know. We'd rather not have the extra 100 basis points for the additional risks on the periphery."

Mizuho and Brookfield both manage global funds and Fleuti is curious about such strategies. "The global banking model is retrenching. You see some funds trying to be global, which is fine in the equity market, but can you be a successful global fund in infrastructure debt? I don't know."

Peer Marshall responds: "Currency is dealt with differently on the equity side from the debt side. Equity can take the currency risk but with debt, there is no upside – so how do you make back even a dollar that you lose? For us, it's just a no go. In Chile, it's got to be a dollar-denominated transaction. If we're in Canada, it's got to be hedged or dollar-denominated."

Taniguchi again remains confident in his strategy. "Our fund invests in emerging-market assets, so when we invest in such regions we usually use an export credit agency such as JBIC and Nexi," he says. "ECAs and multilateral grants and credit enhancements are important, but the ECA must consider what is the appropriate role in the debt space as the market is changing. We can consider investing in emerging-market assets without ECA cover if the host country is investment-grade."

LOOKING AHEAD

As our lively debate comes to an end, the panellists give their views on the market. Waller sees a "quite rosy" terrain for high-yield strategies, although concedes this may come under pressure. Meanwhile, Taniguchi points to a tightening of yield for senior debt.

"Ultimately, leverage creep is the next big thing," predicts Hyman. "People are very disciplined at the moment and that may continue, but we are seeing, certainly for specific sub-sectors, as lenders get more comfortable with the asset class, they are comfortable taking more leverage."

However, Fleuti is concerned about where the growing amounts of capital will be deployed. "You have more investment savings than opportunities in the US and Europe, where pension fund investment requirements are bigger than what we can find to invest in. Over time it's always going to come back to tightening." ■