# GLOBAL LISTED INFRASTRUCTURE ORGANISATION

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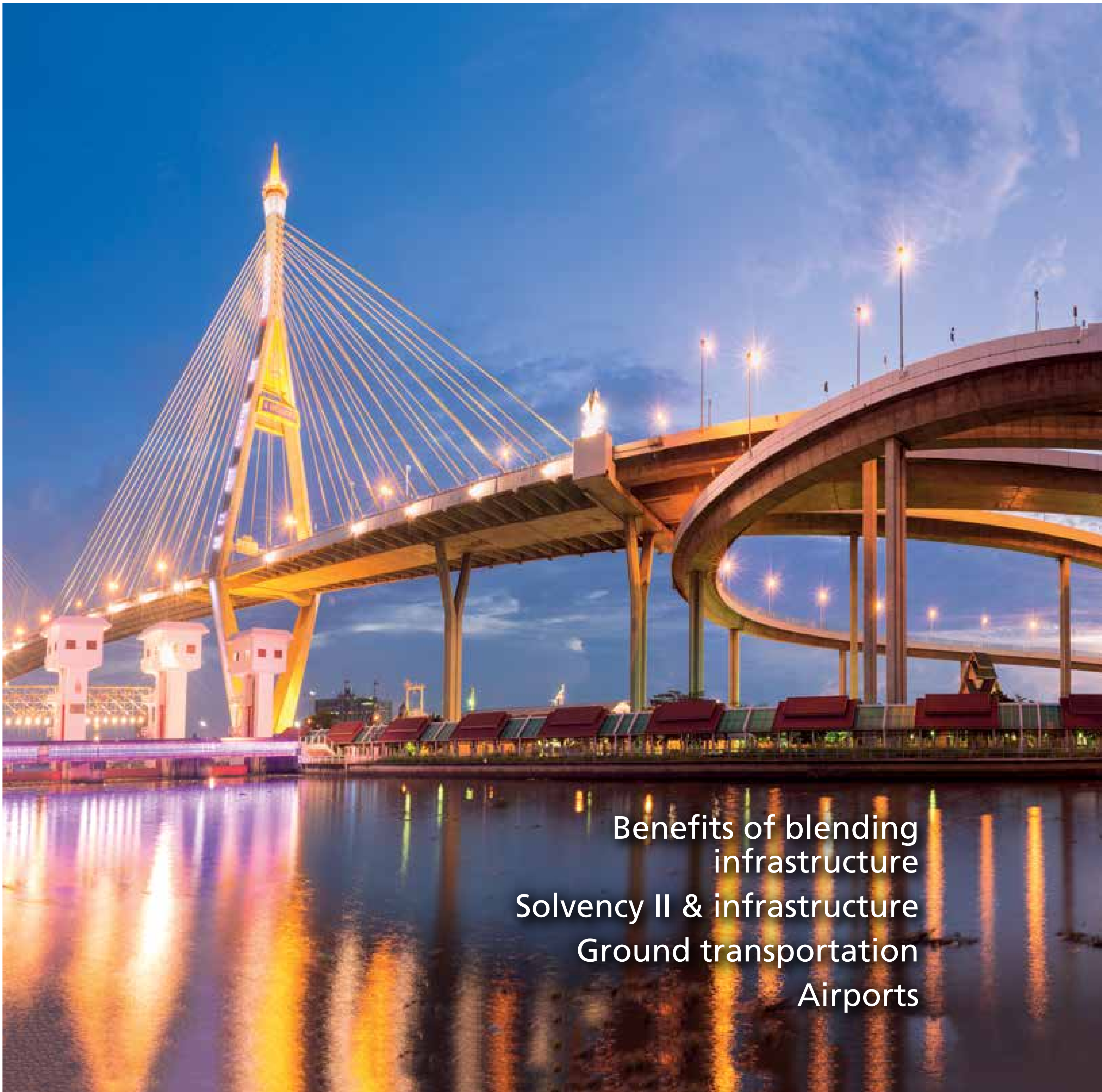

Benefits of blending infrastructure

Solvency II & infrastructure

Ground transportation

Airports

# Debt flow incentives

*By Ryan* **Allison**

**Regulatory and government initiatives driving the appetite for, and supply of, infrastructure debt investments.**

Amid a sustained low interest rate environment, institutional investors are casting their nets wider in search of assets which reward them with sufficiently attractive yield. One asset class which is catching the attention of insurers is infrastructure debt. There are two main drivers for this:

- There appears to be a lack of high-quality alternative assets which display the characteristics required to align to an insurer's existing risk profile and risk appetite.
- The risk-adjusted return on capital achieved by infrastructure debt is attractive, with a number of regulators and governments actively encouraging and facilitating increased investment in infrastructure in their respective jurisdictions.

Infrastructure projects have historically been financed by governments using public funds, due to their inherent economic and social value. In recent years, however, an increasing number of projects are being financed by private funds. The UK Government, for example, recently announced that it expects £483bn of infrastructure investment planned by 2021 to come from the private sector.

## Regulatory and Other Initiatives for Increasing the Appetite for Funding Infrastructure Debt

Looking ahead, the treatment of infrastructure debt under Solvency II (the risk-based capital regime which came into effect for European insurers at the beginning of 2016) may be a more attractive proposition for insurers, compared with traditional investments.

Seeking to encourage infrastructure investment, the European Insurance and Occupational Pensions Authority (EIOPA) recommended the introduction of a new asset class under Solvency II for "qualifying infrastructure investments". Based on this advice, the European Commission (EC) adopted an amendment to the Solvency II Delegated Act in April 2016 which reduced the capital charge for investing in the debt of infrastructure projects (i.e. unlisted infrastructure debt).

EIOPA and the EC are in the process of determining whether a capital charge reduction could also be applied to listed infrastructure debt (referred to during the consultation period as "infrastructure corporates"), however the final advice published by EIOPA on the topic suggested that there may be insufficient evidence to justify a capital charge reduction at this stage.

Nevertheless, listed infrastructure debt still remains an attractive proposition and has the potential to grow the supply of good-quality infrastructure debt investments for insurers. In particular, listed infrastructure debt is more liquid relative to unlisted infrastructure debt and also enjoys a similar expected level of diversification benefits. In addition, listed infrastructure debt investments are likely to require less specialist knowledge or in-house expertise or large amounts of project spend compared with unlisted investments, in order to identify and invest in profitable infrastructure projects. It will be interesting to observe how this subset of the infrastructure asset class evolves as regulatory and government initiatives are realised.

## Other Approaches

The Belgian Government recently proposed plans to help increase the levels of investment in domestic infrastructure. Draft legislation was approved by the Belgian cabinet which would allow real estate companies to invest in infrastructure for the first time. The Belgian Government has also suggested removing the requirement that listed real estate companies hold at least 50% in joint ventures with institutional investors, which could further boost investment in infrastructure debt.

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Beyond Europe, the Bermuda Monetary Authority (BMA) is planning to introduce qualifying criteria for infrastructure equity investments. Such investments which meet the qualification criteria will benefit from a lower capital charge under the Bermudian regime (which has gained equivalence with Solvency II), increasing their attractiveness to Bermudian insurers from a return-on-capital perspective. The BMA has indicated that this amendment to the local regulation is likely to come into force on January 01, 2018, with the potential for a capital charge benefit being extended to infrastructure debt investments too.

## Actions for Boosting the Supply of Potential Infrastructure Investments

In addition to the activity by regulators to encourage private investment in infrastructure debt, a number of local governments have also taken action to boost the supply of infrastructure assets.

The UK Government has claimed that infrastructure spending and construction spending will hit record levels, with £500bn anticipated to be invested between 2017 and 2021.

In addition, the UK Government launched the National Infrastructure and Construction Pipeline in December 2016, which details planned investments in infrastructure across the public and private sectors in the UK. The pipeline contains over 700 projects and programmes which are eligible for investment over the next five years. Of the total £500bn to be invested, projects to be funded entirely by unlisted infrastructure debt are planned to make up over £200bn of this total value. As a consequence, there is still a considerable amount of funding which is anticipated to be met by other sources of finance, such as equity investments and listed debt.

Plans include investments of over £2.6bn to improve transport networks; a multi-million pound package to accelerate the future of broadband, and £7.2bn to construct new homes.

Proposed in 2013 by the Chinese Government, the Asian Infrastructure Investment Bank (AIIB) is an international bank which seeks to support infrastructure investment in the Asia-Pacific region. Infrastructure development is of paramount importance to many Asian nations and the AIIB complements existing organisations, such as the World Bank and Asian Development bank, by providing investment solely for this purpose. The AIIB has recently been joined by a number of major western economies, including Germany, UK and Canada.

Investment in Asian infrastructure is expected to reach $26tn by 2030 with estimates of $14.7tn invested in power projects, $8.4tn in transport, $2.3tn in telecommunications and $800bn in water and sanitation.

Recent AIIB funding includes a $216.5m loan for a Slum Upgrading Project in Indonesia, a $27.5m loan for a Border Road Improvement Project in Tajikistan, a $300m loan for a hydropower >

project and a $100m loan for a motorway section in Pakistan.

Having just passed his 100 days of office, the Trump administration has pledged to invest heavily in the US's infrastructure. Trump stated in his 2016 campaign book *"Crippled America: How to Make America Great Again"* that "fixing the country's infrastructure would be a major priority project". Many political analysts expect that President Trump's upcoming legislative agenda will focus on infrastructure investment, an issue which may cultivate bipartisan support.

Details of the investment pledge are as yet unclear, however the US Transportation Secretary Elaine Chao has stated that an infrastructure plan would be unveiled during 2017 and would be "a strategic, targeted program of investment valued at $1tn over ten years". The proposal is anticipated to cover "transportation infrastructure, energy, water and potentially broadband and veterans hospitals."

## Renewed Focus on Infrastructure Debt Investment at a Local and Global Level

To conclude, there has been a hive of recent activity from regulators and governments looking to increase infrastructure spending, with the anticipated consequence of such initiatives being an increase primarily in unlisted infrastructure debt investments. It will be interesting to see how the listed infrastructure debt market grows as a secondary consequence of such initiatives, and if regulators or governments adjust their approach to take actions tailored specifically to this subset of the investment universe.

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