Award-winning infrastructure investment strategies

Hear from *Infrastructure Investor* and *Private Equity International* Award winners, Capital Dynamics, CDPQ, EQT, Partners Group, and more as they outline what put them at the top of the pile in 2019. You can also hear from and connect with many esteemed award winners at *Infrastructure Japan Korea Week* on 7-11 September.

» Clean energy in action
» A stakeholder-oriented approach to investing
» A thematic approach to infrastructure
» Capital allocations landscape from 2014-19
» Expert insight from 2019

infrastructureinvestor.com/japankoreaweek | #iiJapanKorea
What makes clean energy such an attractive investment opportunity right now?

John Breckenridge: Technology and cost changes have turned the global power markets upside down. The cost of solar has come down by more than 80 percent over the past six or seven years. The cost of wind has fallen by even more than that since the industry began in the early 2000s. What looked like high cost energy a decade ago, has now become competitive on an economic basis.

Then you have the regulatory environment. As a shift to renewables has risen up the agenda of most state and federal governments, incentives have been put in place to fuel that transition. Meanwhile, and particularly in the US, we are seeing the development and implementation of large-scale storage, which enables a greater penetration of renewables.

Finally, limited partner appetite for renewables has grown substantially. While European investors have been focused on the sector for some time, just five years ago, if you mentioned renewables in the US, some investors would cringe. Now investors understand that the sector can deliver on returns, not just a responsible investment mandate.

How are you seeing wind and solar power generation evolve?

JB: Between 2001 and 2005, we saw the emergence of the first economically scalable onshore wind turbines. What was a niche industry, suddenly became a competitive part of the overall power market. At the same time, solar was growing, but still very expensive.

A second wave began around 2010, when solar prices started to fall. Larger-scale solar projects came online, as well as solar thermal projects, which looked like they may become competitive, but have since been taken over by the PV market. About five years ago, meanwhile, solar really started to take off at a utility scale. In the US, the largest projects are 300-400-plus MW in size, with over a million solar panels each. That’s a relatively new development.

Simon Eaves: From a European perspective, prior to the last 18-24 months, onshore wind and solar were subsidised, so money piled into the sector over a long period. That money was fairly agnostic regarding technologies, geographies and natural resources as investors focused on yield. The subsidies for onshore wind and solar have now been largely withdrawn and that dynamic has changed.

With the market largely unsubsidised, location and technologies are becoming increasingly important.

The offshore wind market, meanwhile, remains largely subsidised and historically has been dominated by the larger utilities developing large offshore concessions. Having developed and constructed those assets, the utilities are now selling minority stakes into the market.

What are the fundamental differences that you see in the way the US and European clean energy markets operate?

JB: In the US, most of the subsidies are based on tax, involving complicated financing structures that require a level of specialisation. Projects in the US also tend to be bigger. And you effectively have 50 different markets, which further adds to the complexity.

SE: The European market is becoming increasingly interesting because it is transitioning. Statistically, Europe has the highest penetration rate of renewables in the world, driven by decades of subsidies. Although subsidies are now less common, there is still a lot of capital targeting renewables. Large amounts of capital are targeting operational assets, which are changing hands at high valuations in relatively straightforward deals that attract low-cost capital in search of yield.

At the same time, however, without the benefit of subsidies, building new assets is a lot harder unless you have the relationships and depth of expertise that we have. Utilities tend to dominate the bigger deals, but the really interesting opportunities we see are for assets below the utilities’ radar - medium-sized deals where a lack
of subsidies means there are significant barriers to entry, but with the potential to generate higher returns.

“In the south-western US, we are now at the stage where solar and storage is cheaper than a new thermal peaking plant”
John Breckenridge
Capital Dynamics

What opportunities are you seeing outside of power generation – storage, for example?

JB: We are on the way to becoming the largest owner of storage in the US with 2.6GW hours of storage being constructed. A few years ago, storage was so expensive it was impractical. But that cost has come down by almost 80 percent and in the south-western US, we are now at the stage where solar and storage is cheaper than a new thermal peaking plant.

In the US, I think storage will become a huge part of the market. In California, for example, there is so much solar that in the middle of the day, prices get extremely low, or even negative, meaning you can charge a battery inexpensively and then discharge it at the end of the day when solar comes offline. That’s a very valuable proposition.

SE: There is no doubt storage will be a game-changer. As we move towards a higher percentage of renewables on the system, you have to find a solution to the intermittency of those assets. It will take longer to get there in Europe, because while US subsidies have largely involved tax incentives, in Europe we are moving from a subsidised market to an open market and we need to figure out how batteries fit in.

“The really interesting opportunities we see are for assets below the utilities’ radar – medium-sized deals where a lack of subsidies means there are significant barriers to entry”
Simon Eaves
Capital Dynamics

How do you approach ESG considerations?

JB: ESG has gone from being a nice-to-have to one of the most critical aspects of what investors are looking for. Because we focus on renewables, we naturally have a high ESG content. A couple of years ago, that would have been sufficient. But today, investors are scrutinising supply chains and labour, for example. One of our most recent funds was awarded with a five-star rating by the Global Real Estate Sustainable Benchmark, or GRESB, an ESG benchmark for real assets. Capital Dynamics was recognised as a sector leader for the renewable power generation sector, and three of the power projects in that fund were the top three projects ranked by GRESB in the photovoltaic power generation category. ESG is something we take very seriously.

SE: It is not just the impact we have on a day-to-day basis, but about how you measure and quantify ESG. In addition to third-party measurements like GRESB, we developed a proprietary approach to responsible investment based on the United Nations Sustainable Development Goals. We grade every element for each of our projects, with measurement beginning at due diligence and continuing throughout the life of the investment.

Why have you decided to add a debt strategy to your product offering?

JB: Because of our position in the market, we see most of the opportunities that arise. If there is an opportunity with a long-term contract, we are able to source a very low cost of debt and can generate solid, infrastructure-style returns on our equity. However, we also see projects that have shorter offtake contracts and carry more merchant risks. Those assets command a higher equity return but are not well-aligned for lower cost debt. We don’t take those kinds of equity risk, but the debt element can prove highly attractive on a risk-adjusted basis.

This complementary opportunity set and the attributes of infrastructure debt pair well for investors. We created our credit business to focus on an area in the power market that requires a depth of knowledge and specialisation, which is why we hired Paul Colatrella, who brings extensive experience in this space, to lead this effort. Our credit business focuses on an underserved segment of the market to provide compelling cash yields with notable downside protection. It can help investors to diversify their sources of yield, as these contracted projects are less sensitive to changes in the business cycle.

What are the key challenges that the clean energy industry faces?

JB: First, we are reaching the point where the intermittency of renewables is impacting the grid. That has unleashed technology solutions around smart grids and lower cost storage. Second, wind farms, in particular, use substantial amounts of land. The most obvious locations are used up and development is becoming more challenging. That has led to regulatory and technological innovations.
SE: I would add a third challenge, which is how you differentiate yourself in a market where there is such a large pool of capital looking to be invested. Being a dedicated renewables investor, with our own in-house asset management capability, enables us to stand apart from a lot of the money that is going after the de-risked operating assets which are changing hands at relatively high valuations.

How do you expect the clean energy investment space to evolve going forward?

JB: In recent years, we have invested over $1 billion of equity per annum. That means we have been able to stay at the forefront of the sector’s evolution. When the yieldco model failed, it created a lot of M&A opportunities, and we were able to take advantage of that.

As Simon alluded to, a lot of money has since poured into the industry and those plain vanilla transactions are generating lower returns. But at the same time, there are 1,600 municipal utilities and co-operatives in the US, all looking at how they can find a partner to get better at renewables. So, our business model has evolved to focus more on specialist solutions. This represents a far bigger potential market, but it is also a more difficult, and therefore interesting, part of the market to service.

The other major evolution going forward will be around battery storage. Renewables are still at a relatively early stage. The bulk of power is still produced by traditional thermal plants. As storage increasingly comes online and as technologies get cheaper and cheaper, it will accelerate the adoption of renewables.

SE: The European market is slightly different. We all know about the green push that has accelerated over the past 12 months, resulting in a lot of European countries phasing coal generation out of their generation mix. Furthermore, very few countries are building new nuclear plants. So, you have a huge swath of capacity that has to be replaced. The majority of that new generation capacity is likely to come from renewables. Just from the perspective of system requirements, therefore, the future looks extremely attractive for renewables. Where the real added value comes in, however, as subsidies are no longer available, is in gaining access to quality assets with the right risk/return profile for our investors that others aren’t seeing. We do that through our relationships with developers.

The final piece of the jigsaw, meanwhile, is to contract directly with companies and corporates themselves who want to buy power from us directly through long-term contracts. Real value can be generated by matching these off-take contracts of large corporates with the deals that we have accessed directly from developers; the market is certainly heading in this direction. It is about providing energy solutions, not just building wind or solar farms. The last five years have been exciting, but things will only get better.

John Breckenridge
Senior Managing Director and Global Head of Energy Infrastructure
Capital Dynamics
Although there are plenty of opportunities related to digital infrastructure and the energy transition, the infrastructure sector is replete with challenges that require an experienced team and a steady hand. Natixis’s newly formed affiliate Vauban Infrastructure Partners has 15 years of infrastructure expertise. Founding partners Gwenola Chambon and Mounir Corm say the firm prides itself on taking a stakeholder-oriented approach that aims to align the interests of offtakers, regulators and users when investing in infrastructure assets for the long term.

**What is the DNA of Vauban? And what is your specific focus and strategy to approach the market?**

We focus on core infrastructure assets that provide essential services to communities. We have designed our funds with a long-term, 25-year strategy in mind, in order to match with the nature of the underlying assets.

We prefer to be involved in very long-term, essential infrastructure that aligns with both the regulator and offtaker as well as other stakeholders that will be developing and maintaining the assets in which we invest. That way everybody is on the hook for the long term, making sure that service is adequately provided. If the users, regulators and offtakers are satisfied, then we can expect long term sustainable value on those projects.

This reflects the fact that ours is a very stakeholder-oriented strategy, which, as a mid-market European manager focused on core infrastructure assets, is a key differentiating factor between us and others in the market. We place a strong emphasis on service, user satisfaction and alignment of all interests for the success of our infrastructure investments.

**What challenges and opportunities are you seeing in the infrastructure sector today?**

Infrastructure is a rising star in the private investment space among the private equity and real estate asset classes. More and more capital is being allocated to infrastructure, but the money is becoming concentrated in fewer and fewer hands. And the amount of money in the market is putting pricing pressure on investors. Therefore, in order to maintain relevance, managers need to have a differentiated strategy, a proven track record, and established partnerships to be able to deploy investor capital with efficiency. In a low interest rate environment, you have to take all the benefits of available liquidity but not add more risk on de-risked assets. So, typically, for example, we try not to maximise leverage but rather push for the longest available maturity on senior financing.

Other than pricing and leverage, there is also stakeholder interest in environmental and social governance issues, which you need to consider when investing in infrastructure assets. It is one of the key issues which you must make part of your DNA and investment approach. This is what we try to do with our long-term view. It is also important in terms of the risk approach you take in pursuing new investments to take into account the long-term climate impacts and resilience of infrastructure assets.

“Other trends in the infrastructure market across Europe where there is immense need for capital investment are digital infrastructure and the energy transition.”

Investments in these sectors are essential to maintain Europe’s competitiveness in the market. This can only be done with private sector involvement while reconciling everybody’s interests in order to address those needs.

One further challenge that investors currently face in European infrastructure is that there is a lack of public support for private investments in infrastructure, whereas we’re in a low interest rate environment with a lot of liquidity available from investors that is...
ready to be invested over the long term. At Vauban, we believe that there is a need for the government to support investments by procuring projects.

On the lack of greenfield opportunities in Europe

A challenge for infrastructure in Europe is that we aren’t seeing as many procurement processes for greenfield projects hitting the ground. They are decreasing significantly. Meanwhile, the US is now getting a lot of attention from a procurement standpoint and becoming more important than Europe for the first time ever.

The lack of greenfield dealflow in Europe is partly a result of the debates on the legitimacy of private investments there. We have seen that vividly with the UK private finance initiatives debate on the legitimacy of private investments in public assets. The only way to reconcile everybody is by having a long-term horizon and aligning all interests to regain legitimacy and trust.

Which sectors and geographies are currently booming in European infrastructure?

The sectors we see drawing the most investor interest in the current environment are social infrastructure, utilities, digital infrastructure and transportation.

Our view is that the most active among those today is digital infrastructure. The digital divide has generated a need for a lot of capital expenditure across all geographies and jurisdictions.

In addition, there’s a long-term need to invest in data transport and storage to keep pace with the upward trend in data usage. It is a booming sector across Europe, and some countries on the continent are lagging behind more than others. This means there are some areas where the opportunity set is deeper than others.

Broadly speaking, another sector that is currently very active is the utility space. Opportunities in this sector relate to utilities – such as energy efficiency, electricity transmission, district heating, water treatment and waste, which are in need of greater investment in order to realise energy transition goals.

We have seen new types of infrastructure emerging over the years as the needs of the population have evolved. There is an increasing trend of urbanisation everywhere, so there are opportunities in sectors like electric vehicle charging in several countries. At some point, that may become a standalone infrastructure asset class. This is similar to how fibre emerged 10 years ago as a new type of infrastructure. Initially, when we moved into the fibre sector, we were among the first movers, and many infrastructure funds were wondering whether it would evolve. Now fibre has become an essential utility.

In terms of geography, the historically active European infrastructure markets of France, Spain, Portugal, Italy and the Nordics remain engaging, and these are where we find the most transactions in the private investment space. Ireland is also a dynamic market. Conversely, we see less opportunities in Germany or similar markets where there’s not a culture of private investment in infrastructure, and where there is a very strong local pension industry which makes it difficult for GPs to penetrate and invest.

Tell us more about how Vauban Infrastructure Partners was formed

Vauban is a dedicated affiliate of Natixis Investment Managers that is focused on infrastructure equity investment. It has $3 billion in assets under management, 35 team members and a 15-year track record with an entrepreneurial structure.

Vauban IP completes Natixis Investment Managers’ real assets offering. Natixis IM already had offerings in the real estate and private equity markets, and now Vauban exists to focus exclusively on infrastructure investments. We became a dedicated affiliate at the end of 2019.

Vauban is a fully fledged investment company dedicated to investing in core infrastructure assets in Europe in perfect continuity with what the team had been doing for the past 10 years. Most senior members of the team have become minority stakeholders alongside the strategic investment manager, which is the principle of creating a partnership. Natixis has a circa 60 percent stake, while we maintain a circa 40 percent stake.

What is the typical investment ticket size for projects that Vauban targets?

This is actually quite variable, because while we have funds, we also have co-investment deals, so the magnitude can be large. Our average ticket size can range from $50 million equity cheques to much larger amounts, depending on the transaction.

We try to cover the mid-market and add diversity on the lower and higher ends of the market. We can acquire portfolios of public-private partnerships as well as co-controlling stakes in larger
corporate infrastructure. We take controlling positions and try to be agile, because capacity requirements and agility are the best way to approach leading roles. We have also built industrial platforms and strategic partnerships with industrials. So we could start with a smaller $20 million to $30 million equity cheque and then build it up. When we look at our portfolios, between two-thirds and three-quarters of the transactions we’ve completed were bilateral, acquired through strategic partnerships with industrial sponsors or industrial platforms.

What are your plans for Vauban? What do you see for the company over the coming years?

We hope to continue to grow our platform, and to double our assets under management from $3 billion to $6 billion in the next three years. We want to keep focusing on what we do best, which is core infrastructure in Europe and strategic partnerships with industrial sponsors. For now, we are only focused on Europe. We may at some point in the future look at the potential for geographical diversification.

Join the mid-market panel with Vauban Infrastructure Partners at

Panel: Investing in the mid-market
» What are GPs current interpretations and definitions of the mid-market?
» What are the challenges in the mid-market infra space GPs face, in terms of deal sourcing, operation and exit?
» What opportunities does it offer to the Japanese institutional investors?

Gwenola Chambon
Vauban Infrastructure Partners

Spence Clunie
Ancala

Stephen Dowd
CBRE Caledon Capital Management

Hamish de Run
Hermes Infrastructure

Learn more at infrastructureinvestor.com/tokyo | #iitokyo
Using its unique thematic sourcing approach, Partners Group is at the forefront of the energy transition life cycle. Managing director for private infrastructure Europe, Esther Peiner, explains how to deliver value for investors while creating sustainable infrastructure assets.

**What is the best approach for sourcing investments in today’s environment?**

At Partners Group, we have developed a bespoke thematic sourcing approach whereby we conduct regular analysis to identify those sectors and subsectors that offer higher value relative to others in today’s market. In order to be successful, we need to find themes and geographies that we believe will yield the most attractive investment opportunities for our clients. For example, we look at a handful of thematic global energy trends, in terms of where energy is sourced from, produced and used, as well as trends around urbanisation and mobility. There is a need for capital to construct, upgrade or scale-up infrastructure.

That’s where we play to our strengths. Our ownership model is based on a five- to seven-year period where we work actively alongside our assets to grow and further de-risk their business.

We are in an up cycle today, but we know the music will stop. While our thematic sourcing approach dictates which sectors, regions and specific sub-themes we focus on, we are also conscious of the need to identify potential headwinds in these areas.

**How do you navigate the complex European landscape as an infrastructure investor?**

The theme of the energy transition and investing in the construction of renewable energy generation has been an important focus area for us over the past few years. We have been successful in delivering large and resource-intensive offshore wind projects in Europe, and we have demonstrated that we bring value-add to those projects.

Recently, onshore renewable build-out has slowed in Europe, which is a consequence of complex additional local regulations and permitting issues in various countries. This has led to a lot of smaller scale developers struggling to access funding and, inversely, created an opportunity for larger players to consolidate and secure attractive wind or solar sites for future production.

“The complex of additional regulations and permitting issues in Europe has created opportunity for larger players to consolidate and secure attractive wind or solar sites.”

To counter regulatory obstacles, one must diversify across different geographies. A greater degree of scalability and diversification allows a company to better develop and grow a portfolio more swiftly. We can provide a very good understanding of the European landscape to our partners as we have conducted due diligence on projects in almost all European markets.

For example, our track record led us to discussions with the founding partners of German renewable developer VSB Group, which also has a strong presence in France. VSB is a developer, owner and operator in the renewable energy sector that has delivered over a gigawatt of wind and solar across Europe. We acquired an 80 percent equity stake in VSB in January because the company valued our expertise. A business like VSB requires a partner to fully capitalise on the market opportunity by providing not only capital but also experience outside Germany and France to strategically unlock other markets.

The next step with VSB is to seek out markets which we can develop bottom up and identify acquisition targets that would enable us to expand VSB’s pipeline. This would be an example of materially scaling up a business and of how a large platform like Partners Group can provide a big advantage.

**How do you ensure, as an owner, that the infrastructure assets and businesses you’ve invested in have adequate governance structures?**

Adequate governance requires a senior group of executives that can jointly contribute to the development, scaling up and de-risking of
Award-winning investment strategies

an infrastructure asset or business that we’re invested in. This is not a controlling committee; it is one that provides strategic guidance led by members with different backgrounds and expertise.

For VSB for instance, we will now build a board that will combine international and functional expertise, and we have started to make our first hires. Some board members will be highly knowledgeable in renewable infrastructure technology and recommend what storage technologies are to be chosen in which location, while others will have proven expertise in business-building.

An experienced board provides a great resource when quadrupling the scale of a business, since that comes with growing pains and challenges. Having board members who can be partners to the management team, as they go through a rapid expansion phase of a business, is very important for us. They are also our partners on the investment side. We invite them to invest their personal net worth in the business. Each board member takes on responsibility for one or more value creation projects and is held accountable for them, which is a very hands-on type of governance. This makes our board meetings intense, in terms of their length and depth, and we meet as a board more often than is customary in the industry.

We debate and share a broader view on sectors, trends and business strategy. The market we’re in today presents a substantial risk of macro-economic interruptions or interest rate fluctuations. So ultimately, we want to be in control of our destiny and deliver value creation in projects.

“We need solutions for building new infrastructure or upgrading ageing infrastructure to cope and ensure energy stability”

What role does your network of industry advisors and operating directors play in supporting you during the sourcing, due diligence and ownership phases of the investment life cycle?

The model that works best for us is to identify the right assets, then own them in the appropriate way so that they are worth considerably more when we realise them. Actively working together as a cohesive team is a simple recipe for success, and we replicate that across our portfolio.

For instance, during the due diligence process of our investment in the 400MW Merkur Offshore wind farm development in Germany in 2016, we engaged a highly capable senior advisor who was instrumental in renegotiating every contract around the construction of the wind turbines, and the associated infrastructure installations. That ultimately allowed us to get the most competitive offshore financing in the market. It also ensured that what had been negotiated in the contract was then enforced with the contractors. As a result, not only did we manage any challenges that arose between the parties involved during the construction, but we also refinanced the project before it went into operations. In fact, we had offers on the table from buyers even before it was operational.

Ultimately, we decided to exit the project in late 2019. During our ownership, there were challenges around marine planning tech-
Award-winning investment strategies

Technology and subsea cables, which were tackled well; and importantly, we have been able to transport the lessons learned from this project across to other projects in our portfolio.

Our advisors have deep technical expertise. They apply lessons learned to future projects, and they understand how we think and how we like to de-risk assets. It is a highly collaborative relationship. We look to replicate such successes across all the different industries in which we operate.

We have a network of hundreds of senior executives who support us worldwide. If they support us on an investment opportunity which we end up executing, they have a right to invest alongside us, particularly those that have been through successful investments with us.

Our strong network is also a useful source of potential investment opportunities. Often, such opportunities are not out in the open yet, which allows us to prepare and refine our investment thesis well before they become available for investment. This gives us a clear competitive advantage.

What is the single most important investment theme emerging this year?

For us, it is decarbonisation, and this goes beyond renewable build-out. It is the need to decarbonise transportation systems. It revolves around solving the increasing challenges placed on industries around the world that are trying to reduce the carbon intensity of their production efforts.

One can address a lot of these decarbonisation needs through infrastructure investments and upgrades. By connecting the right dots one can unlock a lot of value in these assets.

Often those who look to decarbonise might not have the expertise or be willing to tie up capital into long-term infrastructure. That is where investors like us look to construct and operate infrastructure with a counterparty that will require it in the long term.

Esther Peiner is managing director, private infrastructure Europe, at Partners Group

Hear more from the Energy Investor of the Year, Global at

Infrastructure Investor
Seoul Summit
2020
7-8 September

Partners Group will share their perspectives on energy transition panel:
Panel: Accelerating the energy transition
» Can you still get good returns in developed markets given the recent erosion of subsidies? How to find these returns?
» What is the role of corporate PPAs in the current environment?
» Investing in emerging renewables markets – which geographies and sectors are of key interest?

Andrew Kwok
Partners Group
Moonkyung Kim
Peony Investments

infrastructureinvestor.com/japankoreaweek | #iiJapanKoreaWeek
When it comes to sector-specific fundraising, clean energy has taken the crown for the past two years. More than a third of capital raised by sector-specific funds between 2017 and 2019 was renewables-focused. That was up from the 15 percent recorded between 2014 and 2016. Traditional energy, meanwhile, dropped from 52 percent in 2014-16 to only 27 percent of the total in 2017-19.

Also of note was the emergence of telecoms as a notable sector in the 2017-19 period, with Digital Colony Partners leading the race after closing its debut fund on just over $4 billion in June 2019.

---

**Expert insight from 2019**

**A little bit of stress could be good. Too much probably freezes things up a bit**

*Andrew Jones*

Global head of infrastructure debt, AMP Capital

---

**When a project is challenged, the tendency is not to recognise the problem’s impact as early as reality is telling you [that you should]**

*Marc Chiasson*

Vice-president of civil infrastructure Canada, PCL Construction

---

**I don’t think you can go a little bit into direct. You either commit to it by hiring a strong team … or you grow the strategy that is easiest, investing in funds**

*Emmanuel Jaclot*

Executive vice-president and head of infrastructure, CDPQ

---

**We believe that sustainability will ultimately become as important as financial returns in driving LP allocations**

*Emma Howell*

Partner and head of asset management, Hermes Infrastructure

---

**Climate resilience is one of the hottest topics of conversation for our LPs**

*Leisel Moorhead*

Partner, QIC

---

**We have a philosophical view that the opportunity set for adding material value through manager selection is just much bigger in the unlisted asset classes**

*Charles Woodhouse*

CIO, QSuper
Join Korea’s premier and Japan’s #1 infrastructure investment conference on 7-11 September, both of which are focused on connecting LP capital with global projects. Connect with global infrastructure leaders, including major Japanese and Korean LPs to discuss the latest global trends and investor needs.

Learn more infrastructureinvestor.com/japankoreaweek | #iiJapanKoreaWeek