Listed infrastructure funds adapt to a changing environment

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Increasing interest rates, limited assets and competitive market conditions are steering UK listed infrastructure funds towards new markets in search of better returns.

The situation for UK listed infrastructure funds is squeezing yield margins. *IJGlobal* spoke to the CEO of a listed fund who named rising interest rates as the main pressure on listed infrastructure funds. The increased interest rates is a challenge to “a lot of the listed funds as the assets are not protected by long-term inflation and the returns are not index-linked”. As interest rates increase, the yield provided becomes smaller especially if the assets are leveraged.

And opportunities are becoming scarce. David Hardy, managing director at John Laing Capital Management, said: “There is a lot of competition for a limited number of assets and this is a big factor, especially in the UK."

This trend builds on several years of competitive market conditions. Rollo Wright, CEO of Gravis Capital highlighted that “the primary PFI/PF2 market has been slow for a number of years. The lack of deal flow and the weight of capital looking for exposure has meant winning deals has become increasingly challenging”.

How listed funds can respond

Competition for UK infrastructure assets and compressed returns may push managers to look outside the UK and consider new sectors.

IJGlobal reported at the end of 2017 that the political situation in the UK could be contributing to JLIF’s search for opportunities in Western and Southern Europe. The manager said it had identified opportunities in Chile, Canada, Australia and the US, with Chile being particularly attractive due to less competition.

Hardy, a manager for JLIF, admits that funds can combat increased competition by looking "at other countries that are less mature in terms of infrastructure but with returns that are still attractive”.

Wright of Gravis Capital idenfies similar options: “[For] funds that are seeking to grow but can’t find appropriate investments in target jurisdictions that deliver sufficient returns, one option is to consider opportunities in overseas locations such as Canada, Western Europe and Australia”.

As well as looking abroad, some funds have been exploring new sectors. HICL for example, invested in Affinity Water – the UK’s largest water-only utility. Before this, it had invested mainly in PPPs.

Similarly, Wright says, “offshore wind is a sector that has been under consideration for some time, although [we] haven’t done any to date”. However, Wright explains that this would simply be an extension of their policy as the “company has reached a size which means investment in offshore wind is a realistic possibility”.

Nevertheless, consideration of new markets is a trend highlighted by many sources. Hardy stated: “Many listed infrastructure funds are moving to areas, which according to commentators, have ‘riskier profiles’. Examples include demand based assets such as tolls roads, rather than the traditional PPPs”.

Hardy added: “Listed infrastructure funds are seeking to broaden their mandates, possibly due to the competition and perhaps also seeking a different risk/return profile”.

The future of listed infra funds

While fund managers have adapted their approach, few expect radical change. JLIF’s David Hardy said: “You’re unlikely to go too far away from the investment policy… and it is important to remember that infrastructure is a very broad asset class”.

Another source at KPMG predicted a steady progression in the risk factor with “PPP funds moving away from PPP, moving to core assets while core funds move to core-plus”.