KEYNOTE INTERVIEW

US infra plays the long game

Allocations will increase as funds seize opportunities to address the infrastructure deficit, say Igneo's Michael Ryder and John Ma

The US has long had an unwanted reputation for ageing infrastructure. Creaking bridges, decrepit airport terminals and an overburdened power grid have increased political scrutiny, though policy measures to address these shortfalls have traditionally enjoyed a high degree of bipartisan support.

Michael Ryder and John Ma, partners and co-heads of North America at Igneo Infrastructure Partners, part of the First Sentier Investors Group, believe that US infrastructure businesses that address essential needs are well-positioned to prosper. And, with the asset class demonstrating its resilience during a time of economic upheaval through covid and the subsequent run-up in inflation, they are equally convinced that allocations to infrastructure strategies will increase in the coming years.

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Q Why is now an opportune time to invest in infrastructure in North America?

Michael Ryder: We've seen maturation of the infrastructure investment environment over the last few years. There are more private funds in the large-cap space, and then with the continued growth of funds like ourselves in the middle market, there really is a significant community of private investors and also a significant pipeline of activity.

The asset class has shown its resilience through the inflation cycle over the last three years. As inflation and interest rates increased, there were questions from investors who perhaps were seeing infrastructure weather this type of environment for the first time. Some were not certain how the asset class would perform. But the fantastic news from our perspective is that, broadly and universally, the infrastructure asset class has demonstrated its ability to generate attractive returns for investors through this higher inflation environment.

John Ma: The essentiality of infrastructure has become clearer as constraints in capacity emerge and demand increases. We're seeing huge underlying demand for investment in a lot of the sectors that we're active in. For example, there's growth in demand in the power sector coupled with a drive to decarbonise. For digital infrastructure, there's growing data centre demand. And in transportation, which historically has been under-invested in, there are pockets of opportunity to modernise and grow transportation-related businesses given the heightened focus on domestic supply chains.

Q How significant has policy support been in drawing investment?

JM: The Inflation Reduction Act in the US has certainly provided a big boost for power and renewables infrastructure. But you really need to work with experienced teams to help navigate the opportunities. We've seen certain instances where the IRA has fuelled demand and there's been backlogs or bottlenecks in supply chains for getting hold of equipment, and delays in interconnection queues. As an investor, you need to know who are the experienced players in the sector and have experience to know who is best positioned to actually capitalise on and can execute against these opportunities.

MR: The US has systematically under-invested in its infrastructure for decades, so there is a huge need for public and private capital to upgrade and improve infrastructure nationally across the US. That's critical for the long-term competitiveness of the US economy. Although domestic policy has created more incentives for investment, a lot of this is about catching up.

Q How important is decarbonisation for transport assets in the US?

JM: There's a big opportunity as transportation looks to decarbonise and electrify, but the sector is still early in its journey. We think this will create opportunity to improve businesses over the long term. We are looking at electrification in the short-line freight rail sector, where we are invested in a leading company, Patriot Rail. The company is actively pursuing pilot projects for alternative power systems. Though the North American freight rail industry largely relies on traditional hydrocarbon-based fuels, it is vastly more efficient than trucking. A single rail car can hold the equivalent of what goes into three to four trucks. But even though moving freight by rail is better environmentally, the industry is conscious that it still needs to do more.

There are still cost and technological challenges to address. Hybrid electric locomotive technology exists. Companies are looking at hydrogen-fuelled locomotives. The next step is to work through the technical adoption issues and the challenges of whether alternative fuel locomotives have the power and duty cycle to be suitable for heavy freight trains over an entire day, or week.

Q How do you see opportunities around digital infrastructure evolving?

MR: We've seen exponential growth in demand for data centres and digital infrastructure over the past decade, and particularly in the past two or three years. This has been mostly the result of covid, migration of data by businesses to the cloud or off-premises, and then the explosion of AI demand.

That has led to significant growth in hyperscale data centres on very large campuses, particularly for AI model development. The users of that capacity are mostly a handful of big technology companies and internet service providers. And because these data centres require significant power supply, we're seeing hyperscale facilities built in locations far from population centres. Today, they're chasing available power supply wherever they can secure it in a reliable way.

The very large end of the data centre development market also tends to require very high levels of capital. It's not so much a middle market investment opportunity, which is what we tend to focus on. Where we see opportunity is around smaller data centres close to mid-sized population centres. We are also leveraging our global experience in the power sector, to explore how we can best support the growth in hyperscale power demand and the need for increased grid reliability.

We also believe wireless connectivity, in the form of small cells, is critically important. It's an area where there will be significant investment over the next decade, which will complement other parts of the digital infrastructure rollout.

Q How are North American LPs weighing their allocations to infrastructure?

MR: The appetite for infrastructure investing in the North American LP universe has grown quite significantly over the last half dozen years. Historically, public pension plans, insurance companies and other institutional investors have been under-allocated to infrastructure in the US – relative to Canada, Europe and Australia. The reason is that there's probably been less focus on the sector.

A lot has changed though. As the asset class has matured, not all, but most institutional investor LPs in North America are now carving out an allocation for infrastructure. People have seen the resilience and the performance of the asset class through covid and then through this interest rate cycle. As funds think about asset allocations to the sector, they are generally increasing – which is great to see.

There were some tactical allocations towards credit and away from infra when interest rates increased, but that is beginning to unwind now. It was quite a short duration opportunity. Over the next 24 months, I think there will be a further increase in appetite and potentially increased allocations to infrastructure, as people move away from the higher interest rates that made credit relatively more attractive. Infra may also potentially be more attractive as people see ongoing struggles in some of the other real asset classes.

Q What do LPs view as the headline risks to the asset class?

JM: I believe that capable infrastructure managers – relative to some other real asset classes – have a lot of levers to pull to protect and create value. That is certainly our experience as active asset managers. Good managers through this last cycle have found different ways to pull those levers such as strategic and top-line revenue growth, cost management, improved operations, smart investments and fundamental business strategy execution.

This underscores the importance of investing with folks who really know the infrastructure sector. From an LP perspective, I think that one of the key risks is that there are new managers in infrastructure with non-infrastructure backgrounds. And there's a bit of a trend to push the boundaries of what qualifies as an infrastructure investment and that may not have the same resilience through economic cycles.

> *"Most institutional investor LPs in North America are now carving out an allocation for infrastructure"*
>
> **MICHAEL RYDER**

We are sticking to true infrastructure businesses that have defensive characteristics and have demonstrated performance across economic cycles.

Q How will economic and political factors in the US affect infrastructure investors?

JM: A year ago, there was a lot more uncertainty around the direction of interest rate movements than there is today. Now, there's a broad consensus that the US Federal Reserve will move into a rate cutting cycle. The exact timing and pace of rate cuts isn't certain, but there's a lot less uncertainty overall.

MR: Because of the interest rate environment over the past couple of years, and some of the inflationary pressures, the transaction environment has been a little slow. People who are not under pressure to monetise assets, such as family owners, have tended to move slowly.

As we move into a rate cutting cycle over the next couple of years, I suspect that we will see an increase in transaction activity, which will help to clear a backlog in deals. We are anticipating that 2025 will be a very, very interesting investment environment. There are a lot of investment opportunities out there, both in the small- and mid-cap space, that we think could be quite attractive.

As for the political environment, history has demonstrated that there is relatively strong bipartisan support for investment. Infrastructure in the US has been under-invested for decades, and there is significant need and political support for investment in the sector in the coming years.

If there is a change in administration, or a change in Congress, there could be some small impacts around the edges. But broadly, infrastructure is fundamentally important for long-term economic growth and we expect to see ongoing strong support at the federal, state and local levels for further investment. ■

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