KEYNOTE INTERVIEW

Redefining resilience

Infrastructure has always been about long-term, sustainable cashflows. But how you get there is changing, say InfraRed's Harry Seekings and James Hall-Smith

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Q Looking back to the late 90s and early 2000s, what was the infrastructure industry's approach to achieving long-term, resilient cashflows?

James Hall-Smith: Harry and I were both advising the government on UK partnering arrangements in the mid-to-late 90s. We were designing models that would attract private investors to greenfield PFI. Clearly, the bedrock of those structures was the fixed-price, fixed-term concession with the public sector. But equally important was the allocation of risk to the parties best able to manage those risks, while also ensuring the counterparties were sufficiently robust to withstand it.

Over the years, those models have stood up well. There have been a couple of circumstances where contractors have failed, but in the main the structuring has meant risk has been borne by parties outside of the project vehicles in which we invest. In other words, those models successfully delivered long-term, resilient cashflows.

Harry Seekings: It was really about applying oil and gas-style project finance principles to a new market. The counterparties were now construction companies and maintenance companies. But the objectives were similar – to allocate risk to those best able to manage it, while leaving project companies with limited residual risks in order to raise significant amounts of debt and drive down the overall cost of finance.

JHS: Outside the formality of the contracts, stakeholder management has also proven essential to providing resilient cashflows. We have always focused on being close to the project delivery parties to ensure on-time and on-budget delivery, and pre-empting and managing risks that fall between delivering parties. The other key stakeholder to manage is the client – the public sector in the context of mid-90s infrastructure. It was about managing their expectations, but also about taking a responsible approach to managing an asset of which they are the principal user. It was, and still is, about being a good citizen.

HS: We develop infrastructure with our unlisted funds, but also manage operating infrastructure, principally with listed capital. The real test of whether you have high-quality, resilient, long-term cashflows – and whether others believe the structuring has worked – happens at the point that unlisted funds exit.

Then you have third-party decision makers examining the contracts and the cashflows. I think the returns we've delivered have proven that we have been able to create value, and that we've done so by delivering the resilient, long-term cashflows that people in the secondaries market want.

Q What sectors were particularly suitable for the strategies you are describing?

JHS: In the early days, it was about addressing underinvestment in UK infrastructure – replacing Victorian hospitals, schools,

Solar power: over half of infrastructure deals in the past five years have involved renewables

prisons and transport systems. Preqin will tell you there has been £60 billion ($72.8 billion; €65.7 billion) of private investment deployed in over 1,000 individual pieces of infrastructure in the UK, so it has been a successful model. That was then exported to Europe and then to Canada and, latterly, the US. In the mid-2000s, we saw the transition of this social infrastructure model into renewable energy, and that was on the back of the subsidies at the time. Investors saw those feed-in tariffs as akin to the UK partnership model and the renewables sector has only grown since that time, led by the social movement to decarbonise the environment and supported by the cost of renewables becoming comparable to traditional generation. Over half of infrastructure deals in the past five years have involved renewables.

Q How has the industry's approach to this question of resilience changed more recently?

JHS: We are moving away from this foundation of a public sector offtake, or subsidy, to deal directly with end users. For example, we are actively investing in energy in Mexico and are seeing a better risk/return profile investing with private end users than we would with a government offtake. That is a mark of the industry's maturity. Investors are also looking through the offtake contracts to the strategic nature of the assets themselves. A good example would be energy storage. Yes, typically these deals are underpinned with medium-term contracts. But you need to look through the contracts to the strategic nature of those assets to provide you with optionality to capture value as the market evolves.

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>
> **HARRY SEEKINGS**

Q Explain what this transition has meant for infrastructure's approach to asset management?

HS: Asset management has become ever more hands-on and ever more important to delivering cashflows. I think it's a given to say that you need boots on the ground in the countries you are operating in – to help manage the delivery of those projects and to help manage key stakeholders. I think the evolving skill sets required of asset managers are interesting as well. Two decades ago, we were an investor managing a handful of assets. Now, we are an asset management business that also makes investments. We have more than 200 individual infrastructure investments here at InfraRed and, as the market has matured, our counterparties have become increasingly sophisticated. That means preserving long-term cashflows – keeping these assets resilient – requires active asset management.

Infrastructure assets are typically high profile. They are physically located in communities and often have a lot of interested stakeholders that have a voice when it comes to how they are performing. We need to behave responsibly and act in the interests of all these different stakeholders. When investors pay disproportionate attention to extracting value, and neglect stakeholders, it can really boomerang. We have had some evidence of that with the recent political backlash against private sector investment in infrastructure in the UK.

Q Which is why this concept of sustainability has become so critical to infrastructure investment?

JHS: Yes, although it's nothing new. Managing stakeholders, consideration for the environment, these things have always run through everything we do. It doesn't have to be altruistic. We do it because it makes good business sense and because it mitigates risk. We don't want to be investors in assets that are rejected by society. Helping society is at the core of our investable proposition.

Q Looking forward, how do you envisage infrastructure's approach to achieving long-term resilient cashflows changing further still?

JHS: There is a wall of money now entering the asset class, chasing a dwindling number of projects. That means there is a risk that people will take shortcuts – that they will forget that infrastructure is actually about long-term, resilient cashflows. We have reached a level of scale and maturity where we are able to walk away from deals if they don't make sense. But we are having to think more creatively about how to secure those cashflows.

One of the things we are doing with our current greenfield fund is invest through platforms. We will enter into joint ventures or partnerships, or back a management team to create the opportunity to invest in the underlying infrastructure. That means we are in control of the piece of infrastructure being developed and of the structuring. It has been a neat way to continue to create long-term resilient cashflows.

Q Is this shift in emphasis changing the way you approach sectors?

JHS: The industry is increasingly segmenting, not by sector, but by revenues. We look at contracted revenues, mitigated revenues – toll roads, for example, which may not have contractual certainty but where there is strong visibility of what the revenues will be – strategic revenues and merchant revenues. Once we have that information, we can look at our portfolio of assets to assess risk to the long-term resilience of the cashflows.

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>
> **JAMES HALL-SMITH**

I would add that the other lever that people are considering more is gearing. That goes hand in hand with revenue segmentation. Sometimes we see projects with merchant revenues that are ungeared as being less volatile than contracted revenues that are geared. You need to look at both revenues and gearing to get a sense of the resilience of cashflows going forward.

Q How is the industry innovating to protect its cashflows?

HS: I think it comes back to stakeholder management. That sounds easy when you are only managing a few investments, but with InfraRed managing 200 diverse assets, it's imperative to have a very systematic approach. You need to be able to map stakeholders and make sure you are communicating with them in the right way. You need to be able to monitor performance and report on that performance in an ever more competitive world. That means embracing advances in technology. We are investing significantly into technology platforms to support our asset management.

JHS: I would also point to flexibility in service provision as an innovative way to add resilience, whether that be offering additional services to the current counterparty or adding new revenue streams with other counterparties. We are also seeing innovation with insurance products. We have entered into an insurance agreement in Australia, for example, that actually underwrites the wind yield of a wind farm as well as the price. That also helps provide long-term resilience for the underlying assets.

Q What projects have you been proudest of over the past decade, or indeed two decades?

JHS: Obviously, the early projects were meaningful. We have just come to the end of a 20-year concession for the helicopter simulator that we built and operated for the Ministry of Defence, and we have managed to extend that concession for a further nine years. It is really satisfying to have seen a project right the way through the lifecycle and then have that extension procured by the public sector.

HS: Similarly, I would point to the Connect project for the London Underground. That was signed in November 1999 and is due to be handed back at the end of this year. There is an enormous amount of satisfaction in being there for the entire delivery cycle.

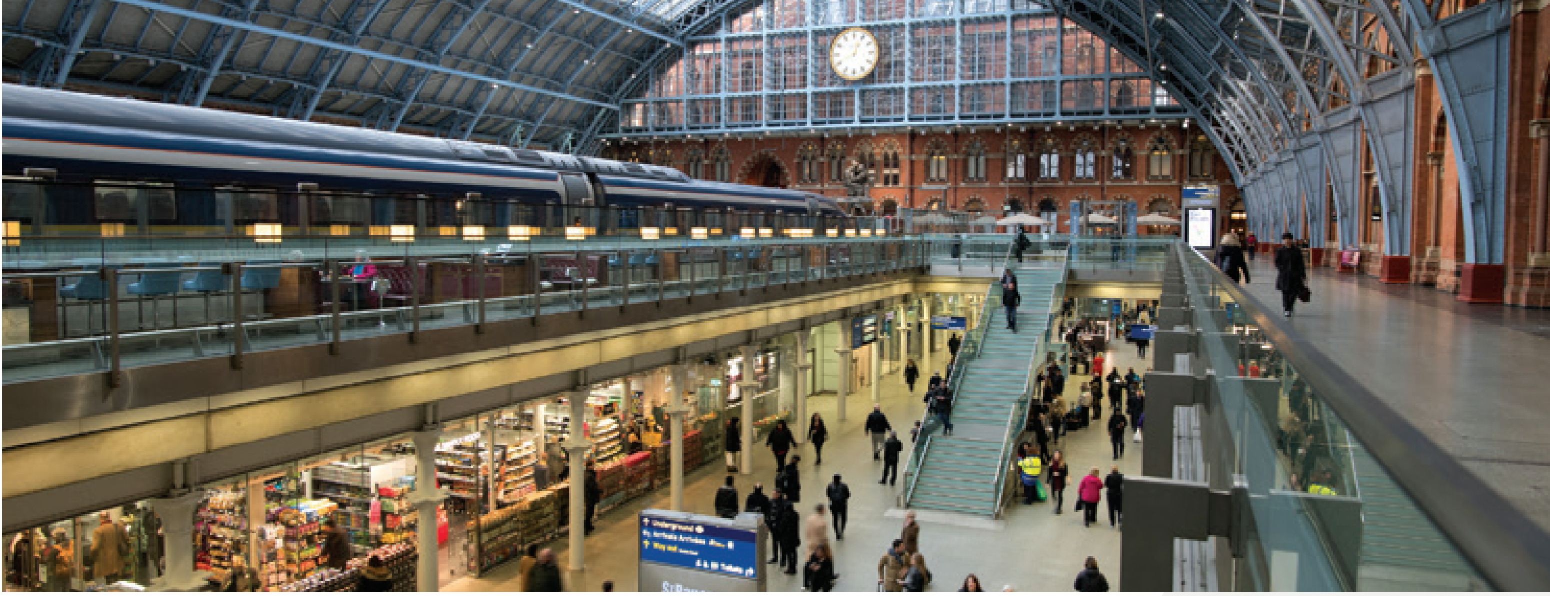
Q And what excites you most about the future?

JHS: I would say the sheer scale of the infrastructure gap that remains, particularly in the US. The US still has a long way to go to catch up with other countries' renewable responsibilities, so we see that as an exciting growth market.

HS: In most countries, the debate about who should own and operate infrastructure is receding. Even in the UK, where difficult questions are being asked, the government consultations are all about how we can attract more private investment to deliver future infrastructure needs. So what excites me is the development of more sophisticated models for partnering, to holistically deliver the infrastructure and energy needs for successful economies in a changing environment. And I think that future looks very exciting indeed. ■

Harry Seekings is a managing partner at InfraRed and co-head of infrastructure. He is the fund manager of HICL InfraRed's core infrastructure fund. Seekings joined the firm in 1998

James Hall-Smith is a managing partner at InfraRed and co-head of infrastructure. He is leading InfraRed's current greenfield infrastructure strategy. James joined the firm in 1997



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At InfraRed we believe that trusted partnership is the key to sustainable success. With 20 years of investing in and managing complex infrastructure projects, we have developed a trusted relationship with partners across the world. We pride ourselves as a responsible investor with a solid reputation for transparency, integrity and high quality delivery. Sustainability is fully embedded in our DNA.

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2001
Becomes part of HSBC

2001
Our first investment in Continental Europe

2006
HICL (core infrastructure) – first infrastructure investment company to list on the London Stock Exchange

2006
Our first investment in renewable energy

2008
Our first investment in North America

2009
Our first investment in Australia

InfraRed
Capital Partners

2010

Our first investment in Singapore

2011

Becomes independent and rebrands as InfraRed

2011

Our first investment in energy supporting infrastructure

2013

TRIG (renewables) – listed on the London Stock Exchange

2016

Our first investment in Latin America

2017

Investment in High Speed 1

First investment in battery infrastructure project

2019

$12bn equity under management