Roundtable

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Fortune favours the persistent

Dealflow constraints, political changes of heart and fierce competition are all part of the Australian landscape. But five industry champions tell **Matthieu Favas** why the market continues to compare favourably to its peers

Seriously bad weather can have serious consequences. In early June, Paris was a sad example of this, when the French capital found itself forced to close iconic museums to cope with its worst floods in almost 80 years. The deluge also threatened to engulf Euro 2016, Europe's biggest football tournament that kicked off on 10 June.

As we found out upon reaching Australia shortly thereafter, things were not exactly dry on the other side of the planet. On the weekend of 4-5 June, Sydney received its heaviest daily rainfall in about 15 years. There was no football tournament to be disrupted Down Under, but for the group of infrastructure investors we interviewed, their game has recently looked more hazard for another reason: political leaders' insistence on moving the goalposts.

The first blow came from Queensland. With a A$37 billion ($27 billion; €24 billion) asset privatisation programme initially on the cards, the state was a key plank in Australia's plan to sell about A$100 billion of assets in the coming years. But in February 2015, recalls Michael Hanna, IFM

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Investors' Australia head of infrastructure, the Labor party won an unexpected victory in the state elections. It vowed to cancel all privatisations, and the bounty vanished overnight. "There was heightened interest in the election because it was on the eve of what was potentially a once-in-a-lifetime quantum of assets coming to market. The industry had readied itself for that volume of activity and within 24 hours it had disappeared," Hanna says.

Another dampener was the cancellation of Victoria's East West Link project. The 18km toll road had been planned by the Liberal/National-led government, and contracts were signed in September 2014. However, on seizing power in state elections that November,

AROUND THE TABLE

Michael Hanna, head of infrastructure – Australia, IFM Investors

Hanna is responsible for managing IFM Investors' Australian Infrastructure Fund and is also a member of the investment sub-committee for the firm's Global Infrastructure Fund. He previously held senior executive positions at the Victorian Department of Treasury and Finance (public-private infrastructure group) and global consulting engineers Arup in the UK and Australia.

Marko Kremer, head of Australia, DIF

Kremer is head of Australia and a senior director at DIF. He joined the Dutch firm in 2008 and has led the Australian office since 2015, where he is responsible for the origination and execution of infrastructure and renewable transactions. Prior to joining DIF, he was an executive director in the leveraged finance team at ABN AMRO. He previously spent five years at ING wholesale banking.

Brett Mitsch, portfolio manager of Utilities Trust of Australia, Hastings

Mitsch joined Hastings in March. He previously worked at a number of investment banks, including Flagstaff Partners, Goldman Sachs and Citigroup, as well as in business development with EnergyAustralia, which saw him involved in the NSW power privatisation. He has also run his own corporate advisory firm, advising the mining sector on port and rail infrastructure development.

Greg Osborne, head of Asia-Pacific infrastructure, Fengate Capital

A managing director at Fengate, Osborne joined the firm in 2013 and is solely focused on infrastructure funds. He is responsible for all aspects of investing, together with establishing and managing infrastructure vehicles. He was previously chief executive of the Macquarie Global Infrastructure Fund I, II and III, as well as discretionary mandates.

Vicki Rigg, investment director, Palisade Investment Partners

Rigg joined Palisade in 2008 from Perpetual Investments. She is a member of the firm's board of directors. Her key responsibility is the acquisition and management of social infrastructure assets. Rigg also assists with the structuring and governance of Palisade's investments and is a director on the board of a number of its investee companies.

the Labour party moved quickly to scrap the project. It subsequently refused to disburse full compensation – estimated at A$1.2 billion – only agreeing to pay A$339 million to the winning consortium.

Yet Vicki Rigg, an investment director at Palisade Investment Partners, thinks Victoria got off relatively lightly after this episode. "I am surprised at how little impact it has had. The weight of capital keen to invest in PPPs seems to have resulted in people letting Victoria off the hook on this one."

Dialling in from Sydney, Marko Kremer, head of Australia at DIF, points out that investors' leniency should not be taken for granted, though. "Yes, investors have moved on from the East West Link debacle. However, politics in Western Australia continues to hamper dealflow, with the Port of Fremantle, Utah Point and other privatisation programmes all under threat again. On a positive note, government agencies do appear to be applying greater rigour to how new projects are assessed."

Brett Mitsch, portfolio manager at Hastings Funds Management, also cautions against getting too focused on government reversals. "The cycle of the politics is sometimes at odds with the long-term nature of infrastructure. The overarching theme around infrastructure privatisations as a way for governments to recycle capital is a well-trodden, tried-and-tested path. The political outcomes in Queensland and what we're potentially seeing in Western Australia are problematic in the short term, but as a whole the picture for infrastructure remains positive."

MULTI-SPEED COUNTRY

With federal elections scheduled for early July – which could potentially produce Australia's sixth Prime Minister in nearly as many years – uncertainty is also mounting in Canberra, the country's capital.

Yet Greg Osborne, a managing director at Fengate Capital, says the election's effects are more nuanced. "Political will is required at both the federal and state government levels to allow private sector involvement in infrastructure assets. And the current federal administration has shown it is favourable to this. But it is really the state governments that are setting the agenda, with the federal government providing the funding grants as and when needed."

And the case for investing more in infrastructure remains, Hanna underlines. "With the mining boom having run off, governments are looking for the next big thing that's going to create employment and economic growth. Infrastructure is seen as a silver bullet." He notes, however, that "the degree of politicisation around major projects is quite significant. And I don't think our country is in a position where it can take its time, given the significant population growth occurring in the key eastern seaboard cities."

Rigg underlines that some sectors have already produced strong economic dividends. "The renewables sector is an area where policies have had a significant influence on growth. It went from being a sector that no one would touch to one in which everyone seems to want to invest. That is largely due to changes in government attitude and policy."

Another example, she says, is transportation, where projects like the Gold Coast Light Rail have strengthened the regions hosting them. "The system has helped transform that part of the Gold Coast, with investment flowing back into the area. And the same is now happening with north-west Sydney, thanks to the Sydney Metro."

This resilient rationale for infrastructure spending, coupled with the vagaries of political cycles, means that the picture across Australia is a mixed one. "From a policy perspective New South Wales did a very good job at saying that privatisation was a means to an end," Mitsch says, referring to the A$10 billion sale of TransGrid last November and the upcoming privatisation of Ausgrid.

"By contrast," Mitsch adds, "Queensland didn't really have a handle on what people were going to do. Victoria is sort of the middle ground between those two ends of the spectrum, and it will be interesting to see what plays out in Western Australia because there's a political process underway there at the moment. If there was some clarity on where funds raised from privatisation were going to be used then that would assist."

Osborne also hails New South Wales as the poster child. "We just don't have enough infrastructure so clearly there's a sense of urgency." He observes, however, that some long-term thinking is needed to counteract the myopia often induced by electoral cycles. "An important question is that of planning related to disruptive technologies. Maybe we need to step back and assess whether, in those infrastructure programmes, everything is going to be needed. Looking at New South Wales, for instance, what is the place going to look like in 10 to 20 years' time?"

Social infrastructure is also on the radar, Kremer adds. "Although the market is relatively slow compared to previous years, we believe there is still a healthy dealflow, particularly if newly revitalised sectors, such as university student accommodation and social housing, are included in the pipeline. It is also apparent that projects can surface relatively quickly in Australia so the pipeline may look quite different a year from now."

Fortunately, Rigg observes, state governments are also becoming much smarter about procurement. "States are starting to do things with a bit more of an investment banking mindset. They should be able to make a lot of money on WestConnex," she observes, pointing at the A$16.8 billion motorway project – Australia's largest – currently being developed in Sydney. "Because construction risks and mitigations are generally well understood, from an equity perspective, they are often not the risky part. The risk is more around traffic assumptions – and once an asset is complete and has an operating history investors are willing to pay a high price."

Kremer questions whether similar outcomes could be achieved through the use of the PPP model. "It is not the construction itself that is the risky part for governments procuring under a design and construct model, it is the costs associated with variations due to projects being under-scoped or rushed to market. A key benefit of the PPP model is that it forces discipline on both

"A significant number of investors seem to have discovered infrastructure in the last 12 to 18 months" Mitsch sides, the procuring agencies and the private consortiums bidding for these projects."

Hanna is keen to emphasise how relevant the concept of "social privatisation" remains, in a context where governments need to justify transferring public assets to private players. "Superannuation funds are the ultimate best owners of infrastructure in this country. It's about moving ownership away from you as a taxpayer to you as a superannuate. Funds are proven stewards of that infrastructure, they continue to invest in it."

HAPPY RETURNS?

With healthy dealflow and good long-term dynamics, prospective bidders these days are facing more competition than ever, especially if they are bidding for trophy assets.

"There is definitely pressure on pricing, but at least in the mid-market we have the advantage that we're relatively flexible as to which assets we pursue, as there are a greater number of them, and more opportunity for bilateral negotiations," Rigg says. Which may be why, she adds, "a number of players have rebranded themselves as mid-market firms".

Partly responsible for this are direct investors from overseas, Osborne observes. "No matter what the market is doing, people in our position are driven by the mandate they have. On some deals we can't compete, others we have to walk away [from]. Indeed, direct offshore investors can make up their expectations and targets as they go along."

"Scrutiny on fees from our investors is at an all-time high. They want to be comfortable that when we participate in auctions we have a very strong chance of success" Hanna

Mitsch agrees, underlining the polarised nature of the Australian market. "A significant number of investors seem to have discovered infrastructure in the last 12 to 18 months. And what is not always understood is the long-dated nature of infrastructure, where value creation flows back into returns. So in some respects, asset pricing is driven by the weight of money looking for a home."

An added complication is the increased focus put on costs by domestic superannuation funds. "Scrutiny on fees from our investors is at an all-time high. They want to be comfortable that when we participate in auctions we have a very strong chance of success. I don't think any of us are going into processes lightly at this point in time," Hanna says.

So how to escape the crowds? By finding hard-to-do deals, our panellists reckon. Mitsch emphasises private-to-private transactions, the lead time of which, he says, can deter competitors. He also sheds light on investment opportunities closer to home. "Options for organic growth are embedded in the assets already in the portfolio and our approach certainly is about making sure we identify avenues for capital deployment."

Rigg underlines Palisade's approach to asset management – the firm recently created a dedicated unit – while Kremer speaks of complexity and sector expertise in areas like social housing. It is worth bearing in mind that "sellers have become especially careful who they're going to sell to", Osborne notes. All of against a background of abundant liquidity, with cheap debt allowing fund managers to "pick up value that is being compressed in the equity returns," Hanna says.

The resilient optimism suggests one thing: fund managers are keeping their eyes on the ball. "Escaping the crowds is definitely possible", concludes Kremer. No matter the short-term disruption and fierce competition, it seems the Australian market continues to be alive and kicking. ■