KEYNOTE INTERVIEW

Infrastructure marches on

As the asset class evolves and expands, its core characteristics provide a springboard for success, says IFM's Luba Nikulina

There is no doubt that infrastructure is likely to absorb an enormous quantity of capital in the coming years and decades, particularly as the needs of economies change and emerging sectors reach greater levels of maturity. Luba Nikulina, chief strategy officer at IFM Investors, says the future of the asset class may be shaped by what she refers to as the five Ds – decarbonisation, digitalisation, demographic change, de-leveraging public finances and finally deglobalisation.

Beyond the financial motivation, she says investing in infrastructure has the potential to deliver huge benefits for society, while also aiming to provide savers with stable, long-term returns.

Q How do you see the definition of infrastructure expanding?

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Infrastructure as an asset class emerged through investment in transportation assets such as roads and airports, alongside energy and utilities. Over the last decade, and especially the last few years, the definition of what makes up infrastructure has continued to broaden.

The first catalyst was the energy transition. Climate change and renewables entered the asset class with force. Since then, everything related to the AI revolution and digitalisation has also come to be recognised by many investors as infrastructure. That includes data centres and the supporting ecosystem, but also emerging AI-enabled operating models. Additionally, there's defence and national security, which is considered to have infrastructure-like characteristics. The asset class, simply said, is evolving.

We believe that infrastructure investing is about seeking to achieve positive societal outcomes, including delivering essential services, while also creating jobs and economic growth. The ultimate goal for investors is to deliver resilient long-term returns for the millions of working people whose retirement savings are invested with us.

Q As the definition of infrastructure changes, have the financial characteristics also evolved?

Infrastructure investors typically look for stable cashflow, resilience, linkages to inflation and the ability to help preserve the purchasing power capacity of their assets.

What has evolved relates to how assets and cashflow within the asset class still need to be developed. This partly requires investors to take on more risk. This is where growth opportunities can emerge and includes value-add infrastructure, opportunistic infrastructure, greenfield projects and capital expenditure for brownfield assets. All of these strategies may offer greater growth potential than traditional regulated utilities.

As an asset allocator, you can pick and choose or take the package, depending on whether you're more focused on growth or resilience. You can also prioritise lower returns with more stability, or higher returns alongside more risk.

Take an asset such as EV charging. The main factor is the stability of the cashflow. There might be some technology risk, but the key is to look at the quality of the contracts. This could be whether EV charging infrastructure in some jurisdictions receives support from government programmes, perhaps through tax credits or commitments to support the roll-out. The quality of the cashflow can therefore vary notably, especially when compared with emerging AI-enabled infrastructure, where returns are potentially higher, but the technology and market risks are also elevated.

Q What structural factors do you expect to shape the asset class in the years to come?

We often talk about the five Ds as the tailwinds that are expected to influence infrastructure as an asset class.

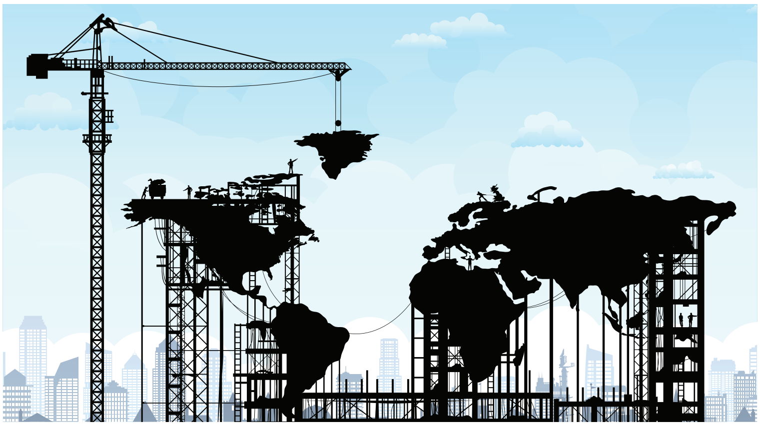
First there's decarbonisation, which is driving the energy transition. Demand for energy transition infrastructure is increasing across many markets. Generating electricity from renewables has become commercially viable in a growing number of jurisdictions, which also helps deliver positive outcomes for society. With demand for energy rising, renewables are anticipated to play a central role in meeting rising power needs.

Digitalisation is also defining opportunities – particularly around AI. It's not only about new technology, but about how businesses are rethinking the way they operate. The potential to modernise existing assets through digitalisation is enormous.

Then there's demographic change centring on ageing populations and how it affects various facilities like social care and affordable housing, which continues to be a significant factor in the infrastructure space.

We're also seeing meaningful de-leveraging of public finance. With public debt at record levels, public-private partnerships can become increasingly relevant, particularly when it comes to modernising existing infrastructure stock.

And finally, there's deglobalisation. This encompasses everything related to geopolitical risk, national security, defence and the reshoring of assets. Many countries are seeking to attract more local capital to invest in the local economy, both from a national security and growth perspective. This affects



Q What role will private capital play in meeting infrastructure needs?

Many governments are seeking ways to crowd-in private capital to help address infrastructure bottlenecks. Investment across different sectors can require significant partnership and collaboration between public and private finance. These assets, which often operate in a monopoly position, are important to the functioning of society. Therefore, the regulatory policies that govern those assets need to be effective.

From a fiduciary perspective, the primary objective for private capital is to generate returns for savers. People have entrusted us with their future retirement. If stable and predictable regulatory frameworks are not in place, then the quality of the contractual cashflow – which is an essential characteristic of the asset class – can be affected.

As a result, having strong relationships, continuous dialogue and an understanding of the way regulators act is critical. For investors, it's essential that we understand the priorities and strategies that governments have for the infrastructure space. Certain opportunities may require partnerships with governments, while some opportunities may need to be co-funded by public and private finance.

supply chains and the way we think about who owns infrastructure.

Alongside the demand drivers, we also need to think about the supply of capital and how that affects asset allocation trends. Investors continue to look for resilience. The recent period of higher inflation has made investors think more about protecting the purchasing power of their assets. Geographical diversification is also important, as some investors seek to avoid being overly concentrated in certain markets.

Q How do you see return expectations evolving in the years ahead?

When I started investing in private markets more than 20 years ago, private equity was the asset class *du jour*. Now, infrastructure continues to gain momentum, and it's notable to observe how return expectations for the asset class have shifted. In our latest Private Markets 700 research, investor net return expectations for infrastructure equity rose by around 200 basis points to approximately 13.4 percent. This is very close to private equity.

In the credit space, infrastructure debt net return expectations have also increased by around 200 basis points, to 9.6 percent, as reflected in our PM 700 findings. This makes sense as a considerable number of infrastructure opportunities may need to be financed through debt instruments.

Infrastructure has historically shown resilience through the recent period of volatility that we've lived through since the pandemic, including higher inflation and rising interest rates. We believe return expectations are already very close to private equity, yet investors can gain more resiliency and lower risk due to stable cashflow linked to inflation.

Likewise, investors can see the overall global need for infrastructure from a societal perspective. McKinsey estimates that around $106 trillion will need to be invested in the asset class by 2040.

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Q Considering these growth trends, is it inevitable that infrastructure managers will face steeper competition?

It's definitely a more competitive space. And, of course, some institutional investors have the option of co-investing or going direct. The way managers compete is very nuanced. A lot of infrastructure investing is about scale. Having invested in infrastructure for nearly 30 years, we've seen firsthand how important it is to build the right capabilities to compete effectively across market cycles.

At the top end of the market, you have a certain number of managers that need the capability and resources to be able to compete for deals credibly. Once you go further down the spectrum, volumes of capital aren't nearly as large and managers need to have the skills to manage those types of assets. The key is to find the right niche and capabilities in a competitive market.

We should also recognise the positives of competition because competition can drive innovation. As a result, we're seeing growing appetite for new models, from an operational and technological perspective, as well as financial. As an asset class, we have an opportunity to innovate financial instruments so that we can support the best pathways and outcomes that society needs. If we can find ways to do that, we will really showcase the measurable value that investing in infrastructure can help achieve. ■