IFM Investors

Deglobalisation's impact on infrastructure

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Deglobalisation is emerging as a major driver of infrastructure debt opportunities, as the US and Europe look to onshore vital industries.

Key takeaways

1	We believe a renewed focus on the reshoring of industries and building economic self-sufficiency will present investment opportunities.
2	Energy policies and the power generation and transportation landscape are evolving differently in the US and Europe.
3	Protecting growth drivers such as the digital economy and advanced manufacturing will require increased infrastructure investment, from fibre networks, data centres, factories and logistics to transportation.

In many ways, the global economy is more deeply interconnected today than at any point in human history. However, deglobalisation has become a popular political talking point, spilling into investor discussions. While we believe the global economy will remain fundamentally interconnected for years to come, we also believe there will be a renewed focus on reshoring of industries and building national economic self-sufficiency, ultimately impacting the patterns of global trade. These trends are driven by, among other things:

- Heightened geopolitical tensions
- Economic nationalism spurred by global competition, the heightened cost of living, immigration concerns, and offshoring
- Supply chain vulnerabilities
- Changes in the resource mix needed to power economic growth and resilience

These movements will shape the next wave of infrastructure investment. Politics and infrastructure have always been heavily intertwined. Support for infrastructure can take many forms and is particularly important for greenfield infrastructure development and growth. A wave of deglobalisation will particularly impact infrastructure investment through:

1) The promotion of energy independence, and
2) Protecting future drivers of growth domestically

These policies will help shape our outlook for debt investing in infrastructure sectors over the coming quarters. In this paper we will consider the landscape in both Europe and the US.

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Promotion of energy independence

Each nation's pursuit of energy independence will look different based on its available natural resources and attitudes towards reducing emissions.

European perspective

In Europe, globalisation led to a reliance on cheap, imported Russian gas, the risks of which became obvious with the outbreak of the Russia-Ukraine war. Immediate actions included increasing imports of hydrocarbons like Liquefied Natural Gas (LNG) from friendlier countries, with the US becoming the leading LNG exporter in 2023. Given Europe's political support for decarbonisation, domestic energy production increases will focus primarily on renewables, where solar, wind, and hydroelectric power have all played a role. Europe has consistently installed around 15 GW of wind capacity over the past 10 years[1], of which around 80% has been onshore. We expect to see further growth in the offshore sector, although supply chain and performance issues could slow deployment. Solar power continues to be very cost-competitive; however, reliable sunshine and land-use trade-offs challenge widespread deployment.

Countries will also need to find ways to generate and transport low-carbon power from places where it is efficient to create, to where it needs to be consumed. Not every country can feasibly deploy commercially viable renewables capacity to power their own grids.

Policy initiatives such as the European Green Deal and the REPowerEU plan have supported the renewables rollout. Norway and Sweden are now two of the largest power exporters to continental Europe via their surplus hydroelectric power. However, in our view, relying on trading energy with regional allies will not be sufficient to meet increasing electricity demand and energy security goals. More capacity is needed, and here Europe will need a multi-faceted approach.

This presents key opportunities for infrastructure debt investors, such as:

- **Increased wind and solar development:** We anticipate continued wind and solar growth, with solar expansion mainly in southern Europe, alongside the UK potentially sourcing renewables via undersea cables from Morocco[2].

- **Grid upgrades:** Europe will need to modernise and interconnect power grids across countries to truly benefit from more renewable energy generation. Investment opportunities lie in domestic grid infrastructure, interconnectors, other transmission infrastructure, and direct feedlines from energy generation sources for energy-intensive projects in the nascent hydrogen economy or for high-powered data centres.

- **Other renewable sources:** Biomass and biogas are 24/7 sources of renewable power that can help balance electricity grids. The key is to ensure sustainable and reliable feedstock sources. Geothermal and potentially increased hydroelectric power in places like the Pyrenees and Alps may also have a role to play.

- **Power generation with carbon capture, utilisation, and storage (CCUS):** Power assets across Europe are responding to evolving climate policy by accelerating efforts to deploy CCUS at commercial scale, with energy from waste and biomass plants driving deployment.

- **The role of nuclear:** The politics of nuclear generation in Europe is complicated. Germany, which produced as much as 170 TWh/year of nuclear power in the 1990s, shut down its last nuclear plant in 2023[3]. Many other reactors in Europe are nearing the end of their useful lives. If these are shut down, even greater investment will be needed in renewables. However, shifting political tides may plant the seeds of a nuclear renaissance akin to what is being seen in the US, which may include small modular nuclear reactors.

[1] Wind energy in Europe: 2023 Statistics and the outlook for 2024-2030, WindEurope
[2] Xlinks Morocco-UK Power Project
[3] Q&A - Germany's nuclear exit: One year after, Clean Energy Wire

CASE STUDY

Waste to-energy plant[4]

Funds advised by IFM Investors provided debt financing for the second largest waste-to-energy operator in the Netherlands. The business is focused on the processing and incineration of municipal, commercial and hazardous waste to generate energy, leading to a reduction in waste volumes going to landfill. It earns revenues through the collection of waste (gate fees) and the sale of energy.

The company has two facilities with a combined permitted capacity of 1,700 kt/year. The first is strategically located next to the Port of Rotterdam, and the second is on the outskirts of the City of Arnhem, near Germany.

We believe both locations are well positioned to receive and process waste and supply energy to continental Europe. The business has plans to build and operate a large CCUS facility in the medium term. Currently, this business is the only waste-to-energy operator with a commercial CCUS facility, and its port location will enable it to leverage existing infrastructure to deploy undersea carbon storage. IFM believes the growth plans combined with its strategic locations mean the business is competitively well positioned to gain market share.

[4] Case studies are provided for illustrative purposes only and should not be relied on to make an investment decision.

US perspective

In the US, political tides have shifted to prioritise energy independence and export, with climate goals taking a back seat. The US possesses an abundance of energy resources, and the Trump administration seems focused on leveraging these resources to maintain energy independence.

After years of relatively flat power demand, two key trends are pushing demand forecasts upward. Electrification of heating and transportation will strain power grids, moving peak demand from summer cooling into winter heating and increasing daily swings tied to electric vehicle (EV) charging. Increased domestic industrial output through an emphasis on onshoring and digitisation of the economy are now being supercharged through billions of dollars of investment in generative AI technologies – representing an opportunity to invest in data centres and the infrastructure to power them.

CASE STUDY

Natural gas power plant[5]

Funds advised by IFM provided debt financing to an 805 MW natural gas power generating plant in the Mid-Atlantic region of the US. The business benefits from higher capacity pricing driven by increasing demand for US power and the need for reliable dispatchable resourcing by the grid operator. Domestic capacity has historically priced at a premium due to imported power limits, transmission constraints, and difficulty constructing new plants. This is expected to continue as load growth and asset retirements tighten reserve margins on the grid.

We believe the business is well positioned to benefit from the forecasted energy demand growth driven by factors including increased EV adoption rates, higher data centre growth, and some building electrification assumed in New Jersey. To date, the business has benefited from conservative leverage, a track record of operations, a robust hedging strategy and experienced equity ownership.

Within the power market, other key investable themes include:

- **Natural gas as a transition fuel:** Natural gas remains a highly efficient source of reliable baseload power and will continue to push out older, inefficient technology and coal fired power. Gas power plants can also step in quickly to maintain grid reliability against fluctuating renewable power output.

- **Solar and wind projects continue:** Even with potential political headwinds, solar and wind capacity can expand in the US, to the extent that projects remain economically competitive. Many projects remain supported at the state level. Broadly speaking, institutional investors may replace funding from the Inflation Reduction Act for economically viable projects. Offshore wind development is more threatened, as President Trump has issued an executive order to halt new offshore wind leases and permits in federal waters.

- **Other renewables:** Geothermal, biogas, and hydroelectric power are less politically sensitive. "Advanced" geothermal projects leverage advances in subsurface modelling and horizontal drilling learned from the natural gas fracking boom to generate clean baseload power. Future water management projects could involve hydroelectric opportunities.

- **Upgrading grid infrastructure:** Like Europe, US grid infrastructure needs significant upgrades in many parts of the country, with transmission lines and transformers operating well beyond their intended lifespan.

- **Nuclear revitalisation:** Driven by demand for clean firm power, operators of three shuttered US nuclear reactors have announced plans to restart their facilities, including a multi-billion dollar commitment from Microsoft to reactivate Three Mile Island in Pennsylvania.

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Protecting drivers of growth: The digital economy and advanced manufacturing

As debt investors, we are keenly focused on protecting against downside risks. Understanding how growth plans can go wrong is important to our decisions to lend to infrastructure projects (such as rail, fibre, and data centres) supporting manufacturing growth. Even advanced manufacturing companies with significant government support have faced challenges, including Northvolt, the Swedish battery manufacturer that filed for bankruptcy last year. When investing in infrastructure to support growing industries, it is important to understand the competitive forces in an industry, and the strength of the contracts and offtake agreements manufacturing companies are able to secure.

We see opportunities to invest in the following infrastructure assets to support domestic technology and manufacturing development.

Data centre development: This is at the top of the agenda for countries striving to compete in the AI technology boom. The economics for data centres vary regionally, depending on factors like grid connectivity, land availability, local climate, and proximity to major tenants in technology hubs. Data centres are power-hungry and less sensitive to power prices than other users, which can lead to compelling opportunities to invest in the power plants tied to them. They also tend to benefit from highly rated counterparties with strong lease agreements.

Improved infrastructure in rural areas: Reshoring of manufacturing will likely mean factories and logistics infrastructure will need investment in more rural areas where there is sufficient land to build facilities. Digitisation has also created opportunities to invest in the fibre rollout in rural areas to replace less efficient copper wires.

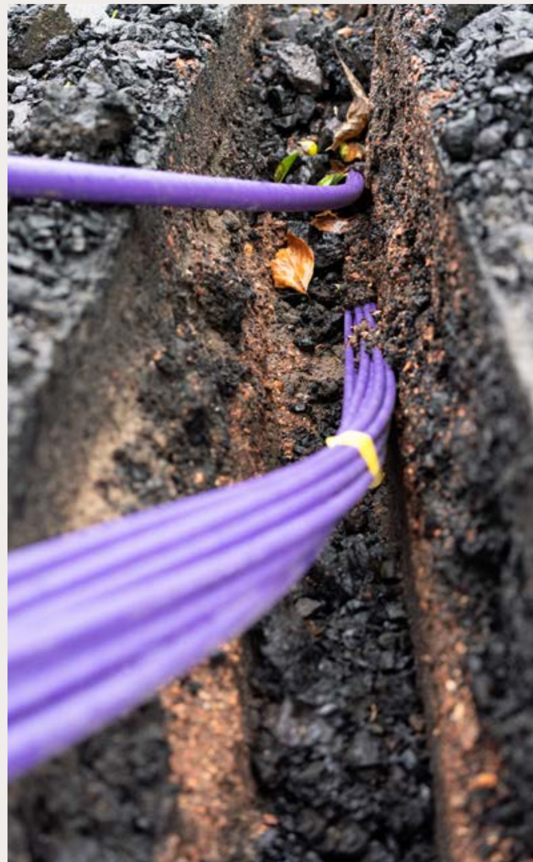
Transportation infrastructure: If supply chains are being rerouted towards allies and trading partners, they will require better local and regional transportation infrastructure. Investment is also needed to electrify transportation to meet emissions reduction targets. We see opportunities to lend to businesses upgrading rail, bus, and ferry infrastructure to make it more efficient, sustainable, and able to handle increased capacity.

CASE STUDY

Fibre-to-the-home[6]

Funds advised by IFM provided debt financing for the largest independent fibre-to-the-home operator in France. The business designs, owns and operates fibre network infrastructure across the country with a focus on low- and medium-density areas where current connectivity is more limited. Currently in France, one in five households lack access to reliable, high-speed internet.

The French government and regulator are very supportive of the provision of fibre networks and the decommissioning of the copper network throughout France to promote digital inclusion via a less carbon intensive source. Unlike many other European economies, the provision of fibre services in France is regulated. Each operator in France has access to the network at determined pricing guidelines and benefits from a permanent right of use of 5% of the network capacity in a given area for a 20-year period. Ultimately this limits the risk of overbuild or over-competition for the provision of fibre services in a given area, especially in low density areas where businesses benefit from subsidies to improve the provision of services.



Conclusion

As the world becomes increasingly digital, we are witnessing economic change happening at a rapid pace. Global trade and mobility will remain important, but as governments seek to protect their domestic economies and improve global competitiveness, we expect to see more protectionist policies. Infrastructure will need to evolve to meet these changing economic needs.

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