INFRASTRUCTURE HORIZONS 2025

IFM Investors

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Expanding horizons

Infrastructure's maturing as an asset class demands fresh thinking

The maturing of infrastructure requires a greater willingness by investors to disentangle the risk and return drivers of the asset class, moving away from the view of infrastructure as a monolithic whole to a risk factor-based approach.

Key takeaways

1. Investors need to consider infrastructure opportunities in terms of risk exposure and return characteristics, rather than pursuing a single-minded focus on core assets.

2. Engaged, active asset managers can extract additional returns through targeted capital expenditure, expanding assets in what is often a proprietary deal.

3. A growing number of thematic opportunities, developing assets, or those adjacent to traditional infrastructure offer the potential for higher returns and the possibility to add value.

For decades, infrastructure was viewed as a reliable, homogenous asset class, with airports, toll roads and utilities the cornerstone of institutional investors' exposures. In Australia, where superannuation funds began investing in infrastructure 30 years ago, they have reaped the benefits of long-term ownership of many of the country's busiest air and sea ports. Their buy-and-hold approach is now sought after as the model to emulate by governments the world over.

But as infrastructure matures, and interest from institutional investors continues to grow, it is time to move away from the perception of infrastructure as a monolithic sector. We should instead consider opportunities in terms of the risk taken on, the sectors in which we invest, and the assets' distinctive return characteristics.

Infrastructure as ballast and buoyancy

The maturing of infrastructure will be an evolution rather than a revolution. The asset class will retain the same fundamental traits: cashflow generative, backed by hard assets, socially vital and difficult to replace, with significant barriers to entry and low competition. We can view infrastructure in nautical terms – as a ship's ballast, which also supplies buoyancy. It provides resilience and stability (the ballast), while also offering the potential for returns to support portfolio outcomes (the buoyancy). Its resilience stems from the fact that infrastructure assets often underpin a well-functioning society. Its users rely on the freight moved through sea ports or the water provided by utilities, regardless of economic circumstances. Both infrastructure equity and debt can provide the ballast and buoyancy that appeal to investors.

Yet as the sector matures, we can start to shift away from labels that no longer reflect its evolving dynamics. Toll roads and airports have traditionally been viewed as core infrastructure assets. Today it can be more useful to think of infrastructure in specific sectoral terms, such as where to consider an allocation to transportation, social and energy infrastructure or utilities.

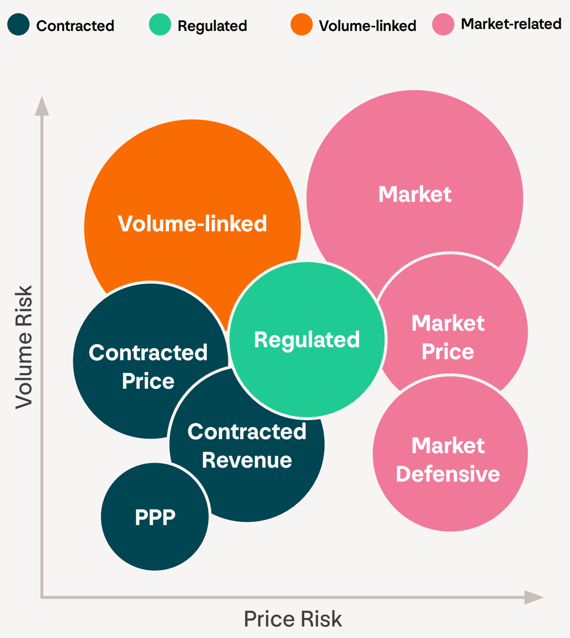
> While developing infrastructure assets do not offer the same level of resilience as mature ones, their return potential can be considerable.

What role is infrastructure performing?

Alternatively, we can consider the specific characteristics that infrastructure can offer investors. Should infrastructure equity be broken down into assets offering inflation protection and cashflow certainty, and those that present greater opportunities for growth? Where investors desire reliable income, underpinned by contracted revenue streams and robust covenants, should they consider the benefits of infrastructure debt over equity? Debt makes up the majority of infrastructure transactions and can offer interesting and complementary characteristics in portfolios. So rather than viewing all infrastructure as a homogenous asset class, investors could instead view it through the prism of the risks to which each asset exposes their portfolio, as well as the ways in which it can generate value and income over the longer term.

FIGURE 1

INFRASTRUCTURE RISK FACTORS



*Public-Private Partnership

Source: IFM Investors

Mature versus developing opportunities

Another way to think about infrastructure is to divide it into mature and developing opportunities. Mature assets are existing toll roads, airports and bridges, where extracting additional return requires experienced asset managers exploring new ways to add value with management teams. One way to achieve this is through capital expenditure, as IFM Investors frequently does. These transactions are proprietary deals that only the experienced owner-manager with a long time horizon and well-established operational capabilities can access. Think of the opportunity for marine terminals to capitalise on demand for energy security and more sustainable fuel sources, as VTTI's recent acquisition of a majority stake in Italy's largest liquefied natural gas import facility attests. These transactions can benefit investors and also improve the value proposition to the wider community.

Some mature assets require an experienced manager to turn around their fortunes. These opportunities can arise upon privatisation, or where an asset suffers from high levels of debt and the threat of bankruptcy. Opportunities can also arise where the previous owner has failed to commit sufficient capital to the asset. This requires a new owner to invest significant sums, such as improvements to road quality and safety upon first acquiring a toll road.

Alongside mature infrastructure, significant capital must also be deployed in developing fields that require an appetite for construction risk, such as energy and digital sectors. The energy transition and the shift to a low-carbon economy are driving increasing capital requirements. The rollout of renewable energy requires a transmission network to connect new solar and wind farms to the homes and businesses consuming it. While developing infrastructure assets do not offer the same level of resilience as mature ones, their return potential can be considerable.

Other opportunities are arising in a 'goldilocks' zone. These are transactions that are neither too big nor too small, yet are often overlooked by infrastructure funds more interested in closing one or two large transactions. These mid-market opportunities are more frequent, and have more attractive competitive dynamics than larger transactions. They present opportunities for experienced managers to implement operational improvements and, potentially, sell selectively.

Some infrastructure opportunities are emerging at the intersection of traditional asset classes. Should a business park adjacent to a major airport be commissioned, built and managed by an airport operator with relationships with airlines flying in the freight? Or should it be an initiative of a real estate developer with relationships in industrial property and connections to large retailer customers? Investors would do better to weigh up their exposure to infrastructure, real assets, or even to risk-based factors, disregarding more conventional asset labels.

Alternatively, many investors are seeking to explore the opportunity set of infrastructure thematically. Three megatrends are reshaping both the asset class and the broader global economy. The energy transition is driving investments in renewables; digitisation of the economy and the advent of AI is driving opportunities in data centres and the expansion of fibre networks. Meanwhile, the reshoring of industries, and a focus on national self-sufficiency, presents opportunities to build and expand energy production, factories and logistics infrastructure.

Building out your neighbourhood

We are also seeing the emergence of opportunities within the 'neighbourhood' of infrastructure. These infrastructure-adjacent opportunities often benefit from the same economic protections as the core assets they supply – albeit without the regulatory framework directly underpinning their day-to-day operations – with the potential for higher returns and the opportunity to add value. This underlines how the categorisation of the asset can be less important than how it generates income and weathers economic cycles.

Infrastructure-adjacent opportunities can include water treatment plants that service growing catchments of metropolitan areas and offer drought protection in regions where water stress is common. They can include facilities adjacent to sea ports that shift freight to trains rather than trucks, helping reduce the carbon emissions associated with goods transport.

As a leading private markets manager with deep expertise, experience and networks in infrastructure equity and debt, and a growing capability in technology-focused growth private equity, we are particularly interested in the confluence of technology and critical infrastructure. Some infrastructure-adjacent opportunities resemble private equity in their risk and return potential. They can be compelling due to their increasingly important role in securing and enhancing a core asset's performance – by delivering cost efficiencies, power bill reductions, improving safety standards or other aspects of performance.

[1] Drone inspections - Ausgrid

Importantly, pursuing ventures that more closely resemble private equity allows us to build an understanding of a nascent and emerging opportunity set. Many of the niche opportunities capitalised by private equity have the potential to grow and become part of the mainstream infrastructure market.

For example, one of Australia's largest energy distributors, Ausgrid, has invested in drones to inspect its vast network, which supplies electricity to millions of people in New South Wales. The drones, typically weighing less than 2kg, can be used to survey hard-to-reach areas for bushfire prevention efforts, remove objects and untangle power lines[1]. Similarly, ageing water utilities could invest in artificial intelligence to better monitor water leakage and potential sewerage spillage – increasing the precision of maintenance programmes and minimising regulatory fines.

The opportunity set and investment universe of these infrastructure technology opportunities are only limited by the speed of technological developments emerging. Consider how far AI has come in ten years, or how drone technology has reduced in cost, making drones viable equipment for anything from surveillance to firework displays. These new opportunities span a range of important investment themes and megatrends, from capturing the energy transition to digitisation and automation.

Drone survey

Conclusion

As infrastructure matures and develops as an asset class, it demands fresh thinking from asset allocators. Infrastructure retains its distinct characteristics – and now it spans the full range of risk appetite, from secure debt investments to high-yielding opportunities equivalent in return to private equity. This evolution encourages not a uniform but a more nuanced and sophisticated approach from investors.

[1] Drone inspections - Ausgrid

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