



# In the face of a new crisis

*What does the ongoing turbulence in the Eurozone mean for fund managers? Infrastructure Investor gathered six investment professionals in London to discuss – and to find out how it has influenced their approach to deal financing, target sectors, fundraising and more. Andy Thomson and Bruno Alves report*

PHOTOGRAPHY BY MARK HAKANSSON



**RARELY HAVE THOSE** invited to an *Infrastructure Investor* roundtable turned up so promptly. And rarely has the volume been cranked up so swiftly as conversation bubbles in advance of the ‘official’ discussion getting underway. You’d be forgiven for thinking there’s a burning issue on everyone’s minds, applying irresistible pressure to share thoughts and elicit views from others. But what could that possibly be?

Funnily enough, once the din dies down and the first question is asked – and yes, you’ve guessed correctly, it’s about the Eurozone crisis – no one immediately volunteers an answer. It is, after all, a big nettle to grasp when the spotlight’s suddenly on you. Rather like being asked to take the first penalty kick in a cup final. In the end, Philippe Taillardat, co-head of infrastructure investment management Europe at First State Investments, breaks the silence.

“US investors have gone very quiet on Europe, they are waiting to see what happens,” he says. “But Europeans, Canadians and Australians continue to be active in infrastructure investing as they look to diversify and dilute their exposure to sterling.” He continues: “There are, however, some concerns

expressed by the limited partner community about doing deals in particular European countries which include Spain, Italy and Greece.”

#### NO CHILL TODAY

Taillardat is seated at the far end of a table which also includes European infrastructure fund management professionals Wim Blaasse (DIF), Wael Elkhoully (EISER Infrastructure), Martin Lennon (Infracapital), Renaud de Matharel (Cube Infrastructure) and Alain Rauscher (Antin Infrastructure Partners). The setting is a room in London’s Athenaeum Hotel overlooking Green Park on a bright and surprisingly warm November morning. Today there is no “chill” in the air – a word that has frequently been deployed in descriptions of the Eurozone’s travails.

Taillardat captures the mood well with his balanced comments. Those gathered do not underestimate Eurozone-related difficulties – and the impact that these are having on their businesses – but they are not dwelling on worst-case scenarios →

➔ As the conversation progresses, the view is frequently expressed that there is simply too much at stake – for the entire world – to allow the Eurozone to break up in a disorganised manner.

There is some hardnosed realism from those present, however. “For those investors wishing to realise value today in the Eurozone, the current loss of confidence would inevitably have a negative impact,” says Elkhoully, head of asset management at EISER Infrastructure. “There are also a number of assets that have an ongoing need to be financed or refinanced and the volatility doesn’t help when it comes to sourcing additional capital.”

De Matharel, chief executive and managing partner of Cube Infrastructure, is also wary of volatility. “Interest rate volatility (see boxed item on p. 22) has increased significantly in Southern European countries because there is concern about government and local authorities’ ability to address their obligations over the long term. So when assets come up for sale, do we go ahead? The terms of the deal may be tempting but you have this volatility. And our investors don’t want volatility – they want stability of our fund’s net asset value and dividend payments.”

He adds: “To continue paying dividends, we have to look at essential assets and crisis-proof assets.”

## LIFE GOES ON

But, while there is acknowledgment that life is far from easy, it would be equally far from the truth to draw the conclusion that the market has retreated into its shell. Rauscher, founder and chief executive officer of Antin Infrastructure Partners, says that, in some ways, it has been business as usual even through the turmoil of the last few years.

“The good deals were getting funded, even at the peak of the Crisis,” he says. “We got a £1.5 billion (€1.7 billion; \$2.3 billion) funding package for [portfolio company] Porterbrook [in October 2008] because of the resilience of the asset. Today also it’s business as usual, but with a flight to quality.”

This is not to say that Rauscher is fearless in the face of macro developments. “If European governments opt for drastic spending cuts, like the UK government did recently, you can end up with no growth – and, if there’s no growth, you can’t repay the debt. What would we risk being faced with if all of Europe did the same? Stagflation.”

DIF managing partner Blaasse is also alarmed: “The fact that there is an open discussion that countries could leave the Eurozone is very difficult. If Italy and Spain leave, there is a serious problem. You have a big problem if you have made investments in euros and you get paid in lira or pesetas.”

While infrastructure fund managers are wrestling with all kinds of different possible scenarios – ranging from the preservation of the whole Eurozone to a partial break-up and a total break-up – few would at this point claim to have a full understanding of all the likely ramifications. Like the rest of us, they are simply hoping that the politicians will – in the end – find an answer.

But while everyone waits with baited breath to see whether Euro land prevails or unravels, fund managers have pragmatic decisions ➔

## AROUND THE TABLE

### WIM BLAASSE, DIF



Blaasse is a managing partner of DIF. He joined DIF in 2005 and is responsible for all aspects of the investment process including the origination, analysis, execution, optimisation and realisation of infrastructure and renewable transactions. Prior to joining DIF, he was a partner at PwC where he was responsible for infrastructure/PPP and energy-related transactions from 2002 to 2005. Prior to joining PwC, Blaasse was head of project finance at Rabobank International. During his 12-year tenure at Rabobank he held various roles within corporate finance.

### RENAUD DE MATHAREL, CUBE INFRASTRUCTURE



De Matharel has 23 years of infrastructure project management and investment experience. He founded Cube Infrastructure Fund in 2007. Prior to this, de Matharel spent eight years with Vinci Concessions where he had executive management responsibilities as general manager of Vinci Airport Management and Deputy General Manager of SGE Concessions. He joined Vinci Concessions from BNP Paribas where he worked for 10 years, notably as head of project finance in Milan and London.

### WAEEL ELKHOULY, EISER INFRASTRUCTURE



Elkhoully has 20 years’ experience in the infrastructure sector, spread across most sub-sectors and in various capacities as a principal as well as advisor. He joined EISER in early 2009 following approximately five years with Citigroup’s infrastructure investment banking team where he covered infrastructure funds and advised on a number of transactions including airport privatisations in Europe and the Middle East, M&A in European utilities and transport as well as fund structuring and raising. Prior to Citigroup, he spent over 10 years with the investment arm of Bechtel.

### MARTIN LENNON, INFRACAPITAL



Lennon has over 20 years of infrastructure-related experience gained in the corporate and financial sectors. He joined the Prudential Group in 1998 where, before founding Infracapital, he led the Project & Infrastructure Finance business at M&G Investments, developing a substantial and diversified business investing in the infrastructure sector across a wide range of financial instruments.

### ALAIN RAUSCHER, ANTIN INFRASTRUCTURE PARTNERS



Rauscher founded Antin Infrastructure Partners in 2007 to capture the growing opportunity in European brownfield infrastructure investment. He is chief executive of Antin Infrastructure Partners, sits on three portfolio company boards and has over 25 years experience including M&A and advisory with BNP Paribas, Lazard Frères, Lehman Brothers and Bain & Co.

### PHILIPPE TAILLARDAT, FIRST STATE INVESTMENTS



Taillardat is co-head of infrastructure investments, Europe and based in London and Paris. He has more than 17 years of relevant experience in infrastructure, energy and other capital-intensive industrial sectors, including principal investing, financial advisory, equity and debt financing. He is an engineer from ENSAM Paris and a MBA graduate from EM Lyon.

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→ to make right now. Which geographies and sectors to invest in – and which to avoid – are practical, rather than theoretical questions.

Lennon, co-founder and head of Infacapital, is bullish: “I can’t think of a time when there was more investment choice in terms of geographies and sectors. Deciding whether to invest or not is at least as much about the qualities of an individual deal opportunity as it is about market specifics. For this reason I think we would be foolish to completely rule out opportunities, say, in Spain or Italy.” He adds that, while infrastructure has its challenges, it’s nonetheless much better placed than many other asset classes as investors increasingly seek relative stability and cash yield.

Elkhouly chips in: “In the Eurozone today, there are very challenging markets. Greece is an example. But I think Italy and Spain are different. Despite the risks, we continue to be interested in those countries because they represent deep infrastructure markets. We have existing investments in both Italy and Spain and we’d consider doing more – but we’d be cautious.”

Blaasse adds that the European Union and International Monetary Fund telling Portugal (see p. 6) to renegotiate its public-private partnership (PPP) contracts (as part of its €78 billion bailout earlier this year) is a good reason to stay away from that country.

#### GERMANY: MIXED FEELINGS

While it’s quite easy to identify the markets that investors would have reservations about in the current climate, a question about most-favoured locations is arguably more challenging. Taillardat is quick to respond, however.

“Germany among other countries is at the top of our list for the coming year,” he says. “It is not an easy market and there have not been too many deals there to date. However, we see a number of encouraging trends, such as its exit from nuclear, the need to develop other forms of power generation and corporates offloading non-core assets.”

The mention of Germany does trigger an unfortunate association in the minds of infrastructure investors, however. In September, Commerz Real said it had been left “surprised” when the German electricity regulator announced it was planning to limit equity returns in the sector – just one day after Commerz Real had led a consortium of investors that acquired Amprion, Germany’s fourth-largest grid, for an enterprise value of €1.3 billion.

Rauscher is prompted to say that Antin Infrastructure Partners has “cold feet” about investing in regulated assets. He adds: “Others



“The fact that there is an open discussion that countries could leave the Eurozone is very difficult. If Italy and Spain leave, there is a serious problem”  
– Blaasse

take a different view and, in normal conditions, it’s safe. In Germany for example, we recently saw the RAB [Regulated Asset Base] change. I remember arguing the point in a recent meeting that regulated assets should have a higher risk premium because of state risk and being told I was not making a sensible point. And then, the next day, the German regulator lowered the RAB.”

Rauscher’s view does not literally draw gasps from those assembled, but the idea that regulated utilities should carry a risk premium is a radical one – or, at least, would have been radical until recently. At the very least, he is correct in drawing attention to the emergence of certain risks around infrastructure investment that were not envisaged at a time when governments were under less pressure to balance their books.

It’s not surprising that some of those around the table would disagree, however, given that regulated utilities is a target sector for many infrastructure fund managers. First State Investments is one of these. “We may disagree on regulated utilities,” says Taillardat. “It comes down to how well you understand these assets and what your relationship is with the regulators. Their appeal to investors is explained by their low correlation with the rate of economic growth, which is particularly attractive in a low growth environment such as we are experiencing today, and the predictability of their income streams linked to the fact that they provide essential services.”

“I fully agree that it’s important to focus on essential services,” adds de Matharel. “The asset is only worth the service that it delivers.”

#### SOVEREIGN RISK

Aside from adjustments to RABs, another type of ‘sovereign risk’ that has grabbed attention in recent times has been the adjustments made by some governments to renewable energy tariff regimes. This issue was back in the news again one day after the roundtable took place when 14 infrastructure investors represented by law firm Allen & Overy handed the Spanish government a demand for international arbitration over last year’s retroactive cuts to Spain’s solar tariff framework.

“From a country risk perspective, looking at those countries which have a big deficit, we’re very selective about renewable energy investments – even more so than in PPP [public-private partnership] projects,” says Blaasse. “The key renewable energy markets for us at →



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“The volatility doesn't help when it comes to sourcing additional capital”  
– Elkhouly



the moment are France and Germany. There is good deal flow in those countries and the regulatory situation is conservative.”

One sub-sector within renewable energy that appears to attract a lot of scepticism from those present is offshore wind. This is interesting since it has been a fairly major investment theme over the last year or so. For example, in August, Blackstone Group subsidiary WindMW secured the backing of nine banks in a €1.2 billion deal to finance what will be Germany's largest offshore wind farm once it is operational in 2013.

Having viewed offshore wind farms up close, Rauscher says they “look spectacular”. But that is where his admiration ends. “We are far from comfortable investing big amounts in offshore wind. You have to bet on teams working in the North Sea, where the weather conditions are very testing. And there is construction risk and a likelihood of delays too.”

“It's very early technology, at least in the context of the environment in which it is being deployed, and we don't like technology risk,” adds Lennon. “We might be more enthusiastic about the sector in the future, but not right now.”

Taillardat offers the opinion that “it is somewhat of a concern

to see some institutions making their first infrastructure investments in offshore wind”. Blaasse underlines the point by suggesting that “while the returns are very similar to other types of renewable energy, the risks are very different”.

#### NO LACK OF DEBT

Turning to a different kind of risk, what is the risk of deals in today's environment being unable to attract the level of financing that they require? After all, just when the banking sector might have been tempted to think the worst of the post-Lehman mess was over, exposure to troubled European economies will surely lead many to cut lending all over again as they try to shore up their balance sheets. If anyone needed reminding of the potential for another banking crisis, along came the multi-billion-euro bailout of Belgian bank Dexia in October.

However, in what surely amounts to an endorsement of the perceived resilience of infrastructure, the roundtable guests claim that the new deal market has not visibly suffered from a lack of debt. “The debt market has always remained open throughout the Crisis”

## INTEREST RATES: ‘OUT-OF-MARKET SWAPS’

As if lack of liquidity and potentially damaging regulatory changes weren't bad enough, investors also have to suffer the indignity of seeing interest rate volatility wreak havoc on their investments' yield curves.

“There is currently huge volatility around the mark-to-market value of interest rate swaps,” remarks Martin Lennon, the head of Infracapital.

Interest rate swaps – the elder statesmen of the derivatives world, having been around since the late 1970s – are near ubiquitous in infrastructure as a hedge against interest rate fluctuations. Author E.R Yescombe provides a neat summary of the mechanism: “Under an interest-rate swap, a project company with an obligation to pay interest at a floating rate under its loan agrees to pay its counterpart (a bank or banks – the ‘swap provider’) the difference between the floating rate and the agreed-upon fixed rate if the floating rate is below this fixed rate, or will be paid by the swap

provider if the floating rate is above the fixed rate.”

But with quantitative easing and the Eurozone crisis keeping interest rate benchmarks like LIBOR low, sponsors now have a problem because “deals that were financed some years ago are locked into long-term interest rate swaps and interest rates are now much lower,” Lennon explains.

In a persistent low interest rate environment, investors are effectively getting more debt added to their investments, because their interest rate swaps are generating negative mark-to-market values.

That leaves investors with two choices if they have loans coming up for refinancing: “You can look to roll the swaps, but then you'll probably have to pay an additional credit spread. Or you can break the swap contracts, but if you do that then you'll have to compensate [the counterpart] for the crystallisation of the mark-to-market position,” Lennon explains, adding: “This can be an additional challenge to deal with at times of refinancing.” One more headache then. ■



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from 2007 to 2011 for quality infrastructure investments,” insists Rauscher. As one example, he points to Antin Infrastructure Partners’ acquisition in October of a 100 percent stake in Axión, a Spanish provider of broadcasting, tower infrastructure and telecommunication services.

“Not many deals have failed because of the lack of commercial debt,” adds Taillardat. “For good quality assets, there is no problem. There is still bank lending in Italy and Spain – and from domestic banks as well as the European banks.”

There is a feeling that, for the right deal, financiers will still come to the party. Equally, there is concern that this state of affairs may not last indefinitely. But it’s not market conditions that are seen as the enemy in this respect – it’s the regulators. “It’s long-term lending for me that is most under threat because of Basle III,” says Lennon.

Adds de Matharel: “Basle III regulations will affect liquidity at a time when banks’ balance sheets are, in any case, shrinking. It could create a quite alarming credit crunch and be bad news for greenfield projects and leveraged buyouts in particular.”

In anticipation of the problems around long-term lending that may be generated by the likes of Basle III and Solvency II (see boxed item on p. 26), some fund managers are beginning to explore other sources of funding. Lennon says Infracapital recently tapped the US private placement market for both senior debt and high yield “to diversify our sources of capital so we have more choice in future”.

### THE PENSION CONUNDRUM

One of the big talking points in the infrastructure investment market is how to involve pensions in providing long-term funding. Industry veterans will tell you this is nothing new, but since the demise of the monoline insurers in the wake of the 2008 Crisis, it has become a more difficult task. This has not stopped the UK government, for example, identifying pension money as the engine for its new £30 billion infrastructure plan.

Elkhouly acknowledges remaining debt appetite for “high quality assets with short tenors”. But, when it comes to long-term



*“It is somewhat of a concern to see some institutions making their first infrastructure investments in offshore wind”*  
– Taillardat

capital, he asks: “Although institutional money has been talked about and is certainly a great match, how easy will it be to channel those monies in infrastructure debt? These kinds of investors [pensions and other institutions] have traditionally preferred investment grade debt in rated bond transactions. There is a question as to what kind of intermediaries will help them analyse the future opportunities, directly execute and monitor investments?”

Lennon adds: “Most other institutions do not have the depth of resources that we have. It’s challenging to invest in an asset class if you don’t have sufficient knowledge and understanding of it. I joined Prudential in 1998 to lead our efforts in the sector. I made that move based on a ‘eureka’ moment, having accessed the bond markets for two road deals, that long-term institutional capital is extremely well suited to infrastructure, and I still believe that. But it’s amazing that it’s taken so long for the market to develop.”

On the subject of debt funds, which are sometimes held up as part of the answer to the long-term funding gap, Lennon raises the issue of fees: “Infrastructure equity managers have experienced some criticism at fee levels - and they are delivering equity returns,” he notes.

### ISSUES

Elkhouly adds that although debt funds are welcomed, there would be a number of issues to work around before they flourish such as the fees and capacity of these funds. “You need to do tickets worth hundreds of millions of euros to be really meaningful in terms of addressing the liquidity gap,” he says. “Does a debt fund plug the huge funding need for something like a large UK water company? Questionable.”

For all that, debt funds have found some traction with investors – witness the more than A\$1 billion closing announced by Australia’s Westbourne Capital in May, and the €241 million raised by AMP Capital’s latest debt fund in April on its way to a hoped-for final close of €500 million.

Light chuckles can be heard around the table as the subject of fundraising is broached. Getting investors to part with capital



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## SOLVENCY II: 'GET IT RIGHT'

"Regulators have got to get it right!" urges one of the roundtable participants. Its tone – a melange of exasperation and longing – certainly resonates with everyone in the room.

The 'it', in case you're wondering, refers to Solvency II – the proposed regulation for insurance companies across Europe that is due to kick in between 2013 and 2014 and which threatens to make it harder and more expensive for these institutional investors to channel their resources into infrastructure financing.

That's arguably already happening, even though the regulations have not yet been finalised. "Solvency II is unnecessarily killing appetite for infrastructure investing whereas life insurance groups are in reality the most adequate investors in Europe to finance infrastructure over the long term," Renaud de Matharel, chief executive of Cube Infrastructure, remarks.

Solvency II, as it's shaping up, asks insurers to put aside large amounts of capital for investments the regulator deems risky. The problem for infrastructure general partners (GPs) is that infrastructure is looking like it will be classed as one of those

risky investments.

"Under the Solvency II framework, infrastructure fund investments seem likely to face capital charges at the same level as hedge funds, private equity, and 'other equity'," Martin Stanley, global head of Macquarie Infrastructure & Real Assets, wrote in a recent paper for the Organisation for Economic Co-operation and Development (OECD).

But Solvency II is also threatening to have a knock-on effect on European pensions, since the European Union has said it is looking at the possibility of using large parts of Solvency II as the starting point for new pension regulations.

If that were to happen, the amount of funds available for infrastructure investing in Europe could be dramatically decreased.

"If pension trustees decided to lower the proportion of real assets to 20 percent – in line with the typical asset allocation of insurers – over €1 trillion of long-term capital would be withdrawn from financial markets," Dick Sluimers, chief executive of APG Asset Management, told *Financial News* in the summer. ■

→ commitments during such volatile times is universally acknowledged to be a tough challenge. Indeed, when Blaasse announces that DIF had re-entered the fundraising fray a few weeks prior, it prompted some applause to break out from his peers around the table. Even for DIF, which has had its share of fundraising success in the past, this is seen as an act of bravery.

"We see that it's a challenging market," says Blaasse. "It's similar to post [2008] Crisis. Some LPs might be positive but then there might be a cut in their infrastructure allocation. So you have to adapt. Track record is even more of an issue than it's ever been. You need to show that your portfolio is doing well and yielding cash, like our portfolios. Cash is king."

Elkhouly believes that many LPs have become more sophisticated in their approach to the infrastructure asset class, meaning that – rather than allocating capital simplistically to the sector – they will pick and choose. "They have a greater appreciation of the difference between sub-sectors these days and know which part of the risk/return spectrum they want to be in. At the moment, more LPs seem to want PPP/PFI and regulated assets than those that involve a bit more risk."

All are agreed that it would be particularly difficult today for new entrants to the market. "We're keeping the new entrants out," declares de Matharel to laughter all round.

Talk of fundraising leads to talk of fees. Here, there is some resistance to the idea that because of the tough economic climate – coupled perhaps with the bad experiences the investor community has had at the hands of some leveraged buyout funds – it means that infrastructure funds have to compromise on fees and carry.

The argument made by Rauscher is that a decent level of fees is essential in enabling infrastructure fund management businesses to be adequately resourced. "You need large teams and you need senior people to be a value-added investor – and you need fees for that," he says.

"Infrastructure is only worth the people that you put into it," adds de Matharel. "It's not about finance and contracts, it's about people." →



“I can't think of a time when there was more investment choice in terms of geographies and sectors”  
– Lennon



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“Infrastructure is only worth the people that you put into it. It’s not about finance and contracts, it’s about people”  
– de Matharel

➔ Adds Rauscher: “There has been some strong hostility to paying management fees and some LPs are tempted to try and take advantage of difficult fundraising conditions. But we offer a 15 percent return and a 5 percent yield, and that’s extremely competitive (and less risky) compared with other private equity models. We have a tendency to be too shy and modest in explaining this.”

There is certainly sympathy for this view, though at least one participant suggests that investors have a right to be concerned over infrastructure funds wanting to charge private equity-type fees and carry (even if there is a decent argument that infrastructure funds might outperform buyout funds in this environment).

#### WHAT NEXT?

Asked for thoughts on the hot topics they expect to be discussing next year, the prize for the least original response goes to those who refer back to the Eurozone crisis. It’s a point worth making though – it will not go away overnight and will demand a constant focus on how to respond and adapt. Other suggestions: the importance of yield, what is the right fund model and the emergence of fund performance data that will help to validate a still-young asset class.

And with that, it’s time for coats and bags to be gathered up. Even as this is done, some fairly intense conversations continue. Unquestionably, there is plenty to talk about. ■

## DEVELOPER FUNDS: ‘SYSTEMIC RISK’

Perhaps unsurprisingly for a roundtable filled with general partners (GPs), there’s not exactly much sympathy for new fund manager entrants originating from the developer community – the so-called ‘developer funds’, like the London-listed John Laing Infrastructure Fund (JLIF).

Wael Elkhoully, head of asset management at EISER Infrastructure, offered one of the most diplomatic assessments of the new vehicles: “With developer funds, they can offer investors deal flow as well as technical expertise. But investors have to weigh that against the likely conflict of interests at the EPC [Engineering Procurement Construction] level.”

“There’s a big conflict of interests [with developer funds] because we have to push them [in our acquisitions] to get the returns,” argues Wim Blaasse, managing partner at DIF. “Also, developer funds do not offer a diversified portfolio,” he adds.

The ‘conflict of interests’ argument has long been one of the traditional GPs’ greatest gripes with developer funds, although the likes of JLIF would probably strongly challenge this assertion by arguing that, on the contrary, sharing the same brand allows developer funds to actually get other group units to do what they ask instead of dismissing their requests more easily, as might happen with third-party GPs.

However, Blaasse hits upon a key point when he mentions lack of diversification, which prompts the participants to also point out that there is a “systemic risk” to developer funds in that LPs are always exposed to the same company.

That is to say, while it’s nice for a developer fund to be able to draw upon the developer’s resources, if anything ever happens to the developer or its units, then LPs would be heavily exposed through the assets they own in these developer joint ventures. ■