Navigating a changing infra market

Matthew Norman, global head of infrastructure for Crédit Agricole CIB, tells how the emergence of a European institutional debt market has altered the lending landscape, why the bank sees institutional investors as partners – not competitors – and discusses the opportunities offered by the core-plus sector

Q Europe has historically been a very bank-centric infrastructure debt market. How has that changed?

MN: The European institutional debt market has evolved significantly over the past few years. While the US traditionally provided a deep, liquid debt market for European issuers, the emergence of a European institutional debt market for the sector is changing the dynamic.

It dates back to the financial crisis, when many banks were no longer able to maintain the same levels of capacity for infrastructure projects due to regulatory and balance sheet constraints. As their lending activities were constrained this created opportunities for European institutional investors to step in directly.

Institutional investors have had to adopt different strategies to access this opportunity either indirectly via fund managers, or directly by building their own private infrastructure debt teams. As opportunities emerge, market-driven solutions have been created to allow institutional investors to build capability and deploy capital to the sector and thereby demonstrate their ability to deliver for clients.

In the past 18-24 months, what we have seen is that, firstly, the number of players in the market has continued to grow, with active investors in private debt space having increased by almost 50 percent. And secondly, investors' risk appetite has expanded, with investors increasingly adopting more flexible strategies across the credit spectrum and its sub-sectors. Notably, in relation to the latter, the market has also started to shift its focus from core infrastructure offerings, such as airports and utilities, to a broader set of opportunities, including rail leasing, waste management, ferries, energy storage and distributed generation.

"If investors start to push into the edges of the asset class, they should consider whether the additional risks they are taking on are being structured appropriately and rewarded accordingly"

Q While it's true that infrastructure investors are much more prevalent in the market, they also face some challenges. What would you say are the main ones?

MN: They certainly face a number of challenges, a key one being a highly liquid market which is very acute for established brownfield infrastructure assets. In particular, the public markets are so liquid, they put pressure on the availability of the private market 'premium', as issuers get more sophisticated and experienced about using ratings on their offerings, hence reducing investors' yield. However, the public market can't always offer them long tenors and that leaves the private market to supply them. The challenge there, though, is whether investors can live with locking into narrow spreads with increasingly limited structural protections late in the credit cycle. For some investors, pricing is less of a problem, since they are match funding assets with their liabilities.

Another challenge is that many institutional investors are gaining exposure to new products and new asset classes under capital deployment pressures in a period of unprecedented liquidity, without having yet experienced a full cycle, particularly when things don't always go according to expectations. Generally, infrastructure is a well-behaved asset class, which is why it attracts investors' interest. However, if investors start to push into the edges of the asset class, they should consider whether the additional risks they are taking on are being structured appropriately and rewarded accordingly.

A key question for investors who are new to infrastructure is: how do they want to access the market? As the market matures with more established players around, you have lots of money chasing a limited pool of deals, which raises the question of how to capture an adequate yield and structure premium.

Q Where do you see their competition coming from?

MN: First of all, I think it's important to note that the market itself generally suffers from a disconnect between the quantum of capital looking to invest in infrastructure and the size of readily accessible assets available on an annual basis.

Moving on from that, banks are one of the sources of competition and they remain very active in project and acquisition financing, though they are less active than they historically were in providing long tenors, for regulatory reasons. Also, Europe has many state-owned banks that can only support projects in their home markets and they are extremely aggressive on terms, as they may suffer from a shortage of opportunities and allocation constraints beyond their home markets.

On the other hand, multilaterals are also a key source of liquidity for infrastructure-related projects. In many cases, you can see multilaterals allocating significant resources to investment-grade rated private sector projects in strong OECD countries, which further exacerbates the abundance of liquidity available for this part of the market, thus indicating they have a shortage of opportunities as well.

Q How has Crédit Agricole CIB adapted to working with institutional investors?

MN: Crédit Agricole CIB has a long history of working with institutional investors across all products globally.

It is important that we see institutional investors as partners, not competitors. We are a global project finance bank with large teams that have significant experience and capacity in structuring, underwriting and managing assets across the sector. We work closely with our investors not only on the advisory side, but also on the arranging side of the business.

> "It is important that we see institutional investors as partners, not competitors"

Institutional investors work with us given our proven successful track record and long-term commitment to the project finance business. Our global expertise and years of experience across the sector enables us to better understand our partners and collaborate successfully to help build the best solution for our clients.

Q What segments of the debt market offer interesting opportunities, in both the short and medium term?

MN: The core sector has provided significant historical dealflow from refinancing and acquisitions. I think going forward, you will still see some refinancing and acquisition activity on the core side, including airports and utilities. In the medium term, we see core-plus offerings getting more interesting as equity investors are spending more time in this area, leading to a greater flow of opportunities for banks and institutional investors. Mezzanine and subordinated loans are also attracting interest in both the US and European markets.

When it comes to greenfield opportunities, Australia provides an appealing pipeline of projects. There is a transportation infrastructure boom happening in Australia right now, on the back of the commodity price slide that is pushing the government's efforts to develop infrastructure as a broader macro strategy to stimulate economic growth. It would be great to see other countries adopting a more visible and enhanced greenfield pipeline of projects to create added positive momentum and further diversity the sector.

Q Looking ahead, in what direction do you see the institutional side of the market growing?

MN: I think in the future, institutional investors will continue to evolve with their offerings from core infrastructure assets to more advanced products. We will continue to see banks and institutional investors 'cross over' into sub-investment-grade opportunities, as there is generally less competition and investors may be able to extract a better yield premium compared with pure investment-grade deals, where liquidity is much more abundant. This trend also incorporates with the dealflow we see coming from the hybrid, core-plus sector, where deals typically have a more challenging time achieving investment-grade ratings. ■

SPONSORED BY
CRÉDIT AGRICOLE CIB