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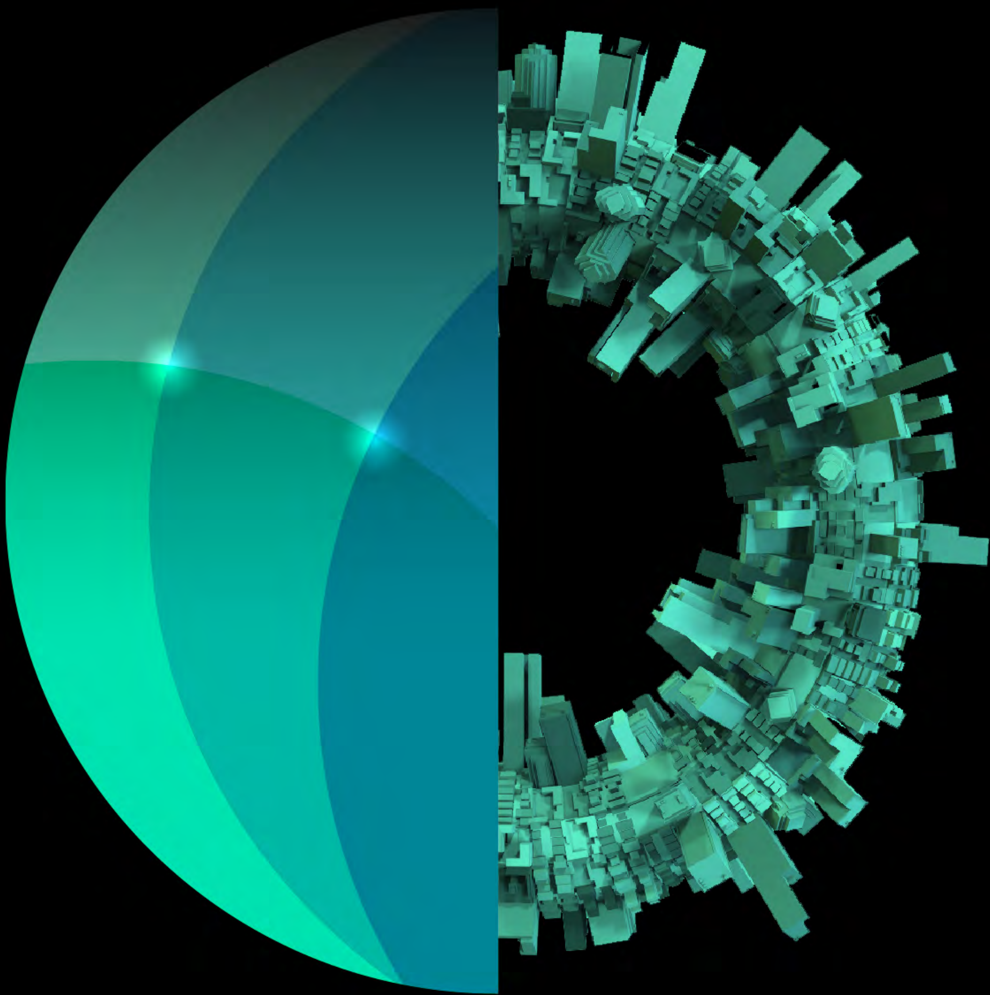

Harnessing private capital in turbulent times through infrastructure stimulus programs

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Governments are implementing ever more advanced support programs to stimulate their economies to recover from the COVID-19 crisis, and broader geopolitical challenges, and to thrive once again. The schemes being established include investments in physical infrastructure, digital and communications upgrades, sustainability improvements and highly-targeted tax incentives.

As these significant efforts move ahead, a key priority will be how to maximize their efficacy. This will require a close examination of which initiatives are best funded and run by government, and where the introduction of private infrastructure investors might drive efficient core infrastructure development and free money for schemes elsewhere.

Governments will continue to be a main capital provider for major greenfield infrastructure developments in most developed nations. Around the world, government funding remains fundamental to ensuring the progress of construction schemes involving roads, railways, seaports and airports, as well as education and healthcare facilities.

However, it is also clear that private investors can have a significant role to play in the effectiveness of existing operations, targeted new developments and asset recycling. Infrastructure funds' dry powder is now estimated to be worth hundreds of billions of dollars globally, with analysts predicting strong growth in assets under management[1] as investors seek stable growth amid global volatility. The expansion in values is also the result of investors increasingly selecting more ambitious 'value add' strategies. Beyond financial gain, the potential for infrastructure assets to meet environmental, social and governance (ESG) requirements is attracting significant capital, particularly as private investors play an important role in green energy transitions in the wake of COVID-19[2] and the Russia-Ukraine war[3].

Asset recycling

Private capital funds often have a role to play where infrastructure is already in use. Asset recycling programs see private actors acquire leases or concessions to operate public infrastructure[4]. The involvement of private capital in these settings relieves governments of the challenge of maintaining service delivery at certain sites and generates money that governments can reinvest elsewhere. The sector experience of private investors also means they can improve local services while running these assets, and enhance the value of local infrastructure.

These investments can create cyclical infrastructure development loops: the government revenues derived from asset recycling unlock fresh capital for further public investment in big builds, and potentially the development of a reliable infrastructure pipeline that further piques the interest of investors and gives them time to consider involvement in future opportunities.

Major building programs are expected worldwide in the wake of the COVID-19 pandemic, partly through government-led initiatives such as US President Biden's US$1.2 trillion Infrastructure Bill[5,6], which addresses areas as diverse as bridges and roads, water and energy, and broadband internet. That endeavor alone includes asset recycling opportunities[7] aimed at improving service quality and raising further capital. Similar schemes may be undertaken around the world, as in Australia, where recycling of port, electricity and registry assets[8] has created a government fund for the new building of railways, roads and education facilities. In Brazil, meanwhile, competitive tenders for operating airports and other facilities have secured high interest[9].

In Canada, there is extensive private investment in operating infrastructure[10], and asset recycling is also gaining traction in parts of Europe, including in the United Kingdom and the Nordics[11], while it is established as a common feature of infrastructure development patterns in Japan, India and increasingly Indonesia[12].

Greenfield investment

Private investment and industry expertise are also increasingly featuring at earlier, greenfield developmental stages. In developed markets, they may be harnessed in the greenfield space alongside funds from specialist national or regional banks, such as the European Investment Bank, and the Canada Infrastructure Bank. In the UK, the National Infrastructure Bank offers debt, equity, guarantees and loans to local authorities, and provides infrastructure expertise[13].

Private equity houses are raising ever larger amounts of capital to focus on infrastructure territory. New funds and longer-established infrastructure vehicles are also looking ever more to investments in which the introduction of industry-specific skillsets, alongside existing financial management acumen, is enabling them to more actively manage risk and develop consistent value growth. Private equity houses have also found a useful exit route of selling their assets, which are characterized by more stable cashflows, to traditional infrastructure funds.

As part of COVID-19 recovery plans, both infrastructure funds, and more classic private equity funds, may have a stronger role to play in the development of assets that are less capital intensive and offer strong returns. This may often start with asset modernization but expand to some greenfield construction. For governments, harnessing this capital begins with understanding where and how bringing in private funds could improve the quality of assets and service for citizens, while accelerating development. Governments should also appreciate the dynamics that govern and underpin fund management.

A changing approach

Many governments have a strong appetite to involve private capital in infrastructure projects, particularly as they seek to accelerate recovery from the pandemic. Their efforts, however, should always begin with an examination of how to improve their own infrastructure scheme development and management, and where private involvement could be introduced for better delivery and operation. With this in mind, and the knowledge of fund dynamics, governments can strategically hone their approach.

Core considerations

In order to harness private capital to help deliver strong economic stimulus, governments may consider the following steps:

STEP 01

Assess goals, costs and risks of infrastructure investment

Infrastructure programs are well established sources of economic stimulus. Governments should begin by considering what new developments are needed and where, to increase productivity and growth in the near and longer term, prioritizing a pipeline of projects. With clear goals, countries can then assess how to pay for these schemes, where and how private funds could improve results, if they are acceptable to involve, and how best to structure projects. Often, the highest risk elements will likely be government-funded as no private investor can confidently back them, but these central investments can be catalytic, unlocking multiple privately-run projects. This is likely to be the case with many countries' accelerating green energy transition, in response to the Russia-Ukraine war, where initial public investments could precede large-scale private capital involvement. There is strong potential to reduce costs on a large scale and, with the right incentives, to help countries meet their service level needs and sustainability goals.[14]

STEP 02 Understand fund characteristics and approaches

It is essential for any government focused on attracting private capital to make a thorough assessment of the different types of funds, what they can deliver and what they will require. Dialogue with private equity and infrastructure funds will help reveal the different capabilities they offer, as well as their investment and risk appetites, their responsiveness to well-targeted incentives, and how collaborations can work. Governments must also remember the politically sensitive nature of involving private, sometimes foreign, capital in essential services, and may need to consider how the public will perceive the involvement of foreign-based private funds working alongside domestically sourced capital. It may also be important to ensure appropriate taxation, and the protection of existing workers' rights and involvement[15].

STEP 03 Consider cyclical investment with asset recycling

Infrastructure investment is not a short-term effort; longer well-designed schemes are able to create a more powerful and consistent effect, gaining momentum. A cyclical approach can be highly beneficial, with governments creating (or principally funding) the initial greenfield big builds, and drawing in private capital to run, maintain or modernize them. Where leased running of infrastructure is concerned, asset recycling programs are succeeding in numerous jurisdictions and providing extensive capital to support further major construction. Governments can provide financial rewards to regional authorities reinvesting the proceeds into infrastructure development, as has been the case in Australia[16]. Where there is an infrastructure funding gap and high levels of public debt, asset recycling may appear a particularly attractive solution.[17]

Market view

EQT Infrastructure, a major arm of the EQT global investment group, has historically focused on core-plus and value-add investments with a five-to-seven-year holding period, often in the digital, energy, environmental, transport, logistics and social infrastructure spaces. It recently raised its fifth fund, of €15.7 billion.

An expanded strategy includes the launch of the Active Core Infrastructure Fund, which focuses on applying EQT's active ownership approach to core infrastructure assets with a longer-term investment horizon of up to 20 years, notes Matthias Fackler, European head at EQT Infrastructure.

Regulatory compliance will remain an important focus for all types of private capital investments in government infrastructure. Mr. Fackler explains: "Funds need to bear in mind everything from environmental regulations to subsidies around broadband rollout."

In a highly regulated environment, governments can more effectively bring in private capital by ensuring "there is real consistency in rules and policies, including subsidy programs", he adds. This enables funds to evaluate the long-term return implications in the regulatory environment: such as how an investment in a school bus operator could have clear risks around diesel usage, but also real opportunities around vehicle electrification. Simple and clear tender mechanisms are also vital to attracting capital.

Additionally, governments and funds alike must play their part in seeking clear, open dialogue, Mr. Fackler concludes. As longer term opportunities proliferate, and risks and opportunities are better understood, "this will lead to increased investor capital coming into the space given the growth on offer."

STEP 04

Structure risk, reward and opportunities appropriately

Clearer project pipelines, better stability within schemes, and consistency of risk pricing, are essential to attracting private capital[18]. It is important for governments to be realistic in how they involve funds, with contracts needing to be carefully crafted and tenders designed to reflect how funds price risk and structure their businesses. An important approach to risk mitigation can be to involve national infrastructure banks as co-investors and experts. It is also essential for governments to properly reflect all the possibilities for funds working with them, by creating and publicizing a clear pipeline of future work[19]. The overall context in which funds can provide effective support is essential; governments should remember that guaranteed consistency of policies, and better regulations and incentives, help to enable more innovation and encourage investment[20].

STEP 05

Combine careful management with positive dialogue

The use of private capital has an essential role to play in delivering economic stimulus but programs must also be well structured and managed. Several high-profile schemes have received bad press, citing failures in management and poor delivery of service. Governments should successfully combine careful management of private capital schemes with high quality contracts and competitive bidding, transparent processes and substantial efforts to help foster positive public dialogue around the potential of their projects. Communication with citizens, including via the media, is vital to conveying details of specific success stories, as well as the overall effectiveness, service quality and economic stimulus benefits offered by upcoming schemes.

In practice

Economic stimulus programs will likely be essential as governments seek effective recovery from the COVID-19 pandemic, and the opportunity for their countries to thrive once again. For their part, investors are often securing strong, reliable returns from an involvement in infrastructure[21]. The large amount of dry powder seeking assets comes at a time of significant government infrastructure stimulus programs, presenting an occasion for both public authorities and investors alike. The well-managed involvement of private capital in appropriate infrastructure development, maintenance and operation will help deliver essential change.

In order to succeed with involving private capital, governments should consider the following:

- Careful assessment of the goals, costs and risks of infrastructure investment is essential from the start, revealing where the involvement of private funds could improve delivery
- Cyclical investments offer long term benefits: approaches involving asset recycling can free capital for other public projects that later attract further fund involvement
- Risk, reward and future opportunities should be well structured, backed by consistent policies, careful management and efforts to foster positive dialogue

Governments are seeking to bolster their economies following the COVID-19 crisis—and to accelerate the green energy transition following the Russian invasion of Ukraine[22]. Now is the time to involve private capital in developing or running important, appropriate assets, potentially increasing their economic stimulus effect. By carefully harnessing private capital, managing schemes well and appreciating political sensitivities, governments can establish an environment of reliable, ongoing growth.

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