

# Narrowing down the US infra opportunity

**Todd Bright**, Partners Group managing director and head of infrastructure for the Americas, highlights the best opportunities in communications, power generation and midstream sectors

NO ONE CAN dispute the need for infrastructure investment in the US. The American Society of Civil Engineers estimates that some \$4.6 trillion are needed between 2016 and 2025 to upgrade America's roads, bridges, utilities, and schools, as well as other key infrastructure. This is in addition to the approximately \$2.7 trillion of investment Citi estimates is needed in oil and gas infrastructure to produce, transport, process, store and deliver cheap natural gas and its derivative products; plus the \$2.1 trillion of investment needed in the power sector to modernise the grid and accommodate the ongoing switch from coal to natural gas and renewables, according to the International Energy Agency.

In short, the number of investment opportunities available in the region is overwhelming, and the potential for private investors to provide capital for these investments appears larger than ever, especially considering the Trump administration's widely touted – albeit unconfirmed – \$1 trillion infrastructure plan.

However, the pool of equity capital available for this US infrastructure investment need is broad and deep. In fact, North America is the largest infrastructure fundraising region in the world with North America-focused unlisted infrastructure funds having amassed \$178 billion of capital over the past 10 years, according to Preqin – some 50 percent more than the next largest market, Europe.

Against this backdrop, it is essential for private markets investment managers to maintain a rigorous sourcing and investment

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process when deciding how to prioritise the North American opportunity set. Without this, they risk becoming overly reactive to an immense and complex market.

At Partners Group, we still believe the best relative value for infrastructure investors globally lies in assets that offer value-creation potential, either through platform building, operational value creation, or through building the asset itself. In addition, we generally look for the following characteristics in order to distinguish the most attractive sectors: good fundamentals; a sound regulatory and policy framework; a sizeable opportunity set; and contractual underpinnings.

In the US, the sectors in which we currently see the best overlap of these four dimensions are communications, power, and midstream energy.

## COMMS: FROM FIBRE TO DATA CENTRES

The communications infrastructure sector is experiencing strong demand tailwinds as future needs grow commensurate with rising online and mobile data traffic. Adding to the attractiveness of the sector in the US is the fact that communications assets are relatively less competed for than other infrastructure assets, because fewer investors have a mandate or the know-how to invest in the sector.

The value chain ranges from telecom towers to terrestrial and subsea fibre networks to small cells and data centres. Tower investments are marked by very high entry prices due to the perceived operating leverage that these assets provide. However, the move to 5G has led to a densification of networks through more fibre and small cells rather than through higher lease-up rates on macro towers, leading to a potential for overvaluation of the operating leverage.

We have focused our efforts in communications infrastructure on fibre – in particular backbone fibre infrastructure, such as our investment in the Seabras-1 subsea cable on behalf of our clients – where barriers to entry are very high, as well as last-mile rural fibre networks such as those developed and operated by our portfolio company Axia, where the networks are first-movers and serve as quasi-utilities. In addition, we see good relative value in wholesale (or hyperscale) data centres, i.e. the infrastructure necessary to house energy-intensive servers that run the internet. These are very capital-

intensive assets, with high barriers to entry, and usually provide essential utility services under long-term leases with creditworthy counterparties.

### POWER GEN: THERMAL AND RENEWABLES

We look at the power generation opportunity set in terms of two segments: thermal (fossil-fuelled) power generation; and renewables.

In thermal power, we focus on gas-fired power and stay away from coal. The latter is unattractive because of ESG concerns, but also because it will be increasingly difficult for coal-fired generation to comply with ever more stringent environmental regulation, while also staying economically competitive in the face of low gas prices and increasingly competitive renewable generation.

A large part of the gas-fired power dealflow is in new-build opportunities, however, these often require investors to take a view on improving power market conditions. New-build gas-fired power generation assets are usually directly exposed to the power market once the initial five-year hedges and debt terms expire, thus moving such opportunities higher up the risk-return spectrum.

This is a poor fit for infrastructure funds that seek robust principal protection. We focus mostly on acquiring existing assets, and with approximately 6,000 power plants in the US, the annual churn of ownership creates billions of dollars' worth of opportunities every year.

We look for assets with good principal protection from existing hedges and offtake agreements, but also with re-contracting opportunities underpinned by strong asset positioning and market fundamentals beyond the initial term of such hedge contracts. Opportunities that fit this profile are few and far between – our investment, on behalf of our clients, in Sentinel Energy Center, a fast-ramping power plant in the L.A. Basin in California is an example. A flexible mandate across



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infrastructure sectors allows for this sort of selectivity in any given subsector.

In renewables, the five-year extension of the federal renewable energy tax credits in late 2015 eliminated a key regulatory uncertainty that had been problematic for the sector in the past. We have invested in US renewables via a platform strategy rather than via single assets, as we have done with our recent investment in Silicon Ranch Corporation, one of the fastest-growing independent solar power producers in the US.

A platform entry point allows for a return uplift versus discrete project-level returns (renewable assets in the US have recently traded at well below 10 percent returns for solar and between 10 percent to 12 percent for wind, even at the construction stage). Platforms provide exposure to a growing

portfolio of operating, under-construction, and development assets, and an opportunity to create attractive acquisition targets for a wider range of potential future buyers.

### MIDSTREAM: THE ENERGY MAINSTAY

Almost a decade since the shale revolution began, midstream continues to be the defining feature of the US energy infrastructure landscape. It has created a value chain of investment opportunities that ranges from upstream gathering and processing infrastructure, to intermediate transportation and storage assets, to downstream processing, logistics, and export infrastructure.

Dealflow is relatively strong in all areas, but we believe the best relative value can be found in midstream assets away from the wellhead, with robust contractual structures and limited commodity price exposure.

Conversely, upstream gathering and processing assets where competition is stiffer, the underlying contracts have no volume commitments but do have commodity price exposure, and where counterparties tend to be non-investment grade, offer less relative value, in our view.

We also avoid opportunities where the drilling economics of very specific production basins and sub-basins are the driving forces behind the assets, as this creates upstream risk for midstream returns.

Opportunities that we have transacted on behalf of clients include new-build long-haul pipelines supported by take-or-pay contracts, such as Fermaca, a leading operator of natural gas pipelines in Mexico, and processing and logistics assets further downstream such as Raven, an ethylene processing facility, where contract terms and counterparties are of higher quality and broad-based demand drivers create the need for the assets. ■

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