REflexions magazine issue 6

Infrastructure **in Australia**

Damien Frawley

Damien has over 26 years' experience in the financial services sector. He has a strong focus on developing and executing strategy, particularly around growth and sales. Most recently, Damien was the country head of BlackRock Australia, responsible for managing $45 billion of assets on behalf of clients. Prior to this, Damien was BlackRock's Head of Account Management, overseeing sales, marketing and product efforts across institutional and retail channels. Damien's career has also included roles at Merrill Lynch Investment Management, Barclays Global Investors and Citibank. On a personal note, Damien is a Queenslander and prior to his career in financial services he represented Australia in rugby union.

In the Casey Quirk by Deloitte "Survival of the Fittest" report, it was stated that effective asset managers will have to differentiate investments with a broader array of active capabilities and strong product development processes. With that in mind, Neil Brown, Partner in Assurance & Advisory at Deloitte, has spoken to Damien Frawley from QIC, which is well known for its global diversified alternatives business building on current and future opportunities in infrastructure investing.

Deloitte: What is your view of infrastructure investment in Australia?
Over the past two decades, Australia has become a global leader in infrastructure investment. The strength of the infrastructure class in Australia has been particularly aided by institutional investors' willingness to diversify portfolio exposure away from traditional global equity and debt capital markets. Given that our nation's superannuation system has created a large savings pool, over AU$2 trillion within the last 25 years, Australia now finds itself in an ideal position to investigate alternative investment solutions.

Through investing in infrastructure, institutional investors have been able to constructively work with all levels of government. This has led to the creation of numerous partnerships which have delivered outcomes that have had positive knock-on effects for various parties including local residents, communities, businesses, and investors.

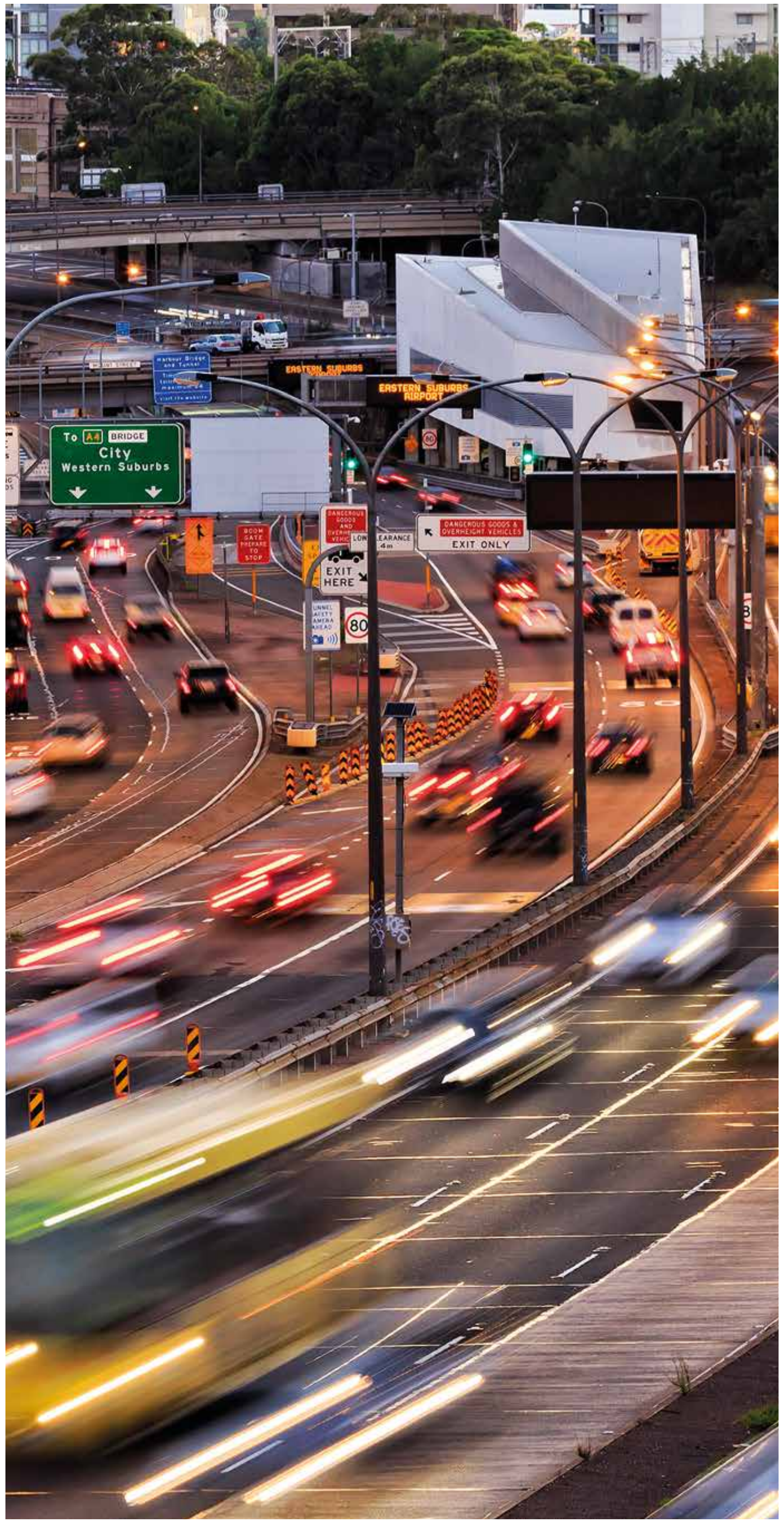
In February 2017, Infrastructure Australia identified approximately AU$60 billion in high-priority and priority projects over the next 15 years.

The competition for quality infrastructure assets can be intense, and prices reflect that fact. What qualities do infrastructure assets offer and what is QIC's approach to ensuring it is creating long-term value for investors?
Infrastructure assets have a number of desirable qualities, including a long-term investment horizon, increased cash flow predictability where the asset operates in a monopolistic environment like a seaport or airport, revenues with direct or indirect inflation linkage, relatively transparent legal and regulatory frameworks, and upside potential afforded through increased demand or expansion optionality.

Unlisted infrastructure assets, one of QIC's core focus areas, typically possess additional attractive features. These can include reduced correlation to listed equity markets, which is important for portfolio diversification, and quite often the ability to have direct governance rights at the asset level. This provides an enhanced ability to directly influence the strategy and risk appetite applied to the asset, thus better aligning ourselves with portfolio objectives. While noting that these benefits can come at the expense of reduced liquidity, it is unsurprising that the popularity of unlisted infrastructure as an asset class continues to grow. This seems particularly logical when we consider relative track record. For example, in an Australian context, MSCI data shows that unlisted infrastructure has outperformed equities, bonds, and property in delivering an average return greater than 13 percent per annum over the past 15 years.

Clearly, increased investor appetite brings greater competition in what can be a sparsely populated universe of prospective infrastructure assets. QIC is focused on being highly selective and disciplined in our approach. We prioritize the opportunities where there is enhanced scope for achieving relative value for our clients.

In addition to this, we also seek to prioritize opportunities of a bilateral or less competitive nature to the extent that we pursue investments through a competitive process.



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When selecting global markets in which to invest, what key characteristics do you require?

From a geographic perspective, QIC typically focuses on infrastructure investments in OECD countries. This is mainly because of the relatively well-established and transparent legal, regulatory, and economic structures. We strongly believe in the merits of portfolio diversification, so we actively seek out investments across multiple jurisdictions.

More importantly, we also look to unpick the underlying macroeconomic drivers and other asset-specific factors relating to each opportunity from the outset. This process allows us to proactively assess portfolio fit and client suitability through rigorous economic scenario analyses. This includes a correlation analysis with the existing assets of the clients in question.

What qualities make Australia one of the global leaders in infrastructure?

We believe there are abundant factors that contribute to the nation being one of the global leaders in infrastructure. Firstly, Australia was a pioneer of facilitating private investment in public infrastructure. This means that the Australian market is mature and well-accustomed to the sorts of transactions, structures, and models that can be employed. It also allows the market to tailor innovative solutions to specific situations. Secondly, Australia has the same level of legal stability as other OECD countries but boasts relatively favorable demographics and a macroeconomic outlook at the upper end of all OECD member states. This is particularly aided by Australia's advantageous proximity to Asia, given the expected growth potential in this region. Thirdly, Australia is a large country, meaning its infrastructure needs and requirements are extensive.

In February 2017, Infrastructure Australia identified approximately AU$60 billion in high-priority and priority projects over the next 15 years. These projects provide a reasonable pipeline of opportunities for the private sector to become involved either directly or indirectly through schemes like the Federal Government's Asset Recycling Initiative. This initiative encouraged brownfield assets to be sold or leased to generate funds for new infrastructure investment.

Further afield, QIC has previously invested in infrastructure assets in emerging markets such as India. We continue to selectively assess opportunities as they arise and to the extent our clients have appetite. Investing in such jurisdictions does not come without challenges. However, as an organization, we recognize and appreciate the long-term opportunities within these markets, further the importance of forging value-adding relationships with local and aligned partners. Making sure these relationships are cemented well ahead of time puts us in prime position for a prosperous and stable future.

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What opportunities do you believe recent government infrastructure plans, such as those seen in the US, will offer investors?

When designed and implemented effectively, infrastructure can drive economic growth in communities and improve quality of life. Any plans by governments to facilitate new infrastructure or sponsor upgrades of existing assets should be applauded. Given governments' increasing fiscal constraints, it follows that there should be increased scope for parties such as QIC to actively partner with governments to reduce their funding gap. This can be achieved through a private deployment of funds in attractive economic infrastructure opportunities.

With respect to the US, it is clear that there has been an underinvestment of investment in critical infrastructure. With estimates of the funding gap required to bring America's infrastructure to a state of good repair potentially running into the trillions of dollars, it is obvious that private funding will be essential. However, it is important to note that previous attempts to modernize the procurement and funding of infrastructure within the US have been slow and inconsistent, with some high-profile process failures such as Chicago Midway International Airport contributing to investor caution.

While limited details have been provided to date, President Trump's infrastructure plan represents a potential catalyst to revitalize US infrastructure through partnering with the private sector. Recent market commentary suggests as much as US$200 billion could be sought from the private sector. Should this come to pass, it would represent a significant opportunity for parties such as QIC to invest in critical infrastructure in the world's biggest economy. More importantly, it is pleasing to see growing recognition of the private sector's ability to deliver and manage infrastructure more efficiently through better procurement methods, market discipline, and a long-term focus on optimizing the asset management lifecycle.

From QIC's perspective, we are actively assessing the sectors and regions most likely to benefit from this potential policy shift and increased activity levels. As a long-term infrastructure owner, we will be looking to work with governments at all levels on the best way for the private sector to deliver value for money and bring innovation to P3s (Public Private Partnerships) and asset-recycling programs. In particular, we will be able to offer a wealth of experience drawing on QIC's key involvement in leasing assets from governments and institutions within Australia and abroad, such as the Port of Melbourne, Brisbane Airport, and the parking system at Ohio State University.

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