IN DEPTH: WHY LISTED INFRASTRUCTURE STILL DIVIDES OPINION

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Listed infrastructure has often played second fiddle to its unlisted cousin. But it is growing in popularity. Despite an increasing number of proponents, the investment option still has many detractors. In this latest in depth feature, we explore the advantages and disadvantages of listed infrastructure.

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Sector: Environment
Power
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Other

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The complex and controversial issue of listed infrastructure raised its head over the summer. The EDHEC Infrastructure Institute (Edhec) claimed that the category is "fake" in an article for the Financial Times. Edhec's Noel Amee and Frederic Blanc-Brude based their assertion on research in which they tested 22 different proxies to determine whether listed infrastructure could in fact emulate the success of the unlisted side.

However, this was sharply rebuffed, again in the FT, by Philip Southwell of Axius Capital. He claimed that listed infrastructure can provide easier access to the sector, while maintaining many of the benefits of its unlisted relation.

But who is correct? Is listed infrastructure something investors should avoid when seeking the benefits many unlisted investments provide? Or could it, under the right circumstances, complement or act as a proxy to unlisted investments?

One of the main arguments against listed infrastructure is that is fails to provide the same diversification as unlisted infrastructure. In other words, since listed infrastructure comprises listed equities, it moves in consort with the listed markets more generally, and may not perform well in all economic circumstances.

"Listed infrastructure is something that most investors are already most likely exposed to. It is really just repackaging," says Blanc-Brude. "Once you put money into listed infrastructure, our data shows you don't get anything more than with equities: diversification does not improve, nor do risk-adjusted returns.

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Resources Group, says the lack of diversification from listed equities is one reason OTPP does not invest part of its infrastructure allocation in listed infrastructure.

"Infrastructure should be a diversifier from equities," he says. "But when you list it starts to behave like an equity, as the valuation tends to be driven by an investor base which takes a shorter term view on valuation. This results in listed infrastructure losing much of its diversifying effect.

"One of the principal reasons we invest in infrastructure is because we believe it is an asset class that performs well across most, 1˙f not all economic scenarios. Equities don't perform well in all those scenarios, so you lose a critical aspect of why we invest in infrastructure:'

> "Once you put money into listed infrastructure, our data shows you don't get anything more than with equities: diversification does not improve, nor do risk-adjusted returns"

Another reason listed infrastructure does not work for OTPP, says Claerhout, is because the pension fund is a control investor, acquiring assets to actively manage and create value. That only works with unlisted infrastructure.

Blanc-Brude says the popularity of infrastructure more generally is helping drive investors towards the listed version. As a result, there has been a rapid increase in the types of listed products.

Infrastructure, says Blanc-Brude, has also caught the attention of active managers, many of whom have fallen out of favour with investors - mainly because of indifferent longer term performance in the equities markets.

"Some active managers now say they can deliver the infrastructure story," says Blanc-Brude. "And because infrastructure is fashionable, it sells.

"But all they really offer is old-fashioned stock picking, except now they are only going to pick stocks within certain industrial codes, so they are even more limited than when they looked at the whole equities market."

Blanc-Brude notes that because infrastructure is portrayed as an 'absolute return' strategy, some active managers earn fees if they beat CPI plus 5% - but in an environment in which the average stock market return is at least 6% or 7%.

"It's quite easy to beat such benchmarks," he says.

Listed infra funds

But what forms do listed infrastructure take? Is it the case that all listed infrastructure is simply a listed equities strategy dressed up for gullible investors? And is every instance of listed infrastructure a fake?

The first kind are listed infrastructure funds that invest directly in unlisted assets. These include HICL, John Laing Infrastructure Fund (JLIF), International Public Partnerships (INPP), and others that invest mainly in renewables. These are fundamentally different to the listed infrastructure Blanc-Brude and Edhec have deemed "fake", and their research acknowledges this.

Fund Name	Manager	Founded	Market Capitalisati
HICL	InfraRed Capital Partners	2006	GBP 2.8bn
INPP	Amber Infrastructure	2006	GBP 2.17bn
JLIF	John Laing	2010	GBP 1.29bn
3i Infrastructure PLC	3i Group	2007	GBP 2.lbn
Infratil	H.R.L Morrison & Co	1994	NZD 1.67bn
Concert Infrastructure Fund	Concert Infrastructure	2010	CAD S0Sm

"We used these firms which we call the 'PFI portfolio' to argue that unlisted contracted infrastructure is low-risk in discussions with EIOPA [European Insurance and Occupational Pensions Authority] about Solvency-2 last year," says Blanc-Brude.

This model involves investing in PPPs or renewables. When the listed fund wants to acquire some unlisted infrastructure, it issues new shares to raise the capital. They then collect dividends from the private infrastructure, and pay out to their shareholders.

JLIF's David Hardy explains the difference:

"We invest directly into infrastructure projects which have all the things that infrastructure should have: high inflation correlation; low correlation to the economy; long-term cashflows; government-backed.

"It's low-risk core infrastructure such as schools, hospitals, roads that are operated for 25-years plus. We have a very low beta to equities. We don't track equities."

But there are other types of listed infrastructure, and it is these that Edhec and Blanc-Brude target. According to their research, there are 104 listed infrastructure mutual funds and 34 exchange traded funds (ETFs), which track infrastructure indices. There are a further 16 index providers that have launched 147 listed infrastructure indices since 2005. Edhec asserts that this amounts to more than USO 57bn of assets under management.

Name	**Inception Date**	**Top 5 Holdings**
AMP Capital Global Listed Infrastructure Fund	Mar-14	American Tower Corp , Enbridge Inc, Kinder Morg, Inc, TransCanada Corp, Sempra Energy
Deutsche Invest I Global Infrastructure	Jan-08	American Tower, Vinci SA, National Grid, TransCar Corp, Crown Castle International
Morgan Stanley Global Infrastructure Fund	Jun-10	American Tower Corp, Atlantica Yield , Enbridge In TransCanada Corp , Crown Castle International
Macquarie Global Listed Infrastructure Fund	Sep-11	En bridge, Sempra Energy, Cheniere Ener gy, Aberti Infrastructure, Ne xtEra Energy
Franklin Templeton Investments	Apr-13	Transurban Group, Atlantia S.p.A, Aena SA, Americ Electric Power, TransCanada
First State Global Listed Infrastructure Fund	Oct-07	National Grid , American Tower, Transurban Groui:: Atlantia S.p.A, Enbridge
Argos Infrastructure Securities Fund	Mar-12	Transurban Group, Brookfield Infrastructure, Rai \ Vinci SA, Eiffage SA
RARE Infrastructure Income Fund	Sep-08	Spark Infrastructure Group, Atlantia, Iberdrola, TA SES

Listed infra indices and funds

The problem is that many of these indices and funds include companies that few would describe as pure infrastructure. For example, some of the indices include companies involved in power generation, facilities management, oil and gas, shipping, and construction.

Of course, some argue that in a very broad sense, a construction company provides a type of infrastructure. But not many in the sector would adhere to this.

"Over the years, the infrastructure definition has been broadened considerably," says InfraRed's Tony Roper. "There are some assets that I would not define as infrastructure at all.

"It's easy to pigeonhole them as infrastructure, but how much of their revenue comes from non-infrastructure like services?"

So when listed infrastructure funds invest in companies only very loosely defined as infrastructure, these investments are unlikely to correlate to the characteristics of unlisted infrastructure.

This criticism not only comes from the unlisted side, but also from those who invest in and provide services to listed investors.

Mark Ebert, who runs Quaero Capital's listed infrastructure strategy says he agrees with the Edhec report, and that much listed infrastructure is indeed "fake".

"There are some that have bonds and non-infrastructure in them," he says. "Others closely track the S&P Infrastructure Index very tightly. About half are dressing up yield funds as infrastructure, but a lot of what they have are bank bonds.

"If you dress it up as infrastructure, then it looks good."

Nick Langley, Co-CEO of RARE Infrastructure says several listed infrastructure indices have been created to include large liquid companies, in order to be traded. That means adhering to a stricter definition of infrastructure is a secondary consideration.

"They are less focused on the quality of the underlying infrastructure, and more focused on how tractable it is," he says. "That means there is equity risk in *them:'*

The case for listed infra

The consensus that some indices and listed funds involve very diluted infrastructure suggests serious questions about what investors actually get. However, finance professionals increasingly believe that some listed opportunities can indeed provide the benefits associated with unlisted infrastructure.

One of the main advantages of listed infrastructure is liquidity, and another is often cheaper fees.

Fraser Hughes, CEO of the Global Listed Infrastructure Organisation (GUO), suggests that the Edhec research took a far too broad definition of listed infrastructure. This means that the results did not reflect what he calls a much narrower 'core' or 'traditional' listed infrastructure universe.

Of course, that also suggests that the wider universe of listed infrastructure is using too broad a definition.

Hughes says GUO's listed infrastructure coverage weeds out around two thirds of the 400 companies across a broad range of infrastructure indices. This means removing companies like AT&T, Verizon, Vodafone, and Royal Mail. The remainder comprises 140 infrastructure companies, and as a result, performs very differently.

"A simple exercise is to take the long-term performance of the listed infrastructure market using the GUO coverage, and the more tightly defined Dow Jones Brookfield Infrastructure Index and lay it over the unlisted performance;' says Hughes.

"What you get is clearly related. This does not even take into account the different pricing metrics and lagging on valuations in the unlisted market. It's a far more nuanced picture than to simply say listed infrastructure is fake.

"If you hold listed assets for the medium to long term, the companies will perform like the underlying assets and cashflows of the business. You get long-term infrastructure performance. It's also diversified, as you can invest in a number of different sectors, regions, and countries - including emerging markets if you wish."

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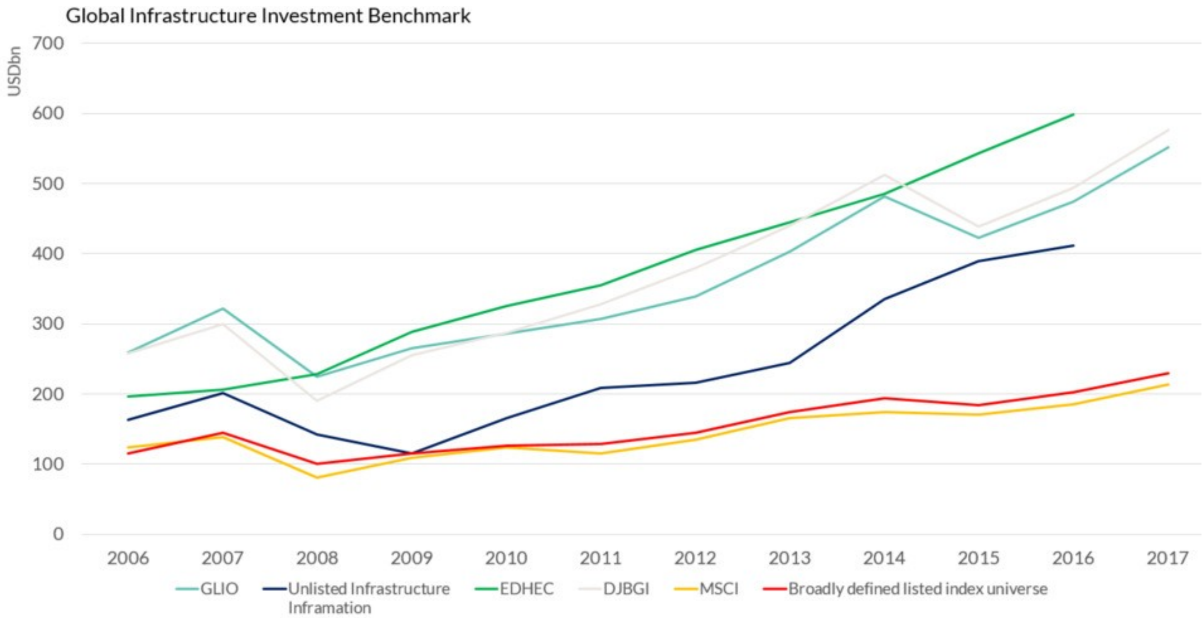
Hughes points out that underlying assets and cashflows remain the same even if ownership structures are different. He adds that both listed and unlisted companies operate under the same set of regulations, using the UK water industry as an example: around half of Edhec's top ten companies in its unlisted benchmark were once listed water companies.

"The underlying assets' cashflows and regulation does not change when you go from unlisted to listed," says Hughes.



Claerhout makes a similar point, saying the nature of ownership should not dictate the attributes of the asset. But he reiterates that public markets frequently value infrastructure assets incorrectly, and may not properly evaluate the individual attributes of individual securities. Furthermore, listed infrastructure tends to move in line with either a bear or a bull market.

But Giuseppe Corona, head of global listed infrastructure at AMP Capital, highlights the difference between the price and value of an asset. He points out that listed infrastructure is marked to market and the price fluctuates daily. But, he says, the value does not change as much.

"People invest in infrastructure for the long term, and so should be focusing on long-term value, rather than short-term price fluctuations," says Corona.

"If you focus on the long term and the fundamentals of the underlying assets, any infrastructure is an infrastructure investment regardless of the way it is held. There are pros and cons to both listed and unlisted."

In contrast to Claerhout, Corona says listed infrastructure can outperform more general listed equities, so it can provide diversification - if investors hold on for the long term.

"If you look at long-term performance of listed infrastructure compared with private infrastructure, over the long term they are quite similar," says Corona.

Valuations versus cashflows

Hughes does not believe valuations are the only way to compare listed and unlisted infrastructure.

"That's not comparing the same metrics - it's not apples v apples," he says. "You need to compare the quality of cashflows of a listed business with those of an unlisted business. Then you start to get a clearer picture."

But many listed infrastructure indices and funds (mutual funds and ETFs) include at least some companies that derive cashflows from non-infrastructure sources. The risks of those cashflows can dilute the benefits from the infrastructure elements of a fund or index.

Blanc-Brude points out that a forthcoming Edhec paper on listed infrastructure finds that over the past decade, active listed infrastructure fund managers have held as many as 1,869 different unique stocks - including Amazon, Nintendo and Microsoft.

Hughes notes that some infrastructure indices suffer from too "loose terminology" when defining infrastructure. The best defined, he says, are the Dow Jones Brookfield Infrastructure, and FTSE Core Infrastructure indices. These, he adds, are the two indices that the vast majority of specialist managers use.

A big change in the last five years is the quality and granularity of infrastructure indices;' says Peter Hobbs, managing director of private markets at bfinance.

"Some of the big providers have produced core infrastructure series that weed out the non-infrastructure type companies, and much more closely capture what infrastructure does.

"You can now identify those companies and benchmarks that track more closely the underlying cashflows of the infrastructure assets. Some of these indices are more defensive and less volatile. They are equities and so are correlated to public markets but over the medium to longer term they behave in line with the underlying assets:'

Corona points out that listed infrastructure must be defined correctly, and exclude companies with service elements or large construction divisions.

"We look for companies that have true infrastructure characteristics: monopolies, high barriers to entry, stable regulation, and long-term contracts," says Corona. We avoid firms with short-term contracts and that are exposed to the economic cycle."

Corona gives three examples of AMP's listed investments: Atlantia, Cellnex, and Severn Trent Water. The latter, he says, has the same economics as privately held water companies - the only difference being that it is listed.

Institutiona l interest

So who is investing in listed infrastructure, and are we about to witness a flood of institutional capital?

Unsurprisingly, retail investors comprise the bulk of investments in listed infrastructure because it is easier to access and it is potentially able to capture the benefits of infrastructure.

But institutional investors are also said to be increasing their exposure. According to Edhec, they make up 30% of share classes by size of shares.

One way institutions do this is through equities allocations. Ebert points out that most institutional investors interested in infrastructure seem to be from quoted equities divisions. Infrastructure, he continues, can provide a safety layer of around 10% of an overall quoted equities strategy.

But are institutional investors using their allocations to invest in listed infrastructure? For the most part the evidence is anecdotal.

Australia's sovereign wealth fund, Future Fund, provides a concrete example, though. According to its 2015-16 annual report, 27% of its infrastructure allocation was exposed to the listed sector.

Unisuper, the Australian superannuation fund, also uses part of its infrastructure allocation to invest in listed infrastructure. For example, it has a 10% holding in Transurban, the listed owner and operator of toll roads.

Hobbs agrees that institutional appetite is growing, and that some are using listed infrastructure for their infrastructure allocations. But he adds that most still prefer to make unlisted rather than listed investments.

"Within Australia, the use of listed infrastructure alongside unlisted has become pretty established, rather like REITs became established alongside unlisted real estate a decade or so ago in most countries.

"We are seeing growing interest in listed - particularly in Canada and Japan - and from more forward looking investors in the Netherlands and other parts of Europe" says Hobbs.

"Many boards continue to have the feeling that listed infrastructure is not infrastructure, so they won't consider it. But it is a credible strategy and not enough of them are doing it."

Hobbs also believes it is more logical to have a listed infrastructure strategy as part of an infrastructure allocation rather than listed equities.

Listed as a proxy

Hobbs and others say institutional investors could use listed infrastructure investments alongside unlisted infrastructure - for strategic allocations and more tactically. This is particularly relevant now given the high valuations of unlisted infrastructure and the challenge of accessing good quality - and well-priced - assets.

"Listed infrastructure is a powerful option for smaller and medium-sized investors, but some of the world's largest and most sophisticated investors also use listed alongside their direct exposures;' says Hobbs. "If they can get core infrastructure performance from listed then it makes sense:'

Corona points out that a listed or unlisted strategy depends on what the investor aims to achieve. But he too believes that listed can be a good option for investors seeking exposure to unlisted infrastructure.

"They can access listed infrastructure as a proxy - and when they need the cash, they can sell the listed shares and invest it privately," he says.

Corona adds that AMP's listed vehicle is balanced between retail and institutional investors, and that most institutions are pension funds and large insurance companies.

Claerhout, however, does not think listed infrastructure is a true alternative.

"The alternatives to unlisted infrastructure would be either real estate or real return bonds," he says. "We think buying listed infrastructure is the equivalent to buying more equities."

The future of listed infra

There is a stark difference of opinion on whether listed infrastructure is a workable alternative to unlisted infrastructure. So where from here?

Central to the problem is whether or not certain listed strategies do act like unlisted infrastructure strategies. Of course, not all unlisted infrastructure investments behave in the way infrastructure investments should. The asset class is strewn with "quasi-infrastructure" investments like motorway service stations, maritime search and rescue, and crematoria. So there is some correlation with listed infrastructure, in that investors can end up exposed to some non-infrastructure risks.

At the same time, there is partial agreement across both listed and unlisted that some assets in the listed category should not be described as infrastructure. As a result, some funds and indices have weeded out non-infrastructure companies. Does this mean listed infrastructure is becoming more like its unlisted cousin?

Hobbs believes that an increase in passive investing will push more investors towards listed infrastructure. This involves tracking, in this case, a listed infrastructure index.

"There is a structural trend towards passive investing, and there are now index providers that really differentiate between infrastructure stocks," he says.

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Will that be enough to convince more institutional investors to take up listed infrastructure?

Claerhout believes the move to passive index investing could exacerbate the correlation to general market movements, further decreasing the focus on the idiosyncratic attributes of individual securities.

Although listed infrastructure may innovate, he notes that for now OTPP is sticking with unlisted.

"You can't rule out financial market innovation," he says.

But is innovation already underway? Hughes believes it is, and that cutting out non-infrastructure stocks is evidence of this. He also believes that listed infrastructure could evolve in the same way as listed real estate.

"We went through these arguments 15 years ago in real estate. That involved proving that REITs were underlying real estate investments over the mid-to long term;' he says.

"Similar to real estate, if you invest in listed infrastructure over the medium to long-term you'll get exposure to a diversified mix of good quality infrastructure assets, and cashflows. It's also more transparent and you have liquidity.

"I believe listed and unlisted infrastructure will work hand in hand and complement each other in the future. Why do you think the major investment houses offer both listed and unlisted to their clients?"

Hobbs says that in a previous role at MSCI, he and his team created a listed index that mimicked the private market by removing the volatile stocks and adjusting for leverage.

"We took a subset of the underlying REIT index that was more closely related to the underlying real estate," says Hobbs. "You can do the same with infrastructure by focusing on these stocks much more closely correlated to the underlying assets."

So does Blanc-Brude think there could ever be a place for listed infrastructure?

"We are not saying that it is impossible or irrelevant to list infrastructure," he says. "But it has to be done in a way that allows you to capture some of what is going on in infrastructure projects.

"We've tested all the indices that list infrastructure and they don't really deliver that. It is not just a case of picking companies by industrial sector, or those related to the infrastructure sector. In the end these are just stocks, but it is important to say there are exceptions."

Beyond the issue of definition, says Blanc-Brude, is access. "Most of the investable unlisted infrastructure are really project finance vehicles and there is no equivalent to those on the stock market today with a few exceptions," he says.

"This can and probably will change."

One of the major criticisms of listed infrastructure is that many of the funds and indices include companies focused outside infrastructure. Another is that infrastructure equities move in line with broader equities markets.

It seems the first problem is being addressed, with many listed infrastructure funds and indices beginning to shed the dead weight of non-infrastructure companies. But the continued existence of non-infrastructure companies in listed indices and funds is something that investors must remain aware of if they want to reap the benefits of an unlisted strategy.

The second problem appears more difficult, but could be resolved through long-term investments in listed infrastructure, as well as financial inn ovations. But only time will tell if these innovations will bear fruit and if listed infrastructure can live up to the expectations of its proponents.