

TOWARD AN INFRASTRUCTURE ASSET CLASS

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Inrastructure investors today use ad hoc benchmarks for unlisted infrastructure investment. EDHEC*infra* wishes to establish an industry standard for the infrastructure asset class – and we've made progress.

We have established a framework for data collection and developing asset-pricing techniques to measure the risk-adjusted performance of private infrastructure. From this foundation, we can now build market indices.

But what are the most relevant broad market indices for this asset class? Do infrastructure investors wish to put assets into the same geographic or sector categories the bond or equity markets use or are they segmenting their universe differently? In other words, what should be the industry standard for unlisted infrastructure market indices and sub-indices?

Input from investors

We recently conducted one of the largest surveys of infrastructure investors globally, with more than 200 respondents, in order to establish their preferences for the segmentation of infrastructure. The majority of respondents were asset owners; more than half were focused solely on infrastructure equity investment, while a third sought both infrastructure equity and debt.

When asked how to consider geographic segmentation of private infrastructure equity, most respondents said economic development and infrastructure investability were the most relevant methods; only 10 per cent said using the geographies of standard capital market benchmarks would be the most relevant method.

For infrastructure debt markets, economic development was also the type of geographic segmentation that survey respondents most frequently proposed – 35.6 per cent said it was the most relevant. These results suggest the reference market indices for infrastructure should follow broad economic development lines.

We found that infrastructure investors preferred both broad and sector-specific segmentation. This is an indication of the infancy of the asset class. The results suggest access to a well-defined asset class remains limited amongst investors who prefer to focus on sub-segments; however, large managers and asset owners who wish to be exposed to infrastructure investments across multiple sectors say that only widely defined sector indices make sense.

The lack of adequate performance data until now has made it difficult for investors to assess strategic asset allocation for infrastructure. Ultimately, until performance of infrastructure is better understood, it cannot exist as an asset class in a multi-class



context.

Infrastructure is still typically segmented by industrial sector but it can be argued that business models – such as contracted, merchant and regulated – are a more relevant way to categorise these investments, especially when considering business risk; for example, Gatwick Airport, a regulated asset, has more in common with Anglian Water, in terms of risk profile, than with Munich Airport, which operates under a merchant business model. In the survey, 90 per cent of respondents said making a distinction between business models was relevant or highly relevant.

Projects versus corporations

The difference between infrastructure projects and infrastructure corporations is as relevant as that between business models. EDHEC*infra*'s research shows it is infrastructure projects, rather than corporations, that offer investors the benefits of the infrastructure investment narrative of equity-like returns with reduced volatility and predictable cash flows. Infrastructure projects tend to have a relatively low-risk business model and are usually smaller in size than an infrastructure corporate. As a result, indices built with infrastructure projects tend to diversify better and faster and this means higher returns and lower portfolio risk measures.

Investors' views were divided on how to benchmark infrastructure projects and corporations: 37 per cent favour benchmarks specific to project finance; 42 per cent would rather use benchmarks that group projects and corporations together; and 20 per cent would prefer an index with infrastructure corporations only. These differences reflect the different interpretations of what it means to invest in infrastructure.

Finally, we asked infrastructure debt investors whether it is useful to create infrastructure debt indices by maturity and level of credit risk – standard components of fixed-income benchmarks, portfolios and products. Respondents were almost unanimous in the need to bucket infrastructure debt by credit risk and maturity.

Eight proposed indices

Using the results of this survey, EDHEC*infra* is putting forward indices and benchmarks to represent the global infrastructure asset class.

We've created eight broad-market indices to provide a global view of infrastructure and respond to investors' requirements for asset allocation. There are also a number of sub-market indices to allow investors to monitor the risk-adjusted performance of particular strategies. (See Figure 1)

The broad market indices segment the debt and equity universes either by areas of economic development or types of corporate structure. The thematic sub-indices (See Figure 2) represent specific risk profiles. With these sub-indices, investors can track the risk-adjusted performance of almost any specialised manager or dedicated

At last, infrastructure investors will have the tools to adequately measure risk-adjusted performance and we can begin to see the development of a distinct infrastructure asset class.

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