



Infrastructure: Calling time on borrowed definitions

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*Infrastructure has adopted terms like 'core' and 'value-add' from other asset classes. But it needs better labelling, writes **Sarah Tame***

Infrastructure as an asset class has evolved over the past 10 years. In that evolution, it has taken classifications and definitions from private equity and real estate, such as core and core-plus.

Recently asset managers have launched investment products offering value-add strategies and increasingly the line between private equity and infrastructure has blurred. The trouble with inherited labels is that they provide no clear definition of infrastructure that suits all dimensions and risk profiles of the asset class, often giving managers licence to make spurious investments.

As infrastructure investment grows, the boundaries are being stretched by some asset managers investing in real estate-type assets with infrastructure value-add labels slapped on top. Investors are often confused as to what core, core-plus, value-add and super-core products encompass. Generally they are a way for managers to justify return targets.

The infrastructure sector does itself a disservice without a clear structure and definition of the strategies it can offer investors. Without a proper taxonomy providing a set of criteria to define infrastructure, it is hard for asset managers to structure the solutions that investors need.

So what is infrastructure? There are several definitions. The OECD and World Bank use definitions based on public policy. Meanwhile, regulators focus on what infrastructure 'is like' in order to qualify it under various prudential frameworks. Under Basel II and Solvency II, regulators apply definitions that try to differentiate how infrastructure investments are distinctive from corporate equity or debt, all the while failing to provide a definition unique to infrastructure.

None of these classifications encompass all of the characteristics of infrastructure, from business risk profile to industrial expertise. Without this, investors continue to buy into vague strategies with no deep understanding of how infrastructure investments are concentrated in their portfolios.

What if we had a classification that embodied all the characteristics of infrastructure? The EDHEC Infrastructure Institute, as part of its work to build performance benchmarks for investors in private infrastructure debt and equity, has launched the Global Infrastructure Company Classification (GICCS) to do just that. Taking existing definitions and perspectives into account, EDHEC has created multi-dimensional criteria to help asset owners and asset managers classify and define the asset class. GICCS is compatible with Basel II and Solvency II definitions of infrastructure, which focus on risk profile, but incorporates the unique characteristics of infrastructure.

GICCS comprises four pillars to structure the infrastructure asset class and provide a frame of reference for asset owners and managers. It is designed to be compatible with other standard investment classifications and takes into account the evolution of the infrastructure asset class.

Infrastructure project companies are created in the context of a long-term contract between an investor and a public or private-sector client with the aim of developing a single project and their incentives to take risk are minimised by their financial structure. Infrastructure projects are highly leveraged and this plays an important disciplinary role, as well as being a signal of creditworthiness.

An infrastructure corporate, however, is akin to a traditional corporate. Managers have the freedom to make investment decisions that change materially and strategically over time. They are also free to change their financial structure and can use multiple sources of public and private financing. Debt can be used to increase returns on equity and creates incentives to take risks.

It is vital that infrastructure differentiates itself from private equity and real estate using clear definitions and structure. Without this, investors will be sold mistruths and will never truly be able to integrate infrastructure into their wider investment portfolios.

GICCS will enable investors to group infrastructure investments in a more structured way. It can define investment styles and will enable asset managers to design investment strategies that explain the characteristics of infrastructure more effectively. In turn, it can be used to define benchmarks for each strategy. And it will enable asset owners, managers, regulators, banks and advisers to structure the sector, and document the investable market for infrastructure in years to come.

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Four pillars to define infrastructure

- **Business risk classification:** while infrastructure is tangible, it is wrong to assume the value for investors lies in the hard assets. The infrastructure itself is not the value. It needs to be used to have value. It is the contracts, not the concrete that matter. This is what differentiates infrastructure from real estate. GICCS sets out three business risk classes – contracted, regulated, and merchant. The business risk classification captures the risk-sharing mechanisms of the revenue model of an infrastructure firm. Today, we think about grouping infrastructure by broad industrial categories such as transport and renewables. In practice, the business risk profile of a merchant toll road has more in common with a merchant power plant than an availability-based road project.

- **Industrial classification:** standard industrial classifications can be ill-suited to represent different types of infrastructure companies. For example, an airport operator and an airline catering company are typically bundled together under the banner of transport infrastructure. GICCS puts forward a detailed taxonomy of industrial activities and technologies and asset-level characteristics that capture the potential diversity of infrastructure companies' services and products. For instance, transport projects have common technical and industrial features, as do renewables and social infrastructure projects, which correspond to broad groups of professionals that have the relevant know-how to understand and execute individual transactions.

- **Geo-economic classification:** infrastructure assets are obviously physical, but their economic exposure is dependent on use rather than location. Therefore, it is important to classify infrastructure investments by their exposure to the different geo-economic levels of the economy they serve. The GICCS geo-economic classification reflects whether an asset is exposed to local, national or global economies. For example, large transportation hubs such as major airports and ports are exposed to global economies despite not being co-located. On the other hand, a global container shipping port and a regional port can be less correlated with one another, even though they might be close together and have relatively similar business models.

- **Corporate governance classification:** the behaviour of an infrastructure company differs depending on whether it was created to develop a single project (infrastructure project) or multiple projects (infrastructure corporate). This behaviour has an impact on the business risk profile of the asset. GICCS puts forward two corporate governance classes to structure the asset class.