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European sustainable infrastructure: in a sweet spot

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In a turbulent 2020, infrastructure was an apparent safe haven, proving relatively resilient. However, the unprecedented shock to the asset class across all industry sectors and geographies at the same time, in a short period of time, has provided food for thought on several issues.

First, infrastructure is critical to a well-functioning economy and society, but not all infrastructure assets are created equal. For example, demand-based transportation assets such as airports and toll-roads were hit the worst. Renewable energy fared well, despite a 5% annual drop in energy demand,[1] whereas renewables outside the electricity sector such as biofuels, as well as conventional energy, suffered more from the impacts of the Covid-19 crisis. Contracted and regulated assets benefited from more stability, while digital emerged as a clear winner. The answer lies in the level of sensitivity to economic cycles, not in the label. This year reminded us that true diversification is key to building a defensive, resilient portfolio in line with the well-established infrastructure narrative.

Second, infrastructure continues to attract significant investor interest. If anything, the prospect of lower interest rates for even longer served to make assets that can deliver resilient cashflows even more attractive. Fund raising for the first nine months of 2020 reached US$78.5 billion, the second highest rate for that period since 2015.[2] Furthermore, sustainability as a whole is in vogue, with public market fund inflows totalling more than €50 billion in 2020's third quarter, or 40% of all European fund flows.[3]

Third, despite the unprecedented drop in economic activity and carbon emissions, global warming is not going away. The drive to accelerate the pathway to a lower carbon future gained renewed urgency. At the same time the pandemic highlighted social inequalities and fragilities in our societies. The concept of business needing a social license to operate gathered momentum, fortifying investor appetite for social investing. European governments enshrined infrastructure investment as a means to stimulate the post-Covid economy via significant green fiscal packages.

Fourth, uncertainty is here to stay. The way we live, work, travel and consume has changed and is likely to have long-lasting impacts on what and how infrastructure is delivered. 2020 showed that even within infrastructure, transitions can happen at warp speed. Digital infrastructure is a perfect example: following the mass migration to work and study from home, demand for data proliferated. This rapidly accelerated a structural trend which has long been coming, with communication infrastructure becoming an integral part of a well-functioning economy. A survey by McKinsey[4] estimates this acceleration in the order of three to four years is boosting the growth of data centres, for example.

All of which makes us confident that our long-term investment thesis and strategy, which prioritise the themes of technology, disruption and sustainability, are well placed for the rapid shift in the economic order.

So, where do we believe we can find value in 2021 in core infrastructure? The answer is in the huge amount of investment needed to achieve Europe's goal of a sustainable energy transition. The EU's Green Deal proposes to invest in excess of €750 billion[5] in support of this, with initiatives focused on hydrogen, heat and buildings, electric vehicle charging, energy storage and batteries. Much of the opportunity in these sectors is naturally in the mid market.

Many are new sectors, but importantly we believe a significant source of generating alpha is to invest in transition assets – that is to say "brown" assets which provide essential social and economic services, but which have clear and ambitious aspirations to transition to green. We are excited about the years ahead. The powerful drive for a green recovery can only strengthen our investment thesis and result in more opportunity.

Sources:

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