

IPA Perpetual Australian Infrastructure Investment Report 2015



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About Us



Infrastructure Partnerships Australia is the nation's peak infrastructure body – formed in 2005 as a genuine and enduring policy partnership between Australia's governments and industry.

Through our research and deep engagement with policymakers and industry, IPA seeks to capture best practice and advance complex reform options to drive up national economic prosperity and competitiveness.

IPA'S FORMATION RECOGNISES THAT THROUGH INNOVATION AND REFORM, AUSTRALIA CAN EXTRACT MORE FROM THE INFRASTRUCTURE IT HAS, AND INVEST MORE IN THE INFRASTRUCTURE WE NEED.

Infrastructure is about more than balance sheets and building sites. Infrastructure is the key to how Australia does business, how we meet the needs of a prosperous economy and growing population and how we sustain a cohesive and inclusive society.

Infrastructure Partnerships Australia draws together the public and private sectors in a genuine partnership to debate the policy reforms and priority projects that will build Australia for the challenges ahead.



Perpetual is an independent and diversified financial services group providing specialised investment management, wealth advice and corporate trustee services to individuals, families, financial advisers and institutions.

Our origin as a trustee company, together with our outstanding performance track record in investment management, has built our reputation as one of the most respected brands in financial services in Australia.

We act as trustee for many infrastructure funds and investors so we have a keen interest in the future of Australian infrastructure. But our interest goes deeper than that. At Perpetual, we are pleased to support infrastructure development which benefits the future of all Australians.

OUR PASSION IS TO PROTECT AND GROW OUR CLIENTS' WEALTH WITH OUR VISION TO BE AUSTRALIA'S LARGEST INDEPENDENT WEALTH MANAGER OF CHOICE.

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CEO Message

AUSTRALIA HAS LONG BEEN SEEN AS AN ATTRACTIVE DESTINATION FOR INFRASTRUCTURE INVESTMENT, AND OUR RESEARCH CONFIRMED THIS.

Infrastructure Partnerships Australia (IPA) and Perpetual are delighted to jointly deliver the *Australian Infrastructure Investment Report*.

We have undertaken this collaborative research project to better understand the drivers and the inhibitors for infrastructure investors – and to benchmark how Australia is viewed as an investment destination, compared to other parts of the world.

Our report captures the views of sophisticated global and domestic investors, including sovereign wealth funds, pension funds, fund managers, developers, banks and insurance companies.

Our respondents collectively own or manage circa \$A150 billion in infrastructure investments across the globe.

While almost all respondents are Australian-based, around half have their head office within Australia, and half have head offices elsewhere.

Our report evidences the heightened appetite for Australian infrastructure investments, with some 95 per cent of respondents reporting a strong likelihood to invest or an interest in Australian opportunities in the near future.

The survey also shows that many investors are seeking large exposures to individual projects, with 50 per cent of investors ready to invest more than A\$1 billion in any single project; and 36 per cent ready to invest more than A\$2 billion.

Investors identify roads as the single most attractive asset type, followed by water, energy transmission and port investments.

The overwhelming majority are also seeking direct (rather than pooled) investments, citing the enhanced control over their assets.

Investors identify Australia's long track record in infrastructure, and our stable economic, fiscal and legal frameworks as key features driving interest in our market; alongside the depth and sophistication of the business sector and the transparency of bidding processes.

Importantly, our report also shows where Australia can improve current practices to sustain global focus from investors, beyond our currently high level of interest.

The number of investment opportunities – and clarity of the project and privatisation pipelines – remain key challenges for investors, with some 42 per cent saying that the Australian market is unlikely to provide sufficient opportunities in the near term.

Beyond the scale and number of investments, 68 per cent of investors cited political risk as the most significant risk to investment.

Undoubtedly, this reflects recent events like the cancellation of Victoria's East West Link; the cancellation of Queensland's asset recycling programme; and the ongoing debate about the ACT's light rail project.

Read together, these events appear to have raised questions in the minds of Australian and offshore investors – and show the importance of settled and predictable political leadership and policymaking in infrastructure.

We hope that this report helps to begin a conversation about the key challenges facing Australia – and the opportunities which exist to drive more investment into better national infrastructure.

While Australia is enjoying a high level of contemporary interest and competition to invest in our infrastructure, there is increasing global competition for infrastructure investment.

We hope that this report provides an opportunity for policymakers, business leaders and public officials to consider anew how we can better attract global skills and capital into Australia's domestic infrastructure.

We thank each respondent for their contribution to the inaugural IPA Perpetual *Australian Infrastructure Investment Report*.



**Geoff Lloyd,
CEO and Managing Director
of Perpetual**



**Brendan Lyon,
CEO of Infrastructure
Partnerships Australia**

Key findings

THERE IS STRONG INVESTMENT APPETITE FOR AUSTRALIAN INFRASTRUCTURE ASSETS



79 per cent are highly likely to invest in Australia in the next 2-3 years.



A further **16 per cent** are considering investing here.

WITH BILLIONS OF DOLLARS IN “DRY POWDER”



50 per cent would consider investing in projects in Australia over A\$1 billion.



36 per cent would consider investing in projects over A\$2 billion.

BUT TOO FEW INVESTMENT OPPORTUNITIES PRESENTS A CHALLENGE



37 per cent say it is likely Australia will provide sufficient opportunity for investment.



But **42 per cent** say there is unlikely to be sufficient opportunity here.

AUSTRALIA'S MATURE MARKET IS A MAJOR POINT OF ATTRACTION FOR INVESTORS

Australia is an attractive destination for infrastructure investment because of:



Strong knowledge of market participants and partners – **55 per cent** of respondents



Economic stability – **50 per cent**



Track record of infrastructure business – **45 per cent**

Results are based on the *Australian Infrastructure Investment Survey 2015*

AND THEY ARE SEEKING A WIDE RANGE OF INVESTMENTS

Investors are considering investing in:



Roads – **73 per cent**



Water infrastructure – **64 per cent**



Energy transmission – **59 per cent**



Social infrastructure – **55 per cent**

POLITICAL RISK REMAINS A CONCERN FOR INVESTORS

The challenges for investing in Australian infrastructure are:



Political risk – **68 per cent** of respondents



Lack of visibility of future projects – **45 per cent**



Cost of bidding – **45 per cent**





Methodology

This report provides a unique insight into the preferences, intentions and concerns of the major market participants about investing in infrastructure in Australia.

In April 2015, IPA and Perpetual conducted a quantitative survey of 22 market participants about investing in Australian infrastructure.

We followed this with detailed qualitative discussions with five industry participants to gain a deeper understanding of the issues.

What follows draws on both the quantitative and qualitative research and provides insights into the perceptions of investors about Australian infrastructure and the factors that influence their decisions.

Participant profile

We spoke to a range of large infrastructure players for our survey, including superannuation and pension funds, asset managers and fund managers, banks and insurance companies, as well as companies in the construction sector.

Half of these organisations had their head office in Australia, followed by North America and Europe. However, nearly all of the individuals we spoke to were based in Australia, with some saying they consider a local presence to be mandatory for participating in the Australian market.

The representatives we spoke to included investment managers, chief executives and general managers, fund managers, and investor relations and corporate affairs directors.

“WE HAVE ACTUALLY WORKED WITH OVERSEAS PLAYERS AND THEY ARE LIGHT YEARS AWAY FROM UNDERSTANDING WHAT HAPPENS ON THE GROUND HERE AND HOW BUSINESSES ACTUALLY OPERATE.”

Australian Infrastructure Fund



Participants' Investments

Between them, our survey participants managed or owned over an estimated A\$150 billion in infrastructure investments worldwide. Over half had global infrastructure investments worth between A\$5 billion and A\$20 billion, while one had over A\$20 billion invested (as illustrated in Figure 3).

Most were already invested in Australia and about a third of those organisations had more than 50 per cent of their investments in this country (see Figures 1 and 2).

The players had a broad range of investments. Roads were the most popular investments, followed by social infrastructure, then water, and ports and marine infrastructure (see Figure 4).

In terms of their investment preferences to date, the survey participants showed a significant preference for direct over pooled investment (Figure 5). They also showed a slight preference for Brownfield over Greenfield investments (Figure 6) and Unregulated over Regulated assets (Figure 7).

"WE WOULDN'T HAVE SET UP AN OFFICE HERE IF WE DIDN'T THINK IT WAS A GREAT JURISDICTION."

Direct Infrastructure Investor

Figure 1
Investment into Australian infrastructure

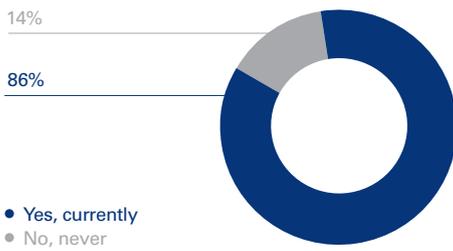


Figure 2
Proportion of investors' total infrastructure investments held in Australia

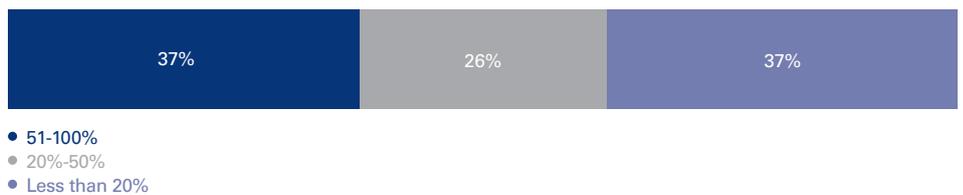


Figure 3
Total currently invested in infrastructure worldwide

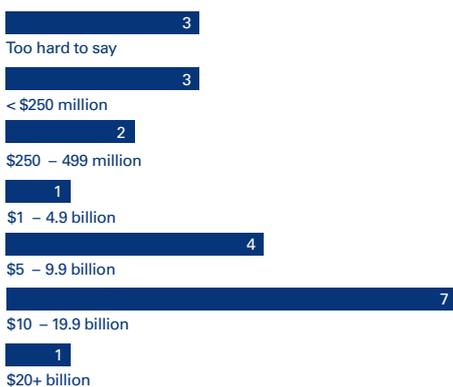
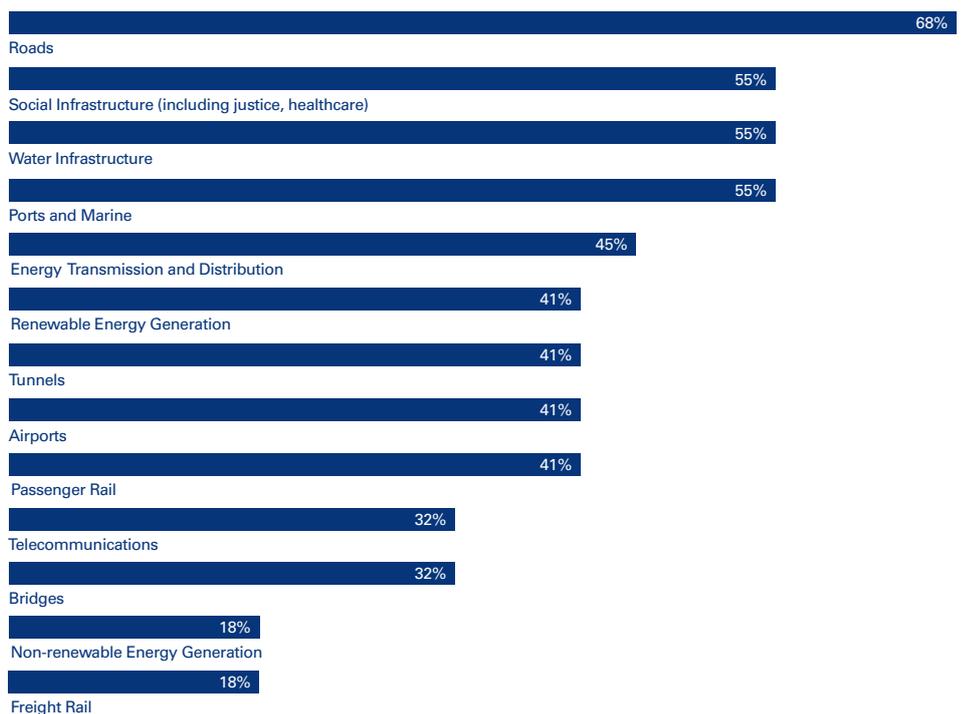


Figure 4
Types of infrastructure currently invested in



Participants' Investment Preferences

Figure 5
Direct vs Indirect

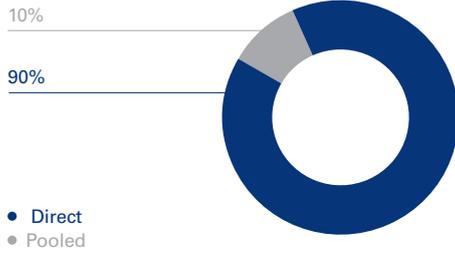


Figure 6
Greenfield vs Brownfield

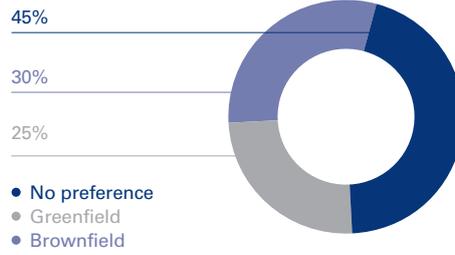
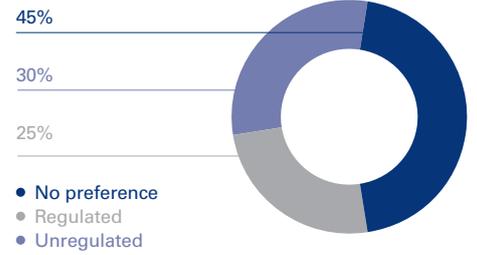


Figure 7
Regulated vs Unregulated



Participants' Investment Intentions

Some 95 per cent of respondents are considering investing in Australia, with the vast majority saying it's "highly likely" they will place funds in this market (see Figure 8).

Roads were the most popular assets, followed by water infrastructure and ports and marine. Investments in both renewable and non-renewable energy were less sought after, with some investors saying they have "social responsibility mandates" that don't allow them to invest in coal generation and others citing the uncertainty over energy policy. However, there remains strong interest in energy transmission and distribution assets (Figure 9).

Telecommunications assets were also less popular and from the qualitative research this was found to be because technology changes so quickly, thus requiring a specialised skill-set to manage these types of investments.

The majority of investors wanted to make investments directly or as part of a consortium, as opposed to via a fund manager, (illustrated in Figure 11), saying it gave them greater flexibility if they wanted to change their exposure or exit. They were interested in projects of all sizes, with a third of the investors considering projects worth more than A\$2 billion (Figure 10).

A strong majority of participants predicted that their investment behaviour is likely to increase or remain constant, with relatively few participants expecting to decrease their investments. This applies across infrastructure investment types (see Figure 12).

"WE DO REALLY LIKE THE OPPORTUNITIES THAT HAVE STRONG CORE INFRASTRUCTURE CHARACTERISTICS; STRONG MONOPOLY POSITIONS, LONG-TERM CONTRACTS AND PLAYING AN ESSENTIAL ROLE IN THE ECONOMY."

Australian Infrastructure Fund



"WE LIKE TO BE TREATED AS EQUAL PARTNERS WITH THE OTHERS. SO DIRECT INVESTMENTS ARE USUALLY MORE APPROPRIATE FOR THAT SORT OF CONTEXT."

Infrastructure Investor and Asset Manager

Figure 8
Likelihood to invest in Australian infrastructure



- Highly likely
- Considering it
- Not sure

Figure 10
Size of projects considered in Australia

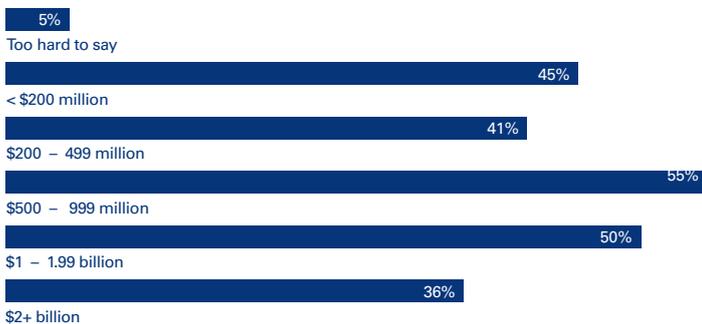


Figure 11
Preferred method for investing in Australia



- Part of consortia
- Direct
- Via fund manager

Figure 9
Types of projects considered in Australian infrastructure

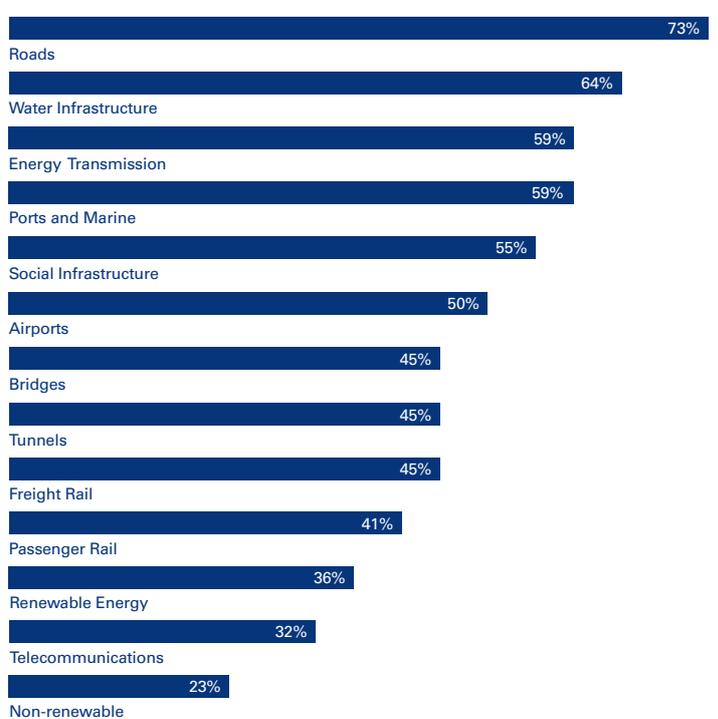
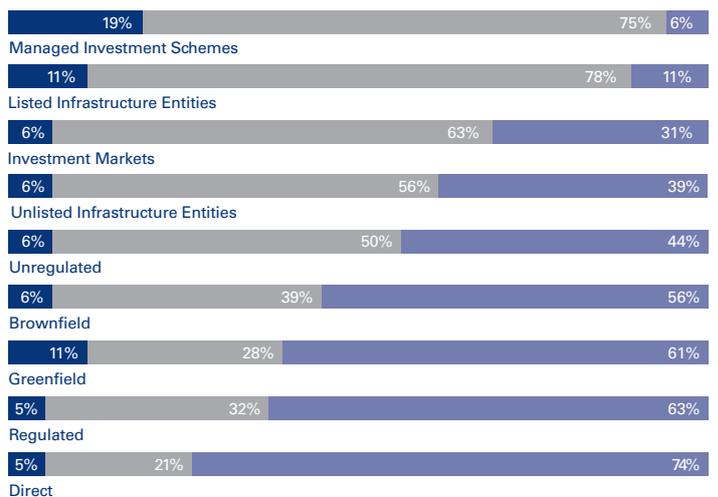


Figure 12
What investing behaviour is likely to change



- Expected to decrease
- Little change
- Expected to increase

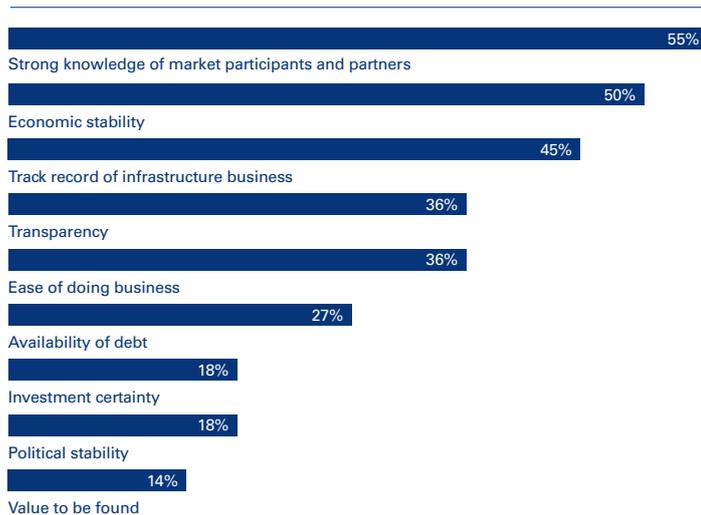
Why Australia for Infrastructure?

Infrastructure investors say they like putting money into Australia because it is a transparent jurisdiction and has a stable economy. They also noted Australia's solid track record in the infrastructure sector and the strong knowledge of market participants and partners (see Figure 13).

The participants said Australia offers "the best of both worlds" in terms of political stability and mature markets, but also provides a way of tapping into opportunities and upside in emerging markets.

Others noted that government sales processes were well run and transparent, and that regulators are fair and open to dialogue.

Figure 13
What makes Australia attractive for infrastructure investment



"WHEN YOU CONSIDER WHAT THE OTHER INTERESTING MARKETS ARE WITH GREAT POTENTIAL AND THE RIGHT RISK PROFILE, THERE ARE NOT THAT MANY."

Infrastructure Investor and Asset Manager

"IT'S A COUNTRY WHERE YOU CAN ALSO BENEFIT FROM THE UPSIDE COMING FROM THE EMERGING MARKETS THAT ARE NOT SO FAR AWAY FROM THE COUNTRY."

Infrastructure Investor and Asset Manager

Australia vs Other Markets

Australia is seen as a global leader in infrastructure, with a strong track record of infrastructure deals and highly knowledgeable participants. It is also perceived as a country with economic stability where it is easy to do business (Figure 14).

Investors also like Australia's strong secondary market and participants' willingness to recycle assets.

However, Australia compared less favourably than other markets when it came to the availability of infrastructure assets to buy and how easy it is to find value. Debt terms are also a negative, with one financial institution saying the lack of long-dated paper is a "gaping hole in the Australian market".

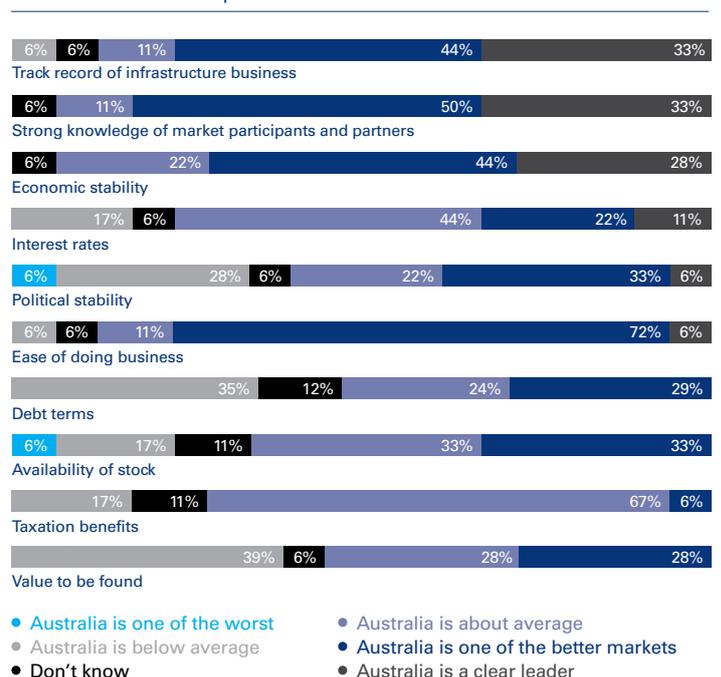
"IT'S A VERY GOOD MARKET HERE; IT'S PRETTY ESTABLISHED, PEOPLE KNOW HOW TO BUILD THINGS AND DELIVER MAJOR PROJECTS."

Australian Infrastructure Fund

"AUSTRALIA IS ONE OF THE FIRST MARKETS ON EARTH TO HAVE EVOLVED WITH THE GREATER SECTOR INTO THE INFRASTRUCTURE SPACE. SO IT'S CLEARLY GOT SHARP, EASY TO COMMUNICATE WITH, OPEN PEOPLE."

Infrastructure Investor and Asset Manager

Figure 14
How does Australia compare to other markets for infrastructure?



Challenges for Australian Infrastructure

Overall, Australia is perceived as having a strong and established infrastructure market, but there are also challenges for investors.

As global competition for infrastructure investment funds intensifies, Australia will have to overcome these challenges if we want to keep benefiting from a healthy infrastructure market and reach our full potential.

About two-thirds of respondents said political risk was a significant challenge (illustrated in Figure 15); a surprisingly high result. This result may be influenced by the timing of the survey which was conducted in April, after the change of government in Queensland, and just after the election in NSW where the lease of key electricity assets was a major political issue. The Victorian Government's cancellation of the East West Link road project late last year also dented confidence, though it later agreed to pay A\$339 million in costs to the winning consortium.

Related to the political risk issue is the lack of visibility of the pipeline of upcoming projects and privatisations, with one player describing it as "patchy and unpredictable." The bid process in Australia is perceived to be transparent and well run, but nearly half of participants cited the cost of bidding as a challenge.

Investors also said it was becoming more difficult to earn an appropriate return, because competition for assets is high as more investors seek opportunities in the local market and the economy isn't as strong as it has been in recent years.

There is also significant uncertainty as to whether Australia will provide sufficient investment opportunity, as illustrated by the difference in opinion represented in Figure 16.

Despite these challenges, appetite to invest in Australian infrastructure remains strong. More certainty about the future of infrastructure projects and better visibility of what's coming up will ensure that Australia will be able to source funds for infrastructure for many years to come.

"I LOVE IT HERE AND I'D LOVE TO BE PURSUING ASSETS IN OUR OWN COUNTRY BUT THERE'S NOT A PIPELINE, WE HAVE TO BE INTERNATIONAL TO ALLOCATE OUR FUNDS."

Direct Infrastructure Investor

"THE QUEENSLAND POLITICAL DECISION POTENTIALLY WILL DEFER A NUMBER OF SIGNIFICANT PRIVATISATIONS FOR AT LEAST THE NEXT FOUR OR FIVE YEARS"

Australian Infrastructure Fund

"IT'S STILL LOOKING BETTER THAN IT HAS IN THE PAST, BUT NOT AS GOOD AS WE THOUGHT IT WAS GOING TO BE."

Australian Infrastructure Fund

"WE WOULD DESCRIBE AUSTRALIA TYPICALLY AS PATCHY AND WE HAVE SOME GOOD PERIODS BUT THEN PERIODS WHEN IT GOES QUIET."

Australian Infrastructure Fund

Figure 15
Most significant challenges investing in Australian infrastructure

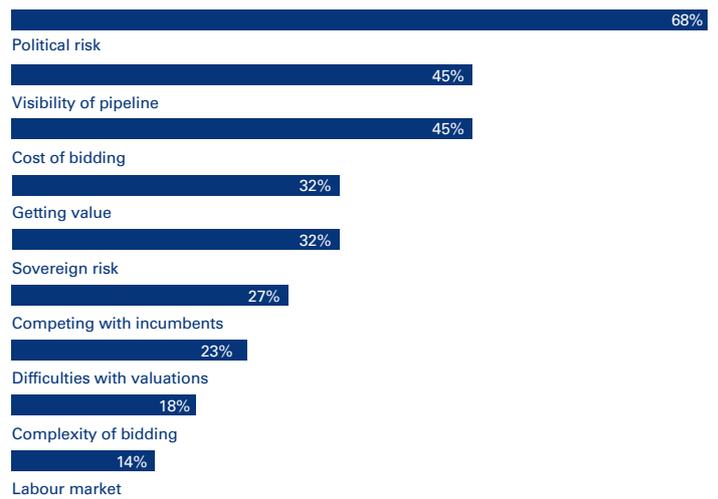
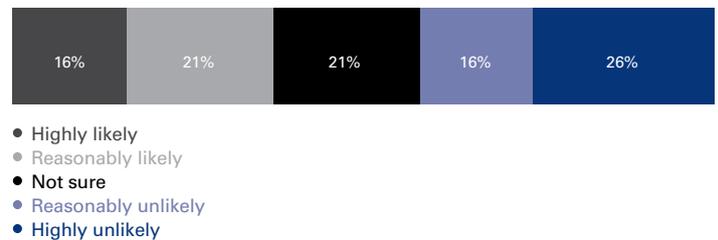


Figure 16
Likelihood Australia will provide sufficient opportunity



Conclusion

The IPA Perpetual Australian Infrastructure Investment Report paints a positive forward outlook for investment into the Australian infrastructure market. Over half of those surveyed were ready to immediately invest in excess of A\$1 billion into Australian infrastructure as projects and assets become available, with 95 per cent of respondents likely or highly likely to invest in the Australian market in the near term.

But amongst the positive outlook for Australia, the Report also exposed some risks and threats on the horizon, showing that as a nation we must not rest on our laurels and allow Australia's world-leading standing as an infrastructure investment destination to fade away because of declining policy and reform momentum.

Australia does many things well

Australia has a wide array of key strengths and competitive advantages in the global infrastructure market place, with economic stability, transparency and a deep and mature infrastructure market all identified by the research as essential elements of Australia's attractiveness as an investment destination.

The strong knowledge of public and private sector participants in the Australian market was cited as a particular strength, with 55 per cent of respondents saying the expertise and experience of market participants made Australia an attractive investment destination. Indeed, 33 per cent of respondents said Australia was a clear global leader on the metric of market participants' knowledge, with a further 50 per cent seeing Australia as one of the better markets globally.

Australia's economic stability was also identified as a feature attracting investment to the market, with 72 per cent of respondents seeing Australia as either above average or a clear global leader. With infrastructure being both an economic stimulator and a beneficiary of economic stability and growth, this is a finding that should serve to focus policy makers on the importance of preserving Australia's appeal to investors.

Finally, transparency was noted by the market as a standout feature of the Australian infrastructure space. Over a third of respondents singled out transparency as a feature enhancing the attractiveness of the Australian market. Notwithstanding the strong showing for transparency as a feature of the Australian market, it did score noticeably lower than the characteristics noted above – indicating the requirement for continued attention from policy makers on maintaining and enhancing the openness and transparency of the Australian infrastructure market.

But complacency is a threat

Australia's hard-won position as one of the world's most attractive infrastructure investment destinations is not permanent. As a nation, if we stand still on infrastructure policy and reform we will go backwards.

The **IPA Perpetual Infrastructure Investment Report** identifies some early indicators of where policy makers and industry must focus attention to maintain Australia's global standing on infrastructure investment. Three themes in particular stood out amongst research respondents:

- Political and sovereign risk;
- Poor visibility of infrastructure pipeline;
- The availability of investment opportunities; and
- Matching project, and investment type and scale, to investor appetite.

Political and sovereign risk were standout themes in the research. When asked about significant challenges faced when investing in Australian infrastructure, 68 per cent of respondents identified Political Risk, while 32 per cent pinpointed Sovereign Risk. The Sovereign Risk concern is reflected by a direct infrastructure investor respondent, who stated:

When an AAA rated government starts speaking of legislating contracts away, that's more like Venezuela, Bolivia, you don't do that in Australia. – Direct Infrastructure Investor

In part, this finding reflects the prevailing sentiment in place when the research was deployed in the first quarter of 2015. Respondents took part in the research closely following the substantial policy diversion away from asset sales in Queensland after that State's election, and in the wake of the cancellation of the contracted East West Link project in Victoria.

Participants drew a clear distinction between Political Risk – a variable policy and project priority landscape based on electoral cycles and other factors – and Sovereign Risk – where governments threaten to, or actually, unilaterally abandon executed contracts without fair compensation. While the distinction is positive, with respondents less concerned about the more damaging threat of Sovereign Risk, it is clear that potential for either Sovereign Risk or Political Risk is harmful to Australia's reputation as a world leading infrastructure investment destination.

The research also identified an outlook from investors that Australia may not be able to provide sufficient infrastructure stock to meet investor demand. More than 40 per cent of participants felt Australia was 'reasonably or highly' unlikely to provide sufficient investment opportunities to meet demand.

Keen investor appetite for infrastructure stock is a substantial opportunity for governments, an opportunity which reforming states such as New South Wales have been able to exploit to unlock considerable capital for infrastructure reinvestment. The Asset Recycling model used in NSW is particularly attractive for investors – providing mature Brownfield assets, and follow-on Greenfield project investment opportunities funded by sale proceeds – giving a diversity of investment opportunities and profiles.

Respondents also noted a related trend to the availability of investment stock, leading to an increasing challenge of finding value in the Australian infrastructure market. Increased competition for a modest number of high quality assets has led to keen asset pricing, with 39 per cent of respondents noting negative views on the level of value to be found in the Australian market.

It was also notable in the research findings that investors are seeking a range of individual investment tranches/project sizes, and sectoral diversification. When participants were asked to identify their interest in particular investment allocation values to individual investments, there was high demand for investments across all project divisions – ranging from projects of less than A\$200 million (45 per cent of respondents would consider Australian infrastructure investment opportunities of this scale) to investments greater than A\$2 billion (36 per cent).

Equally, investors are seeking a diversity of asset types. For instance, in excess of 50 per cent of investors expressed an interest in each of the following asset types:

- Roads (73 per cent);
- Water Infrastructure (64 per cent);
- Energy Transmission (59 per cent);
- Ports and Marine (59 per cent); and
- Social Infrastructure (55 per cent).

Awareness of the diversity in size and sectoral mix of infrastructure sought by investors should allow policy makers to better align and structure the pipeline of Brownfield sales and Greenfield construction to meet investor demand.

Standing still is not an option

In a globally competitive marketplace for capital investment into infrastructure, standing still will see Australia fall behind.

A strong history of reform focus and sectoral innovation has seen Australia rise to be perhaps the most attractive destination globally for infrastructure investment – contributing to Australia's economic success story and the wealth and quality of life of all Australians. But this hard fought pre-eminence could be easily lost as other investment destinations seek to emulate and exceed Australia's success.

The **IPA Perpetual Infrastructure Investment Report** establishes a compelling case for Australia's policy makers to continually monitor the market's attractiveness to inbound infrastructure investment, and to focus on enhancing Australia's competitive advantages while addressing the areas where ground is being lost to our competitors.



