IN THE LONG RUN

The past 12 months have shown a significant increase in valuations in the infrastructure space and a widening of the definition of infrastructure assets as many investors look elsewhere for infra-like returns. **Rob Boots**, Head of Infrastructure Europe at **APG Asset Management** talks to us about APG's evolution from LP to direct investor, and explains how the Dutch pension fund has remained true to its approach to long-term investments and its core definition of infrastructure.

How crowded is the infra space right now and how does APG differentiate itself as an investor?
The market is quite crowded. There is a lot of capital chasing projects available and some transactions are getting overwhelming attention. But this is really the tip of the iceberg for pension fund investors. There is a lot of capital on the side-lines which could be (re)deployed into infrastructure. The industry has only allocated less than 1% of AuM to the asset class and, in line with our own policy, we expect that to grow to 2-3% or even higher. With interest rates remaining stubbornly where they are, that shift is a natural progression but also a relative value question.

APG's approach to direct investments is that we are here for the long-term and not looking for a quick turn on our investment. We are also a flexible capital provider and can provide additional capital to portfolio companies post deal to fund M&A, CAPEX programmes, restructurings, etc. With over 400 billion euros under management we can make sizeable equity investments which give us access to a part of the market which smaller/mid-market players cannot reach. In order to execute our strategy we have built a dedicated global infrastructure team of 20 members spread across our offices in New York, Hong Kong and Amsterdam.

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APG is now a serious direct investor in infrastructure but continues to be one of the largest LPs for funds. How difficult is it to go direct whilst also being an LP? What are your requirements of GPs?
Our approach has evolved over the last decade – it's been a gradual journey from LP, to co-investor to direct investor. We chose to go direct to have better control of our destiny and, to a certain extent, to reduce costs. Whilst to date we have always been a minority investor on our deals, we exercise significant influence over our investee companies either through the legal minority protections we negotiate when we go into deals or, more practically, through building consensus with co-shareholders and board members around decisions that are important to us. We invest a lot in ensuring that our board nominees are equipped to deal with the board-room decision making and maximising their impact.

We still invest in funds where the fund offers niche asset or geographical experience that we may not have in-house. For example, our tie-up with Aquila Capital is a good example. Whilst our team has solid renewables experience in-house, hydropower is a very specialized asset class and traditionally has been at the lower end of the return spectrum. Aquila Capital has an excellent understanding of the industry and screens the market actively to identify opportunities, including the smaller deals which wouldn't be on our team's radar. Another example is our alliance with Argo Infrastructure Partners. This platform gives us access to lower risk energy infrastructure investments in the US and Canada, including midstream, utilities and long-term contracted power assets in addition to low-carbon energy investments.

Where we invest in funds we obviously want to secure acceptable cost and governance. We want good alignment of interests and are an active (founding) member of both the Global Infrastructure Investor Association (GIIA) and GRESB Infrastructure. The aims of GIIA are to be the independent and public voice for investors in global infrastructure, to build increased public understanding, engaging collaboratively with policy makers to create fair, long term investment environments that help stimulate economic growth and provide guidance on best practice, transparency and standardization. GRESB Infrastructure is a tool for systematic assessment, objective scoring and peer benchmarking of the environmental, social and governance (ESG) performance of infrastructure investments. Infrastructure probably still can learn from real estate.

> "Our approach has evolved over the last decade – it's been a gradual journey."

Fund tenures seem to be getting longer in the asset class, reflecting the long term nature of core infrastructure assets. Is this something which APG advocates?
We are less invested in infrastructure funds today. Where we do invest in funds we are open to longer tenures but this brings with it additional complexities which need to be addressed. Investors cannot be forced to wait 20-25 years to attain liquidity and likewise fund managers cannot wait that long for their carry. There should be a partial pay out of carry after a number of years based on the performance of the fund as a whole over that period over an appropriate watermark and/or claw back mechanism. Likewise, investors should be given a liquidity option after a period of time so that those who want to exit can, but other investors can stay in.

Many sponsors have been very philosophical about the asset class, not taking construction or merchant risk and focussing only on certain OECD countries. With a scarcity of good assets, many have become less picky. What is APG's approach?
The trade-off between risk and reward remains at the top of our list on deal origination. As our team grows we can handle additional risks, such as getting into assets earlier and trying new markets. We ascribe to the philosophy that risk stays with those who can best analyse and best price it. If we don't know how to analyse a risk then insurance may help us. Development risk is generally not something we will touch largely but we are willing to take construction risk and have invested at the construction stage of projects in the later stages where we have good visibility on the outcome. There are also some projects which are structured to bring in financial sponsors at the construction stage where contractually the exposure to construction risk is very limited as this is absorbed by the industrial party.

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> Our clients are also expressing a greater desire for highly sustainable investments.

We have a very analytical approach – for a long time, we decided not to invest in offshore wind as we have not been convinced by the technology and we have not been prepared to invest on the back of assumptions and forecasts only. Compensation therefore was considered too low for the risks taken. Consequently we have been studying the output performance of the industry for some time and the technology certainly has improved. The asset class has definitely stabilized and is safer and is something in which we are considering participating more actively.

We have a fairly broad global remit and are certainly looking further East and further South for deal opportunities. Speaking several languages within the team has proven to help a lot.

What is your view on the pipeline for the next 6-12 months and where do you think activity will be?
The pipeline looks very good. We will remain close to our core definition of infrastructure. Our activity will most likely be a bit of everything: brownfield, greenfield (not development), regulated assets, telecommunication, renewables, Public-Private Partnerships (PPPs) including social infrastructure, fund restructurings, and so on.

Our clients are also expressing a greater desire for highly sustainable investments (HSI). Our overall HSI exposure is expected to grow from approximately one billion to 5 billion euros by 2020 with a focus on CO_2 reductions and further ESG integration.

In terms of geographical focus, we will focus on the same markets. As a Dutch pension fund, 'Orange' transactions in the Netherlands naturally carry a high degree of comfort for us about the political landscape. We have however, almost naturally, also invested heavily in the UK over the past decade. With the Brexit debate hotting up we are obviously monitoring that actively. If Brexit were to happen we are considering which of our investments would be affected and how to react. In terms of pipeline we will probably not add a lot of new exposure to the UK ahead of the outcome of the vote in June.

More generally we will continue to structure joint ventures and alliances to facilitate our pipeline of deals. Where we see fit we will still commit to niche funds either by region or sector.

Important to our industry is also our continuous support of important initiatives like GIIA and GRESB Infrastructure.