Current trends in the infrastructure market for investors – By Infrastructure Surveillance expert, Kieran Scullion

Investor demand for exposure to the infrastructure sector remains strong, driven by its ability to match liabilities over a long-term period, the climate transition narrative and by aging infrastructure in developed markets.

While banks are still competitive in the low-risk and public-sponsor deal space, alternative lenders are increasingly involved with projects carrying higher commercial risk and related investment yields.

Presently there are a number of trends we think should be considered by investors looking at the sector.

A NEW GOVERNMENT

Labour has appointed some of Britain's most powerful business leaders to help source billions of pounds in private investment to support the economy and invest in the party's green energy plans.

As it seeks to find new ways to fund its spending pledges, Rachel Reeves, the chancellor, has assembled a taskforce to advise her on creating a National Wealth Fund.

Labours' green plan includes creating a state-owned energy company called GB Energy and investing in the decarbonising of heavy industry through the National Wealth Fund. The party has pledged to invest £7.3 billion of taxpayers' money in the fund to create "good, well-paying" jobs in a zero-carbon economy.

For every £1 of public investment it receives, the fund would be required to find a further £3 of private sector investment. It will be spent on a green industrial revival in deprived areas of the country, with the aim of creating hundreds of thousands of jobs and boost growth and increase tax revenue to invest in public services.

There is currently a lot of discussion, and a degree of excitement, as to how these plans might play out and which areas, other than those already specified, will benefit, particularly in light of the PFI model – which delivered multiple privately-funded public buildings (schools ,hospitals etc) during the last Labour administration – being dropped by the Conservatives under the Theresa May administration. Early indications are that deployment may be more green-investment focussed.

UNIVERSITIES SECTOR ISSUES

The Financial Times recently report that 40% of England's universities expect to be in deficit in the 2023-24 academic year, with an "increasing number" showing low levels of cash flow.

Indeed, Britain's leading universities now receive most of their fee income from foreign students as they become increasingly reliant on overseas money to stay afloat.

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While universities have other sources of income, such as research grants and business ventures, most rely on tuition for the bulk of their income.

Russell Group members lose £2,500 a year on each UK student, which it believes will increase to £5,000 before the end of the decade. With foreign students sometimes paying more than double their UK counterparts for the same course and with tuition fees frozen at £9,250 for the last seven years, they have had little alternative other than to maximise alternative forms of income, albeit this is currently a politically sensitive issue because foreign students count towards overall UK net migration figures.

They have warned that bankruptcies are now a possibility with one in ten institutions already cutting staff to reduce costs.

Infrastructure investors provide funding to many privately-owned student accommodation builds some of which have direct nomination agreements with universities. It would therefore be prudent for investors to stay close to the underlying universities and undertake regular financial health checks on them albeit underlying student demand for accommodation remains very strong.

PFI / PPP DISPUTES

In the post-Covid, public sector financial deficit environment a small handful of PFI / PPP projects have been experiencing issues from:

- local authorities facing severe financial difficulties or becoming insolvent in some cases and/or
- local authorities employing external advisers to review performance and deduction regimes to extract optimal value from the underlying service contract, particularly if it's felt that the Infra private provider of the service (SPV) is not delivering in line with the requirements of the underlying contract

A PFI projects key revenue stream is usually protected even after a local authority becomes insolvent and therefore continues to be paid via PFI credits which are issued by central government at the outset of the loan. These PFI credits are a form of grant (Promissory Note) under s.31 of the Local Government Act 2003 and were designed to enable central government to deliver PFI projects through Local Authorities and are paid by the relevant government department annually and are ring-fenced. These obligations sit outside of the Local Authorities other revenue streams and public sector budgeting requirements and can only be used to meet payment obligations under the contract for which they were issued.

In the case of the second issue, it's always advisable for investors and lenders to keep close to any issues as they develop on projects (higher deductions than usual) and seek to proactively address them early. The key always is to maintain good / transparent relations between the project parties and to avoid unnecessary disputes at all costs.

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IMPACT OF FALLING INFLATION

The impact of record high inflation over the past few years has been largely insulated on PFIs/PPPs due to natural hedges with indexed-linked unitary charges offsetting any associated cost increases. However, it has impacted the wider sector, due to increased capex and operating costs, particularly in the fibre space where capex roll out has been more costly and taken longer to achieve and key project contracts operations & maintenance for example but offset in the renewables sector by unprecedently high commodity prices. As we head for a (hopefully) lower inflationary environment, we should see all of the above settle at a more normalised rate.

The asset class is a resilient one, with the highly structured and long-term nature of the investments making them a solid investment.A new government, coupled with falling inflation, will be a positive for the sector, however, enhanced vigilance is required in certain sectors, notably universities and PFI/PPP.

Sources:

- *Foster, P. (2024) England's universities face 'closure' risk after student numbers dive, Financial Times.*
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- *Wright, O. (2024) Rachel Reeves: Labour will be more pro-business than Tony Blair, The Times & The Sunday Times.*

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