Cohen & Steers

Opportunities for investors in both public and private infrastructure

Chase McWhorter, Institutional Real Estate, Inc.'s managing director, *Institutional Investing in Infrastructure,* recently spoke with **Benjamin Morton,** executive vice president, head of global infrastructure, and a senior portfolio manager for Cohen & Steers' infrastructure portfolios.

Ben, could you give us a brief introduction to Cohen and Steers?

Cohen & Steers is a leading specialist investment manager focused on listed real assets, including real estate securities, as well as listed infrastructure, which we are here to talk about today.

Why would an investor want to invest in listed infrastructure, in the context of today's environment?

At a high level, there is a tremendous need for capital investment in infrastructure. In developed markets, decades of underinvestment have led to a growing need to upgrade existing infrastructure that has become antiquated. In emerging markets, it is a need to accommodate powerful demographic trends, such as rising standards of living and urbanization, which is leading to a visible capital investment case on the part of infrastructure companies. For investors, listed infrastructure offers the potential for equity-like returns, but with materially lower volatility and better downside defense relative to broad equities. Historically, infrastructure has participated in a large portion of the upside in favorable markets but has experienced half the drawdown during market declines, on average.

How has the institutional investor's view of infrastructure evolved over the years, and what are the long-term implications for the asset class?

The most significant evolution we have seen is the increased use of a liquid infrastructure allocation to complement private infrastructure exposure. Investors have been allocating to private infrastructure for quite some time, whereas listed infrastructure as an asset class is still a bit in its infancy. We believe it is a similar situation as we experienced with real estate in the listed REIT market 20 or 30 years ago. Private real estate was an early allocation across many major institutional capital pools, and over time, investors recognized the benefits of having more liquid exposure to real estate in terms of asset diversification and access to a broader set of property types. We have started to see that trend pick up on the infrastructure side over the past decade — and particularly over the last two to three years. Just as many institutions today have allocations to both listed and private real estate, we believe a similar approach will become prevalent in the infrastructure space.

What are some ways investors are implementing their infrastructure allocations?

Some investors are thinking about listed infrastructure as a more defensive carve out of equities. They have seen equities go up for 10 years now and recognize that developed markets are in the later stages of the business and/or economic cycle — so they are looking for a profile with greater resilience in down markets within their equity allocation. We're also seeing institutions allocate to listed infrastructure within an existing alternative sleeve — which is, frankly, where we believe it belongs, considering it provides the differentiated characteristics from a performance and risk standpoint from traditional equity and fixed-income allocations.

I wouldn't say we are seeing people leave private infrastructure to be in listed infrastructure. But we are seeing investors either choose listed infrastructure as their initial allocation, wary of valuations on the private side, or add a sleeve of liquid assets to existing private investments.

Are you seeing any sort of pivot from clients away from dedicated midstream allocations to a broader infrastructure portfolio?

This is an issue more investors are exploring. There was this expectation that high distribution rates from midstream energy investments could defend better in down markets and reduce volatility. That notion has been challenged by the extreme moves in energy prices and poor fundamentals in certain pockets of the midstream universe. Because of that, we have seen midstream investors look to allocate to a broader infrastructure universe that has a better history of providing downside defense and diversification benefits.

There seems to be sustained interest for infrastructure assets from private equity investors. Has that private equity fundraising affected valuations in the listed market?

We continue to see tremendous capital raises among private infrastructure funds. We have highlighted the nearly $200 billion of dry powder equity that exists in the private market today — money that investors have committed but has yet to be deployed. The challenge becomes getting that capital invested when there is such heightened competition for assets. We have seen this impacting the value of listed companies in several ways. Several listed companies have been taken private in recent years, while other listed companies have sold assets to these private firms. As investors focused on listed markets, we are happy for that to happen all day long, as the companies we invest in are typically selling those assets to private funds at high premiums to their current value, implied by the companies' share prices. The whole listed universe will not be taken private, but the combination of privatizations and asset sales help listed companies realize the value of their businesses.

Are there any other advantages of investing in listed securities versus the private side?

We find listed and private very complementary to each other, and that is a common implementation approach for a lot of our larger institutional clients. Listed infrastructure offers the opportunity for greater diversification — we are investing in dozens of companies, each of which typically owns dozens of assets across geographies and infrastructure subsectors. A private infrastructure allocation, on the other hand, tends to offer exposure to a handful of assets that can come with very concentrated risks — whether it is regulatory, political or sovereign risk. The discipline of public market standards is another benefit of investing in a listed portfolio, with corporate governance front and center in terms of how these companies are managed. To be fair, a benefit of private ownership is control — private investors in assets can typically exert greater influence on decisions and strategy than minority shareholders in listed companies.

What are some of the investment themes you believe represent the greatest investment opportunities today?

For one, anything that touches the digital infrastructure spectrum. Cell towers is one we have highlighted for some time. These companies are plays on increasing data intensity of mobile traffic, the continued proliferation of connected devices, and the need for wireless carriers to continue to spend on network upgrades to support that data growth. These are the companies that own and operate cell tower sites, they lease out space under long-term contracts to wireless carriers, have very predictable cashflows, high operating leverage, and they touch everybody on a day-to-day basis. A second theme we like relates to renewable energy — the next-generation utility business model, which is building out renewable energy assets as we continue to decarbonize our global power generation fleet and our electricity systems across the world. These are regulator-supported investments. For example, in the United States, there are state-level mandates to increase renewables as a portion of one's generation mix, and that means you must spend that money on renewables and charge customers for that spending. Companies that have renewable assets tend to have higher growth rates and tend to be the companies in that space that we prefer today and for the foreseeable future.

What are some of the challenges?

The biggest challenge in what we do continues to be regulatory and political risk across the spectrum of infrastructure companies. I noted some of the positive opportunities in utilities around renewables — that is not to say that every regulatory outcome for utilities is positive. In fact, they are the place we see the most regulatory risk in our universe. There tends to be heightened political intervention in regulatory processes, so we spend much of our time as a team analyzing and sensitizing our views on stocks for potential regulatory or political outcomes. That is what poses the largest risk to investors in this asset class.

What role do you see private-sector capital playing in addressing the nation's infrastructure needs?

I hope to see a growing role for private-sector capital as it relates to addressing U.S. infrastructure needs. The high-level story here is that we have very little of our critical transportation infrastructure — toll roads and airports, for example — privatized relative to most other parts of the world. I would ascribe that shortcoming to being a result of a highly politicized structure for a lot of those assets today, where there are so many levels of government involved in ownership, operation and regulation of these assets — municipalities that do not want to give up operation of these assets — and a bid-ask spread between what they would like to achieve in offering up concessions related to these assets to the private sector and what the private sector is willing to pay. I do believe that private owners have shown over time that they can be better owners/operators and financers of infrastructure assets. There would be a lot to gain from privatization or concession agreements given to private operators for many of these assets, and we encourage governments at all levels to further support this type of activity. One program to support this is the FAA's Airport Investment Partnership Program, which allows for the privatization of up to 10 airports in the United States. But we have found over the years that these processes become highly political and rarely go to fruition. So, while I think that is the right answer over time, and I would love to see the private sector play a larger role, I am cautiously optimistic about actual movement on that front.

CONTRIBUTOR

Benjamin Morton, executive vice president, is head of global infrastructure and a senior portfolio manager for Cohen & Steers' infrastructure portfolios, including those focused on master limited partnerships. He has 21 years of infrastructure-related investment experience. Prior to joining Cohen & Steers in 2003, Morton worked at Salomon Smith Barney and at the New York Mercantile Exchange.

CORPORATE OVERVIEW

Cohen & Steers is a global investment manager specializing in liquid real assets, including real estate securities, listed infrastructure and natural resource equities, as well as preferred securities and other income solutions. Cohen & Steers is headquartered in New York, with offices in London, Hong Kong and Tokyo.

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