Talking Points

Infrastructure in a post-COVID world – June 2020

At a high level, infrastructure investing has always been based on the belief that hard assets providing essential services can generate stable, long-term cash flows.

However, after several months of COVID-19 related lockdowns around the world, what is essential is changing in people's minds.

COVID-19 and the end of infrastructure as we know it?

If working from home, social distancing and de-globalization become the new norm, the very definition of infrastructure investing could change. It may be foolish for us to try to imagine what the long-term future would look like, when there is still so much uncertainty in the present. But in a rapidly changing world, having a lack of imagination is an even greater folly.

Working from home

In recent months, CEOs of large corporations have already suggested that "working from home" can become the new normal even after the COVID-19 crisis, as the current lockdowns have shown that people at home can be equally productive. Given that flexibility, some employees will opt to live in less dense areas such as suburbs or rural areas to enjoy more space and have a higher standard of living, with minimal loss of income[1].

[1] Some employers may try to combat this. For example, Facebook announced that it will adjust its employees' salaries based on the cost-of-living at their new permanent addresses.

For infrastructure investors, this means a decline in the number of commuters using transportation assets such as mass transit, which will need to adapt to lower for longer utilization rates. Fixed costs will need to be redistributed to remaining passengers in a way that does not lead to further demand destruction, or attract increased regulatory scrutiny – a fine balance to strike.

However, there are still transportation opportunities for infrastructure investors even if people work from home. For example, people still consume goods and materials even at home, which requires freight transport. Opportunities such as last-mile logistics or cold storage investments are also starting to attract the attention of infrastructure investors, especially those that exhibit more infrastructure-like attributes such as high up-front costs, specialized equipment, and geographic barriers-to-entry.

As people work from home, the spike in data usage means that telecommunication assets have become the main beneficiary in this crisis. However, some new challenges arise longer-term. If people move to more suburban and rural areas while continuing to work from home, the customer base for some telecom assets would shift away from large-scale enterprises in dense commercial districts, to fragmented retail customers spread across wider regions.

The growth in telecom will certainly accelerate after the current crisis, but the industry will need to invest in last-mile connectivity like fiber-to-the-home (FTTH), and embrace a new client base that has different credit risk profiles and consumption needs. This opens up opportunities for incumbents and infrastructure funds that are ready to adapt to this new reality.

Having a more distributed customer base will also impact the way we consume energy. For example, homes are usually less energy efficient than crowded high-rise office towers, which means overall energy consumption will actually increase as people work from home. This may sound bad from an environmental point of view, but the bright side is that economics for rooftop solar panels and behind-the-meter batteries also improve with higher home consumption, which will help to increase residential renewable energy penetration. Similar to the telecommunication sector, infrastructure investors in the energy sector may also find some new opportunities servicing a more retail customer base.

Social distancing

The world has become more optimistic that we will have a coronavirus vaccine within the next two years. But if that fails or if the frequency of pandemics increases in the future, the new investment case to assume social distancing will become more permanent. Working from home is just one part of this equation, as social distancing also has broader implications on non-commute related transportation. The most obvious impact that we are already witnessing is the collapse in air travel. The current crisis has highlighted that not all business travel is essential, as video conferencing can replace many face-to-face meetings. This again seems to show that transportation will continue to lose out to telecommunications, but this doesn't mean that traditional transportation will just disappear.

In this new normal, airlines will need to adopt new seating arrangements and disinfection protocols to protect travelers At the same time, airports may need to add new procedures such as mandatory temperature checks and staggered security lines. This would add time and cost to an already tedious air travel process[2]. Nevertheless, there are no substitutes for air travel in some instances (e.g. long distance flights). There will certainly be pain during the adjustment period, but this could open the door for the private sector including infrastructure investors, who can help retool existing assets or drive new innovations that would help the industry adapt to the new normal.

Beyond air travel, other types of passenger transportation like trains and buses will also need to restructure their business models to lower passenger density and improve overall hygiene. Even with these adjustments, people may still prefer to drive their own cars if that is a financially feasible option, which actually opens up some other opportunities for investors.

For example, workers who do not have the luxury of working from home may opt to drive themselves to work rather than take mass transit. Meanwhile, vacationers may skip air travel and take long road trips instead. This could potentially benefit certain toll roads, especially those in areas where people cannot work from home (e.g. healthcare, manufacturing etc.), those in regions that used to rely heavily on rail transportation, or those that link up to local vacation destinations.

[2] For those who are inelastic to the cost of air travel, private jets and chartered flights now look more attractive

De-globalization
After this crisis, nations around the world may look at increasing the domestic production of certain "essential" products, which would make the anti-globalization voices in this already populist world even more vocal.

For developed countries, this would re-industrialize certain parts of their economies, which increases resource and energy consumption, and is actually broadly positive for infrastructure investments. This may go against the broader environmental trends around the world. However, some can make the argument that de-globalization should accelerate renewable energy adoption, since it localizes energy supply away from foreign energy sources.

On the other hand, de-globalization may also have the unintended consequence of further increasing populism. If developed economies find that domestic wages are too high to support an industrial sector, they may accelerate the shift to automation and artificial intelligence. Machines are also immune to diseases, which makes them more attractive after the current crisis. Unless workers can quickly readjust their skill set, unemployment and populist sentiment could further increase. Although de-globalization could increase the demand for infrastructure, rising populism could also add political pressures on an already heavily scrutinized industry.

Final thoughts
In this article, we take on a bottom-up approach to imagine what the daily life of an average person would look like in the future, and what it means for infrastructure investors.

Obviously, there are other equally important macro themes such as rising geopolitical tensions, climate change, massive fiscal stimulus programs and seemingly unlimited quantitative easing that will continue to shape our world.

Finally, who will pay for all this future infrastructure? Government finances will be stretched after the current crisis, while consumers will be outraged with higher cost of essential services or higher taxes. These factors make it harder for infrastructure funds to receive adequate risk-adjusted returns on their investments.

We are optimistic that time will iron out these opposing forces, and create new investment opportunities. But for now, perhaps the biggest takeaway is that much of the "future" that we discussed above is already here. Investors will need to accept that some of these changes will become permanent – for better or worse.

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