

KEYNOTE INTERVIEW

Head-to-head with the banks



Institutional lenders have clear advantages to offer borrowers; the onus to educate the market is on them, says [Alessandro Merlo](#) of UBS Asset Management

Q How has the covid-19 pandemic impacted your ability to lend, on a day-to-day basis?

When the virus first began spreading aggressively in Europe, and we were all forced into strict lockdown, there were difficult questions asked about how we were going to continue to transact. How would we conduct negotiations, do due diligence or make site visits, when human contact had effectively been prohibited?

As a result, there was a sharp downturn in activity in March and April. But pretty quickly, lenders, borrowers, advisors and investors all learned to adapt.

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To start with, we primarily focused on refinancings and secondary trades in assets we were already familiar with, but as we became more comfortable with operating remotely and as restrictions were partially eased, we have been largely able to return to business as normal.

Q Airports have been hit particularly hard. But how have infrastructure assets fared more generally?

Our portfolio is well diversified across energy, utilities, telecoms and transportation assets and, with the exception of airports, which clearly continue to face a severe reduction in demand as a result of travel restrictions, performance has held up pretty well.

That is true even of other forms of transportation assets, such as toll roads and ports.

Traffic there came back strongly over the summer. We have also observed a dichotomy between passenger and freight, because while private travel has been curbed, volume of freight traffic has been resilient through the lockdowns.

Q How have your relationships with borrowers stood up? Has communication been positive and consistent?

We are significant or sole lenders to all the companies we finance and so we have been able to have frequent and in-depth discussions with management teams. In all cases, those management teams have been very open about what they are putting in place to mitigate impact from covid-19, first operationally, and then financially.

As lender, our focus has been on understanding how projects were securing operational adjustments, and on the safety of workers and users, as well as their cost implications. At the same time, we started assessing and analysing the impact of covid-19 on volumes and financial forecasts. Operating in a non-listed asset class, as opposed to the public markets, means it has been possible to have that constant dialogue, feedback and clarification with borrowers.

Q Has the crisis changed your view of the market? For example, has it altered your perception of the risk associated with certain sectors, such as transport?

What I have taken from this situation, is that the infrastructure sector has generally proved to be extremely resilient. The pandemic has absolutely confirmed the essential nature of the assets that we back. That – combined with government support – has enabled our portfolio companies to navigate this crisis. In fact, I would say covid-19 has reinforced the essentiality of all infrastructure assets, including some of those that are newer to the asset class such as telecommunications and digital. It is something that we were already convinced of, having transacted in this space prior to the pandemic. But now it is abundantly clear to everyone how critical telecoms towers, fibre networks and data centres are to the functioning of modern society.

Q What are the pros and cons of institutional lenders versus banks?

We can offer a great deal more flexibility as institutional investors – longer maturities, fixed rates, lower upfront fees. We are not in the business of churning deals and maximising fees like a bank might do. We are in the business of forging long-term partnerships with our borrowers and of creating long-term stable returns for our LPs.

Of course, the banks can offer ancillary services including structuring, origination, legal support and financial modelling. We need to compete on par with the banks in these areas. We can't just sit in an office in London, Paris or Frankfurt and wait for clients to come to us so we can offer them a pre-packaged loan. We need to get out there and educate borrowers about the advantages we can bring and work with them to structure financial solutions that are innovative and offer a win-win.

The majority of the competition we see is from banks, and we need to confront that head on. We are already seeing more borrowers interested in working with institutional financing as they recognise the alignment of mindset that exists, and I do believe that the institutional lender community will command a bigger share of the infrastructure debt market going forward.



Q Is that where you will be focusing your attention in 2021?

Telecoms and digital infrastructure certainly represent a major theme that we expect to continue. The company that we have already backed in this sector has seen an incredible acceleration of its roll-out and capex plans because of growing demand, which we don't believe will go away. When the pandemic finally ends, there isn't suddenly going to be a drop off in the need for connectivity. We have all gotten used to working from home. We have gotten used to watching Netflix. Furthermore, we are still a long way off from the full digitisation of our regions and there is a great deal of unmet need still out there.

But we expect to see other areas of interest in 2021, as infrastructure of all

types is likely to play a critical role in plans for an economic recovery.

Q How would you describe competition, particularly for a hot sector like telecoms?

Clearly there is competition. We estimate that the European infrastructure debt market totals around €120 billion of financing every year. Around 80 percent of that is still done by banks, leaving only around 20 percent for institutional investors. The real challenge for the fund community is to show borrowers that we can offer something different, and to take a bigger share of the market.

Q How is the global policy response to covid-19 likely to impact infrastructure debt in the months and years ahead?

The massive extension of central bank quantitative easing policies has had a huge impact. First, co-ordinated global monetary policy stabilised markets, which was a positive for everyone. But it has also created further downward pressure on base rates. That compression of rates has made it even harder for both institutional and private investors to find yield. In turn, that has increased appetite for alternative credit as investors move outside the traditional bond market that has historically dominated their balance sheets. There has been a pronounced shift from public to private and we expect that trend to continue.

The other really important piece of macro policy to look out for is the European Recovery Plan. We still don't know all the details, and it remains to be seen how individual countries will implement the plan once it is published, but it will undoubtedly prove critical for the infrastructure industry. There is huge pressure around health-care spending of course, but there is also a lot of pressure around spending on renewables and on infrastructure more generally. We need to monitor the legacy of the pandemic to see what public policy will be put in place to foster infrastructure stock within the EU.

Finally, and not related to covid-19, of course, it would seem remiss not to mention Brexit, which finally reached a conclusion at the end of last year after an interminable and tedious separation process. A line has been drawn in the sand, at last, and having that clarity will prove helpful. But I don't believe it will have any major impact for us. The market had already internalised the move and, with European funds, investing in Euros, we are focused primarily on the Continent, in any case.

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Q You mentioned quantitative easing and the search for yield as driving forces behind investors' decisions to commit to infrastructure debt. What other appeal does infrastructure as an asset class hold?

There are a number of attractive underlying characteristics. The asset class is long-dated, stable and non-cyclical, which means it fits well with investors that have long-dated liabilities and a need for yield generation. That is particularly true of pension funds and insurance companies, of course.

That has been further enhanced, for the insurance sector, by the beneficial capital treatment under Solvency II.

Infrastructure debt is now recognised as an important element of a portfolio allocation strategy by the largest, most sophisticated institutions.

That recognition is spreading into a wider pool of potential investors.

We are now finding that, in addition to institutional investors, the stable yield and cash generation that infrastructure debt offers is proving popular with private investors that have previously been heavily exposed to traditional listed funds and corporate bonds but that are now looking for diversification and enhanced returns.

Those types of investors are increasingly comfortable with closed-end, long-dated funds, whilst also welcoming the decorrelation with economic cycles and cash generation on offer.

Go and see your private banker, and there will be more and more alternative products including infrastructure funds on offer. That simply wasn't the case before. We undoubtedly have a role to play in educating and familiarising these new investors with our industry. ■

Alessandro Merlo is head of infrastructure debt at UBS Asset Management, Real Estate & Private Markets