

# ROADMAP TO INFRASTRUCTURE AS AN ASSET CLASS

## Infrastructure for Growth and Development

Infrastructure is a key driver of economic growth and prosperity. The quality, access and affordability of infrastructure—both physical and digital—are determinants of growth, equity and the access to opportunities.

The G20 recognizes the importance of infrastructure for growth and development and the need to tackle investment shortfalls as a way of lifting growth, job creation, and productivity. Its efforts have been directed at policies, frameworks and mechanisms to increase investment, including through initiatives such as the high-level principles on long term investment financing by institutional investors; investment strategies; the guidance note on diversification of instruments and incentives for infrastructure financing; and the principles of corporate governance<sup>1</sup>.

Despite G20 efforts, the infrastructure investment gap remains significant in both developed and emerging economies<sup>2</sup>.

Although traditional channels for financing infrastructure development remain relevant, it is evident that innovative mechanisms need to be explored in order to crowd-in private capital. It is worth noting that private savings in the hands of institutional investors are currently at an all-time high (US\$80 trillion in assets under management)<sup>3</sup>.

Institutional investors are constantly searching for stable opportunities that can match their long-term liabilities. In that context, infrastructure assets can be particularly attractive due to their time horizons, synthetic inflation hedge, relatively high expected yields and returns that are uncorrelated with business cycles, thereby providing opportunities for portfolio diversification. According to a recent Global Infrastructure Hub-EDHEC analysis, 90 per cent of institutional investors intend to increase their asset allocation in the infrastructure sector.

## Infrastructure as an Asset Class

Given the magnitude of the infrastructure gap, the G20 must adopt a new collaborative approach to crowd in private capital in order to harness the large pool of private savings looking for long-term investment. To this end, it is essential to identify elements that foster the development of infrastructure as an asset class.

It is proposed that the work progresses under a roadmap to “developing infrastructure as an asset class” (the Roadmap).

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<sup>1</sup> These four G20/OECD initiatives have been endorsed by G20 Leaders in 2012, 2015 and 2016

<sup>2</sup> Estimates of the global infrastructure gap vary according to their underlying methodology. For instance, the McKinsey Global Institute estimates a cumulative infrastructure gap of US\$5.5 trillion between now and 2035. On the other hand, the Global Infrastructure Hub estimates a cumulative gap of US\$ 15 trillion between now and 2040.

<sup>3</sup> See: Kelly, Jemima. Reuters “Global assets under management hit all-time high above \$80 trillion.” October 30, 2017

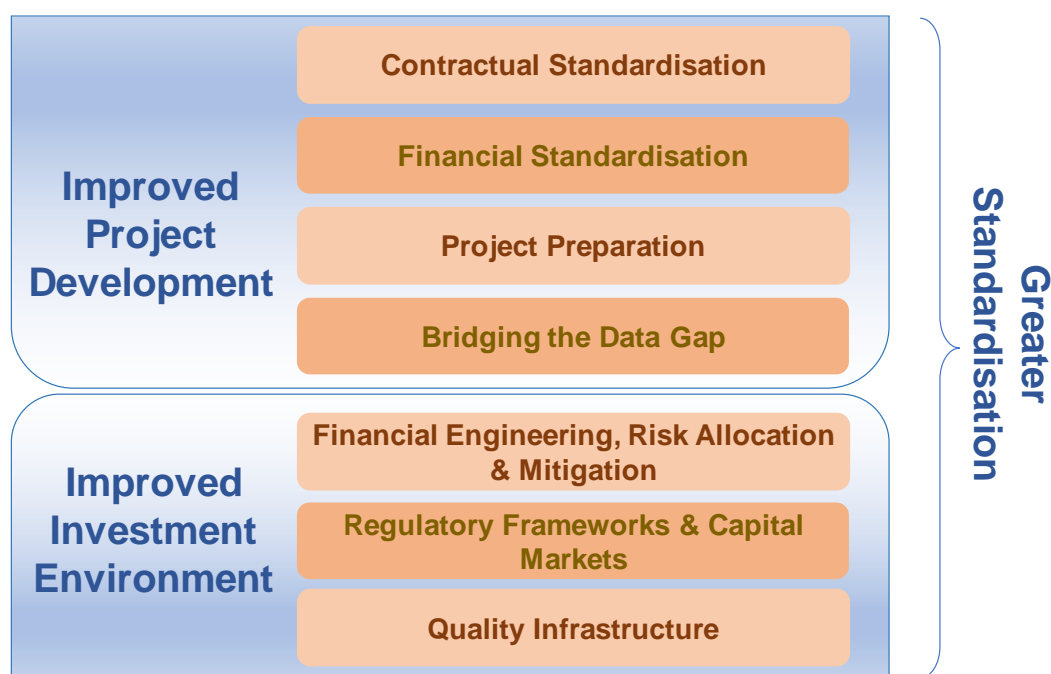
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This Roadmap will address common barriers to the emergence of infrastructure as an asset class, including the heterogeneous nature of infrastructure assets, the lack of a critical mass of bankable projects and insufficient data to track asset performance.

The Roadmap builds on the work of past G20 presidencies and draws together, in a holistic forward looking way, the critical steps needed to develop infrastructure as an asset class and promote bankable projects. Some of these issues may already be under consideration in other fora (such as work being undertaken by Multilateral Development Banks (MDBs) in standardizing approaches to project identification, preparation and contract design, or the Financial Stability Board's work on the impacts of the regulatory reforms on financing of the real economy), or through on-going work by the G20 and other international bodies.

The Roadmap is organized into three overarching pillars with the principal objectives of: i) improving project development; ii) improving the investment environment for infrastructure; and iii) promoting greater standardisation. Upholding the three pillars are seven separate work-streams, which are identified in the diagram below (see Figure 1). A description of each work stream is also available in the section describing the elements of the Roadmap. Some potential areas of future work to be analysed by members are included in the G20/OECD/WB stocktake of tools and instruments related to infrastructure as an asset class.<sup>4</sup>

**Figure 1. Pillars and work streams of the Roadmap to infrastructure as an asset class**



<sup>4</sup> See: G20/OECD/WB "Stocktake of Tools and Instruments Related to Infrastructure as an Asset Class progress report", March 2018

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## Work-streams of the Roadmap

### **Contractual standardisation**

Greater standardisation of contracts and documentation in the bidding and procurement stages of an infrastructure project life cycle is critical to reducing their cost and complexity, as well as facilitating their comparability. In particular, addressing contract ‘over-specification’ helps provide transparency, consistency and predictability to the entire procurement process, allowing decisions to be made objectively and expeditiously. It also helps avoid costly implementation and preparation periods, which often lead to long renegotiation processes. More standardised templates and checklists for structuring infrastructure projects, such as construction, supply, fit and commission, and operation and maintenance, must be developed to encourage greater private sector participation.

Standardisation efforts do not intend to give up the contractual flexibility that is needed to appropriately take into account the heterogeneity of infrastructure projects.

### **Financial standardisation**

The absence of standard financial funding contracts with comparable covenants and legal enforcement principles can lead to significant and unnecessary complexities. Greater financial standardisation would reduce costs and facilitate allocations by institutional investors into infrastructure investment. More homogeneously structured financial contracts, based on good practices, would also allow for improved disclosure and reporting, while simplifying the rating process for the credit rating agencies. Finally, a set of common financial clauses can help create a critical mass of similarly structured projects and foster the development of deep and liquid secondary markets.

### **Project preparation**

As a result of poor project preparation, prioritization and implementation, investment is not always translated into productive infrastructure. Improving these phases of the infrastructure project life cycle has the potential to lead to an enhanced pipeline of “bankable projects”. Common approaches, standards and tools used across project preparation facilities (including those developed by MDBs) will help to crowd-in private capital in infrastructure.

### **Bridging the data gap**

The availability of clear and timely data ensures that investors can assess the key features of infrastructure projects, in particular their expected risk-return profile. However, governments and markets lack comprehensive, asset-level, detailed and systematised data to make adequate and informed assessments.

In order to address this deficiency, further work should be devoted toward developing data on long-term performance of infrastructure at the asset and project level, together with the design of a standardised template for data collection.

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As some institutions have already made progress on this work stream, emphasis must be made on avoiding duplication and creating synergies with their work.

## **Financial engineering, risk allocation and mitigation**

Infrastructure development is characterised by various risks which can materialize at different stages of a project's life cycle. These risks include construction, completion, currency, revenue stability, environmental, and demand fluctuation. Other risks arise as a result of a project's jurisdiction, including risks stemming from the macroeconomic, political and regulatory environment. The viability of infrastructure as an asset class requires that these risks are addressed, mitigated and allocated to relevant stakeholders. Addressing foreign exchange risks of infrastructure projects is of particular importance as infrastructure revenues generally are denominated in local currency, creating mismatches when foreign equity and debt are used in project financing.

A decision to invest in a specific project depends upon an assessment of the project's risks and the availability of instruments to mitigate or manage those risks, including currency risk insurance, guarantee and hedge instruments. However, as the risk profile of projects change over their lifecycle (i.e., brownfield assets may be considerably de-risked compared to greenfield projects), financial vehicles should be developed taking into account this characteristic. An adequate diversification of financial instruments provides a variety of tools which, alone or combined, have the potential to de-risk infrastructure assets. Instruments should be designed to be replicable, scalable and well understood by the market, rather than bespoke products.

Credit enhancement instruments are an example of tools that can better allocate the risks of a project and thereby have a catalysing effect on investment. Mechanisms such as blended finance can also provide a base to effectively crowd-in private funding and enhance risk mitigation.

## **Regulatory frameworks and capital markets**

Appropriate and effective legal, regulatory, tax, governance and accounting frameworks play a role in attracting investment in infrastructure. It is important that these frameworks ensure well-functioning markets for infrastructure financing, protect investors and ensure the efficiency, transparency, stability, promote integrity and anti-corruption, while minimizing unnecessary regulatory burden.

In addition, steps to ensure that domestic capital markets are deep and liquid will also support the development of infrastructure as an asset class. This is especially the case in emerging markets, where currency mismatch is best minimized through medium to long-term local currency denominated financing.

## **Quality infrastructure**

Quality infrastructure investment aims to ensure economic efficiency in view of life-cycle costs, safety, resilience against natural disaster, job creation, capacity building, and transfer of expertise and know-how on mutually agreed terms and conditions, while addressing

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social and environmental impacts and aligning with economic and development strategies. However, at present there is no single defined or agreed-upon set of parameters governing quality infrastructure within the G20. Concerted action across several interconnected dimensions is thus required to deliver quality infrastructure. This could include alignment of investments across sectors, conducive regulatory environments and management of risks. Quality infrastructure should also be affordable, accessible, inclusive and broadly beneficial while being tailored to individual country conditions and consistent with local laws and regulations.

### Way Forward for 2018

With the overarching objective of developing infrastructure as an asset class, in 2018 Argentina proposes that the G20 focuses on the following work-streams: i) Contractual standardisation; ii) Financial standardisation; iii) Project preparation; iv) Bridging the data gap; and v) Financial engineering, risk allocation and mitigation. Throughout this year, progress will be made in each of these work-streams in consultation with relevant stakeholders, including the private sector.

Recognizing the importance of the other work streams canvassed in the Roadmap – Quality infrastructure and Regulatory frameworks & capital markets – we will work with incoming presidencies in the development of these areas, concentrating only on aspects pertaining to the G20 Finance Track, and continue the progress of previous achievements. The G20 troika mechanism will add to maintaining momentum on developing infrastructure as an asset class.