Vantage Infrastructure

Providing debt for sustainable infrastructure

Recently, **Chase McWhorter,** Institutional Real Estate, Inc.'s managing director, Americas, spoke with **Nick Cleary,** a partner of Vantage Infrastructure, about using debt to invest in ESG infrastructure. Following is an excerpt of that conversation.

How has infrastructure investment changed in the past few years?

The past decade has seen significant changes to investor preferences and the range of infrastructure opportunities globally across debt and equity. For example, annual investment in infrastructure across North America and Europe in 2010 was about $150 billion. Now, 10 years later, that number is at $450 billion, so there has been a huge growth, both of investment opportunity and investor demand. At the same time, we have seen large pension and sovereign wealth funds, that had led the first wave of investor demand for infrastructure, start migrating away from fund and separate account investing to invest directly. Parallel to the larger investors moving toward direct investment has been a broadening of the investor universe seeking to participate in the infrastructure opportunity via funds and separate accounts that has also driven the growth of investor demand. Finally, for a number of global investors, infrastructure debt has proved up as an alternative to fill gaps in value or diversification across fixed-income, real asset and private credit allocations.

How have these changes affected Vantage?

We have been evolving our business in response to these changes and our clients' now changing needs. In short, we have become more specialized in order to target the higher-value niches we see globally in debt and equity, while also returning to our roots as a private and independent business. We have increased our focus on capturing value from the next wave of opportunities presented by infrastructure's role in delivering sustainability outcomes, such as a net-zero emission target. As we have seen energy transition accelerating and net-zero emission targets becoming more formalized, infrastructure debt has been a valuable investment strategy for our clients to diversify their investments through the flexibility debt offers to optimize risk and return from sustainability-linked investments at an earlier stage or mitigate risks in traditional sectors.

Is supporting sustainability or ESG outcomes a new focus for Vantage?

Not at all. Sustainability and ESG awareness are embedded in our culture because they play a meaningful role in delivering value from long-term and essential assets like infrastructure. For example, to integrate this awareness from our culture into our investment processes, one of the first policy steps we made when we expanded our debt platform back in 2012 was to embed the Equator Principles in our debt investment process. Today, we have built significantly on that approach and made it more sophisticated. We now have an inhouse ESG assessment tool that we have applied to assess ESG risks on over 80 investments globally. This enables us to highlight our understanding of the ESG factors and transparently communicate with our clients on how we see the ESG opportunities and risks embedded in each investment, as well as our clients' portfolios.

CONTRIBUTOR

Nick Cleary
Partner
Nick joined Vantage Infrastructure in 2012 and has 24 years of relevant experience. Based in New York, Nick leads the North American business, including debt investment origination, execution and portfolio management. He is a member of the Debt Investment Committee and the firm's global Executive Committee.

What infrastructure debt opportunities does Vantage target that support net-zero outcomes?

Net-zero is one of several sustainability outcomes driving investment opportunities, but it is one of the largest drivers because of its impact on electricity generation and transport. When supporting net-zero, the first challenge is actually defining what net-zero means. There is a global consensus on targeting a net-zero economy, with most regions targeting a 2050 timeline and a few optimistic ones targeting the 2030s. What net-zero means for us is linked to understanding these timeframes and the various pathways to get to net-zero. The pathways are often the most complex aspect in identifying the opportunities and understanding the direct and indirect risks.

We target the higher-value niches of an investment opportunity that in the U.S. alone is potentially as large as $2.5 trillion to just start the U.S. down a 2050 net-zero pathway between now and 2030. The largest sectors are the obvious ones of large-scale and core infrastructure investments in renewable generation and the networks that takes energy from supply to demand. That makes up roughly half of the U.S. investment opportunity, but it is also one of the most competitive sectors. The other half is a diverse range of niche opportunities, such as distributed generation and storage, electrification, building energy and efficiency solutions, alternative fuels, and carbon dioxide capture and storage. It is often these smaller, more diverse, specialized and less-competitive niche opportunities that drive better value, which we proactively target.

How do you manage energy transition risks when investing in debt?

With debt investments, there are several ways to mitigate the key investment risks linked to energy transition. For example, we can limit our investment horizon to keep the risks foreseeable. We can size our debt to limit our exposure to contracted cash flows. We can structure specific covenants tied to the business achieving certain milestones that underpin an infrastructure risk profile. But a key tool for us in terms of managing risks related to energy transition is having a deep and broad pipeline of investments that allows us to better identify value, and simply have choice over how we invest across a range of technologies, sectors and regions to optimize risk and return.

You mentioned that you are a specialist infrastructure manager. How does that come into play when you are looking at these opportunities?

It means we are most often an enthusiastic early adopter of some of these newer opportunities, but we stop short of investing in the development phase, where technology and market risks can be more aligned to a private equity or venture capital risk profile. As an infrastructure specialist we want to make sure the characteristics of our investments are consistently on the infrastructure side of the ledger. We will be an early mover as opportunities migrate to having genuine and sustainable infrastructure characteristics.

Do you have an example of where you draw the line?

We were one of the earlier investors in residential solar. We did not do the first bank deals, but once the portfolios established a track record and the financing structures matured, we were an early mover investing across senior and mezzanine opportunities. On the other hand, in the past year we looked at our first carbon capture and storage opportunity, but decided to hold off investing for the moment. We invested the time analyzing the opportunity because we understood the importance of this sector to achieving net-zero and the value was potentially compelling. But while the application of the technology and markets risks were acceptable, a couple of aspects of the transaction structure were less proven, and we did not want to be the first in on that.

Can you invest in midstream infrastructure while supporting sustainability outcomes?

We have always taken a cautious approach to midstream, where we focus on the more mature contracted assets to avoid exposure to the volatility of commodity prices or exploration and development cycles that can overwhelm the infrastructure characteristics of a midstream asset. When we look at a midstream asset from a sustainability perspective, we run various scenarios to consider if the assets we are lending against can exist in the net-zero environment and, equally importantly, that the counter parties that are providing the contracts are also sustainable in that environment. We did a midstream investment recently where we spent a lot of time building out a range of net-zero emission scenarios. We became comfortable that the asset has a role to play in the net-zero economy, and that the businesses that were operating, maintaining and using the asset were also going to be sustainable. We ended up liking what we saw, and the debt ultimately provided a good risk-adjusted return for our clients. Going forward, we will continue to take a cautious approach to midstream and continue to invest where we see investments with like-minded sponsors that offer compelling value, and are going to be resilient to the many and varied unexpected outcomes yet to come.

What are the top energy transition debt sectors globally?

The sectors vary significantly by region, as well as by types of risk-and-return profile. In the longer-dated and investment-grade market, Europe and the U.K. will continue to lead the way. Those regions have a good combination of stable regulation, supportive government policies around energy transition and a general maturity of the infrastructure market. We have been able to provide debt to a broad portfolio of offshore wind projects in the U.K. At the same time, we have also invested in five U.K. waste-to-energy projects that direct millions of tons of waste away from landfills and are supplying non-fossil fuel baseload electricity generation.

The short- to medium-dated and sub-investment grade space in the U.S. is where we consistently see best value. We continue to like distributed generation and storage; this is behind-the-meter rooftop solar and battery storage. This sector has proven its resiliency, and its strong growth is providing a broad range of opportunities. The sector is a really good example of how proven technology in a new application is providing end-users and investors better value than the more traditional utility model. We are also seeing growth in a broad range of opportunities around stand-alone batteries and alternative fuels. These newer sectors are increasingly backed by contracts and, with maturing technology risks, their infrastructure characteristics are steadily proving up.

So, it is quite an exciting time with a diverse range of opportunities in each of our markets. If you look back over the past decade, the opportunities to provide debt to the sustainable infrastructure world have steadily grown year by year, both in scale and diversity, and that growth of scale and diversity is just accelerating as energy transition also accelerates.

CORPORATE OVERVIEW

Vantage Infrastructure is an independent fund manager focused on sustainable equity and debt infrastructure investments, comprising an experienced team, long-standing institutional relationships and a diverse portfolio. As of June 30, 2020, Vantage manages over US$5.0 billion in AUM across Europe, North America and Australia on behalf of global institutional clients.

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