SPECIAL REPORT: INFRASTRUCTURE

ASSET ALLOCATION Investors rate infrastructure highly among alternative asset classes and three quarters have an allocation of up to 10%. Upbeat intentions suggest a huge asset class in the making but current commitments are below target, as **Georg Inderst** reports

Boost in the pipeline

Preqin currently lists over 800 investors in infrastructure funds worldwide. The largest groups are public and private sector pension funds with a share of 23% and 13% respectively. Endowments/foundations, superannuation schemes, insurance companies and sovereign wealth funds add another 8%, 7%, 7% and 4%, respectively. Financial institutions make up the rest.

The eight largest investors in infrastructure (pension plans and insurers) are, with a total commitment volume of US$28bn:

- The Canadian public pension funds Omers and CPP with a commitment of $6.1bn and $4.1bn, respectively;
- The Danish insurance company PFA ($5.2bn) and public pension fund ATP ($1.6bn);
- The Dutch pension funds APG ($4.8bn) and PGGM ($2.1bn);
- The Australian Super ($2.9bn);
- The British Railways Pension Scheme ($1.4bn).

How to classify infrastructure

There are no exact data on the asset allocation of investors to infrastructure. Infrastructure is only slowly appearing on the radar screen of asset allocation surveys and independent performance analysis. One difficulty for data collection is that investors use different routes to invest in infrastructure. The picture becomes more complex as new trends in asset allocation create new categories such as real or inflation-hedging assets.

A first question is how investors classify infrastructure investments in terms of their asset allocation. According to Preqin, as far as unlisted infrastructure funds are concerned, 56% of investors have a separate asset allocation category for infrastructure while 28% classify it under private equity and 16% under real assets. Probitas (2009) finds further distinctions: 39% separate allocation, 27% private equity, 13% real estate, 12% general alternatives portfolio, 7% inflation-hedged and 15% others. By contrast, one may assume that listed infrastructure securities are still mostly kept in the traditional equity and corporate bond portfolios.

Asset allocation data

A second question is about the percentage of infrastructure assets as a proportion of overall assets. Various survey data are circulating but they need to be interpreted with care for several reasons, including very generous definitions of investor, pension fund, and infrastructure.

Also, there are issues over representativeness as many surveys are based on a relatively small sample of investors, and biased towards the more vocal or 'advanced' ones. Furthermore, it is not always clear whether figures refer to capital allocated, committed, drawn down or invested, an important distinction in private equity-type funds.

Preqin records the target allocation to unlisted infrastructure funds by all investors, including the various financial firms. The majority indicate either the range of 1-4.9% (37% of the funds) or 5-9.9% (38%). However, the actual investment levels of final investors such as pension funds, endowments and foundations tend to be lower. It is worth looking at pension funds in more detail.

In Preqin's database, about 300 public and private pension funds globally are reported to already have commitments to infrastructure funds. The number has risen strongly in recent years. The press frequently reports new allocations of individual pension plans to infrastructure, of 2%, 3%, 5% or more of their capital. However, such funds are still in a minority.

The allocation of Australian Superannuation Funds and large Canadian public pension funds is estimated at 3.6% (listed and unlisted funds) and 1.3% (unlisted only), respectively (CFS 2009).

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However, the allocation to specialist infrastructure vehicles appears to be smaller. Against estimated global pension scheme assets of US$23,300bn (Towers Watson 2010b), pension funds' infrastructure investments of $109bn (Towers Watson 2010a) implies an allocation of roughly 0.5%. Another survey of 119 investors worldwide by Russell Investments (2010) sees the share of infrastructure at 0.3% in 2009, but expects it to rise to 1.4% of overall assets in three years' time. The share within alternative assets is only 2% in their sample.

A survey of 10 major European pension funds by Hesse (2008) reported an average allocation of 0.5% with a maximum value of 2.5%. For Europe, ex UK, Mercer (2010) found that 1.4% of unds were invested in infrastructure, with an average allocation of 5.5% for the subsample of those funds that do invest in infrastructure. In the UK, more funds are invested (2%) but with a lower average allocation (3.8%).

The number of actual investments is small also in the US. The JPMAM (2010a) survey of 349 US investors finds that 9% of investors have already invested, with an average allocation of 4.3% among those who did invest. Infrastructure has the greatest appeal among public pension funds of which 18% have invested, perhaps an indication of additional social and economic considerations in some states and municipalities.

In a nutshell, the asset allocation of institutional investors to specialist infrastructure vehicles is growing, but it is still on a level of less than 1% globally. That said, it is important to remember that investors' total exposure to infrastructure is several times higher than these figures because of their investments in traditional listed infrastructure stocks and bonds. As an estimate for stocks, one may take a volume of roughly $700bn or an allocation of 3% of pension funds' total assets. Such investments are dominated by traditional utility stocks.

Investment intentions

According to surveys, infrastructure remains one of the most appealing asset classes. The financial crisis seems to have cooled down investors' interest in infrastructure only temporarily as the latest surveys show a recovery of investment intentions.

In August 2010, according to Preqin, 43% of investors were planning new commitments to infrastructure funds during the next 12 months (up from 40% in October 2009), while 18% (29% in October 2009) had no intention to invest. The others were either undecided or opportunistic about future investments.

An investor survey by bfinance (2010) in May 2010 shows infrastructure as the most attractive asset class in the alternative segment. It found a net 16% of pension funds who intended to increase the asset allocation to infrastructure over the following six months. The comparable figures (for changes within one year) were 8% in December 2009, 30% in March 2009 and 19% in October 2008. The longer-term investment intentions over three years are consistently high: the net figures were 32% in May 2010, 21% in December 2009 and 33% in October 2008.

However, actual changes appear to be slower than intentions. Only a net 4% of investors reported actual increases in asset allocation over the previous six months in the May 2010 survey, down from a net 6% in December 2009.

If the upbeat investment intentions became real, there would be massive new demand for infrastructure assets. To emphasise the potential future demand, Schumacher and Pfeffer (2010) mention that a 1% asset allocation shift into infrastructure by the German insurance industry only would generate new demand of €11bn. To exemplify the demand potential, a 3% asset allocation shift into infrastructure by pension funds worldwide would result in an additional demand of around $700bn.

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