

# Roundtable

UK

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## Land of hope and glory

As the UK continues to consider the fallout of its recent votes, three leading infrastructure investors gather to tell **Zak Bentley** why they continue to have faith in the country despite the risks

**F**rom a volatility perspective, the UK has been the ‘gift that keeps on giving’ following events over the past 18 months. The Brexit vote forced the resignation of then Prime Minister David Cameron and plunged the country into deep uncertainty. Less than a year later, Cameron’s replacement, Theresa May, called an unexpected election

in a bid to deliver the “certainty, stability and strong leadership” she believed the country needed following Brexit. The outcome was quite the opposite – resulting in a hung parliament and her leadership hanging by a thread.

Meanwhile, the UK’s attempts to reach a satisfactory deal with the European Union are hardly filling the investment

community with confidence, while the European Parliament has criticised the internal divisions of the government as an obstacle in the process.

Yet the infrastructure asset class hasn’t built up a reputation of resiliency for nothing and as we gather three industry experts to assess the situation, there is an air of mild optimism around the table.

“My observation was that after the referendum the UK definitely paused for a minute in terms of some live transactions, but it was encouraging that most of the transactions we saw largely got back on track,” says Dominic Helmsley, managing director for infrastructure at SL Capital Partners. “Any hiatus from the most recent election has been very modest, if noticeable at all.”

There’s a nod of agreement across the table from Tom Sumpster, head of infrastructure finance at Legal & General, who continues to see an outflow of private capital and ongoing transactions.

“You certainly have huge appetite from UK pension funds that are looking to access this market and that hasn’t changed,” he says. “Certainly, Asian money is still very strong coming into this market. In fact, if anything, it has got more aggressive on the debt side. We’ve seen pricing tighten in the UK and as a result it’s good for equity investors to be able to access that pool of money.”

The positivity outlined by the pair is endorsed by Nicola Palmer, partner at Arcus Infrastructure Partners, but with the UK’s relationship with the EU still to be determined and access to the single market looking unlikely, she sounds a note of caution.

“I don’t think it’s impacting dealflow, but I do think it’s impacting people’s assessment of different assets,” Palmer explains. “If you’re looking at a regulated asset that has zero GDP exposure and no cross-country exposure, then it’s irrelevant. If you’re looking at a port, an airport, a ferry business or anything else that has cross-border implications, then you are going to be thinking about the Brexit implications on that particular asset, both in terms of existing investments, but also potential investments.” She adds that Arcus has been exploring a series of Brexit scenarios to help cope with whichever outcome is eventually agreed upon when the UK formally departs.

On the fundraising side, Helmsley also points to a change following Brexit, driven by external perceptions of the UK.

“Perhaps, more broadly from the investor community looking at the UK as an investable market, there is some concern about UK economic growth,” he notes. “That’s one of the factors that has influenced the currency of the second fund. Our current fund is sterling-denominated, but our next fund will be raised in euros. That’s partly reflecting that investor concern and partly reflecting the deal pipeline that we see.”

That is not to say the fall in sterling has discouraged everyone. Helmsley says the UK investment universe is “slightly biased towards non-sterling-based” investors, given recent devaluation, and Palmer agrees – noting a desire from overseas buyers to

## AROUND THE TABLE



### **Dominic Helmsley, managing director of infrastructure, SL Capital Partners**

Helmsley joined SL Capital in 2013 to lead the infrastructure equity team, having previously been a partner at Arcus for three years. This was preceded by a spell with Australian firm Babcock & Brown’s European infrastructure team where he worked for just under three years between 2009 and 2012. He has extensive experience in the airports sector having been a director at BAA for 12 years from 1994.



### **Nicola Palmer, partner, Arcus Infrastructure Partners**

Palmer was one of the founding members of Arcus in 2009 following its spin-out from Babcock & Brown. She had been with Babcock & Brown since 1997 following its acquisition of the Australian Industry Development Corporation and joined the company’s London offices in 2005. Palmer led Arcus’s acquisition of Forth Ports and is also experienced in investments across the rail, road, electricity and water sectors. She has more than 20 years’ experience in developing, financing and managing infrastructure assets.



### **Tom Sumpster, head of infrastructure finance, Legal & General Investment Management**

Sumpster joined Legal & General in March 2017 following nearly 10 years at Royal Bank of Canada Capital Markets. He became head of acquisition finance at RBC in 2012 after previously serving as vice-president and director of the group’s structured finance division. Sumpster has more than 16 years advising, arranging and underwriting infrastructure transactions.

purchase UK assets while the currency remains low. This is also a point that rings true on the debt side of the equation.

“If you look at the debt markets, there has been significant competitive money coming out of US private-placement investors taking advantage of a weaker sterling environment,” Sumpster observes. “They have come into a number of sterling transactions on very tight pricing, which Europeans have struggled



to match, so that's been an interesting dynamic since Brexit."

#### THE CORBYN FACTOR

When Theresa May called the early election, she and her team had not banked on a resurgence from the left-wing opposition spearheaded by Jeremy Corbyn – and neither had the investment community. The Labour leader promised a nationalisation of utilities, water companies and rail networks, while his shadow chancellor John McDonnell recently went one step further, vowing to bring all PFI contracts under public control (p. 6).

While the Labour Party remains in opposition, it presents a clear threat to

the current government and to private infrastructure investors. Our participants, however, remain somewhat sceptical on Corbyn's plans coming to fruition should he come to power.

"The leadership team have come out with soundbites about renationalising rail, renationalising PFI contracts and my comment on that is: that's a hugely costly event to undertake," says Sumpster. "So, I would question whether or not it's really plausible in reality, but certainly as a vote winner, it appears to be something that the general public are taking seriously."

Sumpster's right: a recent survey by Populus found that 83 percent of respondents back public ownership of

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water assets, with 77 percent supporting nationalisation of electricity and gas, and 76 percent wanting railway assets back under public control.

The credibility of Corbyn's plans is also questioned by Palmer, who notes that in the rail sector, where "there are huge funding requirements", much remains in government hands bar the rolling stock provided by private investors, including by SL Capital.

"We have [investments in rolling stock] and remain positive about the ownership of those assets," Helmsley asserts. "I don't think we're in a world of expropriating assets at this point in time so I do think we're comfortable with whoever ultimately runs the railway, whether it's in its current model or whether it becomes

a renationalised model. How you achieve [renationalisation] in practice is potentially hugely costly and hugely difficult."

Neither the spectre of Corbyn nor Brexit dampens the enthusiasm of our panellists for infrastructure investment in the UK and Helmsley remains particularly bullish on the prospects of further rolling stock deals, with SL Capital involved in transactions worth more than £1.8 billion (\$2.4 billion; €2 billion) in the sector since February 2016.

"It's a sector we like a lot," Helmsley declares. "We brought something new to it and we're delighted with the progress we've made there. We did think it was a market that needed a little bit of disruption in terms of funding solutions, which have been largely driven by the three

“Is the EIB really going to be missed from the market? Certainly not” Sumpster



incumbent rolling stock companies. The nice thing about that sector is there is a sort of predetermined pipeline of opportunities dictated by the Department for Transport's franchising process."

Palmer is also confident about the prospects of the transport sector, looking at potential opportunities to arise from a government review into private investment in the sector.

"The UK is an island and with increasing renewable penetration there are significant investments that need to be made in energy assets like interconnection, in storage and in distributed generation," she adds. "On the telecoms side, we look at businesses with a combination of mobile masts, broadcasting and are now beginning to reach out into things like data centres and fibre."

Legal & General remains "sector agnostic", according to Sumpster, but is now looking at investment-grade debt in "quirkier assets", such as car parks and ferries. "Even with reducing subsidies, people are getting more comfortable with the long-term nature of renewables," he adds. "Offshore wind, at the moment, is something that we're very focused on."

Helmsley says SL Capital is less keen on the UK's operating renewables space and is instead targeting deals in the mid-stream energy space. "For us, operating renewables in the UK have got quite expensive. A number of the listed yield-cos play in that space quite aggressively so for us, from an equity perspective, it feels like quite a frothy market," he explains.

**ROLE OF GOVERNMENT**

While our participants enjoy the regulatory freedom provided by the UK market to deploy their funds, they are keen to see some innovation from the government to help the market develop new funding structures, much like the one provided for the Thames Tideway tunnel in 2014.

"In circumstances where construction costs could go above a certain level, that [structure] might be very interesting for some other large infrastructure projects, particularly in the rail sector, it might make sense," Palmer says. "Having a combination of some sort of access charge, together with a component of traffic risk, would be quite an interesting approach to take in the rail sector. The debate on alternative financing structures is absolutely happening

right now within the DfT [Department for Transport] and Network Rail. They're looking at alternative models of support for the rail sector and looking to models like Tideway for inspiration."

She adds that such deals are more likely 12 to 18 months away, but is optimistic given the wealth of investment needed. Sumpster agrees that more unique structures could be brought in to help the market.

"Looking forward, if we can have more procurement processes that are shorter in time for institutional bidders than that's obviously helpful because most institutional teams are relatively light in resource but are very keen and have huge appetite to deploy into the infrastructure sector," he says.

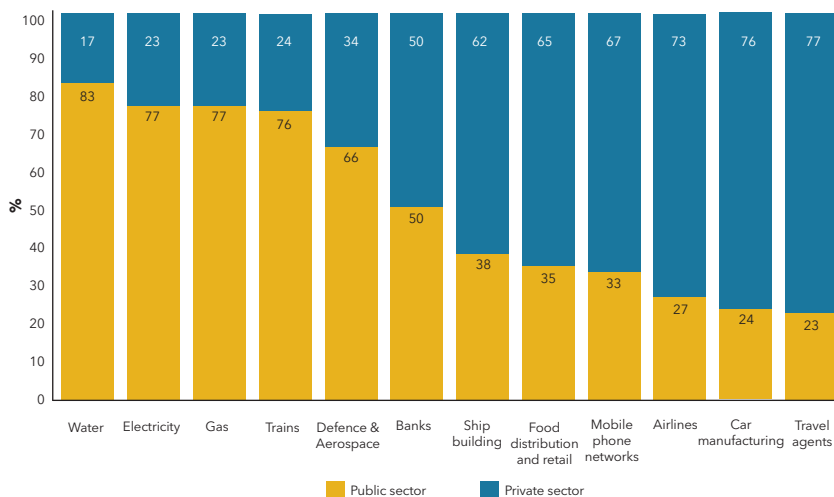
Meanwhile, there have been calls – particularly from advisory body Brexit Infrastructure Group – for the government to replace the European Investment Bank, which provided £5.5 billion to UK infrastructure projects in both 2015 and 2016. However, the proposals are met with a muted reaction from our experts.

"You've got an incredibly deep market for debt in the UK and I think the market can largely cover it," Palmer maintains. "There are some areas where EIB funding might be helpful, particularly on greenfield assets or maybe in investments where there's some sort of merchant exposure where the private sector debt lenders perhaps haven't quite got there yet. Otherwise, I think the UK is in a unique position. I think you need to be very careful if you're the government that you're not actually going in and undermining competition in the private sector."

Is an EIB absence an opportunity for the likes of Legal & General? "Yes, because it's one less competitor out there and the EIB were hugely competitive in the way that they priced transactions," Sumpster believes. "There is a wealth of institutional money out there at the

**POWER TO THE PEOPLE**

Most people in the UK are in favour of nationalising the water, gas, railways and electricity sectors



Source: Populus

“Having a combination of some sort of access charge, together with a component of traffic risk, would be quite an interesting approach to take in the rail sector” Palmer



moment which is driving tighter pricing month by month, deal by deal. So, is the EIB really going to be missed from the market? Certainly not, I don't think, in the UK.”

In a similar manner, our participants warn the government or sector regulators against involving themselves too much in the market. “I think where we get a bit cautious is when you see overregulation,” Palmer says. “You don't want regulators overcomplicating the system, regulating for the sake of regulation.”

Helmsley concurs. “With water, the risk is that the regulator just tries to dabble in more bits and it makes it harder to predict and riskier. Returns in UK water don't necessarily warrant what we perceive as the risk.”

Yet, despite all the risks and shocks to the system, the UK will continue to be a key market for investors. “The UK is always going to be a very significant source of dealflow and you have to take a long-term view as an infrastructure investor,” Helmsley concludes. ■