Introduction and context

The demand for infrastructure in emerging and developed markets as well as its strong correlation to economic growth and creation of employment has meant that governments have had to leverage the private sector in the financing and delivery of such projects. As per the Asian Development Bank¹, developing Asia will need to invest US$1.7 trillion per year in infrastructure until 2030 to maintain its growth momentum, tackle poverty, and respond to climate change. Over the years, private sector developers have participated in infrastructure by way of Public-Private Partnerships (PPPs), and have brought in commercial banks as well as Export Credit Agencies (ECAs) to fund them. Multilateral agencies (MLAs) and Institutional Investors (including pension funds and insurance companies) have also found the sector attractive as a long-term funds deployment destination.

In order to make infrastructure more attractive as an asset class and suitable for investment by a large and diverse pool of investors, the G20 launched a Roadmap for Infrastructure as an Asset Class in 2018². The report highlights that while the private long-term savings in the hands of institutional investors is at an all-time high of over US$80 trillion, there are barriers to be addressed in the emergence of infrastructure as an asset class. Many Emerging Markets have started focusing on improving the attractiveness of the sector by way of improved project development, enhanced investment environment and greater standardization (of processes and contracts).

The onset of the COVID-19 pandemic brings the double whammy of strained government finances (with focus diverted to immediate financial measures for necessary economic support and healthcare spend) and delay in infrastructure project pipelines, thereby further pushing out economic recovery. As per the Economic Policy Institute³, every US$100 spent on infrastructure boosts private-sector output by US$13 (median) and US$17 (average) in the long run. Furthermore, each US$100 billion in infrastructure spending would boost job growth by roughly 1 million full-time equivalents (FTEs).

This strong correlation between infrastructure investment and economic spinoffs has always been top of the mind for various policy makers, especially in emerging markets with a young mix in the demographics that requires strong employment opportunities. With economies coming to a halt during this pandemic, infrastructure investment is seen as an effective tool to fast track recovery.

Emerging themes

To gather points of view from key MLAs, Institutional Investors and Asset Managers, KPMG conducted 1-1 conversations with senior infrastructure sector leaders from 15 organizations in May 2020. Here, we summarize the key themes that emerged from our conversations, to help lay the foundation for infrastructure delivery in the post COVID-19 world:

1. **Financial sustainability is paramount**
2. **Technology to transform infrastructure service delivery**
3. **Revisiting the new normal in pricing and returns expectations**
4. **ESG (Environment, Social and Governance) factors and sector reforms to become a priority**
5. **Strengthened deal pipeline for diversified portfolios to drive the market**

In this article, we discuss each of these themes to bring out related nuances and how these could change the way we look at infrastructure as an asset class post COVID-19.
1. Financial sustainability

While being regarded as one of the more resilient sectors, the infrastructure sector has also been adversely impacted by the pandemic, especially with respect to GDP-linked assets. The turn towards enhanced adoption of technology means that datacenter and technology infrastructure projects have performed well during the lockdown. A focus on essential services has resulted in operating power and utility assets to continue on a BAU basis, to the extent feasible. GDP-linked infrastructure assets have been impacted, especially sectors such as Transport which are not under annuity offtake contracts.

Most investors have focused on the financial robustness of their portfolios, ensuring additional lines of credit and excess liquidity to tide through the crisis. Funds with a portfolio of diversified assets have benefited and this may drive their future thinking as well. Institutions and banks are also gearing up to address potential requests for loan service deferments and the need for working capital/short-term finance facilities from project owners. Projects that are fundamentally strong will also need support to tide through this crisis.

Projects at various stages of development are looking at force majeure clauses, for time and potential cost reliefs under offtake contracts. Governments and institutions involved need to take a sympathetic long-term view of such projects and accommodate short-term requests relating to financial sustainability through contracts and other measures.

2. Technological transformation

A critical enabler that has come to the forefront from this crisis is the need to leverage technology better for infrastructure project delivery. Most utilities and operators are increasingly looking at incorporating technology solutions for increased resilience and more efficient delivery. Operation and maintenance of critical infrastructure projects can be enhanced substantially by using IoT (Internet of Things) devices for speedy response, leveraging data analytics capabilities for monitoring and supervision of projects, and using blockchain for online authentication and disintermediation. These tools will become more commonplace as we prepare our utilities and projects of the future.

The incorporation of technology across the project lifecycle from construction monitoring (by use of drones, etc.) to planning and performance management (digital twin, predictive maintenance and robotic process automation) would become pervasive and essential for future projects to consider and incorporate. Also, with much economic activity moving online, technology transformation would be the driver for a crisis-proof infrastructure project.

3. Pricing and returns expectations

The prevailing low interest rate environment, increased risk spreads, market uncertainty and absence of relevant benchmarks have rendered it difficult to price deals. Limited transaction activity is expected in this period until there is a clear roadmap to the opening of economies and life returning to a level of normalcy. While the existing project pipeline continues to be evaluated by investors selectively, there is a substantial slowdown with the timelines for transaction closure getting delayed or investment processes being stalled.

The post COVID-19 environment would require price discovery and rationalization of returns expectations. Markets have not been able to truly assess the impact of this crisis yet (both immediate and medium- to long-term impacts). This implies that the business case for projects may need to re-assessed. There is reasonable expectation that certain projects will go into financial stress in the short to medium term. Such projects would require support from MLAs and the Government, as well as bridge facilities and other structured financing from institutional investors/funds.

Projects that are unable to obtain the required financial support may be made available in the secondary market for institutional investors to consider acquiring should the price be attractive. Overall, the “new normal” for returns and pricing will take some time to emerge.

4. ESG and sector reforms

It is expected that the sensitivity to ESG as core to business sustainability would take further precedence in the coming years. Most financial institutions will continue to insist on higher levels of compliance and disclosure with respect to ESG aspects.

This becomes even more critical with respect to Emerging Markets as investors start deploying long-term capital in infrastructure projects in these markets. In addition, a key factor coming out from the discussions is the urgency with which governments need to undertake sector reforms to bring in cost-reflective tariffs, transparent regulations offering level playing fields, and certainty as well as predictability. MLAs are expected to play an important role in fast tracking the reforms while ensuring minimal delays in project delivery.
Strong co-operation between government and MLAs to ensure reliance on standard processes and structures would be critical for countries to benefit from the experience of others instead of re-inventing the wheel.

5. Deal pipeline and portfolio diversification

A strong deal pipeline and availability of platforms for investment has been a challenge in emerging markets. Given the quantum of dry powder available and level of interest in both emerging and developed markets, this presents a great opportunity for governments to tap into this pot of funding available. This would entail coming up with a clear pipeline of green-field and brown-field projects via asset recycling, to offer them as an investible asset class for long-term investors like pension funds, infrastructure funds and insurance companies.

While many institutional investors are becoming more comfortable with local currency risk (for toll road and renewable energy projects specifically), a robust pipeline of reasonably-sized infrastructure assets ensures strong interest and aggressive pricing. Assets in the technology infrastructure space will be in demand. Funds would like to diversify their asset base to have a good mix of GDP-linked assets as well as assets with strong green credentials. Healthcare infrastructure and services projects will attract strong interest from both multilateral and institutional investors. A further opportunity arises from the need to potentially diversify supply chains as countries gear up to attract manufacturing facilities, thus resulting in a strong logistics and energy infrastructure pipeline of projects. Overall, a robust, commercially-viable infrastructure projects deal pipeline would be a fundamental catalyst to get alternate forms of capital deployed in country’s infrastructure projects – both greenfield and brownfield.

To conclude, most institutional investors and asset managers we spoke to are cautiously optimistic, have realistic expectations on the post COVID-19 environment, and have their feet firmly on the ground to face the emerging realities. MLAs are gearing up to address infrastructure challenges and complement governments efforts to leverage private alternate capital. The post COVID-19 world will be more resilient, leveraging technology and innovation to create long-term sustainable infrastructure. Many see this crisis as an opportunity for governments to fast track sector reforms, offer a robust pipeline of green-field projects, structure recycling of brownfield infrastructure assets and have a policy framework that can catalyze alternate institutional capital in the infrastructure sector.

References
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