KEYNOTE INTERVIEW

Where mega-trends collide

I Squared Capital's David Rosenblum believes there is a huge opportunity to deploy infrastructure debt at the intersection of digitalisation and power

The digitalisation of our economies is not only fuelling demand for digital infrastructure but also demand for power. As a result, there is a rich pool of infrastructure debt opportunities emerging from these two mega-trends with most of these opportunities to be found in the mid-market, given the proliferation of sponsors and developers looking for finance to help drive growth, says David Rosenblum, an infrastructure credit fund partner at global mid-market firm I Squared Capital. And in addition to senior direct lending, there are, notes Rosenblum, increasingly hybrid structures emerging in response to this form of growth-orientated infrastructure play.

Q What are the primary benefits of infrastructure debt as an investment strategy?

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There is a growing consensus that infrastructure debt represents a unique opportunity to invest in loans that are backed by real assets in sectors that provide essential services. Furthermore, these investments benefit from strong inflation linkage and attractive loan-to-value ratios where the underlying asset has a high replacement cost.

Typically, these assets will also benefit from strong regulatory frameworks and high barriers to entry, providing significant economic moats. All together, these credit investments offer a strong level of protection and resilience.

At the same time, we have clearly seen very high volumes of equity capital being raised over the past few years, which has exacerbated demand for credit.

Overall, we are seeing tremendous growth across the asset class driven by powerful mega-trends including the energy transition and digital transition. This in turn has created a compelling opportunity for making loans within these infrastructure sectors.

Q Why do you think the mid-market is a particularly attractive segment within infrastructure debt?

Historically, infrastructure tended to be financed either by banks, through project finance deals, or by utility type entities or governments. As private capital has played a bigger role in the market, most large infrastructure deals today are either syndicated deals or

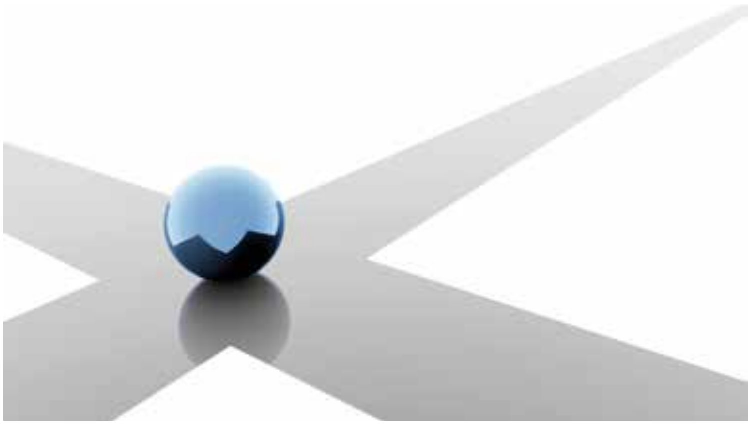
> *"The opportunity set for mid-market infrastructure debt is both vast and growing"*

Q What level of demand are you seeing for mid-market infrastructure lending and where are the most interesting opportunities by sector?

We are seeing demand for infrastructure credit increasing due to the enormous amounts of capital that are required to fulfil global trends such as the digitalisation of nearly every aspect of our lives. The demand for power is directly linked to that digitalisation, and in many cases, the power is sourced from renewable generation assets, which requires additional investment in sectors such as battery storage which will be needed to address the intermittency of renewable power.

As infrastructure lenders, we are investing at the intersection of the digitalisation and power sectors, benefiting from tailwinds that stem from some of the biggest mega-trends of our time. Furthermore, the bulk of the opportunities originating from these macro trends fall squarely within the mid-market.

In addition to the energy and digital sectors, we are also seeing some opportunities to invest in industries that may have fallen out of favour in recent years, such as transportation. Overall, the opportunity set for mid-market infrastructure debt is both vast and growing.



large bank deals where pricing is quite competitive.

By contrast, in the mid-market, we have seen many smaller sponsors and developers bringing assets to the market, meaning there are vastly more opportunities available to finance when compared to the larger deal space. As a lender, that allows you to be highly selective. A less competitive landscape, meanwhile, means that it is also still possible to command attractive pricing.

As an institution, we have deep mid-market development expertise on the equity side, having built over 40 platforms worldwide. We can leverage that expertise in our credit underwriting to provide mid-market loans in a part of the infrastructure ecosystem that often carries added complexity. Having that skillset inhouse has allowed us to provide solutions for borrowers in what we believe to be a highly attractive segment of the infrastructure asset class.

Q How has the appeal of the asset class been impacted by a change in macroeconomic environment, especially in comparison with core equity strategies?

We have started to see significantly more interest from traditional core equity investors. Much of that has been driven by rising rates, which mean investors can achieve a similar return profile with infrastructure debt but still be higher up in the capital structure and protected by an equity cushion. We have undoubtedly seen increased appetite from many different types of investors, and the ability to achieve comparable returns while taking lower levels of risk is the primary driver.

Q How have existing infrastructure debt portfolios fared through this more volatile period,

particularly in contrast to other direct lending strategies?
There have been multiple studies, including those conducted by Moody's and S&P, that have highlighted the resilience of infrastructure credit relative to other private markets asset classes. These studies have consistently shown that infrastructure debt has had lower default rates and higher recoveries, resulting in overall lower loss levels, than other sectors.

This story has been borne out over a long period of time and across many different economic environments and I think it is entirely logical. We are backing real assets, with strong inflation links and high barriers to entry, and so it makes sense that these assets are incredibly resilient.

Q Where in the world is that growth most apparent right now?
From a geographical perspective, both North America and Europe are proving highly attractive. The story is the same on both sides of the Atlantic. The underlying narrative, regardless of regulatory regime or political rhetoric around the energy transition, is the sheer growth in demand in power, driven in large part by the huge quantities of data that we are all consuming today and the data centres required to facilitate that. Those tailwinds are truly global in nature.

Q Have you seen changes to the structuring of deals and how do you expect this new vintage to fare?
While we have seen structures weaken in the corporate direct lending market where lenders are competing with syndicated deals, within mid-market infrastructure, we have been able to maintain the structural protections that are the hallmark of infrastructure investing. In particular, we continue to see lenders command strong covenant packages.

We are also starting to see some evolutions in the types of lending taking place. For example, in the renewables space, we are seeing loans that are not simply either construction loans or holdco loans against performing assets, but rather loans based on either the value of assets or the development pipeline. These structures are more akin to a borrowing base approach.

In terms of likely outcomes for the current vintage, we would expect strong performance both from an absolute return perspective, as well as the ability to pay interest in principle throughout the lifecycle of these investments.

Q What are the biggest challenges on the horizon as an infrastructure debt investor and how can these best be overcome?
One of the greatest uncertainties we are currently having to consider is the political uncertainty that comes with the new administration in the US. We need to consider statements that have been made and how they may affect the regulatory frameworks in sectors where we are active, most notably in renewables.

However, it is important to remember that these sectors are not driven by any specific regulatory regime. They are the products of the digitalisation mega-trend, turbocharged by developments such as the advent of artificial intelligence, and the resulting increased demand for power.

There will continue to be a level of uncertainty until we receive greater clarity around the policy positions of the new administration. But regardless of any announcements that may be made, we believe these are long-term trends that will continue to gather pace and that infrastructure credit, as an asset class, will not be adversely affected.

You will always see an ebb and flow with regards to short-term risk factors. The key is to support businesses that have long-term tailwinds behind them.

"The key is to only back businesses that have long-term tailwinds behind them"

Q Conversely, what are the biggest future opportunities?
We see opportunities to provide solutions in all parts of the capital structure, within senior direct lending in the mid-market, but also opportunities to provide hybrid capital to developers that have growth ambitions. In short, we continue to see tremendous opportunities across the infrastructure ecosystem, with significant near-term opportunities in the digital infrastructure, renewables and power sectors, providing not just one type of solution, but rather providing flexible capital solutions to allow developers to continue to expand in both the near and medium term.

Overall, we are very optimistic about what the future holds. We are in the early stages of an infrastructure supercycle driven by the need for the replacement of ageing infrastructure, the continued march towards energy transition and grid stability and digitalisation mega-trends. We expect to see continued demand for our capital and continued demand from investors. This is an exciting time for us and for the asset class. ■