

A DYNAMIC MOMENT FOR INFRASTRUCTURE INVESTING

Infrastructure assets proved their mettle through the pandemic and post-pandemic years, when inflation and interest rates spiked around the world. Today, although inflation is mostly trending lower, the asset class is being tested again, this time by macroeconomic uncertainty and rising geopolitical risk. Despite these challenges, the characteristics that make infrastructure an attractive diversifier, including yield and stability through market cycles, remain in place. In fact, institutional demand for infrastructure remains high, with allocations to digital infrastructure and energy transition-related assets increasing. Boston Consulting Group estimates that a record \$50 billion was allocated to data center investments alone last year, up from \$11 billion in 2020.¹ In addition, long-term opportunities remain robust in traditional infrastructure sectors, including transportation, power generation and transmission, and other utilities.

Yet the sheer size of the asset class can make it a challenge for some investors. Infrastructure assets under management reached \$1.3 trillion last year, as sector funds raised \$87 billion.² In this insightful article, leading infrastructure managers Igneo Infrastructure Partners and I Squared Capital share their current perspectives on market segmentation, asset valuations and transparency. In addition, they discuss how institutional investors can optimally consider portfolio allocations in this dynamic asset class — which also offers alpha opportunities.

Pensions & Investments: Given the market volatility this year due to changing tariff policy and geopolitical impacts, has infrastructure investing lived up to its promise?

“The first half of this year has been more challenging, given trade policy and geopolitical impacts and the pivots of policy positions in the U.S., but I would say for the most part the infrastructure asset class has continued to live up to its promise,” said John Ma, partner and co-head of North America at Igneo Infrastructure Partners.

“It’s a differentiated and very resilient asset class because, by definition, infrastructure provides an essential service, whether it’s power or transportation, utilities, water, waste or, increasingly over the last few years, digital-related infrastructure,” he said. The combination of defensiveness and diversification are two main attributes that attract institutional investors to the asset class today, he added. But that’s not all. “Infrastructure offers the opportunity, despite very defensive characteristics, to deliver long-duration equity-like returns.”

Tariffs, not surprisingly, are one of the top global macroeconomic issues on investors’ minds. Gautam Bhandari, co-founder, managing partner and global chief investment officer at I Squared Capital, has a firm view about how they relate to infrastructure.

“Tariffs really are an attempt to industrialize the Western economies. You see that push for different reasons in Europe and the U.S.,” he said. “In the U.S., there’s a big movement to reshore industry, which is a massive tailwind for infrastructure because industry cannot exist without the power, roads and everything else that infrastructure provides.”

This supportive environment, however, has not been devoid of risk. “The reindustrialization trend is a huge positive tailwind for infrastructure, but policy uncertainty has been negative around some of the very large headline projects,” Bhandari noted, pointing to instances such as the cancellation of large offshore wind farm projects and the high-profile litigation around the Panama ports. Those risks have been largely around regulated infrastructure, not in the mid-cap commercial infrastructure space where I Squared Capital invests, he said.

While tariffs have led to more “rockiness” in some sectors like transportation, infrastructure as an asset class is large enough to offer opportunities that aren’t impacted by them, Ma noted. “Transportation-related infrastructure is really tied to imports and exports and international trade,” he said. “But there are plenty of other subsegments of infrastructure within the U.S. that are more domestically focused and continue to thrive.” One example is freight railroads, which generally serve a domestic industrial base.

Another example is U.S. renewable power, which was buffeted by policy uncertainty this summer, Ma said. “There have definitely been shifts in policy, but now a lot of that uncertainty has been resolved. The outlook for renewable power remains relatively positive, simply because there’s very strong growth in demand for electric power in the U.S., driven in part by the rise of data centers.”

This year’s tariff shifts and policy changes had led some investors to put the brakes on new allocations, an inclination Bhandari said was also common during the COVID-19 outbreak. “When it comes to investors in infrastructure, we see two types: those



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who recognize this environment as an opportunity to take advantage of the big industrialization push and those who look at tariffs or policy changes and say they'll pause. I think you have to curb that natural instinct to pause and really think like an investor."

P&I: Is infrastructure investing today essentially a megatrends play? What are the underlying drivers for these themes?

"Societal drivers, such as digitalization, industrialization and urbanization, are all megatrends that are happening all at once," Bhandari said. "The drive to reindustrialize coupled with digitalization leads to huge expenditures and a push to build new power plants and other sources of energy, as well as roads and transportation networks. All of that is happening today."

In fact, we could well be in an infrastructure super-cycle. Alongside the demand for new types of infrastructure, like data centers, is aging infrastructure — roads, bridges and power facilities — which, both in the U.S. and Europe, had been experiencing anemic underinvestment for decades. "All those factors have come together to produce what I call an infrastructure super-cycle," Bhandari said.

While the societal megatrends are supportive tailwinds for infrastructure, institutional allocations in this space tend to be much more focused and granular. "It's a megatrends play, but you have to think of it in terms of the old adage, 'Think globally, act locally,'" Ma said. "These megatrends are driving a lot of the activity; but because it's asset based, infrastructure can be very local in nature." For instance, U.S. infrastructure investment is driven both by megatrends and regional differences across the country.

"How power markets work in the U.S. varies by region, and that will drive differences in market structure. So you need to tailor your investing approach and find opportunities within very localized markets," Ma explained. "That's part of the reason we like the middle market for infrastructure, because there is a lot of diversity and variety in terms of the investible market."

P&I: Infrastructure is a huge investible space. How do you segment it?

Traditionally, infrastructure has been segmented the same way as other asset classes, such as real estate or private credit, with strategies for core, core-plus and value add. But the evolution and growth of this asset class requires a multi-dimensional view for institutional allocators.

"It's time that we think beyond those traditional risk definitions, because they're not very helpful," Bhandari said. "We have a far simpler, and quantitative, method of looking at infrastructure: small cap, mid-cap and large cap. In addition, we also use a more granular risk dimension, which ranges numerically from lower risk to higher risk. Our funds are based on size and risk dimension, and we largely specialize in mid-cap."

Igneo, an equity-focused manager, also specializes in the middle market as an attractive segment for infrastructure investment. "Within the middle market there are subsegments, such as the lower and middle-to-upper parts, so it's still a robust and very diverse swath of the infrastructure market with a lot of diversity," Ma said.

Infrastructure market size is typically determined by the investment or equity check that a manager writes when investing in a business. While the definitions around market-cap size vary, typically up to around a \$300 million equity check is considered small cap, \$300 million to \$1.5 billion is mid-cap, and above that is considered large or mega cap. The mid-cap space is a particularly active section of the market.

"It's highly fragmented, but the small- to mid-cap universe represents probably around 95% of all transactions, though by dollar volume it's around 30%," Bhandari said.

The middle market, or mid-cap zone, can also be advantageous when managers are looking to exit an investment. "The businesses are not too big, so there's generally a robust universe of potential buyers when we choose to exit," Ma said.

In addition to market cap, Igneo segments the market by industry sector, focusing on four areas: renewable power, transportation and logistics, digital infrastructure, and water and waste. "Generally, we like to invest in real operating businesses with assets, growth potential and development opportunities in front of them," Ma said.

P&I: What are the similarities and differences between U.S. and non-U.S. infrastructure investing?

Given that infrastructure is a global asset class with regional differences, it has a highly differentiated opportunity set. Economies may be at various stages of growth as they navigate different interest rate and inflation scenarios. Yet the common denominator is that every economy needs power generation and transmission, transportation and digital networks that — even within one country — offer several opportunities, particularly in the middle market.

"The U.S. is a huge and dynamic economy, and as a result, the investment opportunity set is also very large and dynamic," said Igneo's Ma. "The U.S. has good large-cap and mega-cap opportunities, and it's also a great environment for a middle-market approach to infrastructure investing, as this segment has really interesting businesses."

A strong regional business doesn't have to be dominant across the country to present an attractive investment opportunity. "It's sometimes a misconception that in the U.S., it's got to be a large-cap type of investment," Ma said. Igneo takes a very selective approach to identifying potential deals. "We look to invest in what we think of as real infrastructure businesses, ones that have a defensive moat

around them," he added. "The defensive moat could be asset intensity, a contracted type of business, strong cash flows or having a very high barrier to entry, which may include regulatory mandates or requirements around the business."

The current industrialization trend spreading across the U.S. is also evident around the world, particularly in Germany, and some countries in Asia and Latin America. Bhandari pointed to Germany's €500 billion (\$592.7 billion) infrastructure fund, announced in March, which is part of the government's effort to modernize the infrastructure of Europe's largest economy. "Asia and Latin America have also been on a steady path of the same industrialization and digitalization trends that you see in the U.S.," he said.

Infrastructure benefits from economies of scale, and for that reason, the global nature of the asset class is key to successful investing — but, as Ma said, there are both global and local components.

"When I think about what it takes to succeed in infrastructure, first you need to specialize," Bhandari explained. "But you have to do it globally because the same laws of engineering and electricity apply to every market." At the same time, development is a local activity, "and teams need to be localized so they are in tune with local regulations and politics."

That's also where scale comes into play. Managers who specialize in infrastructure and have that global view and local focus are better positioned. "The data center in Singapore looks no different than the data center in Amsterdam or Frankfurt or



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in Virginia, and the power plants are the same,” Bhandari said. “The manufacturers of most of the equipment are exactly the same. So, scale is very important, and we use that to get better pricing and terms.”

P&I: What’s your outlook on the public and private capital drivers behind infrastructure and how they have impacted deal-making?

Infrastructure offers investors both public and private market opportunities, but because of the long-term nature and capital intensity of its assets, private markets are often the preferred method of investment.

“The megatrends and long-term growth drivers in some sectors of infrastructure are driving significant need for private capital,” Ma said, citing energy transition and digitization as two examples. “In many cases, private markets can be better suited to these types of projects than public markets, because of the long-term investment horizon of private capital versus that of publicly traded companies that can be focused on near-term earnings,” he said. “Often, if you’re doing a project that’s going to take two or three years of capital investment just to bring it to fruition, private capital investors have a longer time horizon to see that through.”

In addition, with public finances stretched thin around the world, governments are increasingly looking to private capital to fund much-needed projects. “The desire for infrastructure, whether it be digital or power, is real, and governments are generally running deficits,” Bhandari said. “The role of private capital has increased, whether in the U.K, Germany or the U.S. In fact, governments want to attract that private capital.”

The push by institutional investors to diversify their portfolios also supports private capital in infrastructure, he said. “Currently, public markets are volatile, and they’re expensive,” Bhandari pointed out. As it has low beta, private infrastructure has a built-in “incentive for people to diversify their exposure away from public markets while being hedged to inflation.”

P&I: How do you address investor concerns around valuations and liquidity?

Liquidity, a key component in valuation, is more of an issue in the large-cap space than the mid-cap space, according to I Squared Capital’s Bhandari.

“There have been fewer exits for many large-cap investments, and as a result, managers have been holding on to positions for long periods of time. When you hold a position for a long time, people question your valuation marks,” he noted. But in the mid-cap space, this is less of a concern because there is liquidity. “People are selling and buying assets.”

To provide investors with greater confidence in its valuation method, I Squared uses third-party input. “In addition to our own quarterly valuation, we have a third-party valuation by an outside firm, and we provide that report to our investors,” Bhandari said. “That’s best practice for us.”

For Ma at Igneo, it comes down to investors’ preferences. “We have both closed-end and open-end products. Some investors gravitate to closed-end products because, from a valuation standpoint, they take some comfort in knowing that at the end of a fund’s life, the manager has to exit, and they’ll know what the ultimate outcome is,” he said. Other investors may prefer open-end products, partly for the liquidity mechanism.

Regardless of the fund type, Igneo emphasizes transparency. “We take a partner-

ship approach with our clients, and we’re quite transparent with them about our valuation approach,” he said.

P&I: How can allocators best monitor and benchmark their infrastructure allocations?

When it comes to benchmarking and reporting, infrastructure managers have come a long way, but the process continues to evolve. In July, Wilshire Indexes and GCM Grosvenor launched what’s been called the first-ever infrastructure index: the FT Wilshire Private Markets Infrastructure index. It is a transparent reference index based on the performance of a diversified universe of open-end infrastructure funds. The North Dakota Department of Trust Lands, with \$7.5 billion in AUM, was instrumental in its development and support.

That’s an instance of “progress being made, but I think there’s more to come,” Ma said. “We pride ourselves on our communications and transparency with investors,” such as being ready to engage when any of Igneo’s investors wants to speak with a member of the investment team.

I Squared Capital’s Bhandari said that in addition to getting a third-party valuation, investors should monitor actual investment exits against reported valuations. “I would recommend that investors benchmark exits versus recently reported marks,” he said. That can inform investors on whether valuation marks are prudent and help investors avoid unexpected surprises.

He pointed to the volatility of public markets as a contrast. “Every day, stock markets are up or down 2% to 3%, and individual stocks can be up or down 8% to 10%. So, if you hold a public portfolio, you’re going to see very volatile daily valuations,” he said. “For us, as long as we have marks that are consistent, and a track record of exits that’s within reason of the marks we set, that’s a good sign that our valuation process works.”

P&I: What are the key attributes that an infrastructure asset manager needs to deliver consistent risk-adjusted returns?

A strong origination pipeline, a global and comparative perspective and a consistent adherence to one’s stated investment strategy in infrastructure are all important.

“You need to have a very wide funnel. You need the ability to review a large number of deals and have the ability to say no,” Bhandari said. “You need a strong pipeline to really seek the alpha opportunities and outperformance that you want.”

He said that focusing on a narrow sector or region can be risky, because infrastructure is cyclical. “AI is hot today. Everybody knows it, and it’s reflected in the prices. So, where you invest in digital infrastructure — which subsegment and geographically — is more important than the fact that it’s an AI investment.”

But it’s also important to keep a tight focus on the strategy and not be enticed by the latest investment theme or opportunity. “This is a client-driven business, and part of that is staying true to our mandates and not drifting from that,” Igneo’s Ma said. “If we’ve got a core product focused on the middle market, we intend to stay there. If we’ve got a lower-middle-market value-added product, that’s the mandate, and that’s how we’re going to invest. It’s as simple as that.”

^{1,2} Boston Consulting Group, “Infrastructure Strategy 2025: How Investors Can Gain Advantage as the Asset Class Matures,” <https://www.bcg.com/press/17march2025-private-equity-infrastructure-investment-renewed-growth>.

