E X P E R T Q & A

The expanding renewable energy and digital markets are dominating dealflow, but traditional sectors more heavily reliant on sales and purchases are picking up after a quiet few years, say Brookfield's Ian Simes and Hadley Peer Marshall

The twin forces driving infrastructure debt demand

Given the rapid growth of digital infrastructure and renewable power in recent years, it is not surprising that these sectors are dominating infrastructure debt dealflow. Activity in traditional sectors that rely more heavily on merger and acquisition activity, however, has been comparatively quiet, but is also poised for an uptick. That is the view of Ian Simes, managing partner in Brookfield's credit group, and Hadley Peer Marshall, chief financial officer of Brookfield Asset Management, both of whom are co-heads of Brookfield's infrastructure debt and structured solutions business.

Brookfield picked up the award for Infrastructure Debt Manager of the Year in the Americas in this year's Private Debt Investor Awards.

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Although the new US administration under President Donald Trump is signalling diminished support for renewable energy, Simes says it is the private sector – not government diktat – that is driving the growing demand for clean power.

At the same time, the advent of artificial intelligence along with explosive data centre growth is turbocharging a robust pre-existing demand for digital assets.

Q What are the key benefits of infrastructure debt?

Hadley Peer Marshall: One of the primary appeals of infrastructure debt is that it is largely uncorrelated to other asset classes. It also has strong downside protection because it is backed by real assets that provide services used consistently throughout the economic cycle and often have pricing power to adjust for inflation. Therefore, it delivers stable cashflows and returns, which can be comforting in a volatile world.

This is particularly important from a credit perspective, where there is a real focus on managing downside risk. Infrastructure debt is one of the strongest downside-protected asset classes. In addition to stability, predictability and downside protection, infrastructure debt tends to be highly structured, and that complexity is rewarded by an enhanced spread compared with corporate credit.

Finally, infrastructure is growing phenomenally, with the scale of investment tripling over the past 10 years and borrowing demand showing no signs of slowing.

Q Which sectors are dominating dealflow right now, and which are less active?

HPM: Our definition of infrastructure spans five key sectors: utilities, midstream, transportation, data and renewable power. Five years ago, those sectors were relatively evenly weighted within our strategy; but over the past three or four years, the renewable power and data sectors have become dominant.

There has been a huge amount of asset creation in the renewables space, in part because renewables often represent the lowest-cost form of energy supply and in part because of the push for decarbonisation, which many jurisdictions are prioritising. Everyone is familiar with the explosion in data centres. That was already underway before the advent of AI, which has simply accelerated the trend. There is also a huge amount of capital being invested in the roll-out of fibre-optic technology, while telecommunications companies have been selling off towers to become more capital efficient.

By contrast, when you think about the other sectors – utilities, mid-stream and transportation – new assets are being built but at nowhere near the same pace. Lending opportunities in those industries, therefore, tend to be driven by M&A activity. The sale and purchase of existing assets has declined significantly over the past three years, which has reduced lending in those areas.

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>
> **HADLEY PEER MARSHALL**

Q How would Brookfield define infrastructure in today's environment?

Ian Simes: We are extremely disciplined when it comes to our definition of infrastructure. It is relatively easy to identify what constitutes infrastructure from the perspective of physical assets. We all know that roads, towers, ports, airports and pipelines are types of infrastructure. However, it is critical that these assets also have an infrastructure business model that produces a predictable stream of cashflows.

For example, you can have a solar photovoltaic farm with 15-20-year contracts with highly rated counterparties. We would consider that infrastructure. But that same asset could also just be selling power into the market on a spot basis – day by day – and generating a very volatile cashflow. We would not consider that business model to be infrastructure.

A similar analogy could be made in the fibre market. We would consider the French business model, which relies on public-private partnerships, to be infrastructure. However, the UK 'altnet' (alternative network) model has a much higher risk profile due to potential disruption from operators that can build their own competing fibre projects. This would not fit our definition of infrastructure.

The business model component of the infrastructure definition is extremely important, and it is sometimes overlooked in more exuberant market conditions.

Q Which new sectors do you see falling within your infrastructure definition in the future?

IS: The sectors will continue to evolve and have grown as the asset class has expanded. Data centre financing hardly existed until six or seven years ago. It is still a relatively nascent sector, and yet it has grown so quickly that it already feels well established. We may also see other sectors, including some of the newer energy transition sectors that don't yet have an infrastructure business model or the requisite technological maturity, fall within our definition of infrastructure in the future.

Q To what extent have loan terms changed in response to the evolving macroeconomic environment?

IS: For us, they haven't changed at all. We have never made a covenant-lite investment. We are lending money on behalf of our clients and our own balance sheet, and covenants are a key way to build in financing protection. We would rather walk away than lower our standards, even in more borrower-friendly environments.

Along with maintaining lending standards, we have also maintained our returns through different market environments. Even with interest rates near zero during the covid-19 pandemic, we were able to generate returns ahead of our target. In fact, credit market disruption has created some advantages for us, allowing us to deploy more capital into higher-grade senior debt opportunities while maintaining our returns.

Q Are you seeing competitive tensions intensify as more players come into the market?

HPM: There is no doubt managers are recognising the value proposition that infrastructure represents, and so it is inevitable that we will see new entrants. There is also so much need for infrastructure capital that there are enough opportunities to support multiple strategies.

As one of the first infrastructure debt managers, Brookfield built scale and relationships that are hard for new entrants to replicate. We can also draw on the knowledge and experience of our wider infrastructure and renewables platform to help us assess risk and make better underwriting decisions.

I would add that our credit platform is Brookfield's largest vertical with nearly $300 billion in AUM, which investors often don't realise. Our credit strategies extend from investment-grade through non-investment-grade and even preferred-equity investments. That means we are not focused on one specific credit strategy but can help our counterparties find the right capital solution. That makes us a compelling partner.

Q With concerns growing that the direct lending market may be facing a bubble, could the same be said of infrastructure debt?

IS: Infrastructure debt has always been a specialist market. It is highly structured, and it is important to understand how each asset works – what drives cashflows and what downside protection is in place. A lot of money is chasing the broader private credit theme; but it's primarily going into private equity-style, leveraged finance strategies. We're not seeing the same surge in the infrastructure space.

Most investors' infrastructure debt allocations sit within a specialist infrastructure bucket or an alternatives bucket rather than in their private credit bucket, in recognition of the unique characteristics the asset class offers.

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> **IAN SIMES**

Q What impact will the new US administration have on infrastructure debt opportunities in the coming years?

HPM: Infrastructure tends to be one of the only topics that politicians agree on. Every administration wants to see more infrastructure built, so it's a good place to start.

Obviously, there are concerns that the new US administration will be less supportive of renewables than previous administrations, particularly when it comes to wind projects. However, many renewable assets have already been pre-approved, and we don't expect them to be impacted. Any new government policies will likely be forward-looking rather than retrospective.

Furthermore, the growth of renewables is not being driven by government diktat. Instead, it is being driven primarily by private sector demand. Renewables often represent the cheapest source of power. Last year, for example, Brookfield agreed to provide 10.5GW of renewable power to Microsoft in the US and Europe by 2030. Deals like these will ensure continued investment in the renewable energy sector.

As a credit investor, we are extremely disciplined about how we value platforms. We always want to be sure there are assets that already exist or that are contracted and under construction, in order to service the capital we are lending to our counterparty. The development engine is a riskier part of the business because success depends on finding, creating and permitting new assets. It is this part of a renewable platform that would be at risk of any slowdown in new projects. Development of new assets can lead to higher returns, but it also carries more downside risk, so it is not something we put a lot of value on as a lender. ■