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Deep Dive

# How to navigate infra's worst fundraising market in a decade

*After a dismal Q1, managers will need to adapt to continue raising capital in 2023. We probed the market to find out what they can expect.*

**Zak Bentley** | **Anne-Louise Stranne Petersen** - 1 June 2023

The flood of commitments in 2022 – $168 billion in total – has become but a trickle in 2023. By the end of Q1, only $3.6 billion had been raised by closed-end infrastructure funds, representing a 94 percent year-on-year drop and the worst Q1 since 2009, presaging a bad year even before the current banking turmoil.

As market difficulties became evident at the end of 2022, there were hopes that this would correct during 2023. Five months in, that is not looking likely.

As we headed to press seven weeks into Q2, the situation looked little better. Some A$1.4 billion ($944 million; €857 million) had been raised to close the

Secure Assets Fund II by Australia-based Pacific Equity Partners – but otherwise little beyond small, niche funds were raised.

As commitments from institutional investors have dried up, how are managers battling against the tide and what can they expect from changing investor behaviour?

If we are to assume the fundraising slowdown will persist throughout 2023, there may be some significant structural changes to the infrastructure investment market and a shift in the relationship between LPs and GPs, which may last longer than the current crisis.

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## A perfect storm

To be clear, this is not solely an infrastructure problem. Private real estate also saw its lowest Q1 since 2008 and private debt its lowest Q1 in six years, while private equity fundraising was down 19 percent year-on-year.

The current fundraising crunch is partially the result of the denominator effect after the fall in the value of equities. From a returns perspective, infrastructure investments have held up fairly well compared with other asset classes, but the struggle remains.

A slowdown in exits and the accompanying delay in getting money back to LPs has limited investors' ability to invest anew. As LPs are waiting for funds to flow back to them, they have less cash to service old commitments, let alone to consider new ones. Locked in a somewhat vicious cycle, this situation will neither be resolved overnight nor over the summer. One of infrastructure's problems may be that there are a lot of GPs about, according to Paul Buckley, managing partner at placement agent FIRSTavenue.

"Everybody talks about the denominator effect, which I think is definitely an issue in private equity, but in infrastructure I'd say the issue is simply the number of managers in the market and the amount of competition for capital," says Buckley.

Additionally, GPs are understandably hesitant to sell in a lacklustre market, having gotten used to frothy valuations in recent times – especially those in

the energy transition and digital infrastructure sectors.

Neda Vakilian, global head of the investor solutions group at Actis, says: "It is a question of exiting at the right time, which is an important part of being a custodian of people's capital. The reality is that if there isn't quite as much capital out there looking for opportunities [as before], then it does delay things and that slows the market down a little bit."

Gordon Bajnai, global head of infrastructure at Campbell Lutyens, agrees: "Given the valuation mismatch between sellers wanting to get yesterday's value and buyers wanting to pay tomorrow's price, it will take six to 12 months for those valuations to come closer to each other."

Other explanations for the reduction in available funding is that a lot was asked of LPs last year when the $168 billion raised by infrastructure funds surpassed the $160 billion raised in 2021, although some LPs may have overspent, according to Fabian Pötter, managing partner at Munich-based placement agent 51 North Capital.

"Our investors tell us that their allocations for this year are down 50 percent to 70 percent because last year in H1, when the world was still okay, there were a lot of re-ups coming and, in many cases, LPs went above their allocations and ate into their 2023 allocations to serve the re-ups they had on the table and continue the relationships," he says.

## Seeking sector specialists

With large amounts of cash being chased by Global Infrastructure Partners, Brookfield and EQT – not to mention Stonepeak and KKR, which will be joining them later this year – that is less than stellar news for the mega-funds and for fundraising in general.

What those generalist mega-funds also need to be wary of is a flight to more niche pockets of capital. A host of energy transition funds and digital infrastructure funds sit outside the spectrum of mega-funds.

"There are still a lot of LPs who don't like mega-funds because they believe there are higher returns in the mid-market," says Kelly DePonte, managing

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director at placement agent Probitas Partners.

"There are a number of investors out there, like endowments or foundations, that tend not to invest in funds that are larger than $1 billion. A lot of that on the infrastructure side happens on sector-focused funds, although a lot of these groups are newer and that's the difficulty."

There does indeed seem to be a preference for sector focus across the board. Brookfield Asset Management's launch of its Global Transition Fund II, targeting some $17 billion less than 12 months after the $15 billion close of its maiden effort, is one such example. Other recent ones include debut energy transition vehicles from I Squared Capital and Harrison Street – targeting $2 billion and $750 million, respectively – as well as the inaugural Octopus Energy Transition Fund, which is looking for £500 million ($623 million; €576 million).

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"Anything to do with energy transition is in a slightly brighter spot," adds Kate Campbell, co-founder of Astrid Advisors, and this is backed up by Bajnai, albeit with a caveat.

"Energy transition is a desired asset class, and funds for energy transition can still be raised – even in this environment," he believes. "But the return expectations are up. That means more development, more greenfield, which is actually helpful because, when you buy brownfield you don't contribute to climate change mitigation, and you don't improve energy security."

More generally, Bajnai sees a flight to quality, to "those with top performance, core-plus or value-add strategies. Generating alpha will be

more important than pure refinancing skills".

With relationships being another key ingredient, there could well be value in proximity. "Regional champions have carved out a share of local LP allocations previously taken by global GP managers. These investment teams have strong access to local markets, build trust and engagement with local LPs, and can tailor-make structures more cost-effectively," says Jessica Eistrand from Germany-based placement agent Lapposand.

She mentions Taaleri, Obligo, NIAM, EB-SIM, Palladio Partners and Finance in Motion as regional, niche experts. Funds on the larger side, Patria, IG4 and BTG Pactual, also have region-focused funds in market, focusing on the Brazilian and wider Latin American markets.

"We also see that if you are too generalist, if your geographic or sector allocation is too wide, it is getting more difficult. So, winners will probably be the more specialised managers, either geographically or from a sector perspective," Pötter adds.

That includes secondaries, for which the infrastructure market continues to grow, recording $7.7 billion of transactions last year, up from $7.6 billion in 2021, even while overall secondary market investment fell from $134 billion in 2021 to $103 billion in 2022, according to Evercore.

"Many larger LPs are now considering deploying new money into secondaries either directly or through specialist funds because they find it attractive to get exposure to mature, high-quality funds with a discount," says Bajnai.

Pötter agrees and finds that this presents both tailwinds and headwinds for the infrastructure market.

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### Funds in market

*There were 396 funds in market seeking a combined $312 billion as of 21 April, with multi-regional vehicles seeking the lion's share of capital. The top 10*

> *funds in market account for 42 percent of all capital sought.*

"What takes capital away is a more lively secondary market. We have heard people say that they will buy into a secondary portfolio rather than go with a new GP," says Pötter. "It was always a problem that secondaries usually went at par or premium to par. Now, in this market, for technical reasons, a lot of investors need to sell, and they sell at a small discount at least."

Where the money is less likely to head is to core funds, with Bajnai envisioning LPs hunting operational value-add. DePonte, however, believes value-add fails to offer significant downside protection.

"Renewables probably have more downside protection, but a lot of other areas like energy transition more widely, and digital infrastructure, don't have as much downside protection as the core infrastructure of 2004 had. That's a permanent change in the marketplace."

Although DePonte argues that it is not just the type of asset class that is moving capital away from core vehicles. "When you look at core, you're probably focused on the underlying asset, and you've got the picture wrong. There are people who have lost money in core investments or had sub-par returns because they had return envy and over-levered."

### LPs calling the shots

If a relationship doesn't quite work out, one party may begin to look around for a better deal. Investors are no different, especially when they are provided with opportunities to stray from the straight path of GP-led blind pools.

"Some GPs are offering LPs direct investments outside of funds with the expectation that this will lead to a subsequent pooled investment," says Astrid's Campbell. She adds that the fees charged for the direct investment may well be reduced if the LP commits to the fund.

This was the case with London-based Arjun Infrastructure Partners, which was founded in 2015, operating on a club-deal basis until it raised a €1

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billion fund from four Nordic pension funds in 2021. In addition, some GPs are looking at changing the co-investment relationship and this has added to the fundraising difficulties, according to Buckley.

"A lot of the big brands effectively said, 'depending on how big you are in our fund, we'll give you more co-investment'. The problem with that approach is it sidelines all the mid-sized LPs you need to get to your target fund size. We've had a couple of GPs we advised create discretionary sidecars for co-invest that aggregate those commitments in one lot and those are treated as super-priority LPs."

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> ***Fabian Pötter***
> ***51 North Capital***

In general, terms are an issue likely to become more significant as the months go by, with LPs having a strengthened bargaining position.

"When it comes to terms and discounts for earlier closers, etc, nothing has really moved yet. But I think we're at the beginning of a time when the tables turn," predicts Pötter. "We have had 12 years of GPs dictating fund sizes, timelines, and terms of the fund – a lot of the LPs didn't like it that much, but they had to swallow it. Now, the world is changing, and it starts with timelines where, the LPs say, 'Look, if that's your timeline, I'm not going to make it'."

## Looking further afield

Potentially plugging the dip in institutional capital is the emergence of private wealth and retail channels into the infrastructure field, and some of these new channels could be a godsend for commitment-deprived GPs.

Wealth is looming larger than ever in the private infrastructure space. Efforts have come notably from large managers such as Brookfield, KKR and GIP, as well as from European players such as Nykredit and SEB IM. Data

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from the City of Fresno Retirement Systems clearly illustrates this point: high-net-worth individuals accounted for 11 percent of commitments to JPMorgan Asset Management-advised open-end Infrastructure Investments Fund at the end of 2022, up from zero at the end of 2020.

In February, Brookfield launched the Brookfield Infrastructure Income Fund via its Brookfield Oaktree Wealth Solutions unit. The yield-focused fund has now raised $750 million from private wealth investors and invests across Brookfield's flagship, transition, super-core and debt funds, choosing which deals to invest in on a deal-by-deal basis. It was seeded with stakes of about 15 of Brookfield's existing infrastructure assets.

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"There aren't really any products that are packaged in a way that gives a broad array of individual investors access to infrastructure assets," explains David Levi, head of Brookfield Oaktree Wealth Solutions, with the caveat that it has been working on BIIF for over two years. "The only way that can work is with significant scale." He acknowledges that this channel represents a "growing pie for us and our peers in the alternatives space", with infrastructure the flagship of its offering because the "stability of the returns is invaluable".

"It's another pool of capital. It's another mechanism for the infrastructure team to utilise and add value."

Spanish asset manager, Bestinver, is another example, taking advantage of appetite in the retail space. It closed its first €300 million infrastructure fund in Q1 and is now looking to raise a second fund with a target of €500 million.

"It will probably take another 18 months to two years to raise the second fund, and we hope to see some institutional investors take an interest. These will be institutional investors willing to invest €30 million to €50 million," says Francisco del Pozo, head of infrastructure funds at Bestinver. "The difference with us will be if they put €10 million, €20 million or €50 million into our fund, they will get to build a true relationship with the manager. If they put those €30 million into one of the mega-funds, the interaction with the manager will be more limited."

DePonte, though, is wary of chasing after new sources of capital while entering a downturn, recalling his capital raising experiences of 15 years ago. "If you get a lot of newbies coming into the market and you go through a really tough time and you burn people, you can burn that entire class of investors, who decide they don't understand it and get out of it," he argues.

"The next time they come in is probably 10 years later just in time for the next great crisis. I'm not a big advocate for going after private wealth sources in large amounts [when it] looks like we could be on the edge of a crisis that could be worse than the global financial crisis."

This year may well turn into 2024 before commitments pick up again, and by then, it may become clearer what structural changes occur in the fundraising market and who might emerge as the winners and losers. DePonte has some ideas of his own.

"The funds that did poorly in the GFC were 2005 or 2006 vintages where people paid high prices," he recalls. "Right now, people who have lots of deals they did in 2020/21 aren't having problems with the portfolio. 2009/10 funds, where there wasn't a lot of money and sellers were cutting prices, those ended up being excellent vintage years."

Today's waters may be choppy, but they might prove a blessing in disguise for GPs and LPs alike in 10 to 12 years' time.

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