InstarAGF Asset Management

Building resilience in demand-driven infrastructure

The year may be coming to an end, but the shift businesses have experienced in response to the ongoing health crisis continues to evolve, significantly changing operations, patterns of use and investor interest.

Chase McWhorter, Institutional Real Estate, Inc.'s managing director, *Institutional Investing in Infrastructure,* spoke with **Gregory Smith,** president and CEO of InstarAGF, about essential infrastructure, and the opportunities that can arise from disruption. The following is an excerpt of that conversation.

Do you think COVID-19 could have a permanent effect on the profile of certain types of infrastructure assets?

The pandemic falls into a category of low-probability but high-impact scenarios, such as climate change or geopolitical events that have a significant and varied impact on investments. These scenarios influence macro risks, challenge collectively held beliefs and impact consumer confidence. In response, investors and asset managers must broaden the evaluation of risk beyond financial models and underwriting scenarios to examine the environmental and social aspects of our investments in a deeper, more meaningful way, and how essential infrastructure assets are impacting the communities they serve.

Change is constant. While the long-term impact of COVID-19 on each sector remains to be seen, those businesses that remain flexible and adaptive to use patterns, demand fluctuations and technological advancements will remain resilient decades into the future.

Crises drive substantial innovation. The creativity of businesses in adapting to the new normal has been incredible. We're going to see significant innovation through the recovery and beyond as we work to strengthen our infrastructure, make it more adaptable across a range of scenarios, and better serve stakeholders and communities. Technology and sustainability imperatives are really going to profoundly influence the development and management of infrastructure in the years ahead.

When you reference technology, are you referring to a functional technology at the asset level? Or is it at a more macro level, of different types of infrastructure completely?

I think of technology in terms of three pillars. First, what new advancements are allowing for innovation around technology? We are seeing specific sectors and subsectors emerging as a result of new technological advancements, including long-haul fiber, bioenergy, electric-vehicle charging stations or vertical farming. Technology is the macro trend that drives and enhances these emerging sectors, making them possible and creating huge potential for greater connectivity, a cleaner environment and better food security.

The second pillar is about optimization. How do we leverage technology to make improvements in the operation of existing critical infrastructure? In the transportation sector alone, technology can reduce costs and enhance the tracking, movement and utilization of equipment across the supply-chain and logistics spectrum, leading to greater efficiencies and better service for customers.

The third pillar focuses on how technology helps us engage with local stakeholders. An infrastructure project is only successful if the community deems it successful, and that means local communities need a say in the development and design of their infrastructure. Technology facilitates communication with and feedback from community members, from the project's initial design and development, through to the construction and operating phases.

In this climate, can demand-driven infrastructure assets still offer attractive returns to investors?

The vast majority of investable infrastructure assets globally are actually demand-driven. They are essential to local economies and the social fabric of our communities, and municipalities will need private-sector investment more than ever before, to grow and thrive.

While COVID-19 has affected volume-based infrastructure in the short term, it is important to consider the impact over the course of decades. We need to look through economic recessions and corrections toward restoring growth in the marketplace. For us, this long-term perspective starts by factoring economic down cycles into a disciplined, conservative underwriting approach with core principal protection that can help absorb some of the economic risk and keep infrastructure investments relatively stable during times of turbulence.

A key determining measure of resilience is the ability to reimagine the future and to accelerate through the curve toward it. We know that resilient companies grow at 10 times the rate of non-resilient companies coming out of a crisis or a recession. When you have the right underwriting approach and strong management teams in place, you're able to capitalize on attractive opportunities and innovation in infrastructure. At InstarAGF, we see our role as helping great companies to become even better.

A good example of this, from InstarAGF's perspective, is the resilience of Leading Edge Jet Center — a business aviation services provider in the Pacific Northwest. The business is underpinned by a stable, diversified customer base combined with macro tailwinds of tourism growth in the area, which, together, provide stability throughout economic cycles. The company has also continued to grow in the current environment by acquiring complementary operations.

How does InstarAGF think about economic infrastructure and managing risk?

Economic infrastructure provides a critical foundation for the cities, regions or nations it serves, which means it demands a disciplined underwriting approach. Every investment we make must have a regulatory, contractual or asset underpinning that protects our principal and provides a minimum return, much the same as in core infrastructure assets. We manage economic or throughput risk to achieve our base returns by approaching asset

Leading Edge Jet Center, a business aviation services provider in the Pacific Northwest, exemplifies resilience in an era of change

management with what we call the "optionality of ownership." This mindset defines how we work with companies and management teams to help them grow and de-risk the business through a number of initiatives to achieve superior risk-adjusted returns. That's the value-add opportunity we look for above and beyond our core underpinning. We also seek investments in subsectors with very strong macro tailwinds.

In managing economic risk in this cycle, two key points to highlight are diversity — both by geography and by sector across North America — and low leverage. It's impossible to predict every eventuality, which is why diversity is at the heart of our investment approach. A good example is broadband towers, which was really the start of digital infrastructure investing. Strong macro tailwinds pointed to a predictable cashflow model for 30 or 40 years — but technology disrupted that subsector and changed how we frame digital investment opportunities. Every area has potential disruptors, so achieving a diversified portfolio is a must.

Low leverage, on the other hand, provides the resilience needed during a correction and allows the flexibility to take advantage of opportunities during a downturn. Reinvesting capital in growth and tack-on acquisitions at attractive valuations is a great way to gain market share and presence, and generate value-creation opportunities.

Ultimately, it always comes back to the basics: diversity, low leverage, solid underwriting.

Where is market dislocation creating new investment opportunities?

I think we will see more lifecycle or holistic approaches develop around existing environmental, social and governance (ESG) initiatives. Wind power, for example, is a great investment opportunity, but there is much more environmental and investment value to create if we take into consideration what to do with the blades at end of their useful lives. We need to measure not only what is produced or the footprint during use, but what is produced during the construction and end-of-use, as well.

Similarly, enhancing sustainability within existing buildings, which consume approximately 40 percent of energy in the United States, opens a path for new investment opportunities. Retrofitting buildings to use innovative heating and cooling systems, district energy systems or bioenergy systems creates operational savings that are passed on to users, while at the same time reducing our carbon footprint. By comparison, a newly built zero-carbon-impact structure would still take up to 80 years for the efficiencies to make up for the carbon footprint caused by initial construction.

Overall, we are seeing a significant opportunity for localized infrastructure in North America. Municipalities are seeking ways to attract more investment in their communities, upgrading and innovating across sectors, including transportation and electric vehicles, agricultural infrastructure, and food and water safety and security.

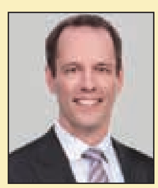
How does localization factor into InstarAGF's investment strategy and value proposition?

We don't believe there is a one-size-fits-all solution for every city and every region across North America. It has to be tailored and directed to the needs of a particular community. And the only way to do that is through earnest community engagement. Excelling on the "S" in ESG comes back to localization — listening to a community's needs first — and then designing the new energy, transportation or connectivity infrastructure that best meets those needs.

InstarAGF has purposely stayed in the mid-market because it's where the majority of infrastructure projects are in North America. Municipalities are responsible for about 70 percent of infrastructure spending, but they receive less than 10 cents of every tax dollar. Multiplied over several decades, this historic funding gap has created both a tremendous need and a tremendous burden on public institutions to improve infrastructure.

These projects are smaller in scale and need help through design and construction to bring them to fruition. While headlines about multibillion-dollar infrastructure projects are attractive to news outlets, in reality it is an upgraded sewer line or a high-speed internet connection that a community needs most. Local projects are the ones that truly improve quality of life and increase equality in a community.

CONTRIBUTOR



Gregory Smith is the founder, president and CEO of InstarAGF, where he brings more than 25 years of experience in the investment, operation, acquisition and financing of private equity investments, including public and private infrastructure, real estate, power and utility businesses.

CORPORATE OVERVIEW

InstarAGF's North American investment platform focuses on infrastructure, real assets and private equity investments in the middle market. Our team's significant depth of sector and investment expertise, relationships and global reach empower InstarAGF to help investors meet their investment goals, and to fulfill our purpose of enriching people's lives.

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