QIC

Exploring the relative value of junior infrastructure debt

The appeal of the private debt asset class has rightly risen with the higher-for-longer interest rate environment. For junior infrastructure debt, there is a continued positive outlook for the medium term, with several factors combining to allow investors to benefit in current market conditions. By their nature, infrastructure assets are valuable and defensive businesses, providing mission-critical services to society. Through private debt instruments, institutional investors can access the advantages of infrastructure assets while benefiting from a debt position's shorter tenor and favorable position in the capital stack. The lower ratings volatility of infrastructure debt investments also proves compelling.

Characteristics of junior infrastructure debt

Junior infrastructure debt lending has similar characteristics to other private debt products; loans are primarily variable, with managers looking to capture illiquidity and complexity premiums, while taking advantage of market segments that are less served by traditional bank lenders.

Infrastructure debt is real-asset backed; borrowers are defensive, noncyclical businesses; and the assets are underpinned by predictable long-term cash flows with a high portion of revenues backed by long-term contract, regulatory protection or monopolistic positioning. These businesses have high barriers to entry and, therefore, limited competition. Their capital-intensive nature means they also benefit from high EBITDA margins. Margins can range from 25 percent to upwards of 90 percent for certain types of infrastructure borrowers. As a whole, the infrastructure asset class also has lower overall default rates and meaningfully higher recovery rates than the broader rated-corporate universe.

Junior infrastructure debt lenders accept structural or contractual subordination (typically behind investment-grade or "crossover" operating-company level debt) to capture a meaningful return uplift, while still enjoying structural seniority to equity and benefiting from the steady characteristics inherent in the asset class.

The current relative value proposition

Infrastructure borrowers typically benefit from inflation protection with the ability to pass on increased costs directly to end users. Junior infrastructure loans are typically floating rate. By lending into the junior part of the capital structure, QIC has typically observed a minimum of 300 basis points of spread uplift compared with senior debt in the same borrowers. Infrastructure debt loans (both senior and junior) typically include full suites of affirmative and negative covenants, including financial covenants, and its heavy involvement in the energy transition allows for infrastructure debt to align with ESG goals and principles.

Why now, and what's the outlook?

The capital-intensive nature of the asset class means it requires consistent investment, both to construct new projects and to refinance and rehabilitate existing infrastructure. It is also benefiting from regulatory, political and market tailwinds.

QIC's areas of focus include energy, digital infrastructure, transport and logistics, and regulated asset sectors. We believe funding will be required for the likes of:

- the replacement of power generation infrastructure with less carbon-intensive sources
- the upgrade of transmission networks and installation of energy storage to match intermittent, smaller-scale renewable energy sources
- the energy transition of other carbon-intensive industries through production and transportation of green molecules
- the continued growth of data infrastructure to support cloud migration, AI and increasing data use of the general population
- regular improvements of aging and no longer fit-for-purpose transportation and utility assets

Despite the macroeconomic factors, we have seen credit spreads hold relatively stable at slightly wider levels across both senior and junior debt. The increase in base rates during this time and, to a lesser extent, the credit spread have resulted in private debt yielding greater returns than those seen by this asset class during the past decade, particularly for junior infrastructure debt.

We believe it is a timely opportunity for investors to consider the relative value of junior infrastructure debt, given its performance in this macroenvironment and the considerable level of transaction activity occurring across refinancing, growth capex requirements and M&A activities.

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ABOUT QIC

QIC is a long-term specialist manager in alternatives offering infrastructure, real estate, private debt, private equity, natural capital, liquid strategies and multi-asset investments. It is one of the largest institutional investment managers in Australia, with A$106.0 billion ($72.5 billion) in funds under management. QIC has more than 900 employees and serves approximately 115 clients. Headquartered in Brisbane, Australia, QIC also has offices in Sydney, Melbourne, New York, San Francisco and London. (As of Dec. 31, 2023.) **www.qic.com**

ABOUT QIC PRIVATE DEBT

QIC Private Debt offers institutional investors exposure to diversified debt investments across infrastructure (within the OECD), and corporate, asset-backed securities and real estate sectors (in Australia/New Zealand). Established in 2021, QIC Private Debt now has more than A$1 billion of assets under management and committed capital, split across multi-sector private debt and private debt infrastructure offerings. (As of Dec. 31, 2023.)