Infrastructure

2025 Outlook

Away from the crowds

Executive summary

"By the time any view becomes a majority view, it's no longer the best view. Somebody will already have advanced beyond the point which the majority have reached."[1]

Friedrich Hayek, Nobel Prize winning economist

In 2025, the macro backdrop for private infrastructure is undoubtedly positive. Economic growth is resilient, inflation remains above average, and interest rates are declining. Valuations have also fallen in recent years, offering relative value compared to public markets. All stars appear aligned for the asset class, but here is a simple truth – there is no easy money left in infrastructure.

Technological disruptions, crowded trades, and valuations are key investor debates across all asset classes. Private infrastructure is not immune. Secular trends such as the 4Ds (decarbonization, digitalization, deglobalization, and demographic change) have opened up new investment opportunities, but sentiment may have become unbalanced.

At a high level, it's hard to argue that infrastructure is crowded. Private infrastructure is only 4% of institutional investors' portfolios[2], and historically delivered stable risk-adjusted returns. However, it's difficult to dispute that there is some hype in sectors such as renewables and digital infrastructure. On the other hand, traditional infrastructure such as utilities, transportation, and waste appears overlooked.

In our 7th annual infrastructure outlook, we try to navigate the increasingly complicated investment landscape. We discuss where opportunities lie, and how to think about underwriting assumptions to avoid crowded trades and value traps. On the recent US elections, we argue that investors are underestimating political risks, although strong electricity demand and the unintended consequences of policy changes will be important mitigants. Finally, we discuss why 2025 offers a window of opportunity for infrastructure debt with the looming maturity wall.

[1] The Constitution of Liberty, Friedrich Hayek, 1960.
[2] 2024 Institutional Infrastructure Allocations Monitor, Hodes Weill and Cornell University's Program in Infrastructure Policy, June 2024.

Running out of excuses?

All stars aligned for infrastructure

In our view, the stars are aligned for infrastructure in 2025. The industry faced various challenges in recent years, and infra-skeptics have clung to different reasons to not invest in the asset class. Now that the macroenvironment and sentiment have turned more positive, we think the bears are running out of excuses.

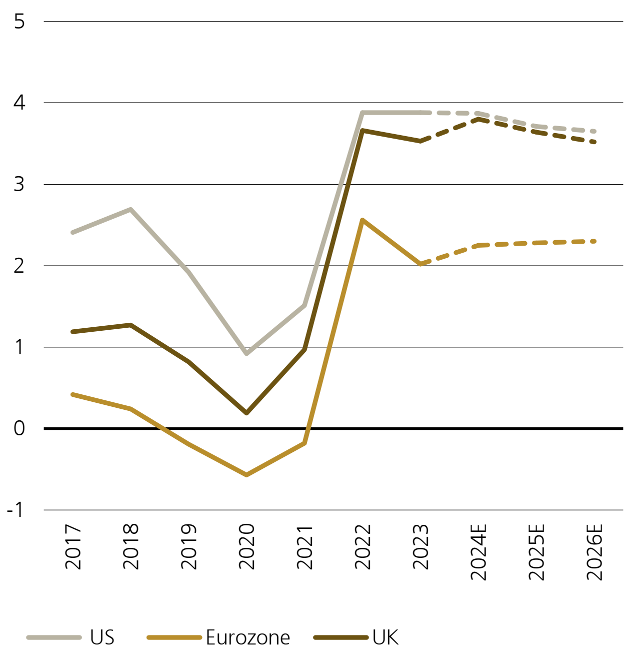
In our Infrastructure Outlook last year[3], we already highlighted that we were seeing silver linings, despite continued weakness in fundraising and dealmaking. Many investors have taken a wait-and-see approach, given the macro uncertainty and the denominator effect.

[3] 2024 Infrastructure outlook: Answering five tough questions from infra-skeptics, UBS Asset Management, December 2023 *link*.

Sentiment improved throughout 2024.[4] On the macro front, markets reacted positively to rate cuts around the world. However, based on latest forecasts, long-term interest rates are declining more gradually, especially for some regions such as Europe (see Figure 1).

Nevertheless, the direction of travel for rates is clear. This is extremely important for infrastructure, as high interest rates remain the biggest concern since the industry tends to use a good amount of leverage.

Figure 1: 10-year government bond yield (forecasts)

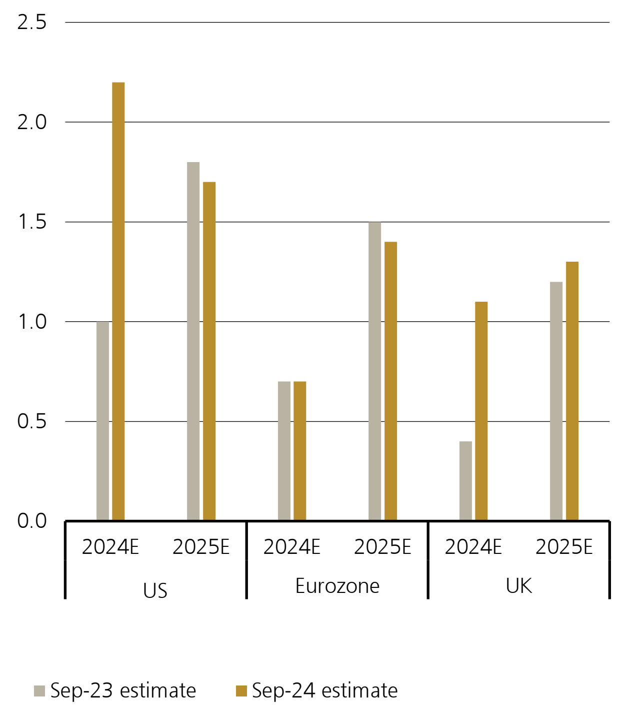


Source: Bloomberg, October 2024. **Past / expected performance is not a guarantee for future results**.

Investors are also recognizing that the higher interest rates are a result of lingering inflation – a positive for an inflation-sensitive asset class like infrastructure, which provides essential services to society, and enjoys strong pricing power and operating leverage when there is above-average inflation.

One underrated economic storyline is GDP growth remains solid in North America and Europe. Compared to forecasts a year ago, 2024 GDP growth is significantly higher than expected in the US and UK, and in-line with expectations for Europe (see Figure 2).

Figure 2: Real GDP growth forecasts
(%, current vs. 1 year ago)



Source: Bloomberg, October 2024.

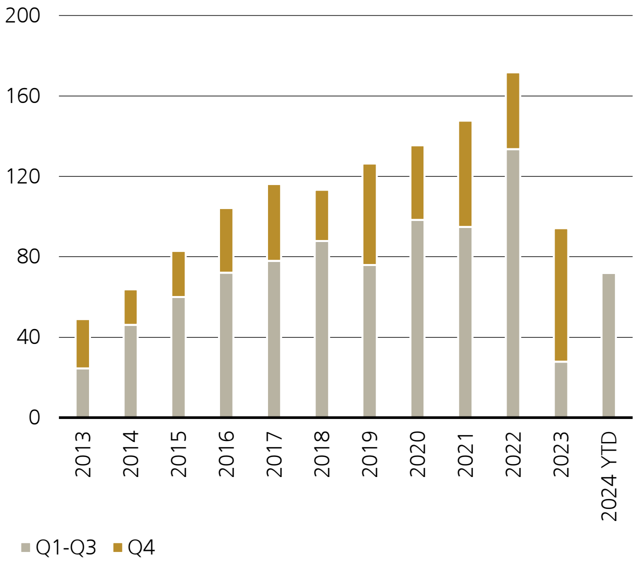
Infrastructure tends to be more inflation-sensitive than GDP-sensitive, but stable economic growth is still a positive, as it removes the risk of a hard landing, which would have also impacted infrastructure negatively.

We're seeing the improvement in sentiment reflected in fundraising. In the first three quarters of 2024, the infrastructure industry raised over USD 70 billion, 150% higher than what was raised in the same period last year (Figure 3).

At the end of the day, it's unlikely that we'll match the banner fundraising years in 2021 and 2022 in the near future. However, recent data at least shows that fundraising has likely bottomed out in 2023, and will most likely improve henceforth.

[4] Fundraising in infrastructure: A return to the market buzz, UBS Asset Management, May 2024 *link*.

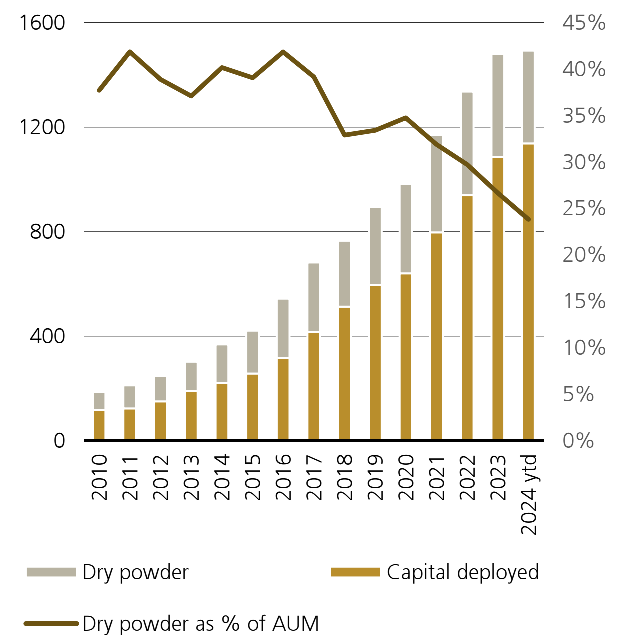
Figure 3: Private infrastructure fundraising
(USD billion)



Source: Preqin, October 2024. **Past / expected performance is not a guarantee for future results**.

There is also a more positive side to weak fundraising. Infrastructure dry powder in dollar terms is at the lowest level since 2020, while dry powder as a percent of total AUM is at the lowest level ever (see Figure 4). The implication is there is now less competition for deals, at a time when the industry still needs capital to grow.

Figure 4: Private infrastructure AUM and dry powder
(USD billion)



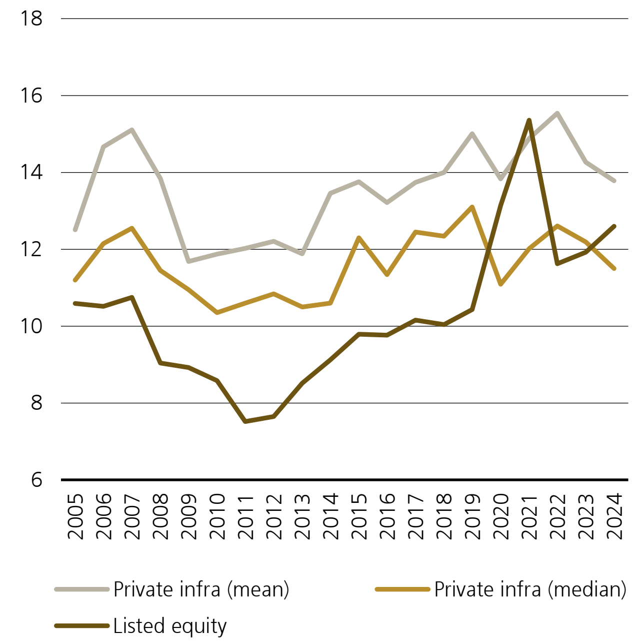
Source: Preqin, October 2024. **Past / expected performance is not a guarantee for future results**.

Transaction volumes are one area that have disappointed, as deal flows are still trending lower than what we have seen in the previous year. There is still some bid-ask spread between the expectations of buyers and sellers, which has limited market activity.

In our view, the stabilized macro environment will narrow this gap, as underwriting assumptions between buyers and sellers converge, which should allow more deals to close.

Finally, private infrastructure valuations have actually moderated in the last 2 years based on data that we track in our proprietary database. This is a divergence from listed equities, which have seen rising valuation multiples over the same time period (see Figure 5).

Figure 5: Private infrastructure deal valuations
(EV/EBITDA)



Source: UBS Asset Management Proprietary Database (based on 1,500+ transactions); Mergermarket; Inframation; Bloomberg, October 2024. **Past / expected performance is not a guarantee for future results**.

To sum up, the macroeconomic backdrop for infrastructure is positive on most counts, including stronger than expected economic growth, above average inflation, and declining interest rates (albeit slowly).

The denominator effect is behind us, after 2 years of strong public market performance. Private infrastructure valuations have declined, while competition for deals have also decreased. The 'biggest election year in history of humanity' is also behind us, removing some political uncertainty. We remain optimistic about the industry going into 2025.

The megatrends playbook

A contrarian approach to secular themes

"Probably the largest aggregate losses are suffered by people who invest over-enthusiastically in a basically sound company."[5]

Benjamin Graham, Author of The Intelligent Investor

Is there herd mentality in infrastructure markets? We're hearing this question more often, but usually behind closed doors, away from large events and the crowds (pun intended). We think the answer is 'yes'.

This concern is reasonable, as the same debate is already happening in public markets, where technological disruptions have led to questions about crowded trades and high valuations. Infrastructure is also exposed to disruptive trends and secular themes like the 4Ds – decarbonization, digitalization, deglobalization and demographic change.

[5] Take Your Dreams Elsewhere (Interview), Forbes Magazine, January 1972.

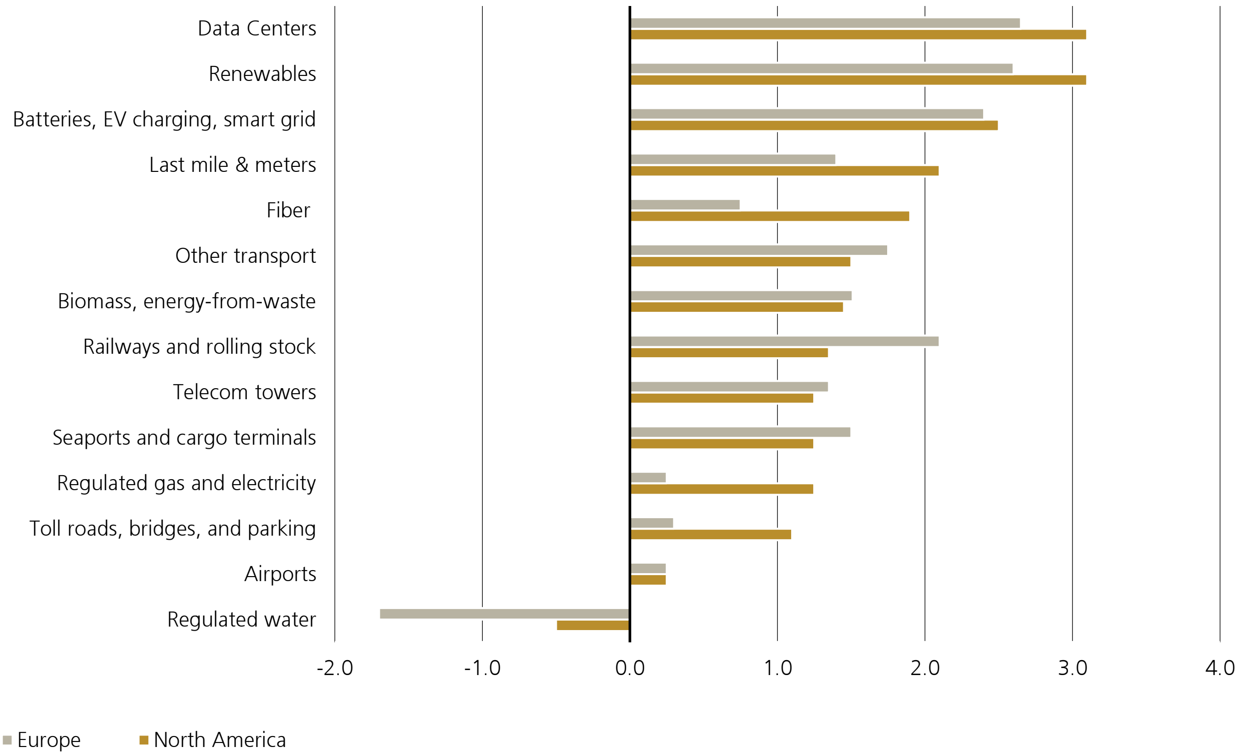
To be clear, we remain bullish on these megatrends. We still believe that they will transform our world and provide significant investment opportunities.[6] But it would be dishonest to not acknowledge that there is some hype.

These investment themes have clearly resonated with managers and investors. When looking at an industry survey on where managers would like to deploy capital, respondents overwhelmingly highlight businesses such as renewable energy and data centers (see Figure 6), since they benefit from themes such as decarbonization and AI.

On the other hand, more 'traditional' infrastructure sectors such as utilities, transportation, and waste management appear lower on the ranking. Not surprisingly, regulated water utilities are seeing the most negative sentiment, due to negative headwinds for some of these businesses especially in Europe.

But sentiment is one thing. Fundamentals are another. Using listed infrastructure fundamentals as proxy, we notice that consensus earnings (EBITDA) growth is quite healthy (see Figure 7).

Figure 6: Outlook for infrastructure opportunities in next 12 months (GP survey, -5: extremely unfavorable, 5: extremely favorable)



Source: GIIA, Alvarez & Marsal Infrastructure Pulse Survey, July 2024.

Renewable electricity and data centers are both showing strong growth, consistent with the positive sentiment. However, what stands out is the strength across all sectors, including roads, waste management and utilities.

Conventional electricity is seeing the strongest growth, as it benefits from AI's strong demand for electricity. Even water utilities, where the sentiment is negative, looks relatively healthy in this analysis.

These earnings estimates may not show the full picture of private infrastructure fundamentals, but it's difficult to deny that there is dislocation between sentiment and fundamentals.

The key is to avoid hype and groupthink when investing in the megatrends. Adopting a more contrarian approach does not mean avoidance. It means being more thoughtful about underlying assumptions. Below, we set out the best practices when investing in secular trends:

The mirage of market multiples

Valuations should not be solely based on how much competitors are paying. Market comparables offer useful reference points, but in a frothy market, the blind leads the blind. An investment's valuation should stand on its own two feet and should be tied to reasonable fundamental forecasts (see below). This also applies to exit valuation assumptions.

[6] Pathways to progress: Unveiling the attractiveness of infrastructure investing; UBS Asset Management, July 2023 *link*.

Sometimes, it's good to have trust issues
Always look at rosy forecasts from management teams and advisors with a grain of salt. Lucrative businesses tend to attract more competition and political scrutiny. Business plans that project the status quo into the long-term should be immediate red flags. Stress test all assumptions, and ensure the business has sufficient mitigants under the worst case scenario.

A real picture of yourself, with no filters
Managers must be honest about their own competitive advantages, especially when investing in trendy businesses. This can be based on sector expertise, industry relationships or synergies from existing portfolio companies. Alpha generation comes down to how much more value you can extract from the same asset compared to a competent competitor. Those who do not have a differentiated strategy will fail.

Beware of fair-weather partners
If an investor does not have the expertise or scale to enter a business alone, having the right partners helps. But beware of partners with conflicting interests. An investor can overpay for an investment from poor governance or deal structures, where there are value leakages to partners even if the headline price tag appears reasonable. These misalignments in incentives tend to show up when the business is facing challenges.

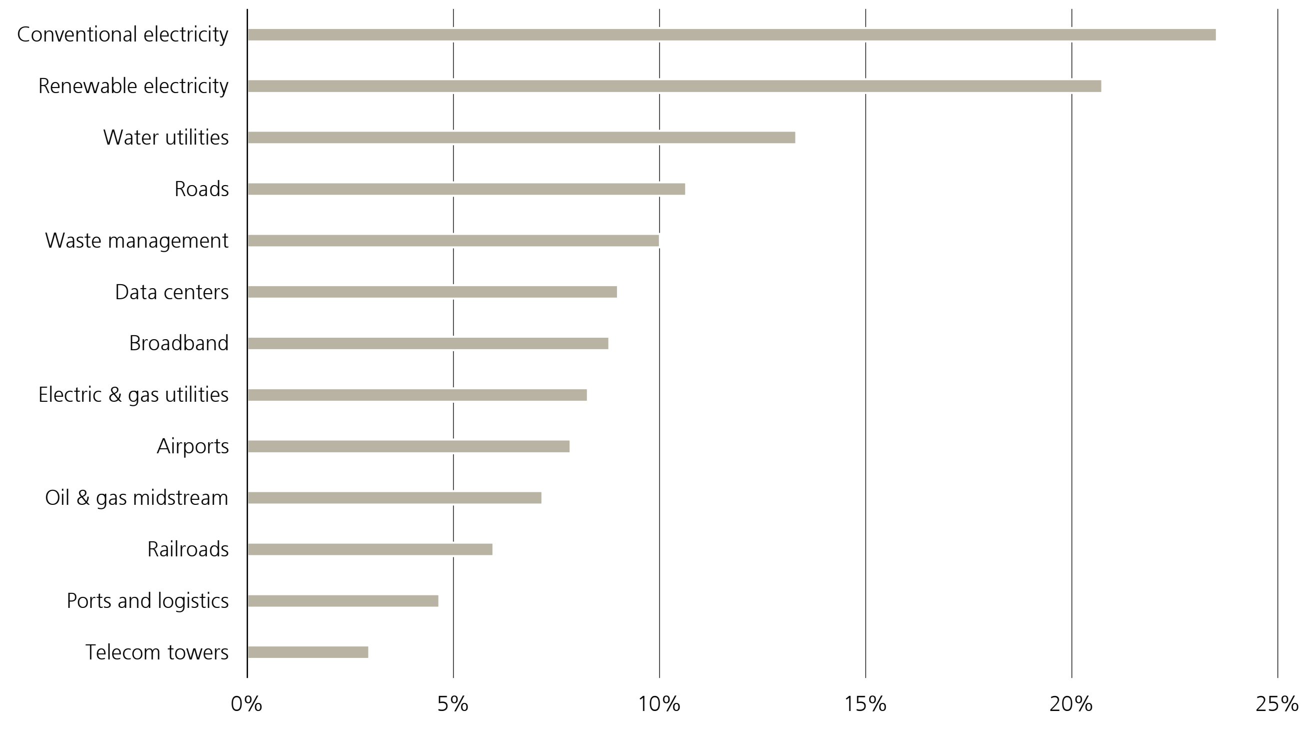
So, you still want data centers or renewables?
We remain strong believers of the secular investment themes, but hot sectors need to be handled with care. We offered a high level investment framework above, and below, we'll provide additional thoughts on specific businesses.

For data centers, large hyperscale platforms in Tier 1 markets will continue to benefit the most from AI, but investors will likely pay rich valuations now for these. Smaller data centers may be offer more value, but investors need to pay attention to local market dynamics, energy supply, and the quality of customers.

For renewables, large wind and solar platforms with strong track records and economies of scale are attractive, but they will fetch high valuations now since returns have compressed. Opportunities may lie in smaller platforms. Investors can also look beyond renewables[7] for other decarbonization businesses, e.g. energy, storage, fleet charging, clean fuels, energy efficiency, biomethane etc.

[7] Future green investments: Emerging energy transition infrastructure beyond renewables, UBS Asset Management, October 2023 *link*.

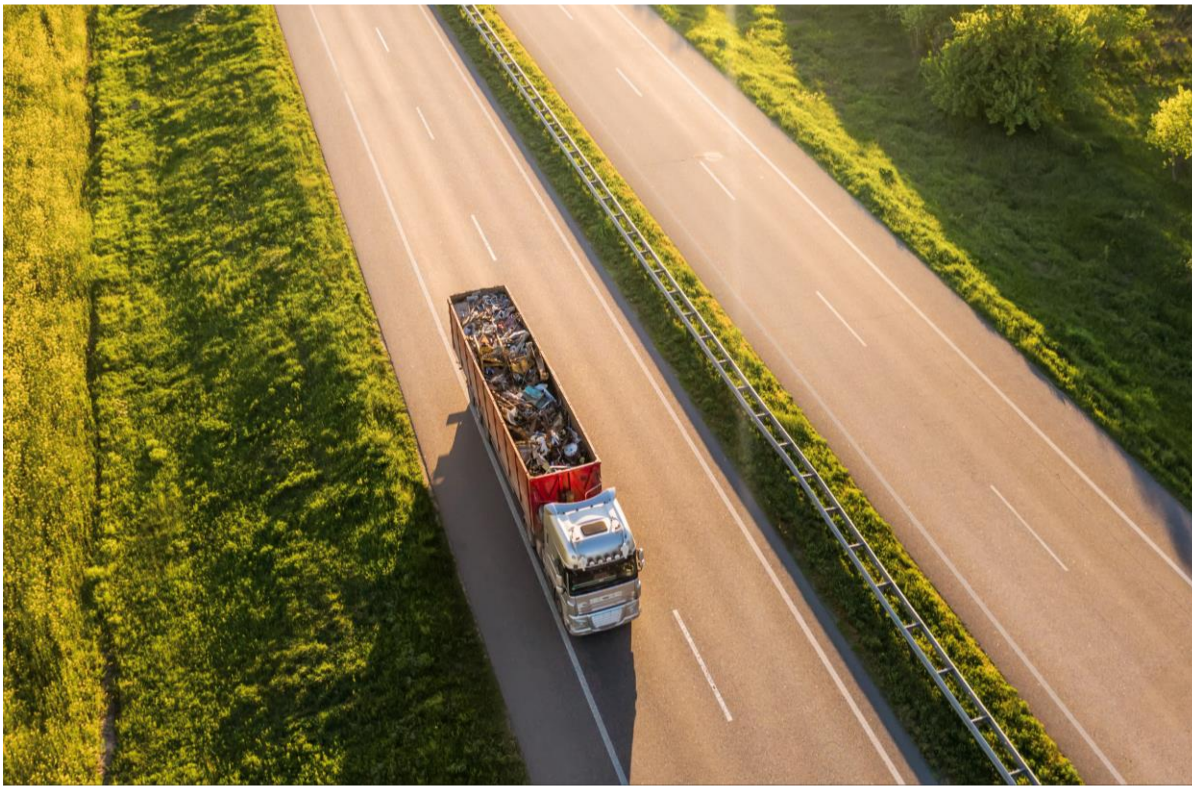
Figure 7: Listed infrastructure 2023-26E EBITDA CAGR by industry



Source: Bloomberg, October 2024.

The road not taken

Finding opportunities in overlooked sectors



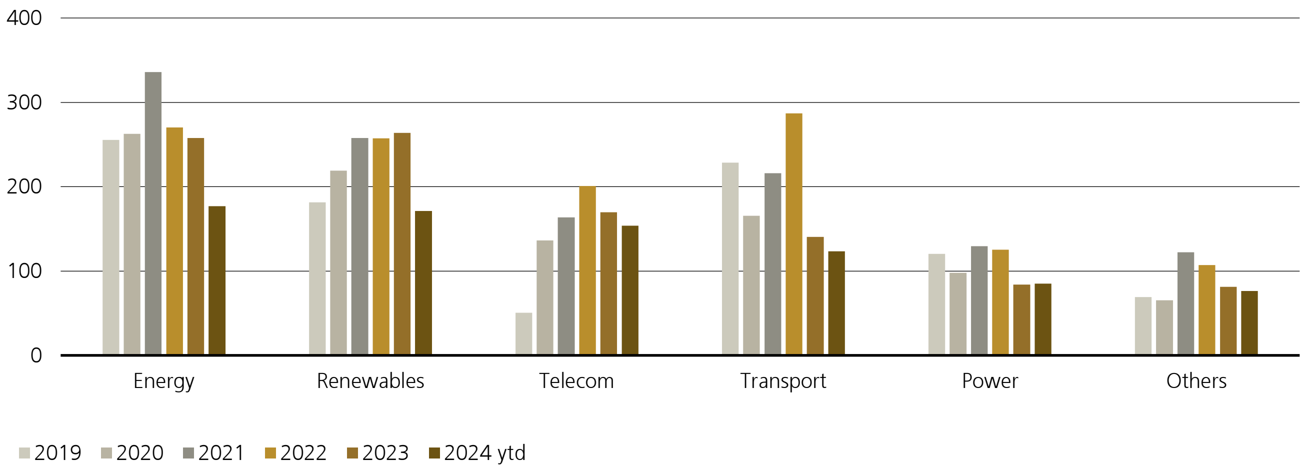
In the previous section, we provided a playbook on how to invest in popular sectors. In this section, we'll discuss the opposite. There are currently many infrastructure businesses that appear underappreciated and unloved. For example, we have seen less deal activity in transportation and conventional power (see Figure 8).

It's important to remember that long before the focus on AI and net zero pledges, infrastructure itself has always been a megatrend.

Back in 2017, McKinsey[8] already identified a USD 5.5 trillion global infrastructure investment gap between then and 2033, covering industries such as power, transport, water, telecom and social infrastructure. The world has always needed infrastructure, including sectors that are now overlooked.

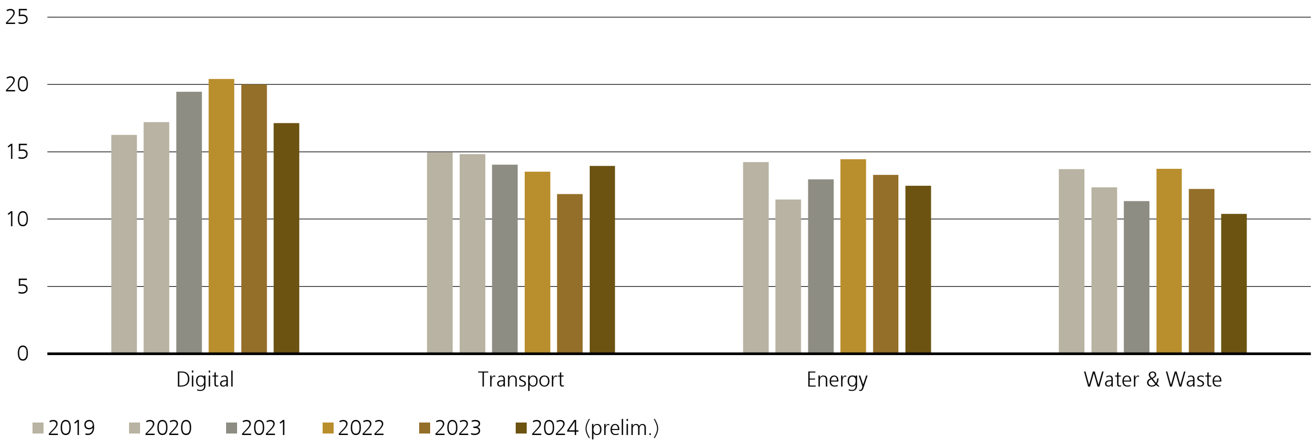
One benefit of investing in these sectors is that they are currently relatively cheap, especially when compared to a growth-driven industry such as digital (see Figure 9). There are clearly more opportunities to find value plays in these sectors, but low valuations do not automatically equate to good investments.

Figure 8: Global infrastructure deals by industry (USD billion)



Source: Inframation, October 2024.

Figure 9: Private infrastructure deal multiples (EV/EBITDA)



Source: UBS Asset Management Proprietary Database (based on 1,500+ transactions); Mergermarket; Inframation, Bloomberg, October 2024.

Below, we highlight the key considerations when targeting these types of investments:

Traditional infra is exposed to megatrends too!
One underappreciated characteristic of traditional infrastructure is its exposure to the same secular tailwinds that are sought after by investors.

For example, utilities are exposed to decarbonization and digitalization, as electric transmission is currently the biggest bottleneck for decarbonizing our grid, especially as we build out more renewables and data centers.

Waste management businesses will also play a key role in decarbonization. By increasing the share of recycled materials that we consume (metals, plastics, minerals etc.), we reduce energy consumption and raw material extraction activities, thus lowering carbon emission.

Other interesting businesses include railroads or railcars that support deglobalization and onshoring; specialized ports or vessels can support the buildout of offshore wind; and power generation that supports the buildout of data centers, and even traditional transportation.

Big fish in a small pond – local monopolies
Most infrastructure investments already have monopolistic characteristics, but small local monopolies may have some of the highest barriers-to-entry. Even businesses located in relatively unattractive markets (e.g. rural areas with low economic growth) could still be attractive investments.

These opportunities do not often interest large investors, as the assets are seen as sub-scale with little upside, and local economic indicators tend to screen poorly. At the same time, these investments could also be natural unregulated monopolies, with economic moats that dominate a niche part of the local economy. In addition, they are good candidates for roll-up strategies.

Bruce Greenwald, famed value investor, describes these as 'small-town monopolies'. They are attractive not because of high margins or returns on capital, but because of the durability of their monopolies. If a new competitor were to challenge the incumbent, 'neither would have enough customer traffic to be profitable… so its best choice would be to stay away, leaving the monopoly intact.'[9]

Knight in shining armor (and with deep pockets)
In the last 2 years, we have seen more special situation opportunities for infrastructure assets due to the macro volatility. For some infrastructure businesses, cost inflation has compressed operating margins, supply chain bottlenecks and higher capex have impacted growth, and interest rate shocks have increased refinancing risks.

These are not necessarily distressed situations, as many are fundamentally sound businesses that require capital to preserve financial flexibility, sustain growth plans, or bridge short-term financing shortfalls.

This opens up opportunities for investors to obtain attractive risk-adjusted returns in businesses or sectors that are overlooked due to temporary headwinds. They can be structured as common equity, but can also come in the form of preferred equity or hybrid debt-equity products that offer significant downside protection.

These types of deals are also available in hot sectors, such as undercapitalized or distressed growth platforms, allowing investors to gain exposure to attractive megatrends without paying a hefty valuation premium.

Don't go chasing inflation
Our industry has become laser-focused on inflation risks, but here's the harsh reality – inflation is now a crowded trade. What we mean is everyone is chasing after assets that have explicit 100% inflation pass-through mechanisms (e.g. revenue contracts, concession agreements), and these assets are becoming expensive.

We believe this misses the bigger picture. Infrastructure as a hard asset already has an indirect inflation passthrough mechanism. For example, when there is high inflation, an asset becomes more expensive to build. This increases the intrinsic value even if revenues have no direct inflation linkages. Higher replacement cost also deters new competitors from entering.

Finally, industries adapt in free markets. Inflation risk is basically being negotiated in every commercial contract nowadays, which means business models will evolve to bake in these concerns. There is no reason to overpay for assets that have inflation passthrough mechanisms now, when assets elsewhere may eventually have them too.

Avoiding value traps
Sometimes, investments are cheap because they deserve to be cheap. Investors should not be contrarian just for the sake of being contrarian, and be thoughtful when examining the upside and downside of these investments.

For example, stranded asset risk is an obvious value trap for infrastructure, as it describes investments that are facing obsolescence (due to technological, market or political changes), and is gradually losing value like a melting ice cube, and will eventually have no resale value.

Investors should stay away from these assets unless they generate extremely high near-term cash flows at bargain valuations. The worst is assuming any kind of 'mean reversion' thesis for businesses that are in secular decline.

[8] Bridging Infrastructure Gaps, McKinsey, October 2017.
[9] Competition demystified: a radically simplified approach to business strategy, Bruce Greenwald, 2005.

Energy, after the vote

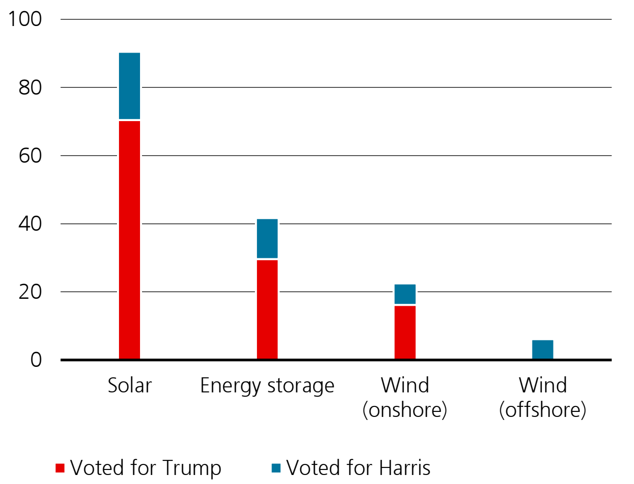
Riding the (red) wave or swimming against the current?

The Republican Party swept the US presidency and congress in the 2024 elections, bringing unease to the clean energy industry. During his campaign, Donald Trump has repeatedly talked about repealing the Inflation Reduction Act (IRA), due to his unfavorable view towards renewable energy, as well as a way to fund his planned extension of the 2017 tax cuts.

In our outlook last year, we addressed the increasing backlash against renewables. Many within the energy and infrastructure industry, including ourselves, have argued that the growth in clean energy has mostly benefited Republican-supporting 'red' states. Naturally, this would indicate bipartisan support for legislation like the IRA.

For example, 70% of US renewable projects currently under development are located in states that voted for Donald Trump in 2024 (see Figure 10). The exception is offshore wind, which is still mainly located in Democrat-controlled states.

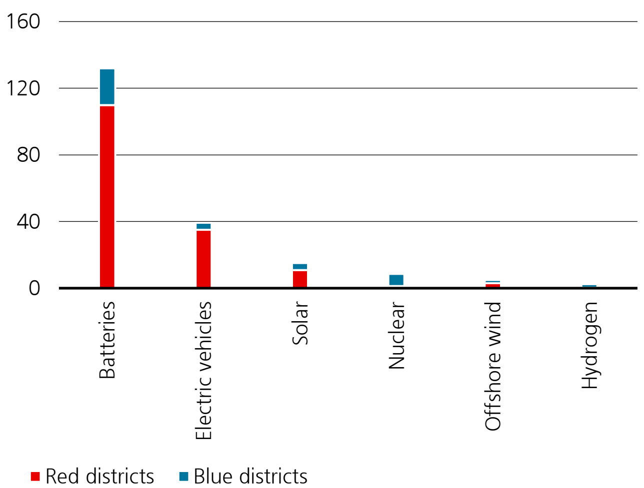
Figure 10: US renewable projects under development by state political leanings (GW)



Source: EIA, October 2024.

The IRA is as much industrial policy as it is energy policy. Combined with the CHIPS Act, the IRA incentivizes the build out of domestic clean energy and semiconductor manufacturing. According to Bloomberg, most of these facilities are built in Republican districts (see Figure 11).

Figure 11: Manufacturing investments by House of Representatives districts (USD billion)



Source: Bloomberg, April 2024.

However, in politics, 'if you're explaining, you're losing', according to Ronald Reagan.

Pew Research's most recent survey shows that over 70% of American adults favor more solar and wind. But we're seeing bifurcation along party lines, which has only widened in 2024 (see Figure 12). A narrow majority of Republicans still supports renewables, but the trend is worrisome, especially on the back of a 'red wave'.

Fancy charts from a New York-based research analyst about IRA benefits to red states clearly do not move the political needle.

In the contrarian spirit of this year's outlook, we have to wonder – if everyone in the industry is repeating the same talking points about the IRA's impact on red states, yet data still shows waning support from Republicans, perhaps everyone is underestimating the risk of an IRA repeal.

Fortunately for energy investors, the evolution of clean energy has never been linear, and swings of the political pendulum are nothing new. In the past few decades, the industry has often faced doom-and-gloom proclamations – the end of subsidies, trade wars, supply chain bottlenecks etc. But time-after-time, the clean energy industry has shown significant resiliency and adaptability.

What the industry can lean on is the fact that renewable energy remains the lowest cost electricity in most geographies, even without subsidies (see figure 13). This means that as an investor, there should be plenty of investment opportunities, regardless of what comes out of Capitol Hill. There are still many moving parts to this debate, which we summarize below:

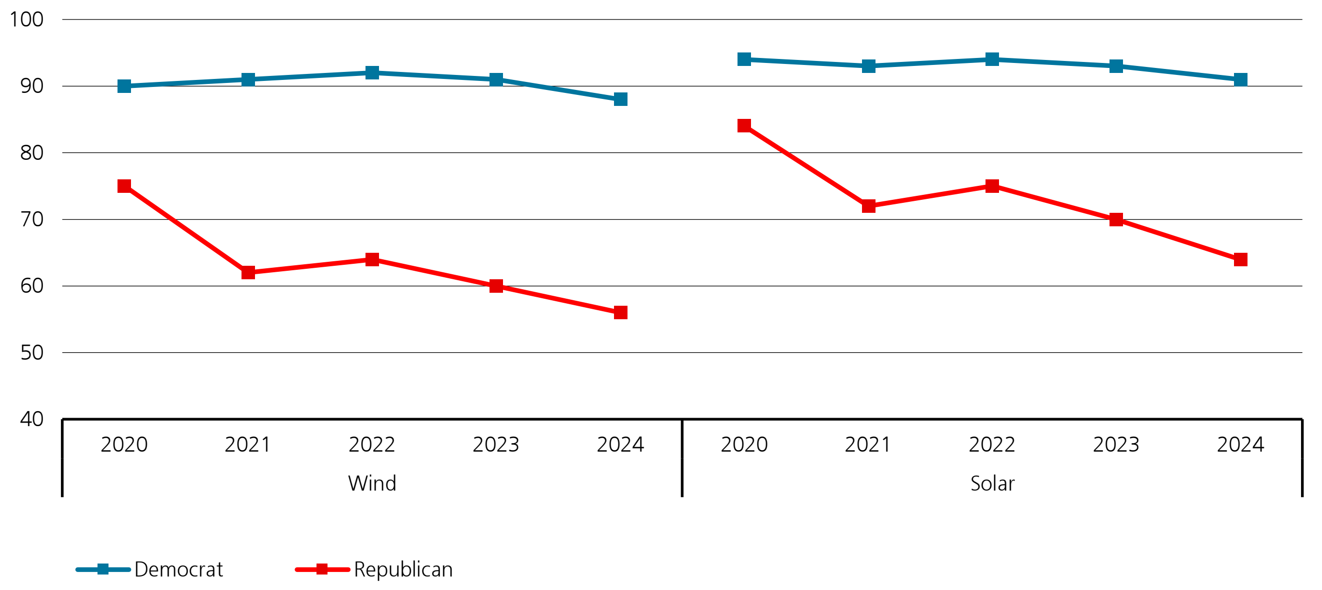
Partial repeal of the IRA is our base case

The markets may be underestimating the scale of the IRA rollback, but we also believe that a complete repeal is unlikely. The razor thin Republican majority in the House means moderate lawmakers will have tremendous negotiating power – similar to what Senator Manchin had during original IRA negotiations. In 2024, 18 Republican house members also signed a letter that opposed an IRA repeal. The house therefore still has some bipartisan voices.

In terms of a partial repeal of the IRA, the renewable energy tax credits and the domestic manufacturing tax credits will likely remain mostly intact, but certain aspects may be changed on the margin. For example, the size of the subsidy could be smaller especially around bonus tax credits. There could also be an accelerated sunsetting of the tax credits, which gives Trump's allies in red states time to complete their near-term renewable projects, but still allow the president to declare victory.

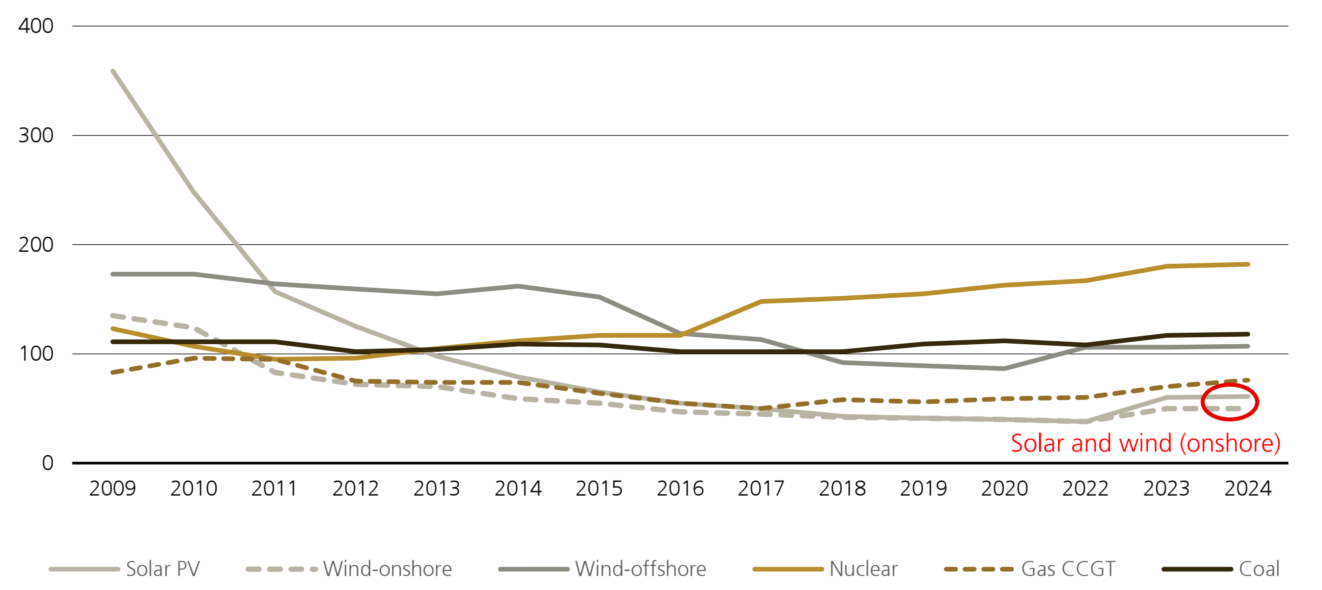
Subsidies for electric vehicles or emerging technologies such as hydrogen and carbon capture are also more at risk. Some argue that the oil and gas industry is lobbying for hydrogen and carbon capture, since they have made significant investments. However, those are relatively small parts of their overall businesses, which means they may not pushback too hard, especially if their core fossil fuels businesses benefit under a Trump presidency.

Figure 12: Percent of US adults favoring more renewables



Source: How Americans View Energy Policies and Personal Choices, Pew Research, June 2024.

Figure 13: Levelized cost of energy by technology



Source: Lazard Levelized Cost of Energy 17th edition, June 2024.

The Trump administration's many other levers

Even without the full or partial repeal of the IRA, the Trump administration can still take various actions through executive orders and government agencies that can impact the energy industry. We summarize some of these below:

Action	Impact
Reinterpret IRA qualifications	– Qualification of IRA bonus tax credits and tax credit monetization mechanisms (direct pay, transferability) may face challenges, as the rules are set by government agencies.
Halt federal loans and grants	– The Department of Energy's grants and loans program, which support emerging clean energy technologies, will likely be under threat.
Change federal agency rules	– The Supreme Court's overturning of the 'Chevron deference' earlier in 2024 limits the power of federal agencies to interpret ambiguous language in laws. – The Trump administration will use this ruling to roll back environmental regulations, such as emission rules set by the Environmental Protection Agency (EPA).
Biased regulatory approvals	– The federal government can prioritize fossil fuels, midstream, LNG, transmission lines and thermal power over renewable energy when issuing regulatory approvals. – Offshore wind will likely be most negatively impacted, as the wind lease areas are usually located in federal waters that are managed by a government agency.
Sharp increase in tariffs	– Donald Trump has discussed 20% tariffs on all imports and 60% on Chinese imports, which will disrupt some near-term project execution.
Others	– Biden's moratorium on LNG export, which has already been blocked by a federal judge and is currently being appealed, will certainly be reversed.

Mitigants for investors

On the other hand, policy changes are nothing new to the clean energy industry, which has developed robust mitigants and contingencies over the years to adapt. Unintended consequences can also help the industry:

Mitigants	Impact
Local governments can step up their own policies	– Historically, when the federal government has rolled back its support for clean energy, states often step up to fill the gap. – Local subsidies and renewable portfolio standards (RPS) have always been important contributors to the growth of the renewable energy industry.
Corporate support for clean energy remains robust	– Large corporations have provided important support for the clean energy industry, as many of them have aggressive net zero targets. – Tech giants are large customers in the corporate power purchase agreement (PPA) market, where they sign long term contracts that support new renewable projects. – AI is accelerating the demand from clean electricity from large tech companies.
Contingencies already baked into the clean energy industry	– Clean energy projects can 'safe harbor' tax credits, which allows them to lock-in tax credits for new projects in the next four years, even if the IRA is repealed later. – The supply chain has already been shifting away from China since pandemic bottlenecks and IRA's onshoring incentives, limiting the impact of higher tariffs. – Renewable developers can already purchase tax credit insurance that protects them from changes to the IRA, a prime example of the ingenuity of the industry.
Unintended consequences that benefit clean energy	– Markets react to change. Regulatory hurdles increase barriers-to-entry for the incumbents, while an IRA repeal decreases future competition; existing projects become more valuable. – Similarly, since tariffs affect the entire industry, customers ultimately bear the cost increase since demand for clean energy remains strong (e.g. higher PPA prices). – If new policies increase the supply of oil and gas, it would actually increase the demand for power. E.g. In Texas, the oil, gas and LNG industries are large consumers of electricity. – Increased LNG exports would put upward pressure on domestic gas and electricity prices, which improves power generation project economics (including renewables). – Deregulation could accelerate the build out of electricity transmission, a positive for renewables as grid capacity is currently a major bottleneck for clean energy.

Window of opportunity

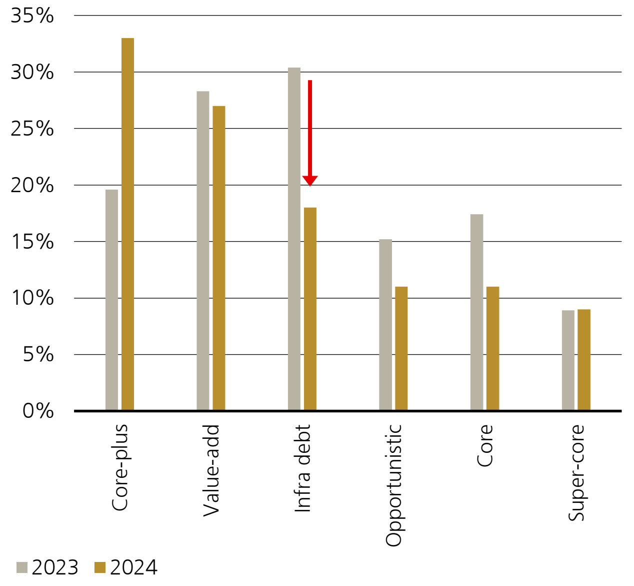
Infrastructure debt uniquely well positioned in 2025

Earlier this year, we argued that infrastructure debt is in a 'sweet spot'[10], as the stabilization and gradual decrease in interest rates would incentivize investors to move away from cash and into private markets, while taking advantage of the still elevated base rates and improving credit fundamentals. In 2025, we believe there is an even bigger window of opportunity for infrastructure debt investors.

[10] Infrastructure debt in a sweet spot for 2024, UBS Asset Management, June 2024 *link*.

Despite the positive backdrop, sentiment for the asset class has wavered. In 2023, infrastructure debt was the most sought after infrastructure strategy by LPs based on Infrastructure Investor's annual survey (see Figure 16). In a high rate environment, debt strategies look more attractive on a risk-adjusted return basis, especially compared to lower risk infrastructure equity strategies.

Figure 16: Infra strategies investors look to allocate to in the 12 months (% survey respondents)



Source: Infrastructure investor LP Survey, August 2024.

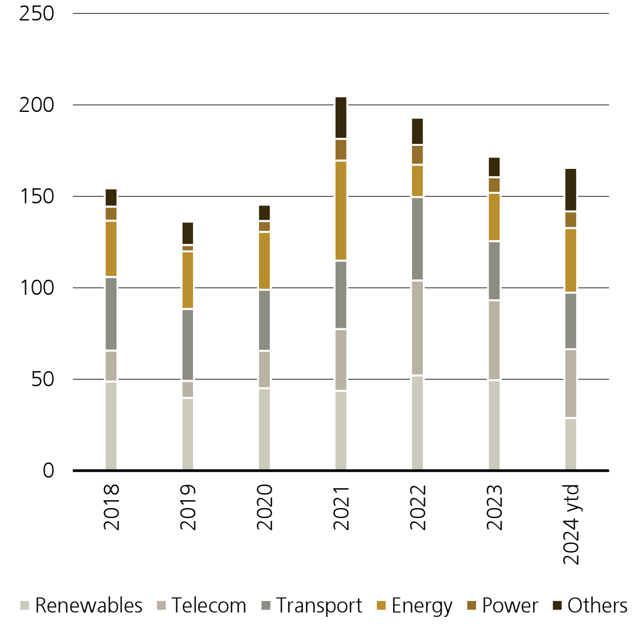
The math for investors was simple. Why get a 6-7% return for a super-core equity strategy, when debt offers more attractive risk-adjusted returns with base rates at 4-5%?

However, the same survey in 2024 shows that infrastructure debt has fallen to 3rd place. Despite being well-liked by most investors, they worry about the lack of deal opportunities due to low M&A activity. They also worry that they are too late to the game as central banks have already started cutting interest rates in 2024. Finally, some find the additional pick-up in spread not worth the effort when base rates are so high.

In our view, these fears are unfounded. As discussed earlier, long-term rates are declining much slower than expected, which should provide investors will a bit more runway to secure higher rates. But more importantly, rates will eventually decline, which means investors should act now before it's too late.

In addition, infrastructure debt markets have actually been quite active, as deal flows will likely match or surpass last year's levels (see Figure 17). The relative strength in debt deal flows vs. equity suggests that it's a lender's market, and investment opportunities would only increase in 2025.

Figure 17: European infrastructure debt deal by sector (EUR billion)

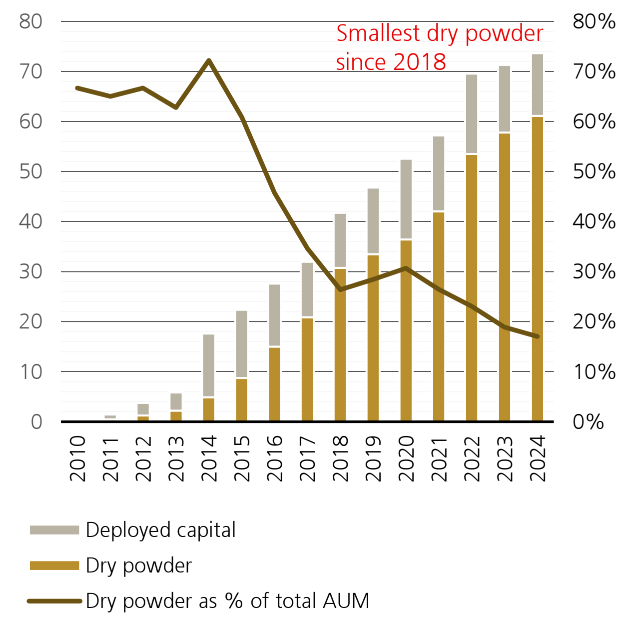


Source: Inframation, October 2024.

Fundraising for infrastructure debt has been relatively weak so far in 2024, with only ~EUR 3 billion raised in European infrastructure debt strategies.

But similar to what we have discusses earlier in this report, weak fundraising also means that infrastructure debt dry powder is at the lowest level ever when measured as a % of total AUM (see Figure 18). This points to less competition for infrastructure debt deals as we look into 2025.

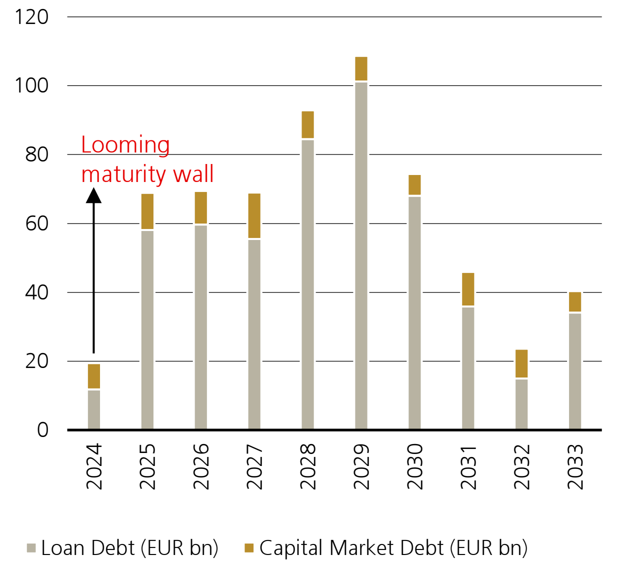
Figure 18: European infrastructure debt AUM and dry powder (EUR billion)



Source: Preqin, October 2024. **Past / expected performance is not a guarantee for future results**.

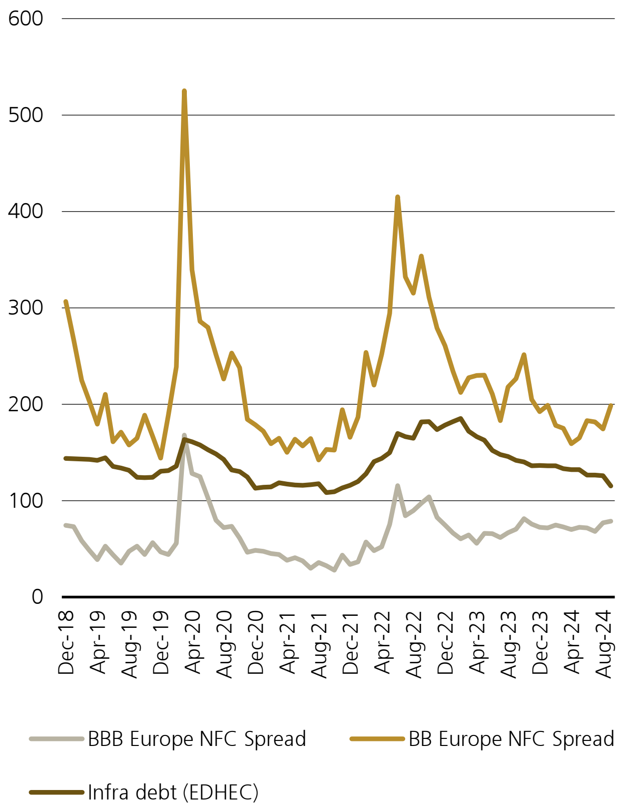
On top of that, the infrastructure debt markets are facing a looming maturity wall in 2025. Based on data of debt maturities in the next 10 years, there is a EUR 50 billion increase in debt maturing in 2025 from 2024 levels. With dry powder at EUR 13 billion, we could potentially face a significant infrastructure debt funding gap.

Figure 19: European infrastructure debt maturity (EUR billion)



Source: Inframation, October 2024.

Figure 19: Spreads for public European BBB and BB indices vs. European infrastructure debt (bps. p.a.)



Sources: Bloomberg; EDHEC Debt Indices (Europe); UBS Asset Management, August 2024. **Past / expected performance is not a guarantee for future results**.

In other words, the debt markets are about to become even more attractive for lenders – they should be able to secure attractive rates and negotiate favorable terms, with the large increase in opportunities and decrease in competition. We believe that sentiment for the asset class will improve in 2025.

Default rates have historically been lower for infrastructure debt than for equivalent credit corporate bonds.
For example, S&P reported that infrastructure had zero Investment-grade defaults in 2023, compared to 0.06% for global corporate bonds. Speculative-grade infrastructure defaults were 2.5% in 2023 compared to 3.7% for global corporate bonds.

Credit spreads for European infrastructure debt remains much closer than corporate high yield than corporate investment grade bonds in 2024 (see Figure 19).

With the slight pick-up in corporate bond spreads in the second half of 2024, we could also see a potential uptick in infrastructure debt spreads in 2025, since private market spreads tend to lag trends in the public markets by 6-9 months. 2025 would therefore be a good entry point for investors looking to lock in attractive rates before monetary policy further loosens.

To sum up, infrastructure debt benefits from many of the same macro conditions that is supportive of broader infrastructure markets. Resilient GDP growth decreases the probability of a hard landing (and the sharp increase in defaults under that scenario). Above average inflation supports infrastructure's fundamentals and its ability to service debt. A slower than expected rate cutting cycle gives investors a longer runway for locking in the high base rates before they eventually fall.

Finally, infrastructure debt is increasingly becoming a lender's market due to the upcoming maturity wall, and we believe there is a window of opportunity for investors in 2025.

Hits and misses

Revisiting our predictions from last year's outlook report

"Experts who acknowledge the full extent of their ignorance may expect to be replaced by more confident competitors, who are better able to gain the trust of clients. An unbiased appreciation of uncertainty is a cornerstone of rationality – but it's not what people and organizations want."

Daniel Kahneman, Nobel laureate and author of Thinking, Fast and Slow

Our infrastructure outlook provides forward looking views on the market, which means we're often wrong in our predictions. As a best practice, we believe that it's important to review the predictions from our last infrastructure outlook. To test Prof. Kahneman's theory that markets prefer research analysts who are confident than those who are accurate, we highlight where we were right and where we were wrong a year ago. Hopefully, this will not jeopardize our careers.

Where we were right	Where we were wrong
We expected continued strength in infrastructure fundamentals and improvement in sentiment.	We thought deal flows should bounce back with a stable macro, but weakness carried over through most of 2024.
We pointed out that valuations should hold up despite higher rates, and performance will continues to be stable.	We underestimated AI's benefits to traditional power generation and utilities, as we mainly focused on the opportunity for renewables.
We highlighted both the hype and opportunities around AI and data centers.	The impact from deglobalization has been slower than we had hoped last year; some projects are facing delays.
We were correct that political rhetoric against clean energy would increase during an election year.	We underestimated the actual deterioration in support for clean energy by Republican voters.

To conclude our 2025 infrastructure outlook, we believe that:

The stars are aligned for the asset class with improving macro environment, moderating valuations and decreased impact from the denominator effect.

Secular themes will continue to provide tailwinds for the asset class, but investors will need to be thoughtful about their investment process, and avoid herd mentality especially within 'hot' businesses.

There appears to be overlooked sectors and strategies such as power, utilities, transportation and infrastructure debt that should look more attractive in 2025, especially on the back of a stabilized macro environment.

Markets are underestimating the potential pushback against the IRA under the Trump administration. However, the clean energy industry will continue to adapt to changes, especially since electricity demand remains strong.

Infrastructure debt is uniquely positioned in 2025 to take advantage of higher for longer base rates and strong deal opportunities.

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