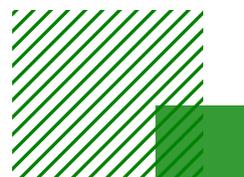




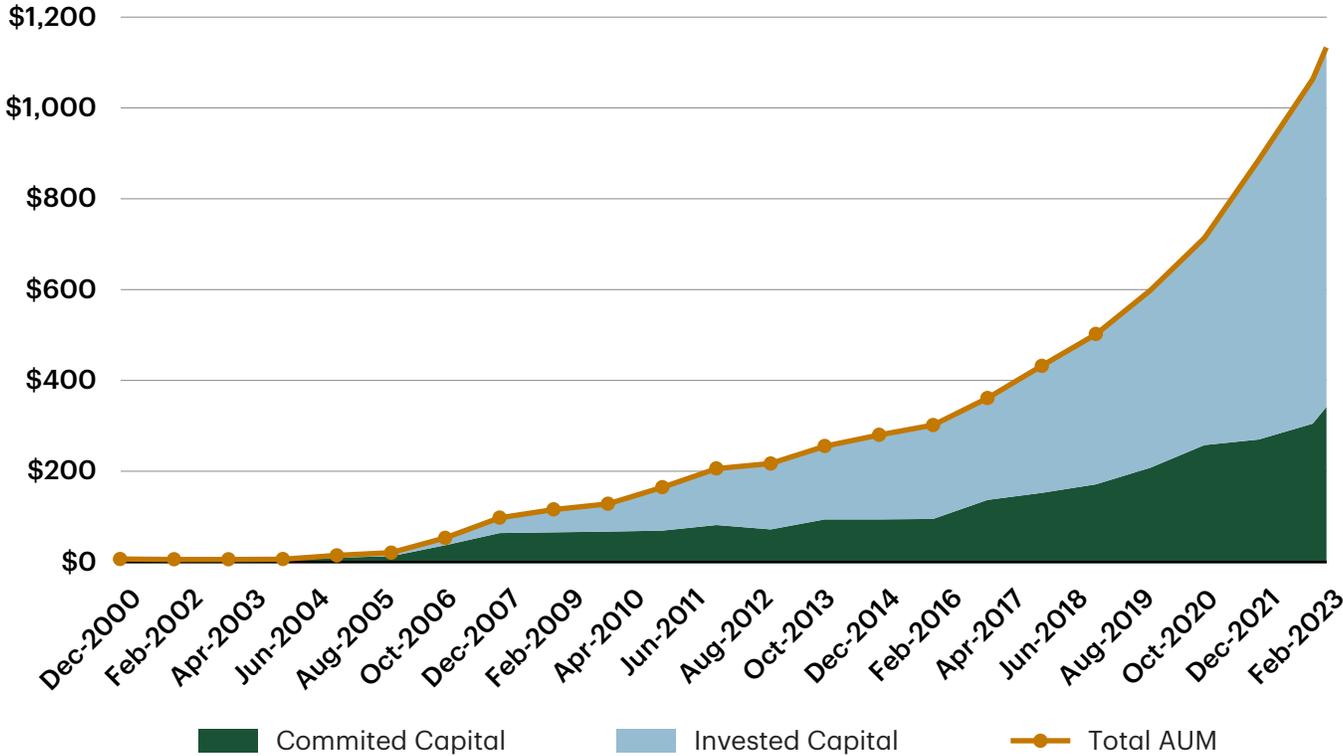
Private Infrastructure: A New and Open Era for Long-Term Investing

Private infrastructure has become one of the fastest-growing asset classes for institutional investors over the past decade, with assets under management (AUM) rising by more than 15% per year.¹ Until recently, most of the fundraising had been in closed-end private equity structures. However, over the last three years the number of open-ended funds has more than doubled. What accounts for the change, and what are the relative merits of open-end and closed-end structures?

¹Prequin. As at Dec 31, 2023.



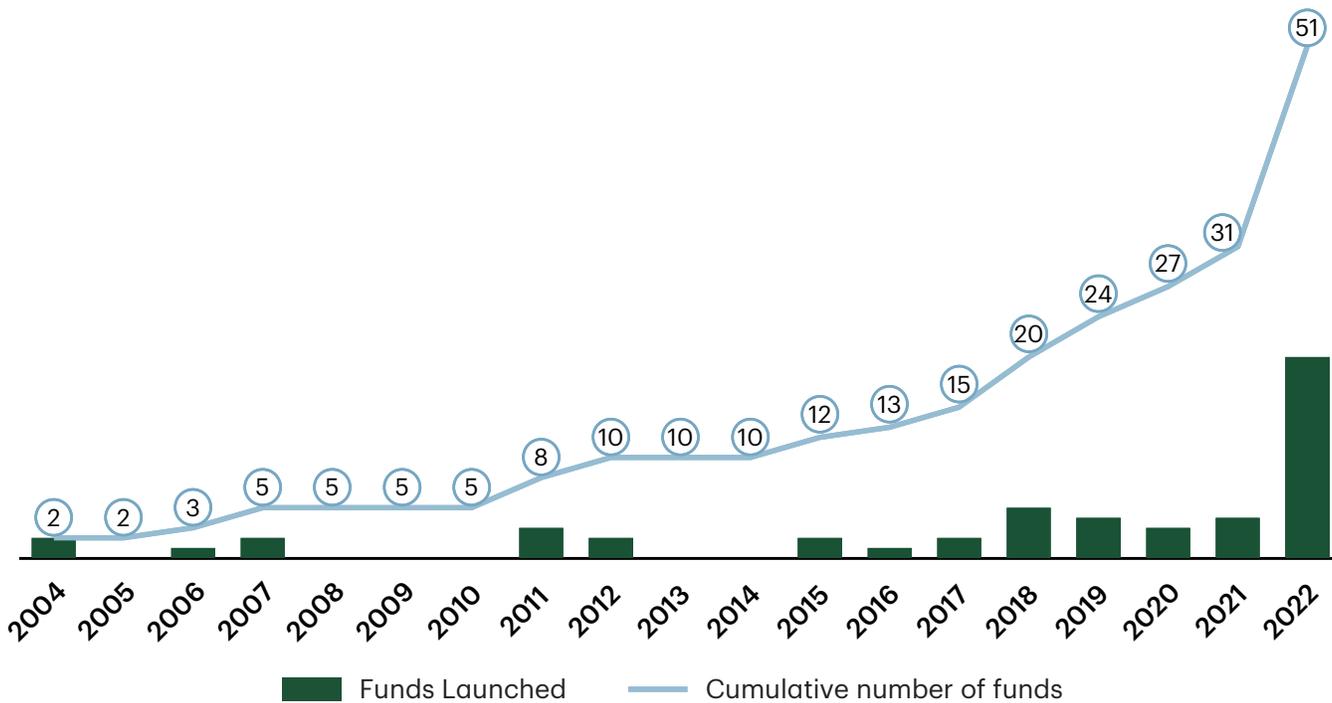
Growth of Infrastructure AUM (\$USD Billions)



Source: Preqin.



The Rise of the Open-end Fund



Source: Infrastructure Investor. As at Dec 31, 2022.

The History of Private Infrastructure as an Asset Class

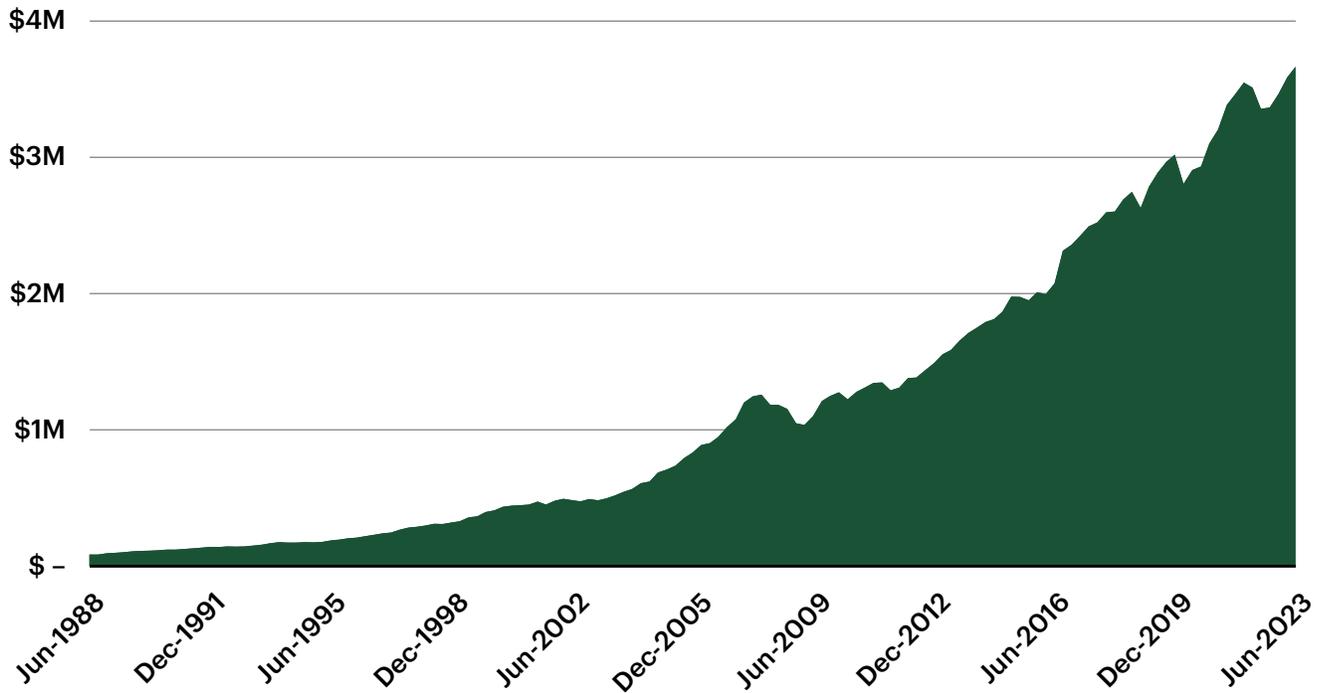
Part of the answer lies in infrastructure's origins as an institutional asset class. The story begins in the early 1990s, when Australia's federal government made a series of decisions that helped give birth to a global infrastructure investment industry that now manages more than US\$1 trillion.

In 1992, the Australian government overhauled the country's pension system, introducing mandatory occupational pensions as part of a new

Superannuation Guarantee, which today has approximately US\$2.4 trillion in assets. During the same period, Australia's federal and state governments began privatizing a range of public sector assets, including airports, toll roads and electrical systems. The new Superannuation funds were eager to participate and acquire assets whose profile of essential services with long-term, monopoly-like cash flows were a good match for the pension system's long-dated liabilities.

Assets

Australian Super AUM (\$AUD Millions)



Source: Australian Bureau of Statistics.

By the early 2000s, many other governments globally had launched their own privatization programs, opening new opportunities for private investment in infrastructure, both through privatization of existing assets and public-private partnerships (also known as P3s) to develop new ones. As the supply of projects increased, large institutional investors – including Canada’s major public sector pension plans – began investing directly in the asset class, drawn by its benefits as a source of inflation protection, excess returns, and improved diversification.

Mid-size institutional investors soon took note. Lacking the scale to invest directly in infrastructure assets, they sought fund-based solutions. In response, private equity firms introduced infrastructure funds with the

characteristics of traditional private equity funds, including defined time-horizons, higher and more complex fees, such as performance-based fees, and carried interest. As the industry continued to grow, investors accommodated themselves to these features for infrastructure investments, having few other options.

With infrastructure a mainstay in large and mid-sized institutional portfolios, smaller institutions and even individuals have been seeking access to the asset class over the past five years. Critics of closed-end infrastructure funds point to the higher implementation costs of managing multiple funds and vintages, as well as the mismatch between the fund structure, the long-term monopoly-like cash flows from essential assets, and an investor’s longer-term time horizon.

Performance

Open-ended Structures

What exactly is an open-ended fund? It's an investment structure that has no defined end date. Instead, it is similar to traditional bond or equity funds perpetually open to new investors and to new investment from existing investors, while offering regular liquidity for investor redemptions, income needs, and rebalancing. To facilitate this, it includes liquidity provisions to enable investors to redeem capital when they need it. By contrast, closed-end funds raise capital in a blind pool over a specified period of time, and then close the fund to new investment. The capital is locked up until the end of the fund's life – typically 10 to 12 years – at which time it is automatically returned to investors.

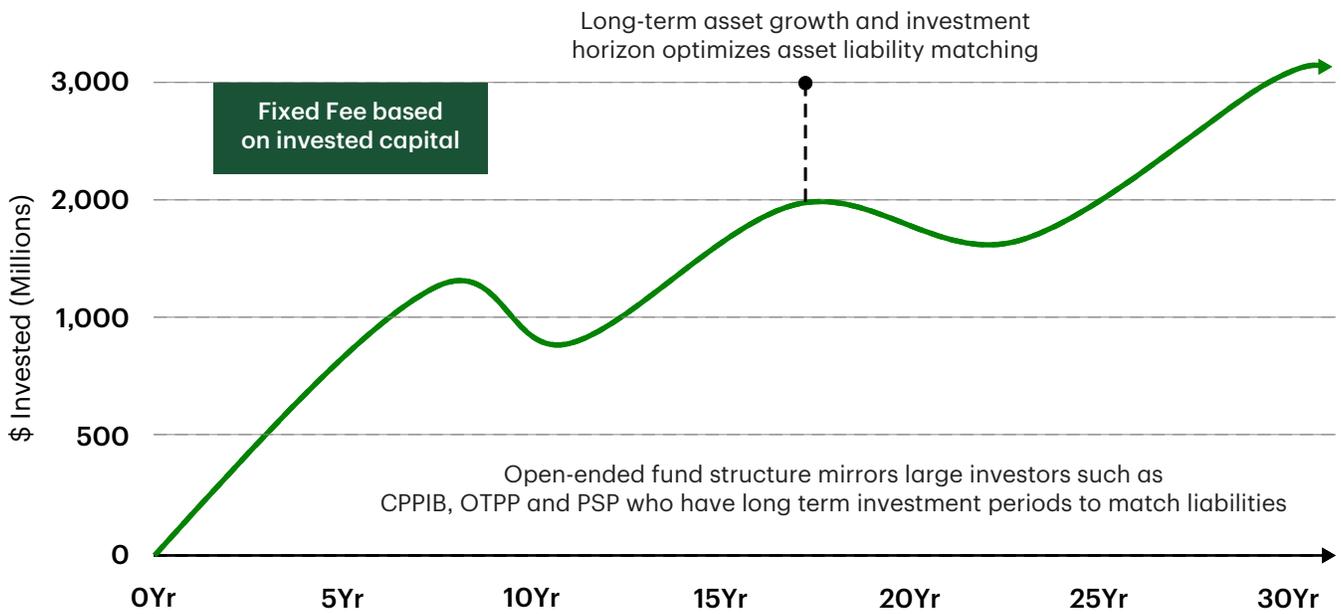
The difference between the two structures goes far beyond an investment end date and impacts the entire life cycle of an investor's commitment. Proponents of open-ended funds highlight the natural fit between the multi-decade cash flows of an infrastructure project and the long-term objectives of investors. In addition, the client experience is much different. As the chart below illustrates, this is reflected in a smoother path of capital, as investors are able to access a known pool of investments and can rebalance their allocation over time, as they do with other asset classes.

Rebalancing a portfolio is one of the more powerful tools in portfolio management for achieving **long-term goals** and **better risk-adjusted returns**.

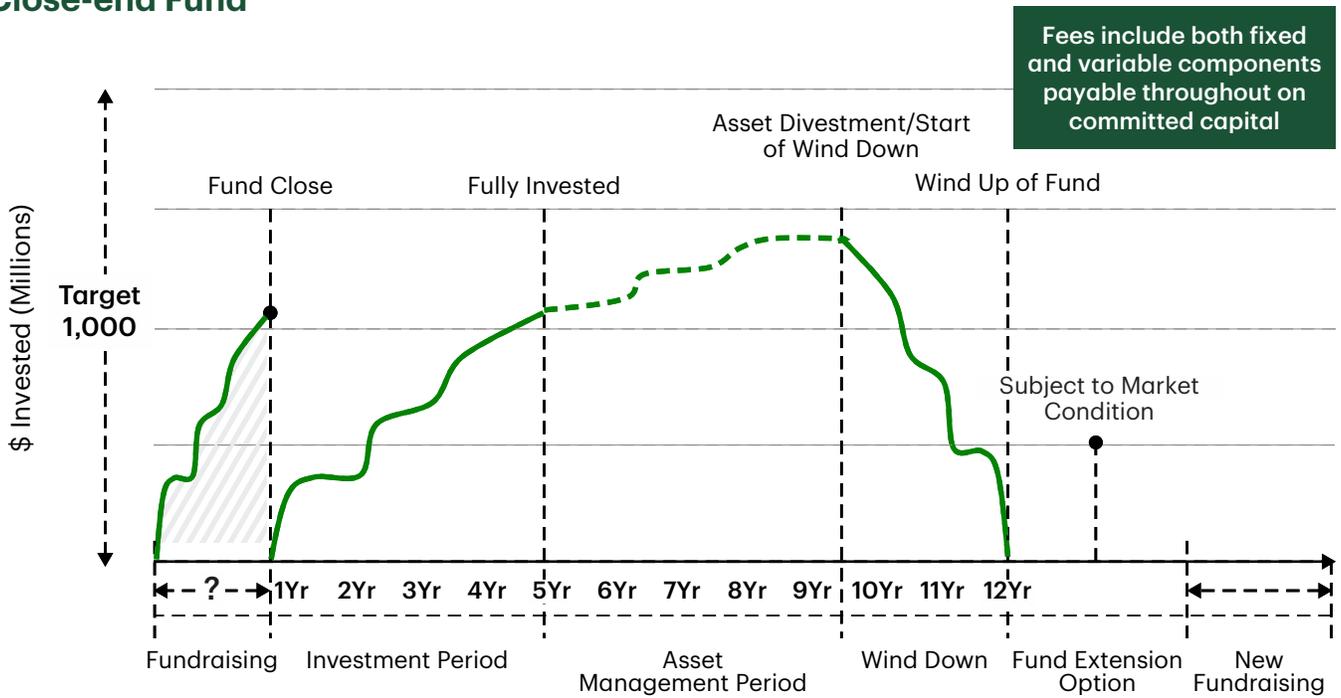
In a closed-end fund, investors typically can't access their capital until the end of the fund's life. This creates a non-linear path for their capital, requiring investment in a series of closed-end funds or 'vintages' to maintain the desired allocation. The result is greater capital friction and higher implementation costs.



Open-end Fund



Close-end Fund



Source: TD Asset Management Inc.

Investment



Opportunity for Growth

Institutional investors have long invested in open-ended funds within public equity, fixed income and private real estate. Infrastructure funds have remained the outlier, having had their debut through private equity firms with mid-sized investment organizations accustomed to the closed-end structure typical in the private equity space. However, as infrastructure continues to demonstrate its value in a balanced portfolio, demand has grown among smaller institutions and investors, for whom the cost and complexity of closed-end structures are a serious impediment.

With the democratization of access to private market strategies, a new set of investment vehicles has emerged, including a raft of open-ended infrastructure funds. Prior to 2018, only a handful of such funds existed. The landscape has now shifted dramatically, with an explosion of open-ended options.

There appears to be a dichotomy of open-ended structures that have focused on two distinct areas of the market. The first group are core or “super-core” strategies, which emphasize lower-risk operational assets, and TD Asset Management (“TDAM”) estimates delivered returns in the 6-8% range². Often marketed as a replacement for fixed income, these strategies were an attractive alternative in a world of near-zero

interest rates. However, with traditional fixed income funds yielding an estimated 5-7%², the risk-reward trade-off for core or super-core assets has been brought into question.

The second group is “core-plus” strategies. These funds incorporate both core assets and asset improvements or new development with an aim to achieve higher return targets in the 8-12% range². Proponents of these strategies point out the ability to act strategically and invest for the long-term. Freed of the artificial time pressure imposed by closed-ended funds, they can evaluate investments over an asset’s entire lifecycle and allocate the time needed for development projects, where permitting, land acquisition, design and construction can take years. The result is often better outcomes and stronger income growth for investors over time.

While the debate is sure to continue about the relative merits of open- and closed-end funds, one thing is certain: investors have never had more options to choose from. Whether they select a single open-ended manager for their entire allocation or assemble a portfolio of multiple open- and closed-ended managers, the opportunities available to meet their goals have never been better. ■

² TD Asset Management Inc.

Growth



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