

E X P E R T Q & A

A confluence of structural mega-trends coupled with new types of capital entering the market make this an exciting time to be financing the energy transition, says Barings' head of global infrastructure debt Pieter Welman



Infra debt's paradigm shift

Q What excites you most about the infrastructure debt opportunity set today?

We think it is an exciting time for the asset class, which is poised for growth in the coming years for two reasons: first, the opportunity set is vast and changing fast; and secondly, the asset class has matured and we see institutional investors from around the world increasing allocations with different types of capital looking at a variety of products to invest in. For an asset manager, these two drivers make it an exciting time to work in the industry.

Multiple mega-trends are converging today to fundamentally reshape the infrastructure landscape and create a broad pipeline for capital deployment. For example, long-term demographic shifts towards urbanisation are creating

opportunities in transportation and social infrastructure, while rapid technological evolutions such as the acceleration of AI are creating a huge opportunity set for infrastructure investors and lenders around everything from fibre to data centres.

Then there is the energy required to facilitate all these developments. Substantial investment will be required not only in the production of that energy, but also in its transmission and how it is consumed.

Q How much appetite do you see from investors for meeting these challenges, and

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how has that changed over the years?

I don't think there has ever been as much appetite from institutional debt investors, with allocations seeming to increase every year. The asset class is considered defensive, and its well-versed virtues – that of inflation-linked real assets with low defaults and high recoveries – have generally been shown to be true, which gives confidence to investors to increase allocations. As the asset class matures further, we expect this increase in appetite to continue and eventually be a core allocation to portfolios.

Another change we have noticed is how many different types of institutional capital now contribute towards the financing ecosystem. When we launched our platform almost 15

years ago, institutional infrastructure debt was largely targeted at insurance companies, and the product profile was primarily designed to meet those insurance investors' objectives. Today, we continue to see strong demand from the insurance sector, but insurance companies have been joined by pension funds, sovereign wealth funds, family offices and a broader range of institutional investor types.

The amount of capital available, along with the different types of capital available, provide flexibility and cost benefits to sponsors, borrowers and governments that should ultimately benefit the consumers of these assets. In many respects, infrastructure debt has become an established asset class, akin to real estate or leveraged finance, and that too makes this an exciting time for the market.

Q Where do you see the most compelling opportunities for deployment, particularly in the context of the energy transition?

The way the energy transition is discussed has evolved materially over the past three to five years. The focus was previously centred on low-carbon generation and environmental benefits. While that remains important, it is now only part of the story. There is a greater emphasis on resilience, energy security and, importantly, affordability.

Given that demand for electricity is rising sharply and could well remain elevated for years to come, that pragmatism is a positive feature of the current market. The energy transition is no longer viewed purely through an environmental lens, as important as that is, but as part of a broader and concerted effort to achieve a more balanced and resilient energy mix for all concerned.

The energy transition space also continues to be an area where we see an entrepreneurial focus from sponsors and developers seeking to identify new ways to connect end users with more

customised energy solutions. This has led to an increasingly diverse opportunity set in terms of geographies and customer counterparties, and emphasises the continuing trend away from a centralised planned energy effort.

Q Where do you feel most comfortable as lenders on the spectrum of established wind and solar generation technologies through to more cutting-edge elements of the transition?

As lenders, we are generally cautious about taking technology risk and tend to focus more on the mature end of the risk spectrum. Renewables financing has been a core area for us and continues to represent the largest component of our energy exposure.

However, we have also financed various other forms of energy generation outside of solar, wind and hydro financings, ranging from batteries to waste-to-energy and RNG facilities. We have even recently been involved in a nuclear deal. Another area of interest for us has been to invest in energy systems with universities and utilities to improve energy efficiency.

Some of the newer aspects of the energy transition are certainly very interesting, and we continue to monitor developments closely. Over time, we would expect to participate more in these areas, but, for now, our focus remains on larger-scale, proven technologies with credit-worthy counterparties.

Q How are innovations in financing structures or capital solutions opening up new areas of opportunity for lenders?

When the institutional debt market first emerged, it was primarily providing senior, project-finance style, investment grade credit that was well suited to insurance companies and banks. It also tended to be highly localised. There were a few major US insurance

companies doing deals in Europe and vice versa, but cross-border capital flows were limited. That has since changed dramatically, with infrastructure financing now coming from all parts of the world, and has contributed to more efficient pricing outcomes and structures over time.

We are also seeing a richer variety of products, tailored to the differing risk appetites of the more diverse set of institutions now involved in infrastructure debt. An investor can access higher-yielding senior debt, junior debt and more bespoke capital solutions-type products, for example. At the same time, those opportunities are available through a variety of structures, including managed accounts, CLOs, commingled funds or co-investment. As a result, the supply-side dynamics have changed massively, with a wider range of capital now available to developers, sponsors and governments.

Q Why should investors feel confident in the long-term growth and resilience of the infrastructure debt asset class?

Investors may take confidence from the confluence of structural, rather than cyclical, drivers underpinning the growth in infrastructure debt. The broader demographic changes and digital mega-trends that are driving sustained growth in electricity demand support a durable, long-term outlook.

Of course, periods of significant and rapid change can lead to missteps along the way. However, the sector has proved itself to be resilient, backed by real assets with contracted cashflows that are providing essential services to society. In that context, infrastructure debt appears to be a long-term investment theme set to persist over the coming decade and beyond.

While the market is still relatively young, it has weathered multiple macroeconomic cycles and, in many respects, has demonstrated the characteristics investors would expect from the asset class. ■