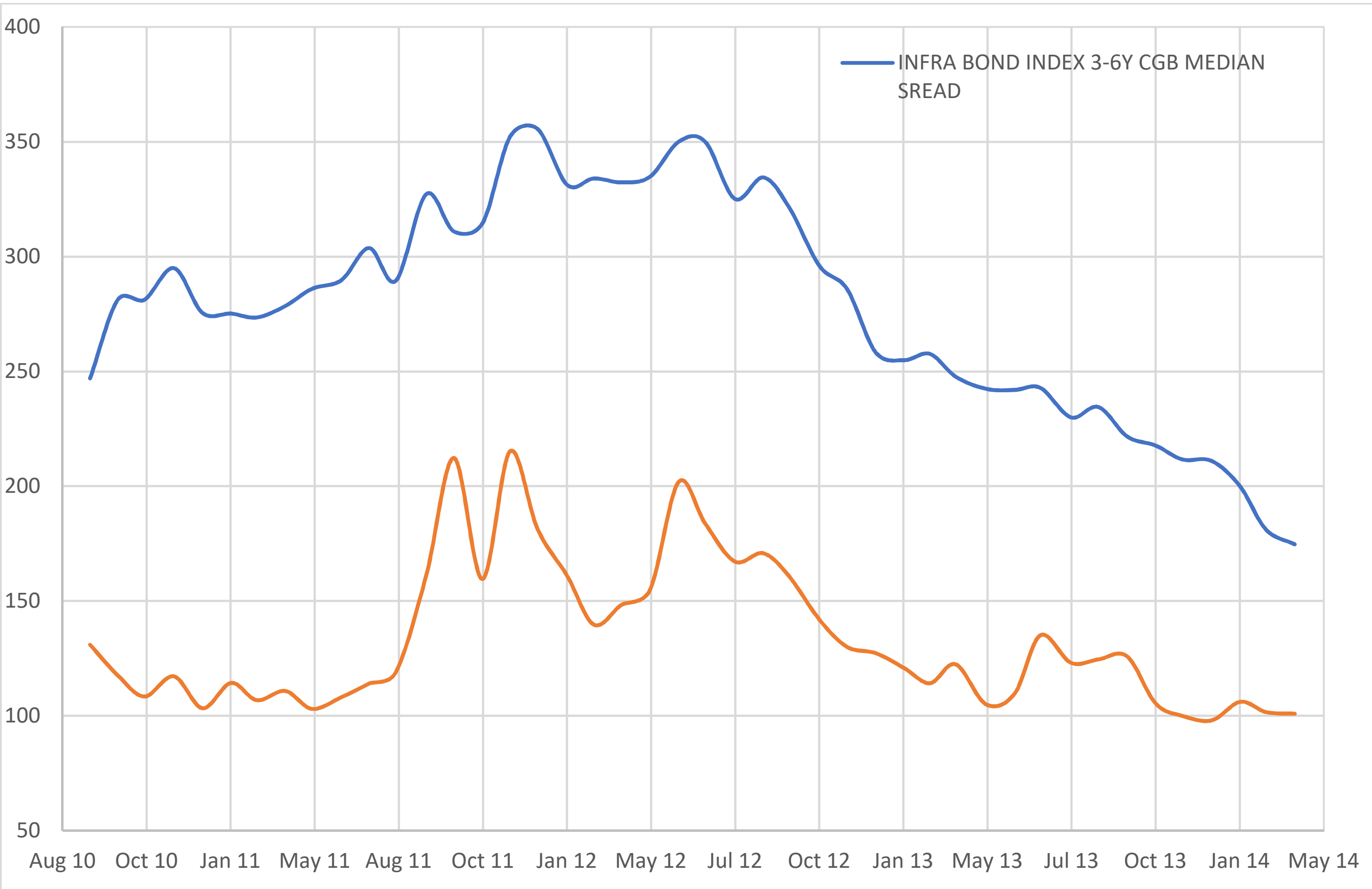
Introduction

This is the first Infradebt newsletter, the intention is to provide news relevant to the Australian infrastructure sector and infrastructure debt in particular. The newsletter will contain rolling commentary and data together with one off news items and factual pieces. We hope that you'll find it useful and informative. If there are other members of your team who would be interested in this newsletter, don't hesitate to drop us an email and we will add you to the distribution list. Equally, if you don't want to receive it going forward, just send us an email.

2013 was a year of record issuance for Australia's total bank loan market with total issuance of over $100 billion. 32% of this was attributable to infrastructure and utilities issuers. This quarter new loan issuance totalled $11.2 billion, of which Infrastructure comprised 22% of issuance (the March quarter is typically much lower in volume than other quarters).

Markets update

The table below provide an update on credit markets on a rolling 5 year basis. As has been the trend, spreads continue to tighten. With respect to the broader infrastructure market, the market (debt and equity) was relatively quiet, the June quarter is expected to be more lively with a number of large transactions due to close.



New issuance and refinancing

The table below provides a list of publicly available deals.

Loans

Date	Issuer	ume (AUD M	Margin	Tenor

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Mar-14	South Australian Schools PPP	185		5
Jan-14	Biosciences Research Centre	233	190	7
Mar-14	Peninsula Link	745		5
Mar-14	Melbourne Airport	1100		4

Bonds

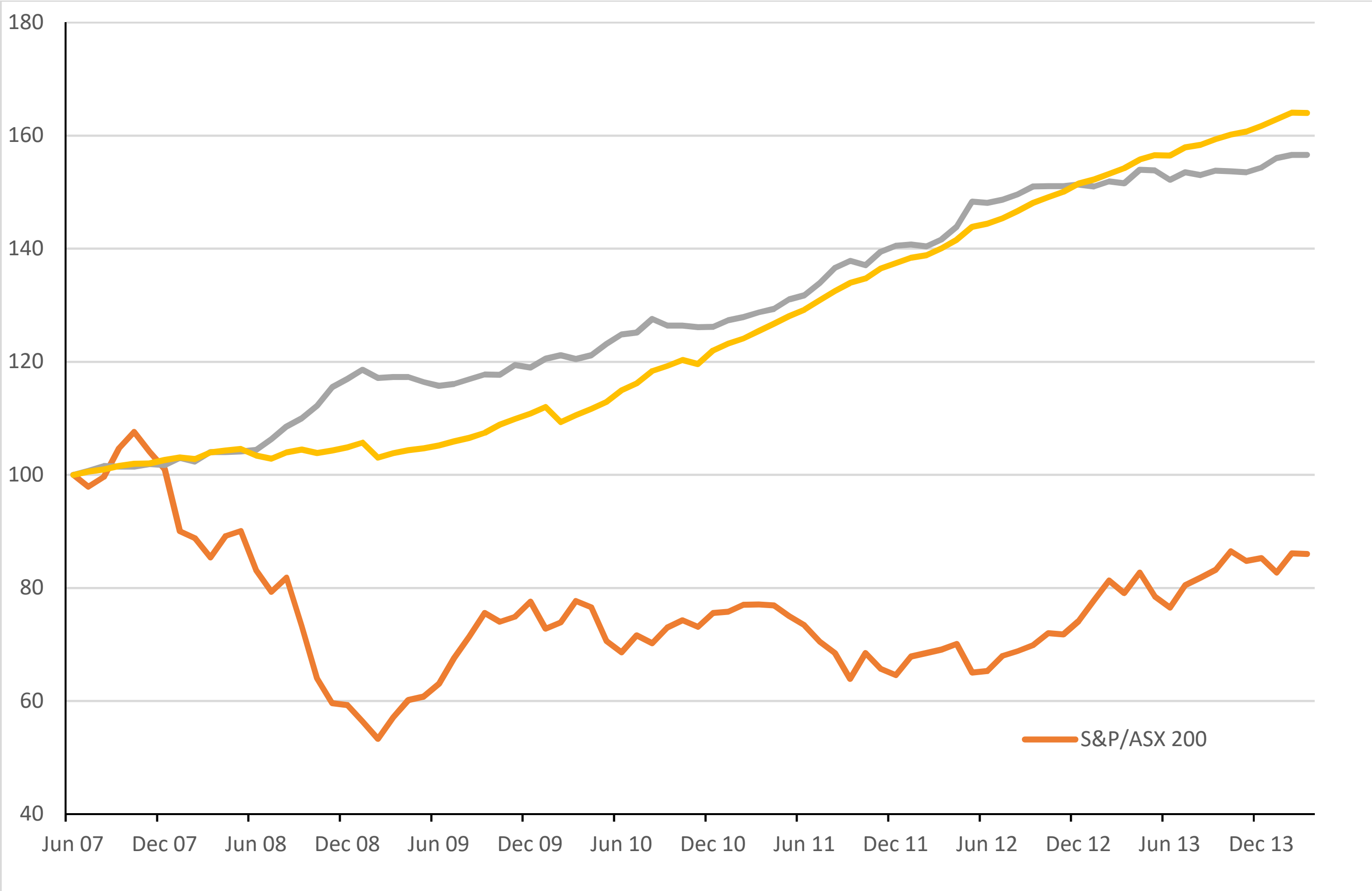
Issue Date	Issuer	Volume (AUD M)	Tenor	Issue spread to swap (bps)
09/12/2013	AQUASURE	150	7	175
27/02/2014	CITIPOWER	150	5	145
12/03/2014	SPIAA	350	7	165
25/03/2014	PERTH AIRPORT	400	7	165

Equity and other news

- **Port of Brisbane,** completion January 2014: Caisse de dépôt et placement du Québec acquired a 27% equity stake for $1.4 billion (implied multiple of circa 28 times earnings)
- **New Generation Rolling Stock Project PPP (Qld),** January 2014**:** Project reaches financial close. Consortium includes Bombardier, John Laing, Uberior and Itochu Corp. The project will deliver and manage 75 six-car trains over 30 years.
- **AquaSure Victorian Desalination PPP,** March 2014: HICL acquired a 5.85% interest.
- **Commonwealth Government,** April 2014: in an effort to incentivise State Governments to privatise infrastructure assets and recycle capital into new projects, the Australian Government has offered a 15% co-contribution payment (based on the value of recycled capital) towards new infrastructure projects commenced before 30 June 2019. It is understood there will be a fixed pool of incentive payments available (on a first come first served basis) with the size of the pool yet to be announced.

Infrastructure debt: relative performance through the cycle

The chart below provides an overview of the relative performance of Australian, senior infrastructure debt since 2007. The chart presents the cumulative return to a basket of equally weighted Australian infrastructure bonds. The basket comprises core infrastructure (toll roads, PPPs, utilities, airports and ports) but excludes greenfields assets and power generation. The benchmark is based on the returns to publicly traded Australian dollar denominated bonds with less than 7 years to maturity.



Follow the herd with hurdle rates and risk getting hurt?

If you will forgive the tongue twister, I want to outline a key shortcoming in how many investors approach investing. When constructing a portfolio, either within an asset class (for example, a fixed income manager) or at a whole of fund level, it is common for investors to adopt a hurdle rate approach. That is, they focus on constructing a portfolio that minimises risk for a given target return or for excess returns. As shown in figure 1, they pick the point on the so-called 'efficient frontier' that offers their target level of return at the lowest risk.

Figure 1: Return Targeting Results in Taking the Most Risk at the Wrong Time

This is fine in an academic model where the world is static, but not in the real world. In the real world, risk/return trade-offs are always changing and, implicitly, the efficient frontier is always moving. Take for example a fixed income manager always aiming for 2% of excess return, this targeted approach would mean:

- When risk return trade-offs are favourable (for example, in a wide credit spread environment) you could achieve the 2% return hurdle with a low risk (i.e. high credit quality) portfolio.
- When risk return trade-offs are not particularly favourable (when spreads are low) to achieve the same return you need to take much more risk – that is purchase a much lower credit quality portfolio.

Inherently this involves taking more risk at exactly the worst time. While this dynamic is most transparent in the world of fixed income – where credit spreads provide a signal of risk return trade-offs – it applies more generally. Return targeting, be it within a single sector or across asset classes, runs the risk of significant implicit shifts in risk…..and this can hurt in a dynamic world.

Contact Us

We're always happy to chat (and learn new things!) if you want to know more, contribute more on a particular topic, or wish to discuss any of the above topics in greater detail feel free to drop us a line. Also, please don't hesitate to send us ideas for future articles.