# Three global megatrends

*An examination of what's driving sustainable infrastructure*

by Michael Harrington

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Infrastructure is one of the fastest-growing sectors available to investors in private markets. Whether it is assets that support the transition to clean energy, those that help drive increased digitization or even physical infrastructure, such as toll roads, economies around the world are set to continue to turn to private capital to help them meet their growth aspirations.

This appetite for infrastructure is reflected in the increasing allocations investors are making to the sector. During the past decade, assets under management in infrastructure funds have increased almost five fold to $1.3 trillion, according to data provider Preqin. And the trend shows no sign of slowing down. With the asset class set to grow between 13 percent and 15 percent throughout the coming years, the market is expected to be between three and four times bigger during the next 10 years.

Meanwhile, a wider range of investors are likely to enter the market. There already have been a series of new infrastructure offerings through private wealth channels. Indeed, Bain estimates that individual investors hold roughly 50 percent of the estimated $275 trillion to $295 trillion assets under management, yet those same investors represent just 16 percent of assets under management held by alternative investment funds. Private wealth is expected to continue to grow quickly — faster than other pockets of capital in the alternatives segment.

Institutional investors are attracted to the sector because returns are robust, relatively stable and characterized by what are often long-term, inflation-protected contracts. Thanks to decades of underinvestment in global infrastructure, the global climate agenda and the growth of technologies driving digitization, as well as robust demographic factors, infrastructure therefore represents one of the largest global investment opportunities of our lifetime.

## THREE GLOBAL MEGATRENDS

Three global megatrends are driving the industry. The first is decarbonization. In 2023, the world's renewable-energy capacity grew by 50 percent to reach nearly 510 gigawatts, the fastest growth rate in two decades. And the trend is only set to accelerate. An estimated $275 trillion of energy infrastructure investment is required throughout the next three decades, according to McKinsey & Co.

Meeting the exponential demand growth for electricity in a carbon-neutral way is critical. This, however, will be a highly capital-intensive undertaking, requiring not just investment in renewable generation sources such as wind turbines and solar farms, but also complex new storage systems, transmission grids and distribution networks.

Because governments are often facing severe fiscal restraints, much of this growth is now being driven by the private sector. Indeed, investors now fully understand that renewable-energy infrastructure represents a safe, defensive asset class with downside risk protection.

The second megatrend is digitization. The global economy is expected to use 20 times more data in 2030 compared with 2020, according to McKinsey. AI is arguably the most important technology in a generation and is likely to drive a huge increase in demand for cloud computing and the data centers that power it. Although the whole world is likely to require significant levels of extra investment, a huge increase in digital infrastructure is particularly important for the faster-growing regions of the world, such as Southeast Asia.

The third global megatrend is deglobalization and, with it, supply-chain reallocations. The digital revolution and energy transition are already reconfiguring commerce and supply chains, while the rise of an urban middle class — particularly in Asia — and the increasing popularity of ecommerce are bolstering demand for logistics infrastructure. At the same time, countries such as Vietnam and Mexico are currently beneficiaries of China-plus-one business strategies, aimed at diversifying sources of supply.

One area in which these megatrends are already changing the market is the increasing levels of consolidation. This is significant, as it will allow more capital to flow into the global infrastructure sector. In 10 years' time, there are likely to be more GPs selling a wider scope of products to LPs, while the LP community is set to move toward more of a partnership structure, where GPs are scalable and can offer more tailored solutions. Investors want fewer, deeper relationships. This is why Actis signed an agreement to partner with General Atlantic in January this year. Together, the combined firm will be uniquely positioned to unlock opportunities for investors that lie at the intersection of the energy transition, digitization and the shift in economic dynamism to growth markets and beyond. The whole is greater than the sum of the parts.

Not all regions of the world are set to benefit equally from these megatrends, however. In the global south, where 80 percent of the world's population lives, the supply/demand gap is more acute than elsewhere. In an era in which the commercial real estate sector in Western developed markets is grappling with significant challenges, investors should consider alternative avenues for growth.

Wherever they choose to allocate, diversification is key. Risks and opportunities can differ substantially between markets, emphasizing the importance of constructing diversified portfolios through long-term strategies.

## UNLOCKING THIS POTENTIAL

How should investors make the most of these opportunities? They should consider the following factors.

In a world of increased uncertainty, portfolio construction is vital to manage risk. There is a lot of concentration risk in many sectors of the U.S. and European markets, which can be mitigated by investing in portfolios that offer diversification through geographical spread. Also, the fundamental nature of the infrastructure asset is important. Is the service being provided in high demand? Does it provide critical infrastructure with long-term, stable, inflation-protected contracts? These opportunities are available in those markets with acute supply/demand gaps of infrastructure.

Finally, investment strategies that were helpful last cycle with declining rates are less relevant given today's market circumstances. Strategies that can drive EBITDA through value creation and optimizing assets rather than a highly leveraged approach will be the winners this cycle.

Investors should therefore aim to work with a firm with the ability to build long-term value through an operational hands-on approach and the aptitude to leverage sustainability expertise to enhance financial value and de-risk assets. And, crucially, their partner needs to have experience both managing risks and navigating the differing challenges seen in each market.

Perhaps most importantly, they need to pick the right partner. A firm with true global capabilities and deep local connections allows GPs to choose the best risk-adjusted investments, no matter where they occur. Origination can be a strong driver of alpha if GPs are able to source deals off market. At Actis, for example, two out of every three deals are bilateral, with around 70 percent coming from a proprietary pipeline.

Finally, there are synergies across energy, digital and real estate. Few firms can deploy this combination of complementary capabilities. Power densities, power efficiency and cooling are becoming critical operational issues. Players that know how to supply low-cost renewable energy will be at a competitive advantage.

Better infrastructure will be vital for the global economy to maximize its growth potential in a sustainable, equitable way. Private investors will play a key role in meeting those needs.

The key for them to unlock success lies in aligning investment strategies with those three robust, secular demand trends and working with a partner who has an in-depth understanding of market dynamics at a granular level. If they can do so, critical infrastructure will continue to offer them a compelling opportunity to achieve their goals. ❖

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