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Why Invest In Infrastructure?
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Infrastructure continues to attract attention and capital as an investment asset class even as it defies easy definition. Why invest in infrastructure? Let's start with a more basic question. What is infrastructure?

Like its investment asset class close relative real estate, infrastructure is a "real asset." Indeed, infrastructure usually exists in the physical world as real estate—a physical asset permanently attached to the ground. But the similarity mostly ends there. While real estate ownership can be forever, its current value at any given time is often linked to larger economic forces: correlated to the economy, so that a buyer's interest is related to economic outlook, will things get better or worse, widely or at least for this particular piece of earth.

By contrast, infrastructure's value is less correlated, that is to say its value may neither strongly increase nor decrease based upon larger economic trends. So what is infrastructure when viewed as an investment target? The answer to this question is annoyingly tautological: real assets whose value is less correlated to economic movements.

This definition differs somewhat from dictionary definitions or commonly held notions which would make it out as “the basic physical structures essential to the operation of a society.” This isn’t a bad starting point as an investment definition, but the key to understanding the investor’s take is the word “essential” and not the word “physical.” A toll road may be physical, but its essentiality is the more important and the more nuanced question: are there other surface transportation options. Moreover, it’s degree of correlation to economic trends is the issue where the investor looks beyond the dictionary: who rides this road, pays the tolls and why?

The key to understanding infrastructure as an investment is to stop thinking of it in the way a member of the public would. An infrastructure asset may be a good idea but not a good investment. Indeed, mass transit is certainly a good idea, moving people more efficiently, but it is often a bad investment as most mass transit systems can’t cover capital and operational costs with tolls, tickets or similar user charges. They are good public policy but not good investments: to attract private capital, governments add revenue guaranties of one form or another.

Indeed, just about any civil infrastructure project can become an attractive infrastructure investment with a little government financial safety blanket. And some things that have nothing to do with government can be perfect infrastructure investments such as power plants with long-term purchase agreements, port facilities with location make them constructive monopolies, power transmission grids that serve stable population centers.

So why invest in this unsexy stuff? This is also tautological: because it is less correlated. All portfolio investment starts with an asset allocation and every asset allocation is specific to the investor. A large pension fund will have a different asset allocation than an individual retiree, a sovereign wealth fund will have a different asset allocation than a day-trader. Infrastructure is not the sexy part of any portfolio—that might be small cap, tech or even high-end real estate. Infrastructure occupies a place almost to the extreme other end of that spectrum, not as far to the other side as treasury notes, but closer to it, an investment bucket designed to provide a better yield than government bonds, perhaps even a bit of inflation protection, but not be at risk of a loss of any capital as a result of all but the most extraordinary events, and not subject to the ongoing fluctuations of markets or the economy.

Utilities used to be called “widow’s and orphan’s stocks” and the modern infrastructure asset class is a grown-up version of that: something to trust the future upon, suitable for individual investors as a counterbalance to broadly indexed listed investments and perfect for long-term institutional investors such as pension funds, insurance companies and sovereign wealth funds.

But don’t be fooled by labels. Lots of “infrastructure” assets can be dicey. Operating assets without long-term substantial use agreements, revenue-based transportation systems—tolled roads—along unproven routes, even core assets like mature highways but lacking binding noncompetition agreements from the government, stable assets in unstable countries. Each of these may be “infrastructure” but its investment thesis may be decidedly not infrastructure, more like start-up risk, a gamble on future government decision making, developing country risk or even currency risk.

The role of an infrastructure investor is to spot and then hedge risks or move on. By contrast, a hedge fund investor risks capital on the basis of an expectation of a movement in listed markets and a private equity investor risks capital upon the expectation that a particular strategy will create value. An infrastructure investor is primarily focused upon preserving value and providing moderate returns.

As markets continue to converge to the point that most everything else is becoming correlated, the emergence of a range of infrastructure investment vehicles for investors both large and small is a welcome trend from a financial services industry still seeking redemption from its role in the global financial crisis.