THE *lure* OF AUSTRALIAN PORTS

Government incentives are a key factor in big plans' eagerness to invest in the country's infrastructure

By ***Julius Melnitzer***

Canadian pension plans' love affair with foreign ports, particularly those in Australia but extending also to the United Kingdom and the Persian Gulf region, shows no signs of abating, with only an overheated market and a potential shortage of supply standing as roadblocks on the horizon.

But with Canada's federal government looking for pension funds to invest in homegrown infrastructure, what do their experiences with foreign ports signal about the types of projects that are likely to attract their interest?

A succession of deals

"Some of the deals done by Canadian investors recently are hallmark deals of which anyone involved in infrastructure is aware," says Brandon Prater, co-head of private infrastructure at Partners Group AG, a global private markets investment manager whose Australian involvement includes light-rail transit in Sydney and a project to deliver new rolling stock in Melbourne.

The past 12 months alone saw the Canada Pension Plan Investment Board and the British Columbia Investment Management Corp. take part in a consortium that spent more than $9 billion in August to acquire Australian port and rail operator Asciano Ltd. in what was 2016's largest corporate takeover in that country. Also participating in the consortium was Brookfield Infrastructure Partners, whose assets in the country already included the Dalrymple Bay Coal Terminal in Queensland.

The upshot was that between them, the two Canadian pension giants secured stakes in three businesses formerly owned by Asciano: Patrick Container Terminals, Australia's largest container terminal operator with four terminals nationwide; Bulk and Automotive Port Services, which specializes in the management of bulk ports, logistics and infrastructure at more than 40 sites in Australia and New Zealand; and Pacific National, the largest combined rail freight company in Australia.

The interest in ports extends to the skies as well. In February 2016, a consortium led by the Ontario Teachers' Pension Plan, which included the Ontario Municipal Employees Retirement System's Borealis Infrastructure unit, bought London City Airport for a reported 2 billion pounds. The purchase made the London facility the fifth European airport owned by the Teachers' plan. Borealis, which has an office in Sydney, followed up in September as part of a group that paid some $9.7 billion for the right to operate Melbourne's port for 50 years.

The Caisse de dépôt et placement du Québec, whose CDPQ Sydney subsidiary has a team of six in the Australian city, capped the 2016 port frenzy in December, taking a 45 per cent stake in a $5-billion partnership with Dubai-based global ports operator DP World to create a vehicle for investing in ports and terminals worldwide. "We're a global investor, so in addition to Australia and elsewhere, 25 per cent of our infrastructure portfolio is in the U.S. and 30 per cent in the euro zone and the U.K.," says Macky

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Tall, president and chief executive officer of CDPQ Infra, the subsidiary in charge of the fund's infrastructure activities.

The interest in Australian infrastructure is hardly a recent trend for Canadian pension funds. As of March 31, 2016, the CPPIB had about $7.8 billion in Australian investments, amounting to 2.8 per cent of its assets. The Caisse had about $13 billion, or 20 per cent of its infrastructure portfolio, invested in Australia as 2016 commenced, following on its $1.2-billion investment the year before in Australia's TransGrid electricity network. Other Caisse infrastructure-related investments in Australia include a 30 per cent interest in Brisbane's port and about 10 investments in social infrastructure with Plenary Group Holdings, in which the pension fund acquired a 20 per cent interest in 2016.

'Pioneers in infrastructure investing'

All of this should be no surprise. In 2013, an Organisation for Economic Co-operation and Development paper noted that "Australian and Canadian pension funds have been pioneers in infrastructure investing since the early 1990s. They also have the highest asset allocation to infrastructure around the globe today."

The extent of the Canadian appetite for infrastructure becomes even more evident when comparing Willis Towers Watson's 2015 ranking of global pension funds by total assets — which saw only two of the big Canadian plans appear in the top 40 — to a survey by the Boston Consulting Group at the end of 2014. The 2014 survey ranked four Canadian funds holding $36.8 billion in infrastructure assets as among the world's top 10 infrastructure investors.

Key factors in Canadian pension funds' interest in Austrialian ports include both the nature of the assets and the current climate for infrastructure investment in Australia.

"Infrastructure investments, such as the Port of Melbourne, position us to generate strong returns and consistent cash flows and match well with our long-term obligations to pay pensions to our members," says Ralph Berg, executive vice-president and global head of infrastructure at OMERS Private Markets.

The income from the Port of Melbourne comes from two sources: rent on port property leased to stevedores and other tenants and charges based on trade volumes passing through the facility. "Australia, as an island nation and a top commodities producer, is a major importer and exporter," says Berg. "The Port of Melbourne transaction provides us with the opportunity to participate in Australia's economic future. The port provides diversity of cash flows linked to trade volumes and rents, and we are part of a consortium with strong operating expertise."

CDPQ Infra's Tall cites "attractive long-term returns, stable cash-flow investment protection and a very good match with the needs of our clients" as factors that make investing in infrastructure a "natural fit for us."

Prater points to the "steady yield stream" generated by transport infrastructure. "These yield streams are GDP-linked, and many of them are inflation protected," he says. "It's expensive to buy inflation protection, so having it built in makes an asset very attractive."

The inherent size of port-related infrastructure is also a factor. "The big Canadian pension funds aren't set up to do $50-million deals," says Prater. "They're more inclined to deploy $500 million or more, and because Australia has had a large number of sizable investment opportunities, they're able to do that in one go."

Because so much of Australia's exports go to China and other parts of Asia, investing in ports is also a way of participating in the region's growth. "For pension funds, Australia acts as a proxy for Asia and is seen by Canadian funds as a way of benefitting from Asian development and growth, without necessarily taking the greater risks that might flow from investing there more directly," says Toronto-based lawyer Chris Murray, who leads Osler Hoskin & Harcourt LLP's Asia-Pacific efforts.

An incentive to privatize

Australia also offers good deal flow. "There's been quite a significant movement to port privatization in Australia, with roughly half a dozen ports having been privatized, mostly in the last five or six years," says James Davis, chief investment officer at OPSEU

HOW DID CANADIAN PENSION FUNDS' INFRASTRUCTURE ALLOCATIONS STACK UP AGAINST OTHER ALTERNATIVES IN 2015?

$90.7 billion	Infrastructure
$60.4 billion	Private equity
$170.4 billion	Real estate equity
$24.1 billion	Hedge fund
$14.1 billion	Mortgage
$13.6 billion	Commodities

Source: Canadian Institutional Investment Network

CANADA'S TOP 10 INFRASTRUCTURE MANAGERS (IN MILLIONS)

		2016	2015	Variance
1	Brookfield Asset Management	$12,926	$9,658	33.8%
2	J.P. Morgan Asset Management (Canada) Inc.	$2,061.1	$1,328.6	55.1%
3	Fiera Capital Corp.	$1,531.6	$1,386.5	10.5%
4	Stonebridge Infrastructure Debt Fund	$475.7	$429.1	10.9%
5	UBS Asset Management (Canada) Inc.	$124.7	$79.5	56.9%
6	Greystone Managed Investments Inc.	$58.4	$26.9	117.1%
7	Northern Trust Asset Management	$20.0	$15.0	33.3%
8	Integra Capital Ltd.	$18.1	$1.7	964.7%
9	Mercer Global Investments Canada Ltd.	$17.0	$8.6	97.7%
10	Sun Life Global Investments	$0.1	$0.2	-50%

Source: Canadian Institutional Investment Network

Pension Trust, which manages and administers the Ontario Public Service Employees Union pension plan.

Behind the deal flow are the Australian government's liberal privatization policies. As falling commodity prices and the economic slowdown in China impair the country's revenues, Australian Prime Minister Malcom Turnbull is encouraging the states to sell assets as a way of funding new projects. The government has gone so far as to offer incentive payments of some 15 per cent of the value of the assets the regions sell, funding the plan with almost $6 billion. The principle condition is that the proceeds of the sale go towards financing new infrastructure.

"Both the federal government and the states have put attractive assets, including ports, up for sale in a way that other governments, including the Canadian government, haven't," says Murray.

"That's part of the reason that Australia has been attracting more than its weight in foreign infrastructure investment."

Todd Nelson, senior investment consultant and Toronto investment leader at Willis Towers Watson, is of similar mind. "Australia is one of the oldest and most developed infrastructure markets in the world, and its government has figured out how to attract capital, so it's a natural home for the Canadian infrastructure appetite," he says. "And unlike places like the U.K., where public-private partnerships are more common, Australia is unique in that the government tends to build the infrastructure themselves and then sell it into private hands."

Finally, there are tax incentives.

"Australia offers a very low effective tax rates for offshore funds that operate infrastructure assets," says Prater.

The prospects for the future, however, aren't so obvious given the concerns expressed by some senior pension fund executives that prices for many infrastructure assets are too high.

Despite the concerns, the fact remains that the Asciano deal, the London City Airport purchase and the DP World venture all took place in 2016. If that's a slowdown, it doesn't detract from the notion that Australia continues to have a special charm for Canadian investors who, according to data compiled by Bloomberg, invested a record $35 billion in the country in 2015. That's an astounding statistic given that, as the Bloomberg report noted, Canadian purchases in Australia grew more than eightfold over the previous year.

Ironically, investors' experiences in Australia could lead to more Canadian pension funds investing at home. When the federal Liberal government announced it was doubling its infrastructure spending over the next decade, Bloomberg reported that Canada's largest pension funds had been urging it to follow the Australian model and "think big."

But according to Janet Rabovsky, a partner at Ellement Consulting Group in Toronto, Canada would do well to consider how it structures its infrastructure opportunities if it's going to attract the interest of both small and large pension plans. To date, she notes, much of the focus has been on public-private partnership arrangements, rather than equity deals.

"Most of the PPP deals in Canada are too small for the large pension funds, although not for the smaller funds," says Rabovsky.

"PPP financial structures usually involve 90 per cent debt and 10 equity, meaning that the equity available is small, even more so because some of the construction companies like to take a share."

In other words, to attract the big pension funds, the Canadian government may have to commit to selling assets, as the Australians have.

"I can't imagine why the large funds wouldn't be interested, especially in infrastructure assets that have a long-term flow of facility payments," says Rabovsky.

"The problem is that there just aren't enough of them around right now in Canada."

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