

## Recovery, disintermediation and politics: A decade in UK infrastructure

*In the first of a two-part series on UK infrastructure, Darryl Murphy looks back on a turbulent decade that saw bank lenders retreat only to re-emerge and a new broom of investors enter the market, as well as the demise of the PFI/PPP model.*

After an eventful and uncertain end to the decade politically, the UK government and the infrastructure industry will be keen to make progress in delivering the infrastructure investment the country needs for the long-term benefit of society; not just in terms of socio-economic value but also to make the promise of net-zero carbon a reality.

However, before we look forward, it is worth reflecting on the last decade; a period which began with the industry still in recovery mode following the global financial crisis. Back in 2010, when banks were no longer providing long-term loans (and very little short-term finance either), the total volume of infrastructure debt deals was only £8.3 billion – a little over a quarter of the value in 2019.<sup>1</sup> The market was dominated by social infrastructure, with around 70 per cent of activity coming via private finance initiatives (PFI) or public-private partnerships (PPP).

Politically, the Labour government that had governed since 1997 made way in 2010 for the Conservative-Liberal Democrats coalition of 2010-15, before the Cameron-May-Johnson merry-go-round of the past five years. One striking difference between the current administration and its predecessors is the emphasis on infrastructure investment, with spending promises dramatically increased.

Back in 2010, the Treasury was focussed on attracting more private-sector capital from insurers and pension funds. However, many would argue this trend happened of its own accord given infrastructure's attractiveness as a long-term, stable asset class suitable for matching liabilities as well as a necessary source of diversification from low-yielding fixed income securities.

In October 2010, the UK National Infrastructure Plan was published to much fanfare, setting clear objectives for the sector for the first time.<sup>2</sup> It is worth re-reading the document, if only to show it remains relevant in terms of its vision and challenges. The only striking difference is the theme of increasing private investment into infrastructure, which is seemingly not as central to current government policy as it was in 2010. It is also worth acknowledging that the quality of debate and thinking on UK infrastructure policy has improved over the past decade, particularly through the emergence of the National Infrastructure Commission and the National Infrastructure Assessment in 2018.

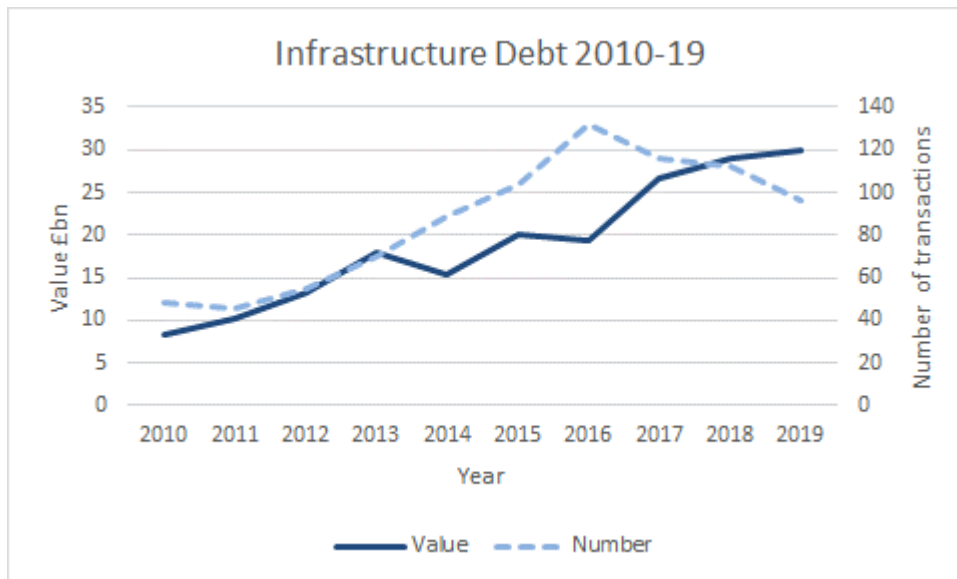
The last decade also saw the Green Investment Bank (GIB) established in 2012 to stimulate investment into the green economy; an objective that was largely achieved before the eventual sale of GIB in 2017 to Macquarie. Somewhat ironically, however, one of the key points raised following 2019's Infrastructure Finance Review was the need for a government-backed entity to provide early-stage funding through development capital, especially in the new technologies required to stimulate the transition to a low-carbon economy.

This perhaps illustrates why many people in the industry argue the level of progress and delivery has not matched the ambition of the original NIP. And that is despite the attention given to infrastructure by successive administrations and steady rise in deal activity over the decade, with the number of debt transactions reaching financial close hitting a record £30 billion in 2019.

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<sup>1</sup> All data from Infranews as at December 26 2019 for the period 2010-2019

<sup>2</sup> <https://www.gov.uk/government/publications/national-infrastructure-plan-october-2010>



### A summary of the key trends in the past decade

While the political environment undoubtedly had a major impact on the infrastructure market, here are some of the other major themes that defined the decade.

#### *Infrastructure emerges as an asset class for institutional investors*

Activity in the past ten years was dominated by the increase in capital available to debt and equity investors seeking long-term, stable assets. The UK emerged as a key global market for institutional investors due to the range of assets owned and delivered by the private sector.

Private-to-private deals accounted for much of the growth in deal flow. Assets once considered borderline became mainstream, with service stations, ferry companies and crematoria businesses among the assets owned by infrastructure funds.

#### *Public confidence in private-sector delivery sinks to all-time low*

While this rose to prominence in the run up to the 2019 general election as a result of the Labour Party's nationalisation plans, it would be misleading to think this was not an issue before the campaign or that it has gone away. Restoring public and political confidence in the private sector's delivery of infrastructure remains one of the great challenges for 2020 and beyond.

#### *Challenges in the construction industry*

On a related note, the liquidation of Carillion in 2018 was the low point in a disappointing period for UK contractors. Today there is little appetite for taking fixed-price cost risk, which means large global contractors are key to delivering UK projects.

#### *The rise of renewables*

In 2010, there were few financings of onshore and solar renewable projects. However, just as investment in social infrastructure withered, government support for renewables increased. Around 40 per cent of the 30 largest infrastructure debt deals of the past ten years were offshore wind transactions, including refinancings of early construction deals.

This demonstrates that closing a £2 billion greenfield or refinancing of an offshore wind farm has become readily achievable, a trend few would have predicted ten years ago.

### *The demise of PFI/PPP*

It has been a long and slow decline over the past decade, which started with the initial review of PFI in 2011 and the implementation of PF2 in 2012, and subsequently led to the formal end of the model by the former Chancellor of the Exchequer in late 2018. The model in the UK was predominantly used to finance social infrastructure, which makes its demise ironic given the likelihood increased public spending by the government will fund more schools and hospitals. Debate continues over whether a new dominant funding model will emerge.

### *The success of the regulated asset-base model*

The RAB model remains the mainstay of private-sector investment into water and energy transmission and distribution companies. The adaptation of the model in the development of Thames Tideway Tunnel is possibly the most innovative structure in the past ten years.

Meanwhile, its application for other asset classes continues to be considered, including nuclear power following the pure corporate financing of Hinkley Point C. Nevertheless, the relationship between the regulator and private investors remains strained, with the former demanding greater investment and efficiency from regulated companies.

### *Baseload energy transition is not easy*

Renewables stand out as the only true success story in the transition of energy generation; the early-stage development of baseload energy from tidal energy failed while battery storage, carbon capture, utilisation and storage and nuclear still face significant challenges in terms of delivery at scale.

The development of policy incentives in relation to a capacity mechanism assisted existing gas plants to operate, but aside from the growth in peaking plants, the role of gas remained constant and material to the UK's energy mix.

### *Rail industry struggles to evolve*

The decade started with the active trading of rolling-stock companies (Roscos) in the UK and ended with the seventh consecutive rolling-stock franchise-specific financing, all of which saw major involvement from institutional investors.

However, investment into government-owned rail infrastructure via Network Rail remained constrained. Furthermore, what should have been the highlight of UK rail infrastructure of the past decade – Crossrail – ended the decade embroiled in further delays and cost overruns. The ongoing review into HS2 also continues, with its future similarly unclear.

### *The financing market continues to evolve*

While liquidity was scarce at the start of the decade, it is abundant today. There has been a resurgence by commercial banks, most of whom are comfortable lending long term, especially for renewables. Institutional lenders have also grown in number in terms of direct investors and specific debt funds. The market currently seems more buoyant and active than at any time in its history.

### *Data becomes an infrastructure asset class.*

The delivery of broadband, data centres and masts offer some of the most exciting opportunities for investors, but this was not always the case – despite the refinancing of Arqiva in 2013 being the largest infrastructure debt deal of the decade.

One commonality of these trends is that they remain relevant today, along with new themes that are starting to shape the infrastructure market. In part two of this series, we will look at these emerging themes in more detail.