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Biden Bill May Boost Pensions' Appetite for Infrastructure

By Bridget Hickey August 3, 2021

U.S. pension funds have historically devoted a sliver of their portfolios to infrastructure investments, but as President **Joe Biden**'s nearly $1 trillion infrastructure package makes headway, funds looking to juice up returns, hedge against inflation and meet sustainable investment targets may wade further into the asset class, industry observers say.

The infrastructure package aims to repair roads, bridges, mass-transit systems and deliver other long-awaited improvements. If passed, the bill will be a "catalyst that lets pension funds… know that the government has a focus, and an intent and a dedication to invest in infrastructure," said **Michael Underhill**, CIO at **Capital Innovations**, a real assets manager that has invested $9 billion in global infrastructure projects on behalf of institutional clients.

To successfully create an infrastructure investment program in this country, it's going to take public capital, private capital, government and pension funds, Underhill added.

"It's going to take a series of different vehicles, private equity, private debt, different types of funds, unitized vehicles, to be directed at the problem," he said. "We're already starting to see fund formation, deal formation with this Biden-administration push and focus on sustainable infrastructure."

The average allocation to infrastructure by North American pensions in December was 4% for public funds and 3% for corporate funds, data from **Preqin** shows. That's an incremental increase from five years ago, when the average allocation was 3% and 2% respectively.

Preqin's data includes Canadian funds, which typically have a higher allocation to infrastructure than U.S. pensions. The $221.2 billion **Ontario Teachers' Pension Plan**, for example, has an 8% allocation.

U.S. pensions that have made recent commitments to infrastructure funds include the $70.9 billion **Los Angeles County Employees' Retirement Association**, or LACERA, which increased its target allocation to infrastructure to 5% in May, up from 3%. LACERA in July committed $100 million to **Smart Infrastructure Managers**' fund I and $500 million to **KKR**'s Diversified Core Infrastructure fund, the pension's CIO, **Jonathan Grabel**, confirmed. The pension also committed $165 million to Axium Infrastructure's Canadian-based mutual fund, and $250 million to Axium's U.S.-based mutual fund in June, meeting minutes show.

The $92.7 billion **New Jersey Division of Investment** committed $160 million to **EQT Partners**' Infrastructure Fund V, according to May meeting minutes. The fund currently has a 2.22% allocation to real assets, which includes infrastructure, with a target allocation of 3%, a May investment report shows. MandateWire first reported the commitment.

Most U.S pensions are investing in the asset class through infrastructure funds, as opposed to direct investments or co-investments, said Underhill. He estimates that only 10 U.S. pensions currently have the in-house expertise in this asset class to make co-investments and direct investments, but he expects this to change in coming years.

"The Biden administration's actions to stimulate sustainable infrastructure investment will cause more pension funds in the United States to create co-investment programs, and potentially triple if not quadruple the number of pension funds [with the] capabilities to invest directly in sustainable infrastructure," he said.

An increased infrastructure allocation can play a “really big role” for pensions looking to commit to sustainable investing, said **Dave Lowery**, head of research insights at Preqin.

On the environmental side, pensions can use their infrastructure allocations to invest in renewable energy sources, such as onshore and offshore wind power, he said. On the social side, pensions might also look to invest in health care facilities or schools, through public-private-partnerships-style-deal structures, which are commonly used in Europe but have been less developed in the U.S.

“As we start to see the market evolve a little bit more, I think we'll start to see a huge amount of activity coming through,” he says.

Some managers are encouraging U.S. pensions to consider boosting their commitment to the asset class to address risks around inflation.

"We think most plans could benefit from a greater allocation to real assets, and in particular, to infrastructure,” said **Zach Buchwald**, head of the U.S. and Canada institutional business at **BlackRock**. “We think that's beneficial to expected returns. It reduces risks and it can also be an inflation hedge."

But some investment consultants are waving a red flag.

"There is an enormous illiquidity aspect to investing in infrastructure,” said **Michael Rosen**, principal and CIO at **Angeles Investment Advisors**. “These typically are projects that are 10, even 20 years. And so to lock up your money, to give up liquidity for that period of time, in our judgment, requires a significant liquidity premium.”

Further, returns tend to be “pretty modest” in the mid to high single digits, he added.

“The projects we've seen have very low expected returns relative to the enormous illiquidity that they entail,” he said.

Infrastructure managers will argue that the asset class is low risk, Rosen said, but he believes some risks are under appreciated, such as the prospect of obsolescence. Revenue from infrastructure projects may be disrupted by technology or changing patterns of trade or consumer behavior. He pointed to toll roads, which saw an unexpected drop in revenue when traffic slowed during the pandemic.

"If you want to tie money up for 10 to 20 years, we just think investors need to demand a significant return premium, [and] that generally just doesn't exist in the infrastructure space," Rosen said.

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