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Secret of good infrastructure investing: do the due diligence

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Ron Lepin from Bastion Infrastructure Group. Picture: John Feder Source: TheAustralian

IT'S a simple fact nowadays that mention of the word Ontario in any discussion of infrastructure investment immediately serves as a badge of quality, since the pension schemes in that Canadian province have paved the way for lesser mortals like us to follow.

Ron Lepin, managing partner of Toronto-based Bastion Infrastructure Group, is the man who founded, built and led the Ontario Teachers' Pension Plan direct infrastructure investing program, best known of all.

And National Australia Bank is Bastion's major financial backer, although the numbers are kept secret.

NAB is a "non-controlling shareholder" and that seems the key to how he wants infrastructure investing to be: independent, direct, long term, skilled and thorough. It was not ever thus, he makes clear.

"Macquarie, Babcock and Hastings were world beaters and then from around 2006 onwards, US banks got involved," he says, with the air of a man who has bad news waiting.

"Goldman Sachs, Morgan Stanley and Citi got in and most of those have had, at best, a mixed performance" in infrastructure assets, he says.

Lepin has been investing directly in infrastructure assets, for funds he runs or advises, since 2002 and what he doesn't want to get involved with is intermediaries. "Some had a transaction-driven business model," he

says. "It wasn't a fiduciary, long-term model."

Meaning, in simple terms, that the people organising the transactions weren't the ones who ended up owning the asset, and that was the problem, before you even get started on issues such as "compensation policy", as he carefully puts it.

He points to several port transactions in the US "that are now on their second or even third refinancing" after the wrong investors and intermediaries paid too much for them.

He expresses no surprise to hear that the Cross City Tunnel in Sydney looks likely to go into administration for the second time, pointing out wryly that "overseas investors and financiers have given a gift to Australia" that our NSW government most certainly appreciates.

So, is Australia ready to invest heavily in infrastructure and should our hefty $1.62 trillion superannuation treasure chest get involved? Point one, he says, is we're much better prepared than we were "say 10, 15 years ago, particularly in regard to the market for capital".

But he doesn't want to see a dramatic change any time soon, noting: "If everyone in Australia was investing in infrastructure, returns would only go one way and that's down."

And, most important, he would be seriously concerned to see any government mandating of funds to invest in infrastructure. "It's a mistake do these things on a macro level," Lepin says, noting: "It's much easier at a project level.

"In those cases a government, state or federal, can identify needs and can find ways for debt and equity to be attracted. A good project will always attract capital, be it local or international."

He adds that in the US, municipalities are able to give tax benefits to projects they want, "although that means tax revenues then go down", so there's no magic solution.

So how does Lepin see the misalignment in Australia between industry funds, with their big holdings in illiquid assets such as infrastructure, and retail investment funds that have been underperforming by about 1 per cent a year because they don't have them?

"There's a greater willingness now on the part of retail funds to look at illiquid assets, particularly as the superannuation pie gets bigger, because they are finding there is less risk of redemption than there was," he says.

"There is no need nowadays for a fund to have 100 per cent liquidity available on a day-to-day basis and we are starting to see higher allocation to illiquid assets among retail managers."

His lingering concern is that not all funds realise quite how much due diligence they should be doing on infrastructure assets before they invest.

"It can take three or four months, and sometimes you don't do the deal," he says. "It's very, very labour-intensive."

Lepin says although it is possible for a Canadian fund to spend months on buying a European asset by flying staff home regularly during the process, "it's not so easy because you are much farther away". He expects Australian funds to get more into infrastructure offshore, to avoid that crowding effect, "but they have to be prepared to spend a lot of time looking at assets that are a long way away".