STATE OF THE MARKET

EVERCORE | Private Funds Group

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Infrastructure secondaries are powering up

BY PAUL BARR, PARTNER AT PANTHEON

As many institutional investors know, private infrastructure investments offer significant resilience against wider market volatility. The attractiveness of the infrastructure asset class to institutional investors has steadily increased, with annual allocations to the asset class growing by 3.8x between 2007 and 2023.[1]

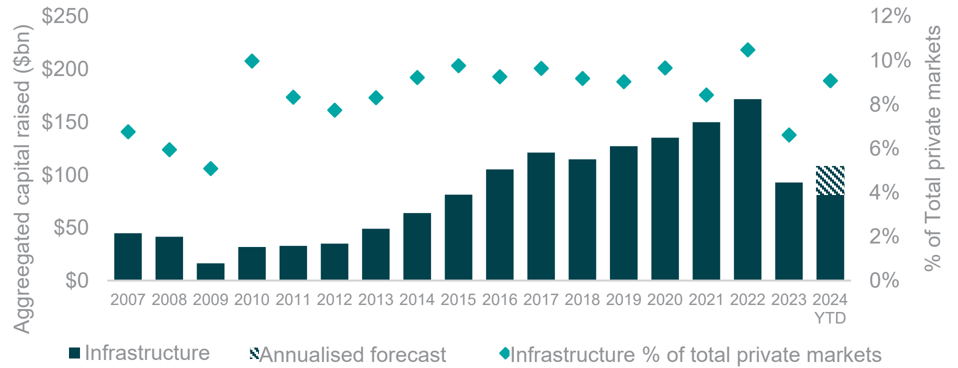
While the private infrastructure market was not immune to the broader market challenges of 2008 and 2023, market data suggests that fundraising in 2024 is likely to be closer to its recent trend line, accounting for almost 10% of total private markets fundraising (see Figure 1). Investor sentiment towards the infrastructure sector remains generally positive, largely due to tailwinds from the global megatrends of digitalisation, decarbonisation and deglobalisation and the increasing focus of many institutional investors on building a defensive or yielding portfolio, with high levels of inflation protection.

Infrastructure secondaries are gaining traction

As of Q4 2024, we estimate the total amount of capital raised and invested by infrastructure funds to be approximately $1.1 trillion and an estimated $400 billion of capital committed to but not invested by infrastructure funds.

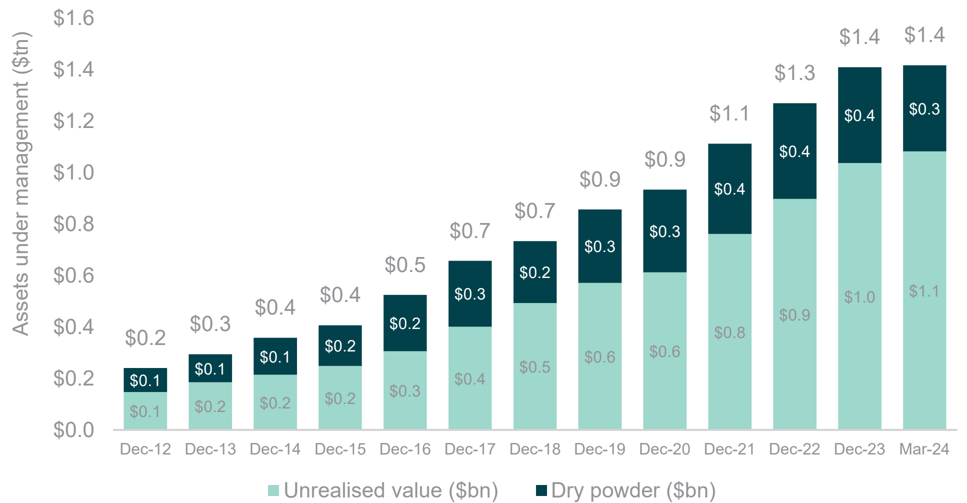
However, recent increases in the cost of capital, coupled with a wider slowdown in transaction activity and increased public market volatility, have eroded fund managers' ability to create liquidity for their investors through traditional exit routes such as sales to other GPs or strategics. This has played out across the private markets, leading to a significant liquidity squeeze for many institutional investors, which in turn has created an opportunity to acquire LP interests in infrastructure funds at attractive prices, as investors have sought to monetise existing fund investments to provide much-needed liquidity. In many cases, infrastructure fund positions have been sold ahead of private equity or real estate investments, as infrastructure valuations have proven to be less volatile; accordingly, sellers have been able to secure more favourable headline pricing upon their exit of these fund positions.

Figure 1 – Infrastructure fundraising over time shows a potential slow and steady return to pre-pandemic levels



Source: Cambridge Associates, as of 30 September 2024

Figure 2 – Historical infrastructure assets under management

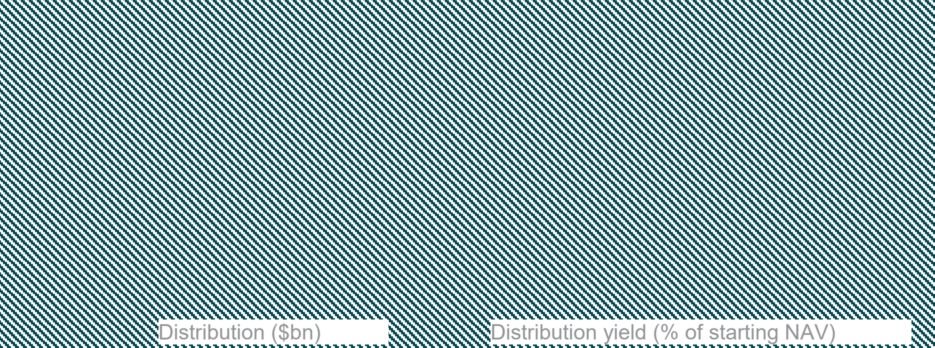


Source: Preqin Pro, as of 31 March 2024

To better illustrate the structural pressures and liquidity constraints facing many investors in infrastructure funds, Figures 3 and 4 show the decrease in quarterly distributions — in real terms and relative to the aggregate NAV — and the negative net cashflow outcomes for LPs. Distributions as a proportion of NAV have been below 10% since 2023, while investor cash flows have been negative across both infrastructure and private equity since 2022.

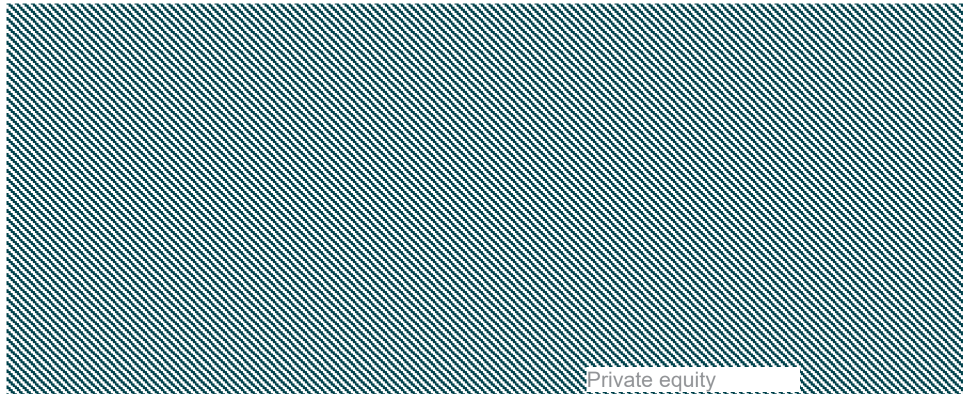
This liquidity crunch has created an

Figure 3 – Quarterly fund distributions have fallen in the last 12 months



Source: Cambridge Associates, as of 30 June 2024

Figure 4 – Negative net cash flows highlight exit delays

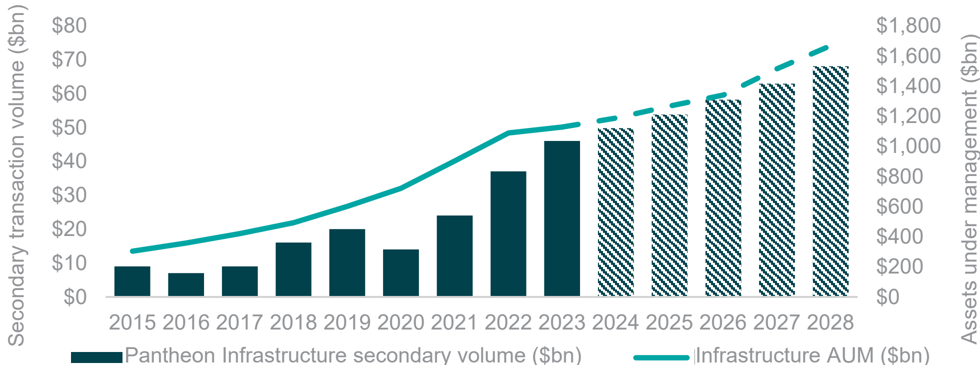


Source: Cambridge Associates and Infrastructure Global Report, as of 30 June 2024

Figure 5 – Shortage of infrastructure secondary capital at historic highs

Source: Pantheon secondary deal flow based on internal data as of 31 December 2023. Based on all secondary transactions screened from 2015-2023. Market dry powder based on average reported infrastructure secondaries dry powder from Preqin as of January 2024, PJT and Evercore. Estimated market dry powder and secondary deal flow based on 15% CAGR from Campbell Lutyens infrastructure market report H2 2023

Figure 6 – Infrastructure secondaries volumes are set to grow alongside infrastructure assets under management



Source: Pantheon (as of January 2024) and Preqin ("Future of Alternatives 2028", December 2023). Forecasted transaction volume assumes the same annual growth rate for AUM: ~8.1%

unprecedented opportunity in the market for secondary interests in infrastructure funds and private markets funds more generally.

By acquiring such fund stakes from LPs, infrastructure secondaries investors can access the asset class at prices that are typically below the fair market value of the underlying assets, providing additional downside protection and future return potential, leading to attractive risk-adjusted returns compared to other investments within the private infrastructure market.

Changes in the macroeconomic environment and the resulting liquidity challenges for some institutional investors, combined with a need to reassess overall portfolio risks and compositions, has led to a rapid rise in the volume of potential infrastructure secondaries deals that have been brought to market in recent years, growing from $14 billion in 2020 to $46 billion in 2023.[2] While the volumes of potential infrastructure secondary deals have risen, available capital to invest in such deals has grown at a more moderate pace, leading to a substantial supply/demand imbalance, which further improves the potential to earn above-market, risk-adjusted returns from investing into infrastructure secondaries.

Deal flow will continue to drive growth in secondaries investing

Preqin estimates infrastructure secondaries deal flow will reach $70 billion by 2028.[3] Pantheon's potential infrastructure secondary deal flow would appear to support this level of expansion, as it increased from $9 billion in 2015 to $46 billion in 2023, a 23% compound annual growth rate.[4]

We expect growth in infrastructure secondary deal flow to continue into 2025, and most likely well beyond, as institutional investors continue to generate liquidity from their infrastructure portfolios due to the limited exits by their fund managers, and GPs continue to explore additional routes to provide liquidity to their LPs (for example, through GP-led transactions such as continuation vehicles or tender offers). So far, LP portfolio sales have been a strong driver of much of this volume, accounting for about 60% of the market (up from historical levels of about 40% between 2019–2022).[5]

In addition, the infrastructure GP-led secondaries market continues to grow in line with its historical trend, as managers proactively explore liquidity options other than outright sales in a challenging exit market. This trend mirrors the earlier stages of growth in GP-led deals in the private equity secondaries market, where exits via GP-led secondaries have increased as a percentage of deal volume over time.[6] Notwithstanding a likely increase in the number of buyers

of infrastructure secondaries, the market is forecast to remain inefficient, with the total buyer universe staying limited relative to the large volume of potential sellers. Given this dynamic, leading infrastructure secondary buyers should be able to source high volumes of proprietary deal flow compared to other parts of the private markets, continuing to secure attractive risk-adjusted returns.

Advantages of infrastructure secondaries investments

At Pantheon, we see opportunities across all infrastructure markets, including digital infrastructure, power and utilities, renewables, transport and logistics and social infrastructure. Each sector presents a different set of challenges and opportunities. While we are agnostic as to specific sectors and evaluate each investment on its merits, as a secondary buyer, we are uniquely placed to overlay concerns around certain assets or sub-sectors and can acquire exposed assets at low valuations, providing a buffer against further downside risks.

Investing in assets with available returns data, both absolute and relative to similar sectors, provides secondaries investors with greater visibility into specific assets. For mature funds, this includes asset track records, risks and cashflow profiles. This makes secondaries investing particularly attractive during periods of macroeconomic or geopolitical uncertainty.

In addition, because secondaries investors will invest in funds of varying ages, secondary investors achieve diversification across a number of prior vintages, as well as assets, GPs, sectors and geographies. This results in reduced downside risk to future returns relative to investing in primary fund commitments with a more concentrated portfolio, or co-investments with single asset concentration risks and other resulting idiosyncratic risks.

Pantheon infrastructure secondaries expertise

Pantheon's platform is built on broad expertise and a long-term track record. Pantheon was one of the first fund managers globally to recognise the potential of infrastructure secondaries, raising its first fund focused on the strategy in 2010. Since then, Pantheon has raised four additional infrastructure secondaries funds and has committed over $7 billion to the strategy.

Pantheon's global infrastructure team leverages its deep relationships with a wide range of leading infrastructure GPs to generate meaningful deal flow and enhanced returns. This extensive network gives them an edge in accessing information and opportunities, especially in the secondary market.

Pantheon is well positioned to continue to leverage its relationships across the market to source opportunities and to provide liquidity to LPs and GPs across the wider private infrastructure sector.

In a developing and increasingly less predictable global environment, the need for robust infrastructure is clear. Infrastructure secondaries is a strategy that is gaining traction due to its structurally attractive risk-adjusted returns, high level of cash-on-cash returns and tailwinds from the increasing need for liquidity solutions across the private infrastructure market by both LPs and GPs.

1. Cambridge Associates, as of 30 September 2024
2. Pantheon internal data as of November 2024
3. Preqin Future of Alternatives 2028 report
4. Pantheon internal data as of November 2024
5. Based on Pantheon internal data for number of infrastructure secondaries deals screened as of November 2024
6. Evercore Private Capital Advisory, July 2024. 'H1 2024 Secondary Market Review'

Paul Barr is a Partner in Pantheon's Global Infrastructure and Real Assets Investment Team. *He previously worked at GIC where he was Senior Vice President, Infrastructure with a global remit focussing on primary, secondary and co-investment opportunities. Paul also has expertise in infrastructure direct investing and infrastructure debt transactions. Prior to GIC, Paul worked at Challenger Infrastructure and Macquarie Capital.*

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