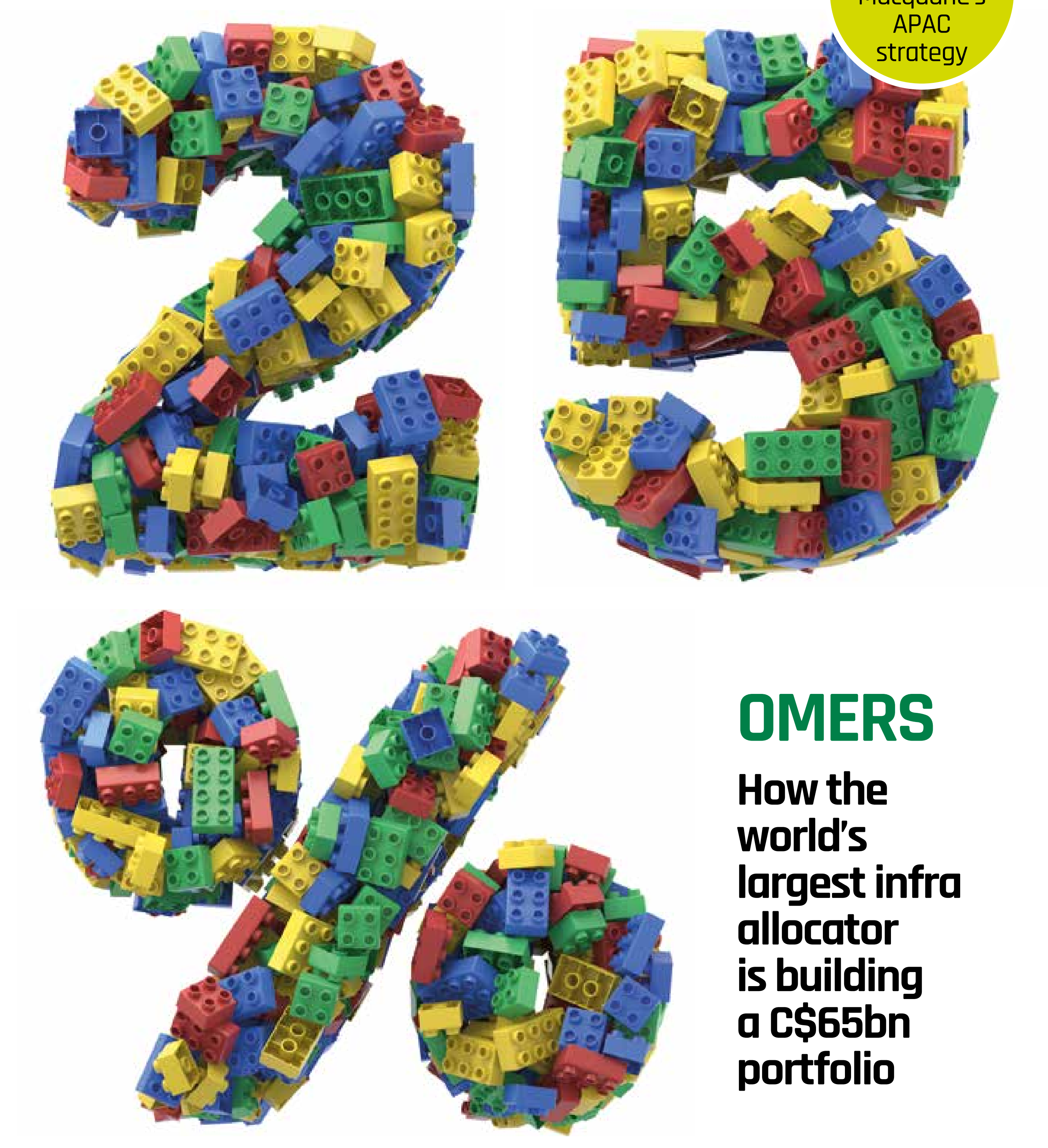
Infrastructure Investor

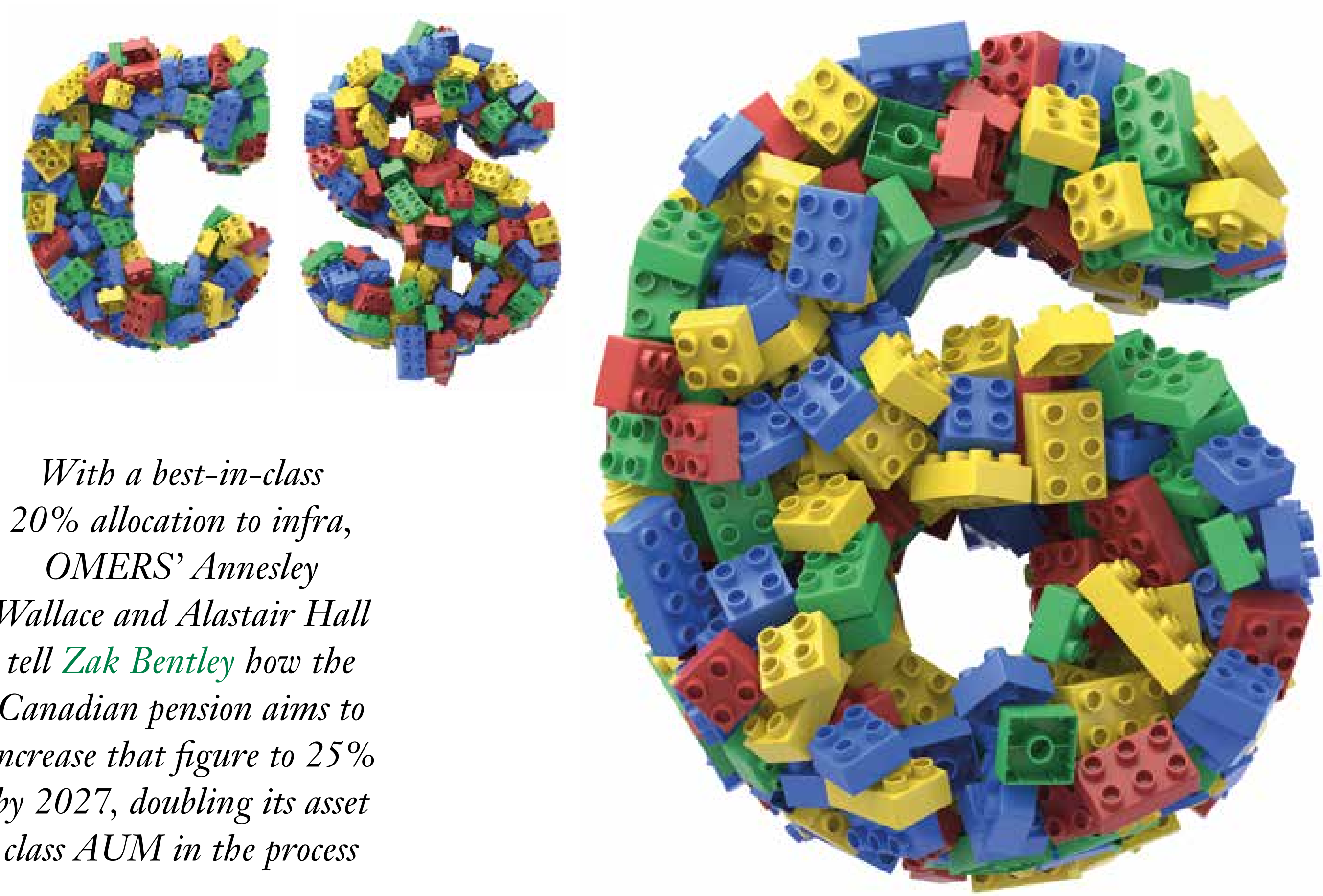
July/August 2022 • infrastructureinvestor.com

EXTRA
Inside Macquarie's APAC strategy



OMERS

How the world's largest infra allocator is building a C$65bn portfolio

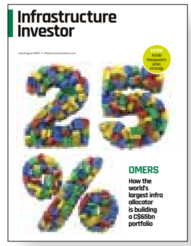


OMERS supersizes its infra portfolio

With a best-in-class 20% allocation to infra, OMERS' Annesley Wallace and Alastair Hall tell Zak Bentley how the Canadian pension aims to increase that figure to 25% by 2027, doubling its asset class AUM in the process

Nothing quote demonstrates the purpose and effectiveness of an infrastructure allocation better than the performance results within Ontario Municipal Employees' Retirement System's 2020 annual report. As the world tumbled due to covid-19, so did the returns of credit (-4.3 percent), private equity (-8.4 percent) and real estate (-11.4 percent). Infrastructure stood out, generating an 8.6 percent internal rate of return that year, thereby showcasing its stability and resilient cashflows. That is even as Annesley Wallace, OMERS' global head of infrastructure, admits to *Infrastructure Investor* that "we do take a fairly broad view when it comes to what can be classified as infrastructure".

As the other asset classes rebounded



Cover story

emphatically in 2021, infrastructure continued its steady performance, generating for OMERS a 10.7 percent IRR last year. That came amid a significant structural change in January 2021 when Ralph Berg, the pension plan's global head of infrastructure since 2015, became its global head of capital markets. Wallace, who worked within the OMERS infrastructure team from 2012 to 2018, returned after spending just over a year as the group's chief pension officer. Further change was afoot later in the year when Philippe Busslinger, its head of European infrastructure, departed in October to Wren House Infrastructure, with Alastair Hall, at OMERS in London since 2014, taking over.

With Berg and Wallace having kept the ship steady through the covid years, the pension fund is now looking to the future. Wallace reveals their intention to double the infrastructure portfolio from C$32 billion ($25.1 billion; €23.8 billion) of assets under management to approximately C$65 billion in 2027, lifting the allocation from 20 percent to 25 percent. That will be a significant boost to what is already the world's largest infrastructure allocation, as a percentage of overall AUM, according to our Global Investor 50 ranking.

The anticipated growth is centred around what Wallace calls a "refreshed strategy" focused on five themes: energy transition, mobility, connections (digital infrastructure), natural systems (water, distribution) and community (social infrastructure). Semantics aside, the focus is on ensuring that the portfolio is ready for the 2020s and beyond.

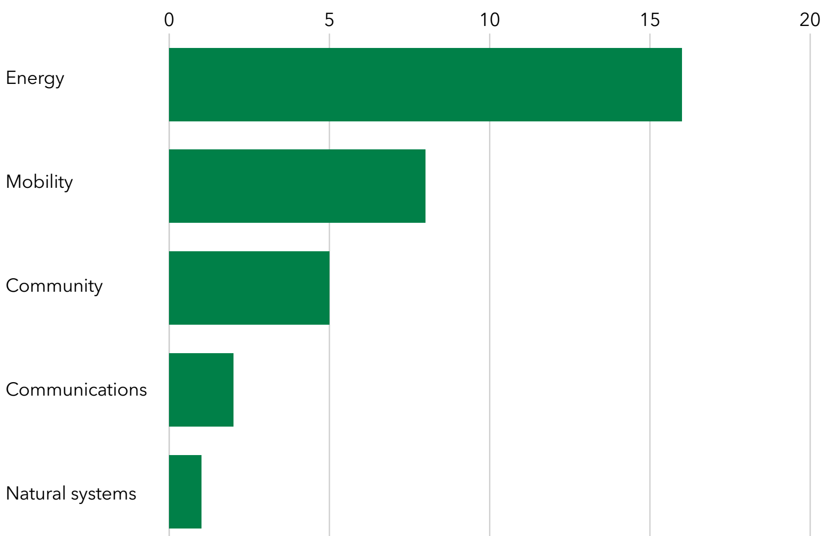
"It was driven by really wanting to be able to identify what are going to be some of the big trends in infrastructure in the future," says Wallace. "We fundamentally believe that there is going to be continued disruption in the infrastructure sector and the pace of change is likely to accelerate. So how do we best position ourselves to be ahead of the curve so that we're identifying what are going to be the next core infrastructure investments? And how do we best position ourselves to be ready to invest when we feel they meet those important infrastructure investment criteria?"

While Wallace concedes that OMERS may own assets that could conceivably fit into a super-core bucket – Thames Water in the UK being one such example – she says the pension is focused on buying core or core-plus assets and subsequently de-risking them.

The opportunity set for those types

> *"We're probably less likely to continue to put more money into more traditional transportation, whether that's roads or airports, not that we wouldn't"*
>
> **ANNESLEY WALLACE**

OMERS is seeking to diversify its portfolio, which at present has a large share of energy assets (Number of assets by sector)



Number of assets does not account for deals yet to close
Source: OMERS, June 2022

of assets continues to be prevalent in North America and Europe. However, as is the case for several other western infrastructure heavyweights, OMERS is anticipating significant future growth to come from the Asia-Pacific region.

This will include continued investment in Australia, where it has held a stake in the Port of Melbourne since 2016 and has since added to the Australian portfolio with electricity transmission network Transgrid in 2020, solar developer FRV in 2021 and in May agreed its first digital infrastructure deal in the region with the acquisition of a mobile towers portfolio from TPG Telecom. Wallace is now looking to diversify the APAC offering beyond Australia, including in India, where it has made significant inroads in recent years.

"OMERS at the organisational level is very focused on growing our overall exposure to the region because we really see it as an opportunity to get access to a high growth market," she says. "We opened an office in Singapore in 2018 and from our infrastructure group, we now have a strong presence in that Singapore office, as do the other OMERS asset classes. We'll continue to focus on North America and Europe, and in Asia we'll be focused around India, Indonesia and the Philippines primarily, while also continuing to deploy capital in Australia."

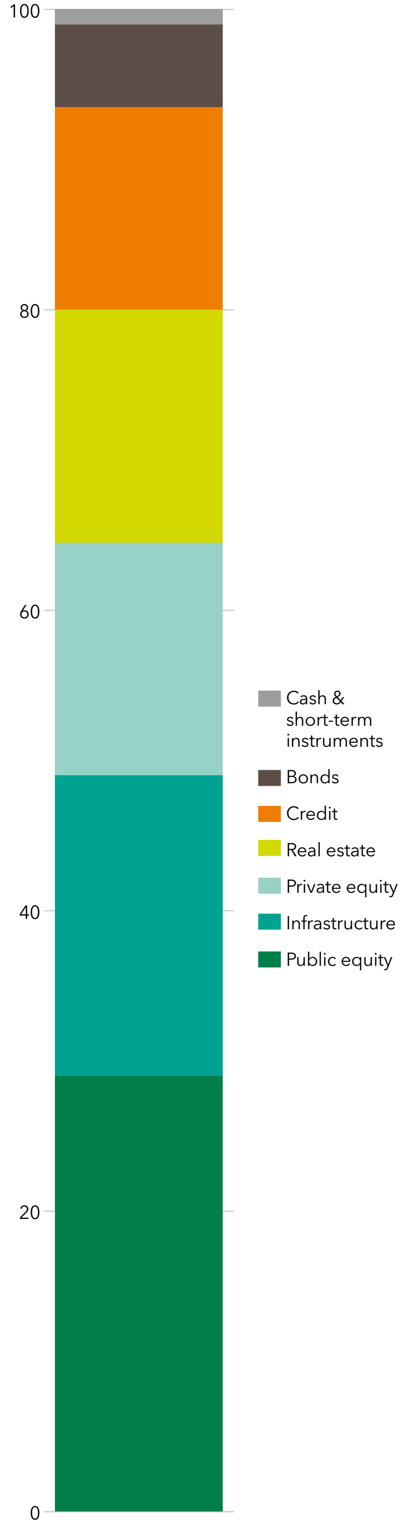
Helping to fund this growth is a strong appetite for portfolio rotation, a relatively unique approach compared with some of its direct investing pension fund peers. Sales of assets were traditionally a rare occurrence, although this changed in 2020 when OMERS made eight realisations from its infrastructure portfolio. A further three were made last year, while four have been agreed or completed so far this year.

"There are some investments that we have in the portfolio that we've now held for almost 20 years, and we may continue to hold them for another 20 years," Wallace says. "We have also now taken a more proactive approach to our capital rotation strategy and some of the things that we think about in terms of when it might be the right time to exit an investment. One is if we think that the market will realise more value than what we see for the risk profile of the investment.

"Another that is incredibly important to us is whether we see continued opportunity to really drive incremental value in the investment. We prefer to be invested in companies where there is a real opportunity for us to help add value. Not every infrastructure opportunity offers that and not every infrastructure investor prefers that type of investment.

"The last is from a portfolio fit perspective. We look at our capital allocation and we want to remain well diversified by sector [and] by geography; and so, in some cases, that could also lead us to exit an investment."

OMERS' 2021 asset mix: Infrastructure accounts for the largest share of OMERS' private markets allocations (%)



Source: OMERS

The March agreement to sell Chile-based LNG outfit GNL Quintero to EIG and Fluxys is one exit that encompasses all three of these rationales, she adds. OMERS originally invested in GNL Quintero in 2017. The deal was hailed at the time as its entry into Latin America, which is "not a key priority region for us anymore", according to Wallace, although she says that this is more down to the opportunities in other regions, rather than LatAm itself.

Other realisations fitting Wallace's criteria include the sale of a 25 percent interest in UK gas distribution network SGN to Global Infrastructure Partners' core strategy in December, mirroring its May 2021 disposal of Finnish electricity distribution network Caruna to KKR's core fund and to compatriot Ontario Teachers' Pension Plan.

"In every single year we've been net invested into infrastructure," stresses OMERS Infrastructure's senior managing director for Europe, Alastair Hall, highlighting the pension's C$2.3 billion net investment recorded in 2021. "I think that's important, even after we've been exiting assets in a more systematic way for assets that don't fit with our ideal future-focus portfolio."

Crowding in

Also unique to OMERS' position as direct pension fund investor is its management of third-party capital, which began with the formation of the Global Strategic Investment Alliance (GSIA) in 2013 with four Japanese investors.

That has since grown to a more globally diverse group of 15 investors in a co-investment programme and is a "fundamental component of our strategy", according to Hall, as well as of OMERS' 2027 ambitions. Bringing in such capital under its management on a deal-by-deal basis enables the group to access larger deals, as well as larger ownership stakes.

"We're wanting to maximise our governance at every single opportunity, bringing capital behind us as well as

"We're wanting to maximise our governance at every single opportunity, bringing capital behind us as well as alongside us in partnerships"

ALASTAIR HALL

as alongside us in partnerships," says Hall. "And of course, the fee income is a helpful component of managing our overall costs."

Despite Hall's quip regarding fees, there do remain significant advantages for those in the programme to deploy with OMERS, including a no-carry clause. "There's obviously many different ways to get exposure to infrastructure, and many of our clients continue to deploy capital into infrastructure through traditional funds. What we offer is something extra.

"We offer the ability of those investors to actually deploy capital alongside specific investment teams or things that they are trying to prioritise, so all the disadvantages of investing in a blind pool go away. We allow them to invest significant capital in that single investment behind us."

The GSIA is now part of a wider platform dubbed the Strategic Partnership Program (SPP), managing about C$8 billion. Of OMERS Infrastructure's 33 assets, nine are supported by investors within the SPP.

Investing in the 2020s

As Wallace suggested when discussing recent exits and the portfolio's refocus on five key themes, there are some subsectors where OMERS will be reducing its exposure on the road to 2027.

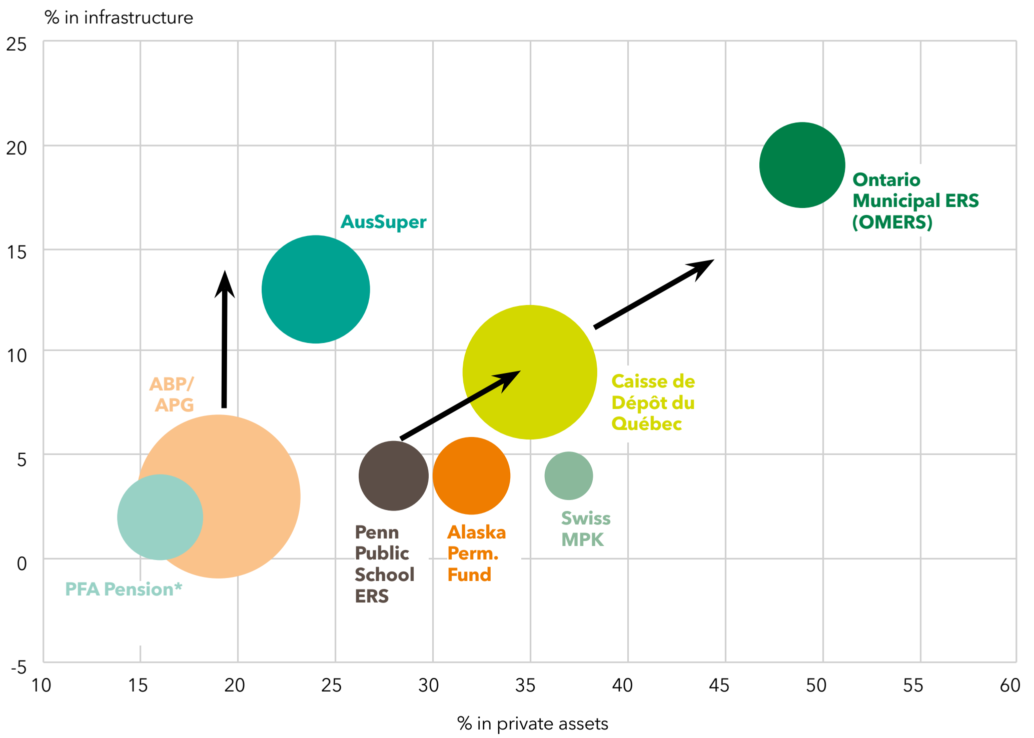
"If I take mobility as an example, I think some of the things in the mobility space that we're keen to continue to invest in would be the rail sector, for example," says Wallace. "We're also interested in the e-mobility space, and we think there will be significant growth in those opportunities going forward. We're probably less likely to continue to put more money into more traditional transportation, whether that's roads or airports – not that we wouldn't."

Indeed, OMERS' Indian roads infrastructure platform, which the pension invested in three years ago, bought in June an additional five roads from Brookfield Asset Management for an enterprise value of $1.2 billion. OMERS' sale of the Detroit River Rail Tunnel to Canadian Pacific in December 2020, for $312 million, might be more indicative.

Wallace is also keen to stress that this outlook on roads and airports is not due to covid. "I think it's more about an evolution of the portfolio, a continued focus on trying to diversify further and, also, really focus on where those opportunities will be to invest in core to core-plus infrastructure that over time we can de-risk. We see that opportunity less in some of the traditional sectors that just have more competition because they are either core or super-core types of investments."

There's a similar philosophy at play in some of OMERS' energy-based

Infrastructure and private markets trends



The black arrows show the likely asset allocation evolution for the next four years, with a marked increase in the allocation to infrastructure and also private assets across the board

Fund size represented by size of circle is indicative

*Denmark's PFA Pension represents a typical EU or US pension fund, with 15-18% in private assets

Source: World Pensions Council and EU ASEAN Centre research, 2021 fund documents

exits, such as the aforementioned SGN, Caruna and GNL Quintero. In turn, over the past year OMERS has entered renewable developers Azure Power in India and FRV in Australia. The pension is not, however, willing to use the energy transition bucket to buy into the largest renewables assets.

"I think our approach has been to remain incredibly disciplined around pursuing those types of investments, as opposed to trying to ultimately pay a market price," says Wallace. "We've looked at each of those opportunities and really understood how we see value and where we think we can add the most value."

In more established markets, OMERS acquired US-based distributed generation platform Navisun in January, while in May it agreed alongside APG to buy Groendus, a Netherlands-based company only established in 2021 through the merger of six companies in the rooftop solar, metering and energy services spaces. Wallace believes Groendus shows how one can be successful in the energy transition space without compromising on targeted returns.

Hall adds: "Given the scale of the need for decarbonisation, both in the Netherlands but across Europe and the world, we believe that in many cases it's business-to-business investment platforms that will holistically design, build and operate assets that help with their customers' decarbonisation challenges – [these] will be leading the next wave of investment in getting towards net zero."

When it comes to clean power, OMERS again stands out in the infrastructure world. It is the only major infrastructure investor to own a nuclear power plant since its 2003 investment in Bruce Power, the world's largest operating nuclear power facility at 6.4GW.

With the world's path to net zero a rocky one and with actors like the UK government trying to entice private sector players to the nuclear industry, could OMERS' nuclear portfolio grow beyond Bruce Power?

"We continue to put capital into Bruce Power, and we'd have to take that into consideration if we started to look at other nuclear assets globally, and there could be different ways of doing that," responds Wallace. "There's the [UK] example, but small modular reactors are also an interesting opportunity that we have mapped as part of our energy transition thematic, and something that we've started to spend a lot of time thinking about on our own, as well as with Bruce Power."

OMERS might not have its finger on the button for further large nuclear plant purchases, but it certainly has its finger on the pulse as it chases the next C$32 billion. ■