Weathering market cyclicality and volatility with infrastructure debt

Infrastructure debt has been established as an asset class for some time and is considered an alternative investment offering stable cash flows and often lower correlation with traditional markets. How has the asset class evolved, what role can it play in investors' portfolios and what is its outlook? Financial Investigator spoke with Schroders Capital's expert Emaad Sami.

By *our editorial team*

Why is infrastructure debt attractive today? What is the outlook of the asset class?
'Investors are navigating an ever-changing market environment and systemic global shifts today – from diverging macroeconomic trends to rising protectionism and deglobalization. There has also been a recalibration of return expectations in certain parts of investors' private markets portfolios due to stalled exits or delayed distributions. Against this backdrop, predictable income returns have become a valued outcome in investor portfolios. Infrastructure debt delivers such resilient income returns that exhibit low correlation to other asset classes, making it uniquely suited to weather market cyclicality and volatility.

The investment outlay for the asset class is extensive: infrastructure is at least 40% larger relative to the corporate market, and Europe accounts for a third of global activity. In a European context, growth is well supported by the EU legislative framework with initiatives such as the EU Green Deal, but also large state plans announced like the € 500 billion German infrastructure spending plan. It's not just about growth, deployment is equally key: this is where a manager's ability to put capital to work is a clear differentiator. Everyone has a different approach; ours is a preference for predominantly brownfield assets, where efficient drawdown ensures our investors' money is at work.

In summary - infrastructure debt acts as a resilient allocation in uncertain times, underpins the foundation of economic growth backing the investment case for debt, whilst playing a central role in realizing critical global agendas.'

How has the asset class evolved?
'There is growing energy demand from the mega trends of digitization and energy transition, but also an evolution of the opportunity set in classic sectors such as transport. Investors are looking beyond renewables and data centers: we also see attractive transactions in areas like waste management and rail infrastructure, for example, supporting decarbonization through themes like electrification.

As opportunities proliferate across sectors, debt will play a key part in supporting platform growth. This is evidenced in the relevance of the sub-IG market that is now a mainstay and where we led as a pioneer with junior debt in Europe. Sponsors are now seeking tailored debt solutions from specialist alternative lenders who are able to lend across the capital structure. This is being driven by the growth and migration of what were previously core+/value-add sectors more towards core/core+ asset profiles.

There is still significant growth within mega-trends. For example, although data center asset creation was well underway prior to the arrival of AI, that has just accelerated the trend.'

What role does the asset class play in investors' portfolios compared to other private credit asset classes and what kind of returns can investors expect?
'The asset class delivers clear diversification – relative to corporate assets in general, direct lending, as well as within a real assets context – as investors gain access to a completely different set of borrower and sector profiles. Infrastructure debt continues to be well supported by insurers as a fixed income alternative. What we're also seeing now is increasing appeal to both

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real assets and private credit allocators, as it brings together income returns backed by essential infrastructure assets and structural protections unique to the asset class.

How this translates into allocations is nuanced: IG debt remains attractive to insurers as a capital efficient fixed income alternative, and while sub-IG strategies also attract insurers due to favourable SCR under Solvency II, we're increasingly partnering with return seeking investors – pension funds, foundations, family offices – where sub-IG infrastructure debt complements their direct lending or real assets credit allocations. On risk/return, sub-IG strategies also offer a relative value play; infrastructure debt delivers returns that match or exceed what's on offer in broader private credit at equivalent credit quality and similar duration profiles, but arguably with more robust credit underwriting standards and protections compared to the corporate market.

Finally, as the footprint of infrastructure assets lends itself well to the delivery of ESG and impact outcomes, the asset class offers an efficient way to achieve these objectives in our client's investment charters.'

What key risks or concerns would you highlight and how can investors mitigate these?

'Three topics come to mind here: portfolio diversification, competitive tension and emerging infrastructure.

On the first and second points, it's important to differentiate between the large-cap space and the mid-market; we see roughly five times more deal flow in the mid-market allowing greater choice of transactions. This becomes especially important in more competitive environments, where the mid-market offers compelling relative value versus the large-cap space that has greater competition for fewer assets. It is also important for investors to differentiate between managers. As origination and execution in infrastructure debt is highly structured, having an experienced team is essential. Our team has been involved in shaping the European infrastructure debt market. That kind of precedent brings track record and sourcing relationships that are difficult for new entrants to replicate, as sponsors have a strong preference to work with long-term participants who are viewed as trusted advisors.

On emerging infrastructure, these growth areas, while promising, require careful evaluation since business models can still be nascent, contract lengths tend to be shorter, and utilization projections depend on evolving consumer behaviour and technology adoption. We remain focused on assets that embody traditional infrastructure credentials where business models are tested. Although certain players may get comfortable with pathfinder transactions, we believe taking this risk may be more appropriate in equity rather than debt.'

How can you achieve ESG objectives and deliver impact in your infrastructure debt strategies?

'In terms of SFDR, all our funds are Article 8. We take a cautionary stance on Article 9, as from a credit perspective, there are diversification implications of this designation. Our approach is firmly rooted in delivering diversification with credit discipline – whilst ensuring strategies address real-world challenges without compromising on financial performance or ESG standards. In adopting this approach, we progress with regulations – still under development with SFDR, for instance – but also believe in the importance of creating outcomes that go beyond regulations. What allows us to do this, is a comprehensive and proprietary impact framework that we've developed as an impact investing pioneer with over two decades of sector leadership. Our work on this has been recognized by industry bodies such as Bluemark where we are an Impact Practice Leader. We have partnered with well-known investors in the Netherlands, who see our approach as market leading, as we are able to classify specific impact outcomes precisely, generate bespoke reporting, and provide investors with financial returns that are not concessionary.' ■

Emaad Sami

Infrastructure Credit Product & Solutions Director, Schroders Capital

PHOTO: ARCHIVE SCHRODERS

SUMMARY

Infrastructure debt provides stable, predictable returns with low correlation to traditional markets, making it attractive in volatile environments.

The asset class is expanding through megatrends like digitalization and the energy transition, with opportunities in sectors such as transport, waste management, and data centers.

It supports diversification and competitive returns while also helping investors achieve ESG and impact objectives.

While IG debt is particularly attractive to insurers as a capital efficient fixed income alternative, sub-IG strategies are increasingly gaining attention from return seeking investors where this segment complements their direct lending or real assets credit allocations.