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Even educated fund managers do it…

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DIF do it, EISER do it, even educated Arcus do it. Let's do it. Let's flip a fund. That almost trips off the tongue, and it's a darn site easier to sing than to achieve. It would appear that when it comes to infrastructure equity funds, Aristotle's aphorism that "the whole is greater than the sum of the parts" rarely stands true.

That said, there have been some notable successes in recent times. DIF has just pulled off the continuation fund flip, as have EISER and Arcus. Beyond that, InfraRed pulled off this switcheroo with its second fund back in 2012.

However, any equity fund investigating the option of rolling over into a new vehicle (we're not there yet for debt funds) had better take some solid advice before merrily tripping along this punishing path.

And why is it such a challenge? Bottom line – it has to offer an all-round win situation… for exiting LPs, incoming LPs, and the fund manager itself. As one senior contact rather succinctly puts it: "The chances of getting the sun, the moon and the stars to line up is really quite remote."

Yet people will persist and sometimes all three do line up. Usually this will happen on a homogenous group of assets like PPP or renewables, and hopefully across the same currency.

The Infracapital experience

These dark tidings are stood up by Infracapital which looked into extending its 2005 vintage fund. This was its maiden brownfield infra fund with a 10-year primary term and the option to extend (twice for two years each).

Back in the run-up to 2005, the fund manager raised £908 million capital and invested in seven assets over its life. Earlier this year, it was left with four assets sitting in Infracapital Partners LP:

- 10% of Kelda Group – controller of regulated UK utility Yorkshire Water – sold to co-shareholders GIC and SAS Trustee Corp
- Zephyr Investments – 391.2MW portfolio of 17 UK onshore wind farms – sold to JP Morgan Asset Management
- Alticom – Dutch telecoms and broadcast infrastructure owner with 24 towers, as well as data centres that account for 10% of its revenues – sold to Cellnex Telecom
- Red Funnel – UK operator of ferries between Southampton and the Isle of Wight – sold to consortium of UK and Canadian pension schemes led by the West Midlands Pension Fund and the Workplace Safety & Insurance Board of the Province of Ontario

Campbell Lutyens was mandated to advise on the continuation fund and swiftly came to the conclusion that Infracapital would be far better off auctioning them in a crazy market where there the likelihood of picking up a portfolio premium was remote to laughable.

There was a premium to be had – which was stood up by the sales process – from the legion of bidders desperate to

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snatch up solid assets to fill out their own funds.

Caveat emptor – caveat venditor

To be fair, there are limited opportunities on this front as this mostly impacts funds of a certain vintage (set up between 2006 and 2008) and most of them have already sold their assets or resolved what to do.

As to staring into the abyss, it will require two financial advisers to squabble over independent asset valuations and a goodly amount of gentle persuasion from the manager… the one party who is guaranteed to come out of the process with a smile.

"It is likely to work best – if at all – if the initial investors' target returns have been met and they are happy for those assets to be sold. If you're unhappy, it gets a whole lot more difficult as finding a price they are willing to sell at will always be difficult," says one infra fund veteran.

Fund managers – as individuals – are incentivised to keep things going. If you have a fund that is nearing the end of its life, and they are making a tidy sum… chances are they will be perfectly happy to sell.

However, this is where human nature kicks in and they are less keen to part company with a steady fund management annuity stream… but how ideal would it be if they are able to pop up again as the manager, looking after these assets they know so well.

One infra fund guru says: "The historical days of many infra funds – which has generated a whole series of asset recycling – was on the basis that many of these were 10- or 12-year closed funds. Someone ran out, spent the money and as they got to the end of the fund they were left wondering what to do.

"So what do you do? Do you sell the assets to someone else – which is fine. The investors pocket it and the fund manager gets a slice and everyone's happy. But the fund manager will be thinking: why don't we just bring some new investors in and encourage some of the others to roll over?"

Isn't the real issue that funds with a lifespan of 10-12 years are fundamentally unsuited to holding assets with a 20-30 year life (or perpetuity)… but that's an issue for another Friday.

For now, it's almost the weekend and it's time to start pondering… just what it is that birds do, bees do, and even educated fund managers do while APG fills its boots.

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