Infra fund dilemma – blame the pig or the feeder?

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In the same week that Luxembourg announced plans to legalise cannabis (and make all public transport free), folk have been wondering whether many infrastructure fund managers will domicile in the small European duchy to enjoy the benefits of a liberal system while they play fast and loose with targets and hard caps.

The spiralling size of infra funds – debt and equity – is far from newsworthy these days as fundraising records are broken with alarming regularity.

New records for fundraising by unlisted infra funds were set last year, smashing the previous spike of 2015 when $88.2 billion was raised across 89 funds, greatly boosted by GIP's $15.8 billion Fund III.

Given that by the end of Q3 2018 funds had already surpassed that figure with $92.9 billion through just 57 final closes, 2018 was always on track to set a new benchmark.

We're putting the finishing touches to fundraising data for the last calendar year and will publish it shortly, but at this stage the total for 2018 stands at $102.3 billion by 66 funds. The largest fund last year was KKR Global Infrastructure Investors III which had a target size of $5 billion, and came in at $7.4 billion.

Fewer funds raising more money from a growing pool of investors, and the same investors ladling out ever-bigger sums to fund managers who have impressed them with the speed at which they deploy the cash. It's becoming cliché.

As to what they are investing in… that's another matter entirely. Infra purists shudder at infra funds acquiring the likes of fish farms in Australia, holiday camps (hi-de-hi) in Belgium, and a cooking oil business in the US. But funds managers gaily shoehorn them into vehicles under the "core plus plus" banner.

This last week we've seen two instances of targets/hard caps being raised by alarming degrees. This trend is increasingly common and something we anticipate will continue for the foreseeable future.

Ardian Infrastructure Fund V – which the French fund manager launched last summer – had to raise its hard cap to meet demand. It initially targeted €4 billion, but has already brought in €6 billion and has still not called final close. Some sources suggest it is turning cheque-wielding investors away in their droves.

Meanwhile, Digital Bridge's Digital Colony Partners – which is due to close this quarter – has already exceeded its hard cap of $3 billion having raised $4 billion and shows no immediate signs of calling it quits on the fundraising front.

These days fundraising targets (set at a level fund managers believe they can exceed) are now every bit as flexible as hard caps (traditionally a tad more aspirational) as shooting fish in a barrel becomes easier with fish leaping out of the water, targets pinned to their chests.

Hard caps – soft targets

Talking to sources this week, opinion is divided. Some see flexibility on targets and hard caps as a healthy sign of a robust market, others worry about investor sentiment, while some furrow brows and foretell challenging times ahead.

Bottom line is: the hard cap is an arbitrary figure set by the fund manager at launch. They set it to lend comfort to investors that would take fright at big numbers, while also lending credence to promises that they will stay true to the fund strategy.

That's all fine and good, but you can't factor out the human element and its impact on assets acquired.

The bigger the number, the more likely you are to see the likes of fish farms sneak into the line-up as originators smile sweetly (sweating slightly) and justify their actions with talk of how Asset X fits perfectly with the "wider strategy".

However, you can't help but feel it's all a bit of a swizz.

What is the hard cap for in the first place if not to lend confidence to investors that the fund manager will exercise discipline from the outset?

If only it was so simple. Here goes with a perfect example of how the best intentions are often warped by market reality…

As senior financial adviser working with funds says: "If I was an investor and saw fund managers raising a 12-year fund with a four-year investment period that was then 70% deployed within one year – I'd be worried."

And quite right too. If the money has been heaved out the door so fast they hardly have time to count it, the team will be back out fundraising every year or so.

"I can see why – from an LP perspective – they would be left wondering which is worse," says the FA. "Is it better that they hit the hard cap and spend it all… which then forces them to go out fundraising again, taking the eye off the ball for the last fund? Or would I rather have a bigger portfolio and keep giving them more and more money?"

All fair and good, but early investors who are lured in by fund managers building a vehicle with a target size that would make them a significant player on the team will doubtless be dispirited as they see their stakes overshadowed. However, one would hope there is some form of true-up for earlier closers.

And you can blame the human element for that, as discussed last autumn. I'll save you the horror of repetition by condensing it to: fund managers are gathering as much dry powder as they can now in anticipation of a market correction. Better to have full coffers in a market where bargains will crop up than to go into it empty-handed. At the end of the day, if you have to hand it back… it's not the end of the world. And if you've already deployed a good chunk of it, managing the assets (who knows it better than the person who bought it) will keep you in a job until the market comes back.

As another senior advisory source says: "Better to raise as much as you can now – and then you have as much optionality as you want. And you can always hand it back if you don't spend it."

One fund manager calls it the way it is: "As long as you don't call a hard cap, there is no hard cap. If your investors accept that, you get away with it. As long as investors are not screaming out and pulling you back, that's the only limit you have. There is no legal limit that prohibits you from doing whatever you want."

With the speed that funds are being raised and deployed, you can expect funds to continue filling their boots with highly dubious assets that set shivers down the spine of an infra purist (or *IJGlobal* data analysts who cannot categorise them in the database).

One fund manager puts it rather beautifully: "Who's to blame? The pig, or the one who feeds the pig?"

And with $102.3 billion in the 2018 trough – as more/bigger snouts snuffle their way to the front – it really doesn't matter what you buy… so long as you bring home the bacon.