Defining the digital revolution

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International law firm Allen & Overy is playing a dominant role in the evolving landscape of digital infrastructure, leading (at time of writing) the *IJGlobal* 2021 DI league tables, having acted on some of the most significant deals this year.

For example, this year, A&O advised American Tower Corporation on its acquisition of Telxius Towers from Telefonica, comprising 31,000 communications sites across Europe and Latin America. The firm subsequently advised American Tower on the investment by CDPQ and Allianz in American Tower's European platform to form a new long term strategic partnership.

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A&O also advised the sponsor – Digital Colony – on the $750 million cell towers sale and leaseback of more than 4,200 assets, in a transaction with Indonesia-based telecoms provider Indosat Ooredoo.

More recently, A&O again acted for the sponsor – this time Clifford Capital – on the highly-regarded Bayfront Infrastructure Capital Securitisation 2021, as well as advising Telenor on the merger of Digi.com and Celcom, one of Malaysia's largest M&A transactions. These significant deals closed on 11 June and 29 June respectively and will doubtless feature in next year's IJGlobal Awards as a ground-breaking transactions.

Across the broader "infrastructure finance" category in the *IJGlobal* DI league tables for the last calendar year (2020), A&O comes second by deal value but leads (by a comfortable margin) for number of deals closed, having worked on significantly more transactions than any other legal adviser in this sector. Last year, it held a global market share of 11.4% having closed $12.4 billion of transactions.

Among these deals were the likes of the refinancing of the GSM-R Rail Communications PPP in France which won a trophy in the recently-announced *IJGlobal* Awards 2020 (details in *IJGlobal* Magazine). To give a further flavour of A&O's 2020 international activity, the law firm acted on KKR's acquisition of a majority interest in Telefonica's fibre to the home network in Chile, advised AdaniConneX JV, the joint venture between Adani and EdgeConneX to build out data centres in India and Manassa Hornbaker; and brought to financial close the A$6.1 billion ($3.9bn) revolving credit facility for NBN Co in Australia.

With digital infrastructure still retaining its fledgling status – one that is surely about to be shed – pedigree and track record for advisers is paramount. Given that A&O has positioned itself at the forefront of this burgeoning global sector, that bodes well for the law firm in the years to come.

The digital infra view

IJGlobal has spent the last month compiling the findings of its second annual global digital infrastructure survey – run in partnership with Allen & Overy and M&E Global – and in the coming pages reveals the findings of this far-reaching research.

Last year, the survey revealed a growing degree of comfort in the asset class as market participants increasingly shifted their focus to target developments in this space… a trend that is continued again in this latest survey.

Sara Pickersgill (*pictured*), co-head of Allen & Overy's global infrastructure group, has witnessed the sea change in perception for this asset class – which has been given a significant boost by the coronavirus pandemic.

"The pandemic has increased demand for digital infrastructure with working from home and flexible working among innumerable reasons that have helped push this sector to the forefront of the minds of infrastructure funds that had not been playing in this space before Covid-19," says Sara.

"The pandemic itself has demonstrated the resilience of this infrastructure sector and thrown the spotlight, in many cases, on portfolio selection and diversification.

It has highlighted something that took a lot of people by surprise – that not all infrastructure (or even "core infrastructure") is immune to macro-economic events. To take an obvious point… airports, toll roads and mid-stream energy have all suffered as a result of the pandemic. And it is this that brings into question portfolio selection and diversification."

This, Sara adds, is compounded by shifts in working patterns as offices increasingly open for staff to return… but with many companies incorporating policies that allow an increased capacity to work remotely. "We all know that we are going to need more fibre infrastructure to meet demand," she says.

One of the key results of the increase in appetite to invest in the sector is that competition for assets has stepped up a gear – which is having the inevitable consequence of driving up prices.

"Competition has become really fierce for quality assets in this sector," says Sara, "but it's not just a cost-of-capital shoot out – the acquirer's profile and expertise is often a crucial factor, something that is marking out the successful funds playing in this space. The winners, more often than not, are those with a well-defined sector specialism."

Jocelyn Land, partner in A&O's global infrastructure group alongside Sara, comments that a similar set of pressures apply to funders. "While we continue to see infrastructure funders maintaining support to their clients in areas such as aviation, they are also keen to diversify their lending portfolios into sectors where current demand is growing and there is a need for capital.

While the nature of digital infrastructure assets can vary significantly, these can often be existing businesses with a significant need to raise further funds to expand. This is a sweet spot for many funders who like the ability to assess an existing business while also seeing an opportunity to deploy further capital. The sector is developing quickly and there is significantly more flexibility available now for the right sponsor and asset than there was a few years ago."

Telcos and mobile network operators

The changing role of telecoms companies (telcos) and mobile network operators (MNO) had long been in play prior to Covid-19, but the pandemic has accelerated developments.

"Telcos and MNOs are seeing an opportunity to monetise their infrastructure assets at higher value than they thought possible," says Sara. "This is partly driven by their need for capital to upgrade infrastructure and densification – to increase capacity – building more towers, adding small cells, installing more fibre-to-the-home, and to roll out 5G.

"They obviously need more capital to achieve these goals and they are often balance-sheet constrained, which means they have greater appetite to partner with private capital."

But it's not all about making a profitable exit, there are also efficiencies to be achieved by telcos and MNOs through partnering with infra funds and building a relationship with an independent towerco or infrastructure operator.

Sara adds: "We have seen lots of active and passive sharing between telcos and MNOs – but those relationships between competitors have not always been happy. Having an independent towerco or netco operator to stand in the middle and lease out the space to a number of them is a happy medium."

This relationship allows the telco/MNO to focus on dealing with customers, and on network and service technology, while a third party – the infrastructure fund – operates the essential infrastructure.

"The efficiencies that can be achieved are many," says Sara. "The independent infrastructure operator can lease out more space and enter into co-location agreements with all your competitors which reduces costs.

"But for the telcos and the MNOs, they are not just looking to monetise. They are looking for an experienced partner to manage assets that are critical to them.

"While there is a lot of capital looking to come into this space, the successful ones are often those that have track record and can demonstrate that they have done all of this before. This again plays well to those with a sector specialisation."

The ESG angle

And then you have the environmental, social and governance aspects of digital infrastructure. Across the entire infra sector, this has evolved into such a key focus area that *IJGlobal* this year launched its inaugural ESG Awards to celebrate achievements in this space.

In the DI space, ESG is building momentum. "Infrastructure funds are trying to make compatible their commitments to decarbonisation, to attain stringent ESG targets and reduce their carbon footprint against building out data centres, for instance, that consume huge amounts of energy," says Sara.

"They are having to think strategically about how they offset that impact, finding interesting solutions that range from solar panels on the roofs of these facilities and investing in renewable energy to offset their impact on the grid.

"There are however positives for ESG rankings – even if there are some negatives on the E side – as enhanced connectivity could bring some beneficial impacts on carbon footprints with, for instance, people travelling less.

"On the S element of ESG, demonstrable positives include the supporting of local communities and rural connectivity, bridging the social divide in these areas. Further, improved connectivity and access to reliable internet arguably leads to improved access to education and employment opportunities in disadvantaged areas."

Matt Townsend, partner and co-head of A&O's environmental and climate team also observes the growing connection between the sustainability agenda and digital infrastructure. "Whilst the whole life cycle of an asset increasingly needs to be taken into account, countries are not going to hit their climate targets without significant investment in digital assets. These have a major role to play."

Matt notes that "many of the core strands of the recently announced 'Fit for 55' package from the European Commission will need digital support and innovation even though they are targeted at many of the more traditional infrastructure asset classes."

Jocelyn Land adds: "We are also really seeing the infrastructure funders increasing their focus on ESG, both in terms of increasing their monitoring of what their borrowers are doing and offering more attractive financing terms to companies that can demonstrate excellence in key performance indicators. As Sara says, the E and the S can conflict with each other in the digital infrastructure space, but the approach of funders is just another incentive to find innovative solutions."

In terms of innovative solutions, Jamie Palmer, a partner in A&O's Sydney office who has worked on several data centre deals in APAC including Equinix' acquisition of Metronode for AUD1.035 billion, notes the breadth of thinking. "We are advising a bitcoin miner who builds data centres that use only renewable energy power sources. This creates a pathway for environmentally conscious investors to obtain exposure to digital infrastructure and bitcoin (as the business model sees the bitcoin generated from the mining activities immediately converted to cash)."

The role of governments

Nobody doubts the scope of the digital infrastructure opportunity. There is a huge international pipeline of greenfield developments on the cards as the DI revolution gains momentum, coupled with government support.

“There is political support for digital infrastructure investment with governments setting ambitious targets,” says Sara. “In the US alone, President Biden’s announcement of the $2 trillion infrastructure build which committed $100 billion to digital infrastructure, particularly to reach currently unserved and underserved communities, is a significant development.”

Similarly, the EU has ambitious targets by 2030 for all households to have gigabit connectivity and for all populated areas to be covered by 5G. But political support is coming at a time of increasing scrutiny over foreign investment on the basis of national security considerations.

Over the last three years globally we have seen a rapid influx of new foreign direct investment – or FDI – regimes come into force and countries with existing regimes introduce more stringent rules.

“Traditionally the focus was predominantly on defence and security-related sectors, but the vast majority of FDI regimes have extended scope to critical infrastructure – a definition within which digital infrastructure is now firmly seated,” says Sara. “Much of this new regulation was hastily put together as a response to the pandemic, with low acquisition thresholds triggering review, lengthy assessment periods, and often with a lack of clarity as to the specific assets falling within scope.”

While historically the majority of investments into Europe that are subject to these regimes receive clearance, there are often draconian consequences for falling foul of the rules - in some cases criminal sanctions, or even for individuals, imprisonment.

As a case in point, Sara cites the UK’s National Security and Investment regime, set to commence fully on 4 January 2022, bringing with it wide ranging government powers to investigate and intervene in transactions on national security grounds. Data infrastructure and communications networks are among the 17 defined sensitive sectors requiring mandatory prenotification and clearance.

“The combination of some lack of clarity of exactly what falls within scope of the mandatory regime, civil and criminal sanctions for getting it wrong, and the government’s power to call in a transaction for review up to five years after close are bound to create some uncertainty for investors looking to transact in the sector,” says Sara, “and while none of that seems to have dampened appetite to invest, transactions in the sector are getting more complicated to bring to the finish line.”