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EXTRA
IST's Swiss approach to investment

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The Swiss approach to infrastructure investment

'From pension plans for pension plans' is the IST Investment Foundation's slogan. Members of its infra team demonstrate what that means in a conversation with Kalliope Gourntis, charting the co-operative investment manager's journey to date

There are many things that Switzerland is known for: fine chocolate, luxury watches and scenic train rides. But, it is also known for its sophisticated financial services sector and, more recently, a major bank bailout, which might explain the rather unique framework under which Swiss pension funds invest.

"The Swiss were far ahead in thinking about prudently managing pension plans and the benefits of size and critical mass, to be able to attract and retain talent and reduce costs," comments Mark Weisdorf, founder of New York-based Mark Weisdorf Associates. He is referring to the IST Investment Foundation, which was the first to be established in 1967, paving the way for other such foundations to follow.

Today, IST serves more than 500 Swiss pension funds and manages SFr10 billion ($10.7 billion; €10 billion) on their behalf, offering 45 financial products. But, it wasn't until 2014 that the investment manager launched an infrastructure strategy and its open-ended infrastructure fund IST3 Infrastruktur Global.

"The strategy was originated based on an LP-led effort to develop and implement a strategy that met investors' needs, rather than a GP-led effort to sell a service or a product," remarks Weisdorf, who joined IST3 IG's investment committee in 2017 and serves as its chair since January 2020.

Martin Ragettli, who joined the foundation in November 2016 as head of acquisitions, private infrastructure equity, expands further on IST's structure: "IST is owned by pension funds and is basically an extended workbench providing access to investment teams these pension funds could not access on a standalone basis either due to complexity or costs."

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While all Swiss investment foundations enjoy tax-exempt status thanks to legislation passed in 1985, IST is one of only a few that operates on a not-for-profit basis. As such, it also does not charge its LPs performance or management fees.

"By making these organisations tax exempt, the Swiss regulator and government enabled the commingling and aggregation of capital as if it was coming from a single pension fund. Also abroad, the Swiss investment foundation often benefits from its pension fund status through tax relief or exemptions," Ragettli adds.

IST also stands out for being one of a few such entities – there are currently 66 in Switzerland – that remains independent, which according to Weisdorf, is important because "once a bank or insurance company is managing such a foundation, it's much more like a traditional GP/LP relationship. IST, if not unique, is fairly rare, because the LPs are actually very close to the management and participate directly in oversight, governance and strategy development."

Starting from scratch

What is unique, according to Weisdorf, is the way in which IST's infrastructure business evolved, with capital being committed, an investment committee being established and seed investments being made before an investment team was recruited.

Stefan Weissenboeck, who was the first full-time employee to join IST's infrastructure business in March 2016 and is head of portfolio and asset management, attributes the infrastructure group's success so far, to the following: "I think what is really unique, is that LPs have been patient and supportive, giving us time to grow both the platform and the team in a sustainable manner. We always explained our strategy and targets in a very detailed manner, kept LPs closely involved in the decision-making process, and brought all key stakeholders to the table. It's a very Swiss approach."

Indeed, IST3 IG has developed steadily and sustainably. Two semi-annual fundraising rounds are held each year, targeting around SFr200 million in total.

"That is also about the capital we deploy each year, through two to four investments," Ragettli says. "And that's driven by our investor base, which prefers not having to manage too many open commitments. So, I don't think that's typical when compared to other funds, which try to raise as much as possible in one go and then deploy it."

Since its launch, IST3 IG has built a diverse portfolio both from a geographic as well as a sectoral perspective. Examples include wind portfolios in France and Germany as well as PV solar in Germany; a portfolio of 25 hydro power plants with a combined capacity of around 100MW in Spain and Portugal; two college buildings in Dublin, Ireland; and a newly built

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electricity transmission line in Alberta, Canada.

Of the nearly 30 investments IST3 IG has made to date, one third are direct investments, either in the form of majorities or significant co-control minorities. But IST's infrastructure team does not just invest directly. It is also active in co-investments as well as in secondaries. "We're structurally flexible, so we can cover the whole spectrum," Ragettli says.

The fund's open-ended structure also provides flexibility allowing IST3 IG to hold on to assets for as long as it makes financial sense.

"That's easy to do in the renewables space because the land lease and life of a wind or solar farm is 25-40 years before you have to repower or replace it," Weisdorf notes. "But when you're investing in fibre-to-the-home, that could last for much longer. So, we have to be prudent. That's why we like control or co-control investing because we can choose to hold an asset for a long time and manage lifecycle expenses with a long-term view.

"In a lot of the traditional structures, the funds have a limited life in order to generate a carry and so those assets get sold out from underneath you. We'd rather earn a lower return but be able to count on it for the longer-term. Because once you exit, you have to find a place to re-invest and re-investment carries a very high risk if you're a pension fund; and, there is also the leakage that occurs every time you sell and buy an asset."

Taking control

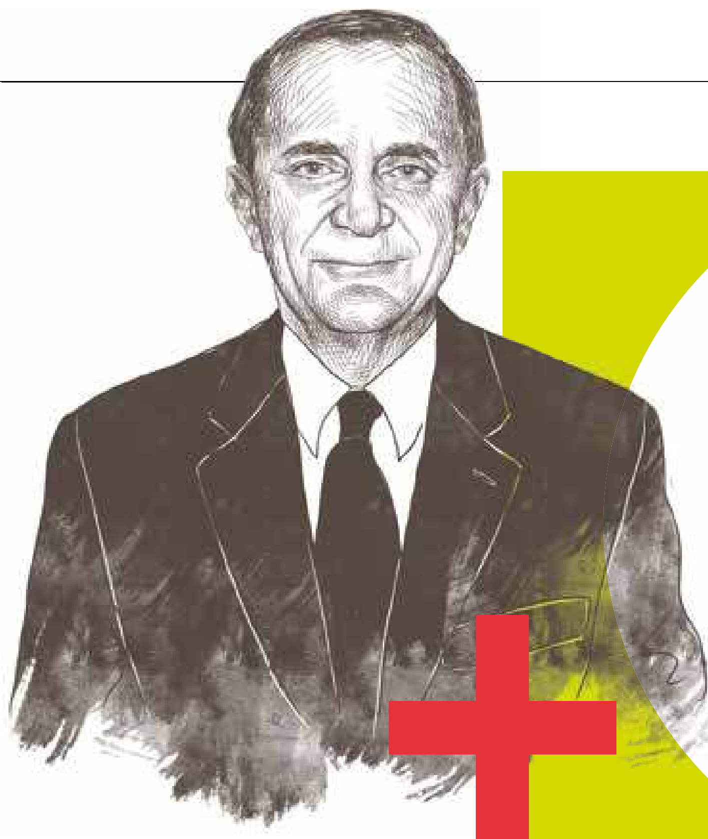
The issue of control also played a role in a deal IST3 IG closed in January, alongside Real Assets Investment Management and Daiwa Energy & Infrastructure. The Swiss investment manager acquired a 75 percent stake, with DE&I picking up the remainder, in the N25 Waterford Bypass, a 23km toll road in southeastern Ireland that provides access to commercial ports and improved accessibility to Waterford Airport.

Procured in 2006 under a public-private partnership scheme, the project was built by Celtic Roads Group and cost around €600 million. It was completed in 2009, but after traffic volume proved lower than projected, the concessionaire was taken over by its creditors in 2021.

RAIM, an emerging infrastructure investment firm based in London, secured exclusivity for the transaction and conducted the due diligence. "We discussed the deal with them and told them that governance was important for us if we were to take a 75 percent stake. So, we have the governance – budget control, capital structure control, which means we can really influence the asset with a view to owning it over the long term," Ragettli explains.

The acquisition of the N25 Waterford Bypass also illustrates IST3 IG's approach in general, as well as its view of the asset class in the current environment.

"We felt that this toll road in the current environment, and transportation assets in general after covid, are fairly priced," Weissenboeck says. "Renewables on the other hand, can



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>
> **MARK WEISDORF**

be overpriced as higher risk-free rates are not yet, or only partially reflected in market valuations. We are not forced to buy renewables at elevated prices in the current environment, but we might go back if things change."

That is the advantage IST3 IG has, which is the ability to invest opportunistically across a broad range of subsectors and geographies, according to Weissenboeck. So, where does IST3 IG see opportunities going forward?

Bypassing inflation

"Inflation is a big topic," Ragettli concedes. "We like our returns to be somewhat correlated with inflation across our portfolio. But on the other hand, it's clear that assets directly linked to inflation are quite expensive at the moment."

That's why in the current macroeconomic climate, IST3 IG favours indirect inflation correlation "either through rate based assets, capex expansion programmes, such as electricity grids in the US where you have FERC-regulated rate-base assets where inflation linkage finds its way indirectly into the cashflows", Ragettli says.

Another example is what he calls growth sectors, such as telecoms, where inflation is not the biggest value driver. "It's a sector where we seek full value chain exposure and work through the upselling of products and bandwidth. You get an indirect inflation hedge because the growth and demand in the sector exceeds inflation by far."

While IST may be making some adjustments to its strategy, it won't be making any material changes. According to Weisdorf, patience, discipline, risk identification and management will continue to be important.

It does plan to grow, however, both its strategy – to SFr1.5 billion – as well as its eight-member team, with three new hires this year, and another 10 in the next five years.

That plan seems quite timely with Swiss legislation having recently changed, recognising infrastructure as a stand-alone asset class, separate from other alternatives. As of 2020, Swiss pension funds can allocate up to 10 percent of their total AUM to infrastructure.

That creates plenty of room for growth since Swiss pension funds' allocation to the asset class is quite small compared to other jurisdictions, ranging between 0 and 2 percent.

"But now with this change in regulation, there are indications that a lot of pension funds are considering creating a dedicated infrastructure allocation or increasing existing ones. The expectation is that only some will move towards 10 percent over time," Ragettli says. "On average, however, we expect allocations to reach 4-5 percent in the next few years."

Considering that the Swiss pension funds industry manages around SFr1.3 trillion, the increased range of 4-5 percent amounts to SFr50 billion -SFr60 billion. "That's quite a bit of money," Ragettli admits. "And given our unique set-up, local presence and existing relationships with every third Swiss pension fund, we are happy to be a facilitator and centre of excellence in the space. ■