

The **Lazard Sustainable Private Infrastructure (SPI)** strategy was established to offer clients differentiated access to private infrastructure: an open-ended product focused on sustainable/Article 9, Core-plus and mid-market infrastructure assets.

- **Growing sustainable infrastructure businesses:** The SPI strategy invests in established small and mid-sized sustainable infrastructure-related businesses to promote their growth through capital expenditure, consolidation of fragmented markets, or greenfield construction.
- **Value in distributed and uncorrelated renewable energy:** We believe value exists in distributed renewable energy sources that are uncorrelated with national grid-distributed energy.
- **Investment performance-led with inflation protection:** The SPI strategy invests in companies with protected or contracted long-term cash flows that are directly linked to inflation.
- **Positive environmental and social impacts at the local level:** Each investment must deliver positive social and/or environmental impacts aligned with the UN Sustainable Development Goals (SDGs).
- **A robust pipeline:** The SPI strategy's first two investments were designed to combine financial returns with tangible and measurable ESG impacts. Our deal pipeline is robust and diversified by sector and geography.

Investment Case Study:

Shawton Energy Limited - Plugging into local generation and consumption

Think commercial solar power and many people envision a giant solar farm dominating a rural landscape in warm climates, not a rooftop installation in Burnley town centre in northern England. But Shawton Energy Limited (**SEL**), a developer and owner of rooftop solar PV projects for UK commercial and industrial clients, is providing a rather smaller, more local dimension to the renewable energy revolution, putting the emphasis on "behind the meter" energy generation and consumption.

Burnley College, nestled in the heart of the former mill town in north-west England, is one of several operational projects developed and owned by SEL. In partnership with the Warrington-based firm, the further education establishment has installed a rooftop Solar PV system that is expected to cut its carbon emissions by approximately 48 tonnes per year and reduce its annual electricity costs by over £80,000. Through rooftop solar projects such as the one in Burnley, SEL produces renewable electricity that it distributes through private wire or localised grids, with the company aiming to deliver more than £50 million of invested capital in high-quality solar projects over the next five years.

In September, the Lazard SPI strategy acquired a 50% stake in SEL through New Regions Energy, a platform that invests in distributed, renewable energy projects in the UK. SEL represents the SPI strategy's second investment after DBE Energy Limited, a biogas producer. The transaction was secured through exclusive negotiation, structured to provide the SPI strategy with preferred returns as well as a co-controlling equity stake.

We believe off-grid infrastructure, particularly in renewable energy generation capacity, is the next big theme in sustainable infrastructure investing. For both individuals and industrial stakeholders, locally produced and consumed energy has materially grown. In the UK alone, installation of private PV increased from ~50 MW a quarter in 2019–2020 to over 250 MW in 2022. And the expansion in off-grid energy infrastructure is not a UK phenomenon. The success of companies such as Germany's Enpal or Otovo in Norway may indicate a growing trend.

Tougher times for private markets overall

Many infrastructure investors have been bruised over the past year. High interest rates have hit public and private valuations hard. Typically highly leveraged core infrastructure assets have especially come under pressure, as rates have ratcheted higher and refinancing deadlines have drawn closer: ~€150bn of debt will mature in the next three years, putting pressure on valuations for asset managers.¹

Furthermore, in common with their public infrastructure pooled counterparts, fundraising for private markets strategies has been hurt by institutional investors' portfolio allocation decisions and overall market sentiment. As of Q3 2023, total new commitments are 85% lower versus the same period last year.² This sharp decline in funding comes despite a solid performance by the asset class in 2022: it recorded a pooled net internal rate of return of 8.7%, far outperforming private equity, which recorded a 9.2% loss, and global equities, where the MSCI World Index fell 25.1% as elevated inflation and rapidly rising rates sapped investor optimism.³

...but sustainable private infrastructure continues to thrive

This tougher funding climate does not look set to last. According to Infrastructure Investor, 48% of institutional investors surveyed considered themselves under-allocated to private infrastructure, led by Western European investors.⁴ Multiple external research providers have reached similar conclusions.

Therefore, we remain positive about the prospects for private infrastructure and anticipate a rebound in investor interest in the near term. We believe our view is further validated by recent M&A activity around established infrastructure managers, with the likes of DIF Capital Partners and Energy Capital Partners being deal targets in September.

Although private infrastructure deal activity may have dried up for now, the colossal challenge of weaning the global economy off fossil fuels means deal activity has remained buoyant within one corner of the market: renewable energy and energy transition. This is especially the case within Europe, where 50% of the capex required to meet net zero emissions is related to infrastructure assets.⁵ Such needs have been reflected in European infrastructure M&A statistics: the renewables and energy sectors have gained market share (57% of activity in H1 2023, up from 43% in H1 2022).⁶ Another indication that the sustainable sector remains attractive despite the current challenges facing private markets is that 45% of infrastructure funds accepting new commitments as of June 2023 focused on energy transition and renewable energy.⁷

Renewable hotspots

A deeper dive into the expanding pool of the sustainable private infrastructure market reveals areas that have garnered high levels of investor interest and funding, including rooftop solar PV and electric vehicle charging networks within Europe. Deal value for the latter passed a record €6 billion over the year to date to 10 October, and deal volumes could reach their highest ever figure by the end of the year.⁸ Elsewhere, overall deal values for solar PV and offshore wind for the year to date are already higher than for 2022, which we believe reflects the competitiveness of Solar PV, assessed on a levelised cost of energy (LCOE) basis, and an increased focus on locally produced energy.⁹

The net zero tailwind

The funding requirements associated with the future infrastructure projects needed to create a sustainable world are huge: US\$275tn of new investment is required to achieve net zero globally, while global demand for electricity is likely to double from today.¹⁰

We believe this can only be achieved via good cooperation between private and public stakeholders. And here the general political landscape is largely favourable in our targeted markets. This is partly due to the extraordinary turbulence in energy markets created by the Russia-Ukraine war, which has prompted compelling incentives to “relocalise” energy production and supply chains and increase resiliency. Furthermore, recent landmark legislation—in the form of the Inflation Reduction Act in the US and, in Europe, the NextGenerationEU (NGEU) programme and the Green Deal Industrial Plan—has provided a tailwind for the renewable infrastructure sector.

Merits of the middle market

Deal activity in sustainable infrastructure projects has been pronounced at the smaller end of the scale in small and medium-sized businesses. This chimes with our long-held view that the future growth in the sustainable private infrastructure universe will largely be spurred by smaller projects. The Lazard SPI strategy was launched to capitalise on this segment of the market, with our preferred approach to consolidate and invest in small and decentralised infrastructure assets. We believe this is where some of the most attractive opportunities exist, where demand and technology are established, but such companies may need a long-term partner to support their growth.

For us, one of the attractions of targeting the “middle market” is the increased scope for partnerships with management teams and bespoke deal structures. Operating at the smaller end of the deal spectrum may also mean reduced competition from large institutional investors, such as sovereign wealth funds, in providing capital.

Healthy pipeline

Drawing upon our experienced team's global network of contacts across sectors, we have identified a diverse range of opportunities in the UK, Europe, and the US, including hydropower, biogas, and cold storage logistics. We are also interested in local and distributed renewable energy generation (see investment case study: Shawton Energy Limited). In our view, renewable energy generation needs to move beyond large-scale wind and solar farms to locally generated and consumed renewable energy, as this strengthens the grid and can be completed with minimal bureaucratic challenges.

Open-ended structure means liquidity

Liquidity is a dominant consideration for many institutional investors today. Beyond our differentiated focus on smaller, niche projects, we believe the SPI strategy is distinguished by its open-ended structure. This should appeal to institutional investors desiring sustainable infrastructure exposure but needing a liquid solution.

We accept new commitments on a rolling basis, albeit we will only do so when we have an identified pipeline, as is the case today. And in contrast to closed-end funds, this focus on mid-scale deals may shorten the J-curve for investors, whose capital is often deployed within six months of a commitment.

Active stewardship

We insist on board representation and co-control as a minimum for all Lazard SPI investments, with a preference for taking outright controlling stakes. Therefore, we define ourselves as active stewards of capital rather than passive minority shareholders with little influence over the strategic direction of our investee companies.

Positive local impacts

The SPI strategy has a dual mandate: to generate attractive long-term risk-adjusted returns and to produce tangible sustainable outcomes aimed at benefiting local communities.

- **World-class objectives:** We incorporate UN SDGs into the investment process, and we are committed to Article 9 of the EU Sustainable Finance Disclosure Regime (SFDR).
- **Actionable plan:** We have measurable ex-ante objectives for ESG improvements and mitigating ESG risks for each investment.
- **Accountability for results:** We focus on enhanced sustainability reporting and regular third-party validation.

It has been a tough year for public and private infrastructure alike in 2023. However, as noted above, we believe sustainable private infrastructure is riding a powerful structural trend. Meanwhile, with our second investment completed via our New Regions Energy platform and a diversified pipeline of potential investment opportunities ahead, we enter 2024 with a spring in our step.

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Robert Wall is the Head of Sustainable Private Infrastructure at Lazard Asset Management. He has more than 20 years of experience in growing private market investment portfolios, investing in infrastructure companies, and delivering engineering projects. Robert began working in the investment field in 2007, and prior to joining Lazard in 2021, he was a partner and member of the infrastructure investment committee in private markets at Federated Hermes. Previously, he was a founding member of the infrastructure investments team at the Canada Pension Plan Investment Board. Robert has acted as a Non-Executive Director of operating companies and he began his career as a professional engineer. Robert has an MBA from Queen's University and a BE in Civil Engineering from the University of Canterbury.



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Notes

1. Source: Investors Forum Renewable Energy 2023, supporting materials, 12 October 2023
2. Source: Inframation News, "3Q Fundraising Report: Activity set for worst year in nine despite uptick"
3. Source: Infrastructure Investor, "Infrastructure strives to weather the storm," 11 September 2023
4. Source: Infrastructure Investor, "Investor Report H1 2023"
5. Source: McKinsey & Co: "Infrastructure investing to build a net-zero-carbon world," 2 December 2021
6. Source: Infralogic, data accessed in August 2023, market share in the infrastructure sector in terms of deal activity (energy, renewables, transport, power, telecoms, social infra, environment and commodities)
7. Source: Inframation, "Fund market tracker: activity set to increase in 2H," 14 July 2023
8. Source: Infralogic Investors Forum Renewable Energy 2023, 12 October 2023
9. LCOE is a measurement used to assess and compare alternative methods of energy production. The LCOE of an energy-generating asset is the average total cost of building and operating the asset per unit of total electricity generated over an assumed lifetime.
10. Source: McKinsey & Co: "The net-zero transition: What it would cost, what it could bring," January 2022

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