EXPERT Q&A

Private infrastructure debt fundraising has been dwarfed by private infrastructure equity fundraising despite infrastructure projects being 60-80% debt financed. Nuveen's Don Dimitrievich expects that to change

Non-investment grade infra credit can capitalise on mega-trends

Q How would you describe the evolution of alternative credit as an asset class over the past decade, and how has that driven the growth of non-investment grade infrastructure credit as a strategy?
Having watched the growth of private credit over the past 15 years, and the way in which regulation impacted bank lending on the corporate side post-GFC and created an opportunity for alternative capital, it is interesting to see a similar trend now happening in non-investment grade infrastructure credit.

As infrastructure demand continues to grow, driven by several factors, there is a huge opportunity set opening up.

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Capital requirements to fund the infrastructure needed for global energy transformation and digitalisation will be unprecedented.

We tend to divide the growth drivers around power demand into four categories, with the first being generative AI and digitalisation and all the escalating energy requirements that come with that. People typically overestimate the power requirements over a two-year window but underestimate them over a 10-year window, so there is a huge demand driver over the medium to long term.

The second theme is the geopolitics around manufacturing and bringing jobs back onshore. We have seen President Donald Trump's threat of tariffs as a means to encourage manufacturing back into the US, and that shift will require an enormous amount of power.

Then there are increasing electrification trends, resulting from energy transition or due to the increasing cost competitiveness of renewables. Finally, the demographic drivers of urbanisation and population growth will also drive power demand.

All these trends will necessitate significant capital deployment in this addressable market, and bespoke private credit solutions will play a growing role in those capital solutions.

The infrastructure private placement investment grade project finance market will also grow, because there is an opportunity there too.

But non-investment grade bespoke solutions are playing an increasing role, as traditional project finance with relatively long-dated maturities with significant refinancing costs are not optimal for borrowers that are growing quickly or executing projects and will seek to refinance their capital structures within a few years once they achieve scale to access lower-cost debt.

Providing flexible capital solutions is paramount, which is consistent with the themes we observe in private credit. The risk capital treatment for banks' infrastructure assets is making it more costly for them to operate in the market just as it did in corporate credit. With those traditional sources of capital under regulatory pressure, an opportunity is catalysed for alternative lenders.

Q What is driving the market opportunity for investors as we move into 2025?

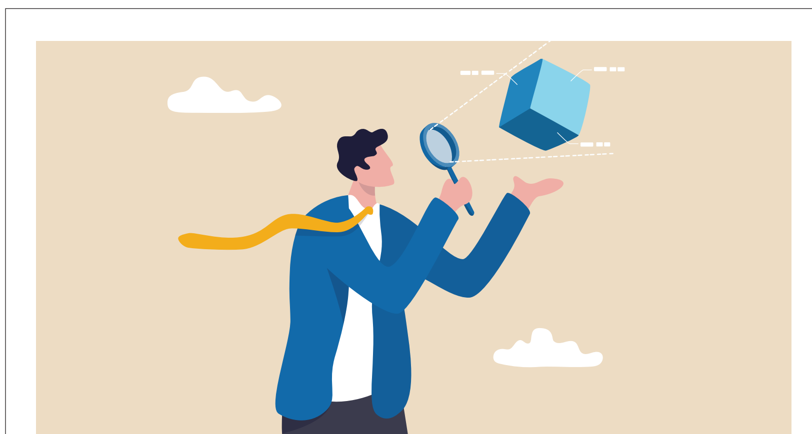
This year is going to be interesting. There is a lot of uncertainty around what the Trump administration will do, but we have had some visibility around that with some of the executive orders he has already made in relation to energy policy. Clearly, he wants to use energy to drive down inflation and has talked about affordable energy as an important part of his agenda.

The North American opportunity in 2025 will therefore be focused on Trump's core priorities such as conventional thermal power. What will be interesting is whether he takes the approach that energy demand is growing and tries to support all sources of energy, an 'all of the above' approach or if he will fixate on traditional natural gas sources of power. If it is the latter, not all investors will be positioned to take advantage of that.

Meanwhile, we expect to see a bifurcation in policy between the US and Europe, as Europe continues to prioritise decarbonisation efforts, but perhaps at a more moderate pace than we previously have seen, as the continent is still adjusting to the aftermath of the Russia/Ukraine war and its effects on the energy market.

The other element to all this is the cost of capital, and whether base rates will remain elevated, because some of the underlying policy shifts being discussed are likely to prove inflationary. Those two drivers may cause power prices to increase in some areas. We have witnessed power price appreciation in some parts of the wholesale market. The question is how that will shape investment opportunities, the equity returns for project owners and the pace of deployment in projects that are capital-intensive.

If we do see a certain agenda adopted by the Trump administration, there



Q How do non-investment grade infrastructure credit returns and default rates compare with corporate credit markets?

Given the increase in base rates over the past few years and that they remain at heightened levels, credit is able to achieve what historically would have been equity returns, but with significant downside protection. We are benefiting from the rate environment on an absolute return basis, allowing us to achieve double-digit returns, and our investments have capital that is junior to our debt investment protecting our downside.

Obviously, project economics still need to make sense but ultimately the increased cost of capital is borne by equity investors in the projects, so my expectation is that we will see higher power prices as a result. We have to keep an eye on that.

From a defensive standpoint, infrastructure assets provide essential services, so are less correlated to macro risk with their hard collateral and offtake contracts, which can provide cashflow certainty and inflation protection. The combination of these features results in lower default rates and lower losses when compared with corporate credit.

We are currently seeing investors that historically may have looked at real assets equity becoming more interested in debt because it is offering a similar return profile with lower risk. There are also investors that have invested in private credit or direct lending and want some diversification from a macro risk standpoint. They are looking to diversify their direct lending portfolios by investing into infrastructure debt.

Those are just two new investor bases that have emerged to capitalise on the opportunity in the non-investment grade infrastructure debt space.

is also the potential that individual American states may react to enhance renewable portfolio initiatives in the same way that we saw in 2016. That push and pull between the federal and state governments will also create opportunities.

Q Energy transformation is a big focus for infrastructure investors. How has power demand shifted and where are the opportunities beyond energy generation?

For the past two decades, power demand in the US has remained relatively flat, but what we are now witnessing is a paradigm shift driven by some of the factors we have already discussed, which will accelerate power demand dramatically.

A large part of the surge is being driven by the rapid expansion of generative AI and cloud data storage centres, and that will be further fuelled by onshoring of energy-intensive manufacturing, particularly semiconductors, and the development of large-scale batteries for grid storage.

With respect to AI, advancements like DeepSeek could improve energy efficiency by reducing power needs and costs. However, these innovations may also accelerate AI adoption and deployment, potentially intensifying overall power demand. The key question is how these dynamics will influence the net growth rate.

While energy transformation remains a focus, there are opportunities beyond energy generation in areas like energy efficiency, storage, grid enhancements and infrastructure supply chain investments.

Secular trends around energy efficiency continue to be key drivers of opportunity, for example. There are two ways of solving the demand-supply imbalance in relation to energy, with one being new sources of energy and the other reducing demand through energy efficiency. That is a non-controversial way to tackle energy consumption and one that we think will remain a key priority through 2025 and beyond.

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Q Finally, private infrastructure credit continues to be dwarfed by infrastructure equity as an asset class. How do you see that dynamic changing over the coming years?

If you consider a typical capital structure, 60-80 percent of the capital stack is ordinarily funded by debt. And yet when you look at how much capital has been raised, infrastructure equity has always attracted the bulk of investor capital and is a more well-established asset class. Around 90 percent of capital raised is for infrastructure equity and only around 10 percent for infrastructure debt.

Logically, that split should be the other way around. If you look at corporate credit versus private equity over the past 15 years, back then private credit was almost non-existent and most of the fundraising was for private equity, whereas that has changed significantly over time.

We expect to see similar trends play out in infrastructure debt as an asset class relative to infrastructure equity. It is by far the largest part of the capital structure and there is a clear role for flexible capital solutions as well as investment grade project finance solutions. Those two options can clearly co-exist as a response to changing borrower demands.

Our expectation now is that you will see this asset class really grow in prominence and over the next decade we will see a significant surge in debt solutions available in the market. Investors clearly want access to these secular trends that are driving power demand: digitalisation, and power and energy consumption. Private credit investment managers with energy and power expertise are going to be well positioned to take advantage of these mega-trends.

While base rates have been a driver of returns over the past few years, these are secular trends that are not going away. Obviously, we are benefiting from rates as they sit today, but my expectation is that over time the zero-rate environment experienced post the financial crisis will be considered an anomaly. Even if rates now normalise from where they are today to a more steady state, that will be materially north of a zero-rate risk-free environment, so private debt can still capture that value.

We expect rates to remain at a level broadly in line with where we are, given the inflationary trends, and that makes this asset class very attractive for the long term. ■

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