

July 2009

Americas Infrastructure Update 2009

Introduction

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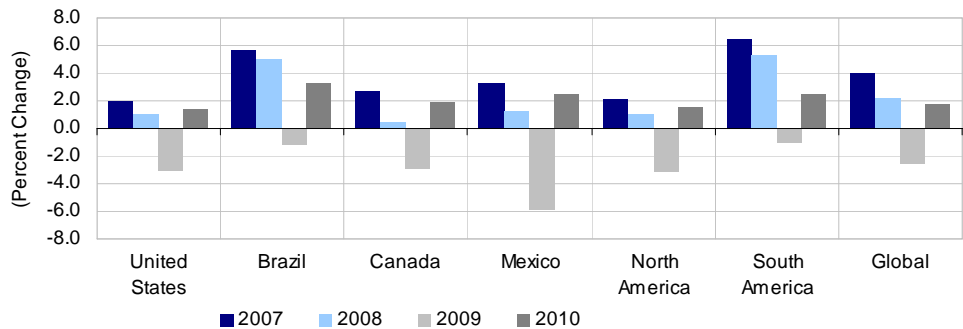
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This past year has been a pivotal one for the future of infrastructure in the Americas region. While the state of the global economy and financial markets have been suffering, investment in infrastructure is seen as a panacea for stimulating growth, encouraging private and public sectors to work together, and bringing new investment opportunities to the forefront.

A number of exogenous events have taken place since 2007 that have had a direct impact on the infrastructure industry. The two main catalysts of change are the world economy sliding into recession and the credit crisis. The major economies of the Americas region are all expected to post negative GDP growth this year (Exhibit 1) with many nations having entered into a recession in 2008. This environment has led to widespread job losses, lower productivity, fewer exports and lower government revenues. Furthermore, the financial crisis has resulted in higher financing costs, drawn-out or cancelled infrastructure deals, deleveraging and forced sales of assets. Though infrastructure is an asset class that tends to remain resilient in the face of adversity, economic and financial shocks have lowered return expectations, caused performance volatility, put valuations under stress and forced investors to reevaluate their allocations towards more liquid investments.

Exhibit 1
Real GDP Annual Change



Source: Global Insight

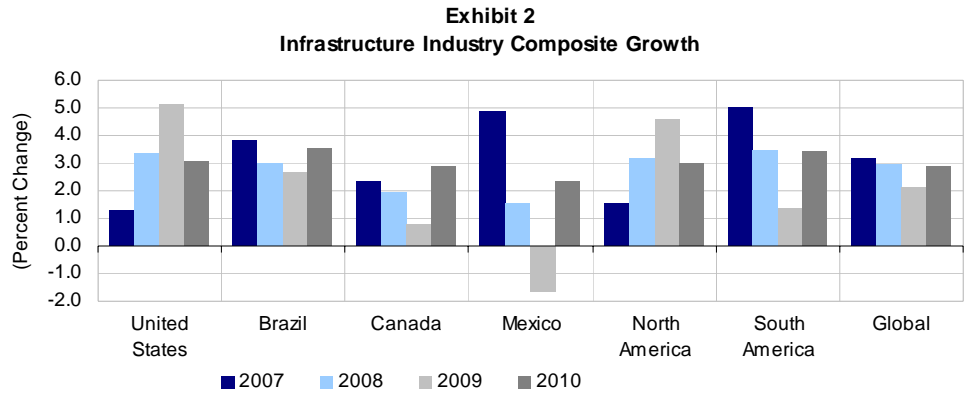
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Amongst all of the changes facing infrastructure, there are overarching themes that remain the same. Much of the Americas region is still suffering from inadequate or poor-quality infrastructure. Developing nations such as Mexico and Brazil are experiencing a short-fall of infrastructure given their economies' rapid growth while countries like Canada and the US have deteriorating infrastructure that needs to be maintained. Demographic trends also point towards an increasing usage of infrastructure facilities and services. Rapid rates of population growth and urbanization mean that new and improved infrastructure is needed. Budget deficits are limiting state and municipal funding of projects. This problem has been exacerbated since the credit crunch and recession began.



Despite these challenges, market conditions for infrastructure are poised to recover given recent policy adoptions benefiting the sector. Economic stimulus packages have been pledged by various regional governments with large earmarks for infrastructure development and reinvestment. New legislation is being enacted to foster more public-private partnerships (PPPs) whereby the costs and benefits of infrastructure are shared by both parties. And finally, more infrastructure managers are entering the market, looking to privatize assets, and lend their operational and financial expertise to improve efficiency. From an investment perspective, investors are still seeking stable, long-term cash flows that mature infrastructure can ultimately provide. Exhibit 2 below shows the forecasted growth of infrastructure-related industries as measured by change in gross output.



This annual review of the infrastructure market in the Americas region will cover the following topics. First, there will be an overview of market fundamentals in terms of economic drivers, deal activity, market size estimates and fundraising. Next, there will be an analysis of infrastructure performance as an asset class. We will then highlight major developments pertaining to infrastructure in three major markets: Brazil, Canada and the US. Finally, we will examine current opportunities for infrastructure participation and investment.

Overview of Market Fundamentals

Economic and Financial Drivers

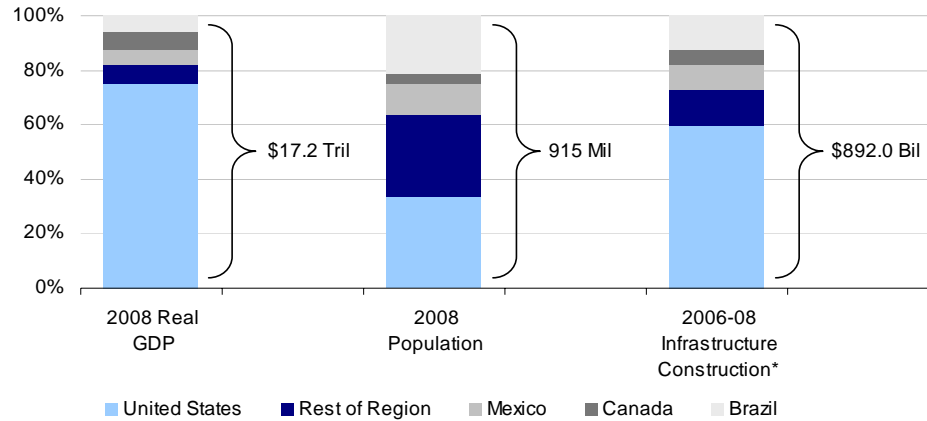
Infrastructure development is largely motivated by a set of structural drivers that are continually expanding and evolving. Unlike other sectors that fluctuate according to cyclical indicators such as GDP growth and labor productivity, infrastructure is influenced by long-term demographic shifts as well as trade patterns. In the Americas region, there are five major catalysts for infrastructure development: a growing population base, an urbanization rate in most nations at or near 80%, a rising middle class in developing nations, an increase in the standard of living for underserved populations and expanding international trade.

The case for infrastructure provision is most critical in Latin American countries. According to Exhibit 3, Latin American nations represent 63% of the region's population while only accounting for 35% of region's infrastructure construction over the past three years. Additionally, the infrastructure that currently exists lacks the quality and competitiveness that most Western and East Asian economies possess. This shortfall should be rectified in part by \$7.4 trillion in cumulative infrastructure spending between 2005 and 2030¹. Comparatively, the US and Canada are projected to spend \$6.5 trillion on infrastructure during the same period².

¹ Booz Allen Hamilton, Global Infrastructure Partners, World Energy Outlook, Organisation for Economic Co-operation and Development (OECD)

² *ibid*

**Exhibit 3
Relative Market Share**

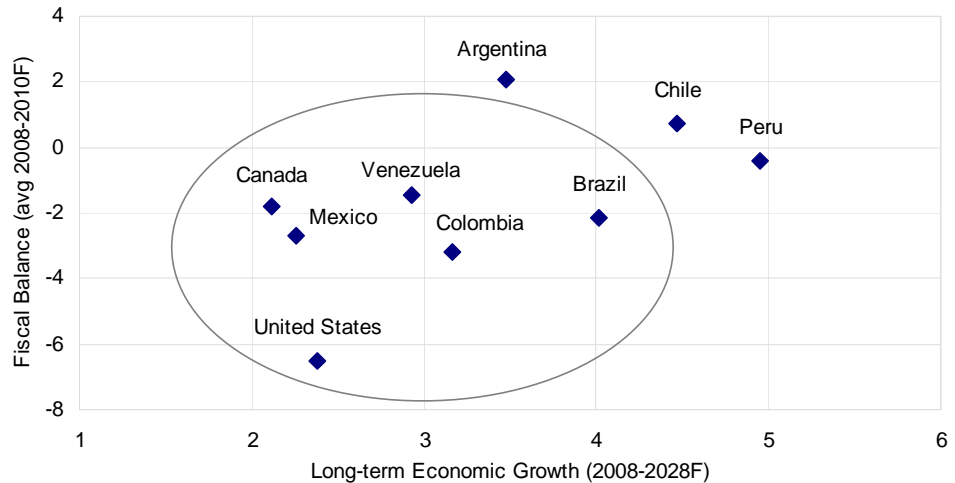


* Energy, Transportation, Utilities, Communications

Source: Global Insight

Infrastructure provision is also driven by a set of financial considerations by both the public and private sector. For governments, there has been an ongoing challenge to provide adequate levels of infrastructure in the face of budget deficits and strained public debt markets. These constraints, set against a backdrop of long-term growth plans, have resulted in an increasing pressure to privatize assets (Exhibit 4), often through PPPs. This is often seen as a logical consideration for the sector, given that the obvious deferred maintenance of assets, coupled with some high-profile failures, put into question whether governments are financially and operationally capable of full oversight of the industry.

**Exhibit 4
Increasing Pressure to Privatize**



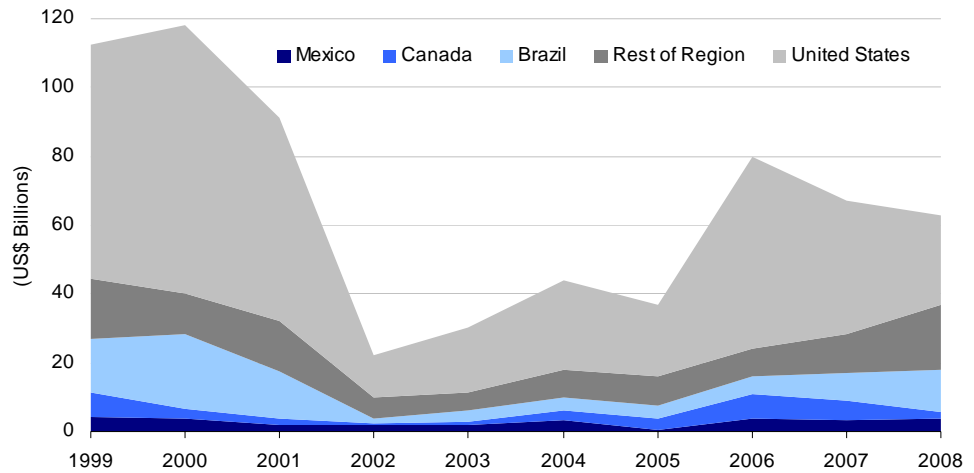
Source: Global Insight and RREEF Research

Deal Volume

Transaction activity for infrastructure projects have held fairly steady since the onset of the credit crisis nearly two years ago. In 2008, nearly \$63 billion of deals were closed in the Americas region, down justly slightly from \$67 billion in volume that was closed in 2007 (Exhibit 5). The most recent peak in deal activity was in 2006 with almost \$80 billion in closed deals. So far in 2009, \$13 billion in project finance and non-project finance deals have been closed with another \$56 billion in the pipeline.

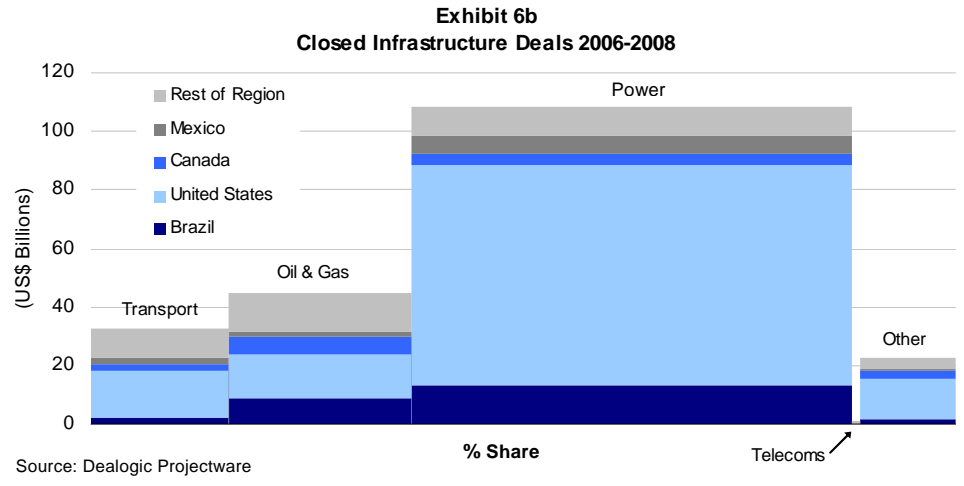
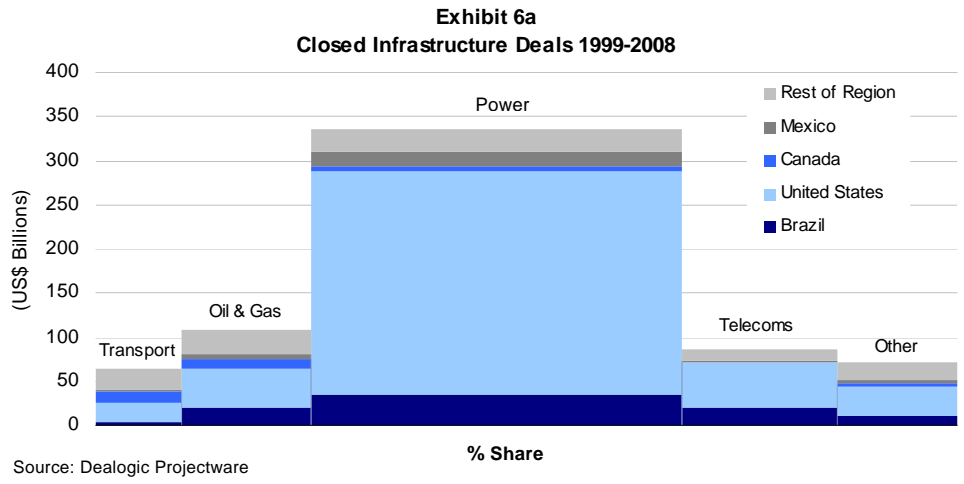
Amongst individual countries, the US leads the region by far, with 57% of completed deals over the past three years. Brazil is the second most active country, closing 12% of the region's projects followed by Canada which represents 7% of deal share. These ratios have not differed much over a longer 10-year range. The most striking observation looking at transaction volumes since 1999 is how large the volume of closed deals were between 1999 and 2001 compared to the most recent boom in 2006. On average, more than \$100 billion of deals were completed in 1999 to 2001 with a sharp drop-off in 2002, mainly attributable to the US recession. This past cycle did not peak as high in 2006 as it did in 2000 nor did it experience the same huge subsequent downturn either. Transaction volumes have become relatively less volatile as the infrastructure investment market has matured.

Exhibit 5
Closed Infrastructure Deals

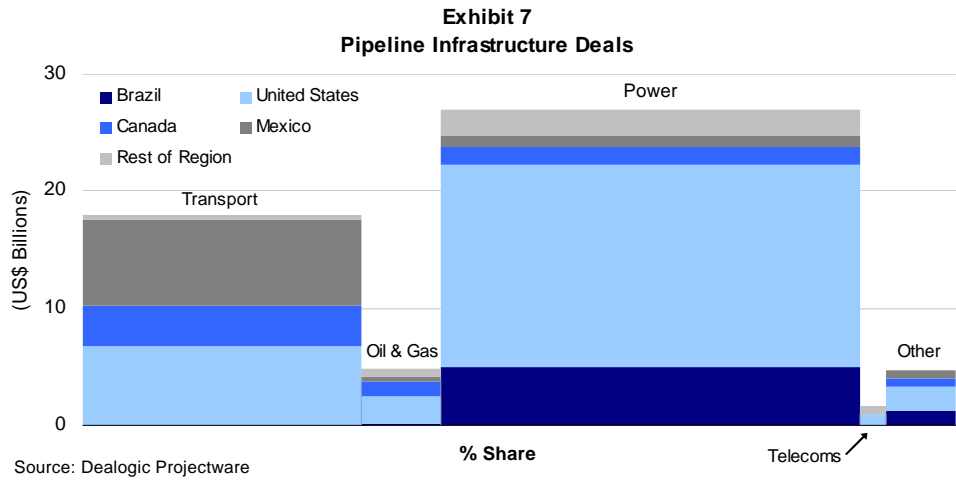


Source: Dealogic Projectware

As for sectoral trends in infrastructure deal activity, there have been significant shifts in focus over the past 10 years, three years and current pipeline. Between 1999 and 2008, half the deals were in the power sector which includes power plants, renewable fuels and wind farms (Exhibit 6a). This is clearly one of the most demanding and cost-intensive infrastructure provisions required by society; therefore, it is not surprising that \$337 billion in deals were closed in 10 years. Next, in terms of deal volume, was oil and gas telecoms which had 16% of deal share and closed \$108 billion in deals, followed by telecoms which retained 13% of deal share and completed \$86 billion in deals. Excluding power, the other four represented major infrastructure sectors (transport, oil and gas, telecoms and other) had similar levels of deal activity and regional dispersion. Looking at the past three years though, telecoms have essentially seen no deal activity while the transport and oil and gas sectors have increased their presence (Exhibit 6b). This reflects a regional concern to tap other energy resources in order to limit dependence on foreign oil as well as to reinvest and maintain transportation infrastructure which has been largely overlooked.



As shown in Exhibit 7, the current pipeline of infrastructure transactions shows heavy anticipated deal volume in largely two sectors—power and transportation. The case for investing in power is well-known while an emphasis on transportation is mostly likely the consequence of two issues. The first is poor rankings of infrastructure across the region. The American Society of Civil Engineers recently rated US transportation infrastructure as Poor (D grade) while the World Economic Forum found Latin American countries to have large gaps in transport infrastructure quality. In order to combat this inferiority in transportation as well as help boost the economy, national governments in the Americas have put together new stimulus packages with specific spending allocations for transportation. These stimulus packages—with the improvements in infrastructure quality and jobs they help create—are the second reason why transportation is beginning to take-off.



Market Size Estimates

In 2008, RREEF Research set out to determine the size of the infrastructure universe using two estimation methods. The first method uses public capital stock as a proxy for infrastructure stock while the second method calculates infrastructure stock as a percentage GDP and adjusts for variations in quality. Despite the strength and weaknesses of both estimation methods, they converged on a similar global stock value of \$20.5 trillion (c 2006). Regionally, the net capital stock approach estimated the North American infrastructure market to be around \$5.6 trillion in value while the South American region was estimated to be \$1.3 trillion. Using the GDP-adjusted for quality approach, the value for North America came in higher at \$6.9 trillion while the value for South America was lower at \$0.5 trillion. Averaging these two results, RREEF projected that the market size of North American infrastructure is in the order of \$6.3 trillion while the South American market is \$0.9 trillion.

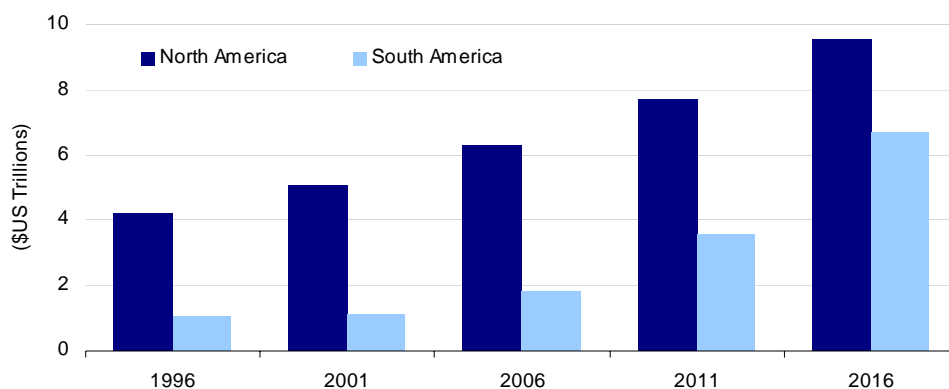
**Exhibit 8
The Infrastructure Universe
(in US\$ Trillions)**

Region	Net Capital Stock Approach	GDP, Quality Approach	RREEF Projection
North America	\$5.6	\$6.9	\$6.3
South America	\$1.3	\$0.5	\$0.9

Source: RREEF Research

Using these estimates and applying a growth rate based on GDP projections, RREEF expects the Americas infrastructure market to reach \$11.2 trillion in size by 2011 and \$16.2 trillion by 2016 (Exhibit 9). North America will still comprise about two-thirds of the overall regional market; however, South America will almost double in size between 2006 to 2011 and again from 2011 to 2016. Since the continent is starting from a smaller base of existing infrastructure, it has the ability to grow the fastest. North America will realize most of its gain in market value from reinvestment in deteriorating assets.

Exhibit 9
Estimated Infrastructure Market Size



Source: RREEF Research

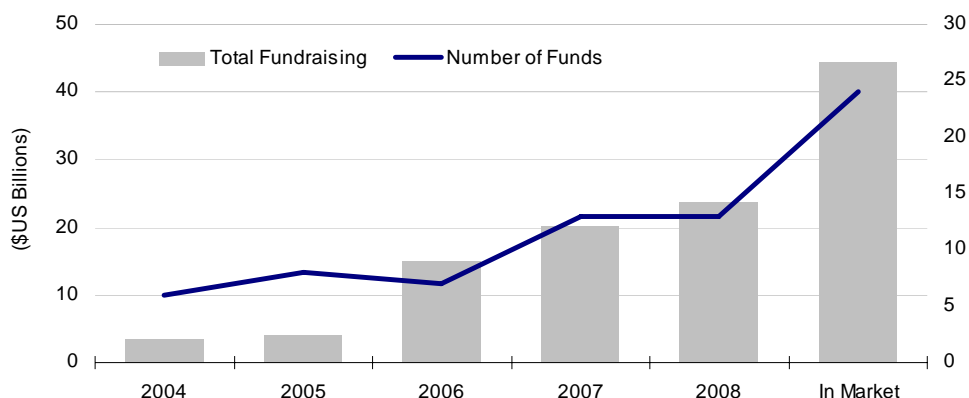
Fundraising

Infrastructure has evolved in the past five years from being a niche sub-sector to becoming a distinct asset class for many institutional investors. There is an increasing trend to provide a separate allocation towards the asset class and giving it an identity of its own—the identity being that infrastructure represents an essential service, with high barriers to entry, stable and inflation-hedged cash flows, hard-asset backing and provides portfolio enhancing capabilities.

Infrastructure as an asset class has already been established in Canada with a trickling of deal flow in the US and expressed interest in Latin America. In 2004, there were only six infrastructure funds that closed targeting investment in the region with \$3.4 billion of capital (Exhibit 10). By 2006, the number of funds in the market stayed nearly the same but the amount of capital raised more than quadrupled. Two years later, 13 funds raised \$23.9 billion in capital and today, there are 24 funds actively fundraising \$44.4 billion to invest in Americas infrastructure.

The lingering effects of the credit crunch are expected to cull the number of infrastructure managers as evidenced by the failures of Allco Finance and Babcock and Brown. In the longer term, the number of infrastructure managers is expected to increase, although firms are expected to become smaller players, more specialized and regionally focused. These managers will also compete with a growing presence of multilaterals and international financial institutions to finance infrastructure projects.

Exhibit 10
Infrastructure Fundraising Targeted for the Americas Region

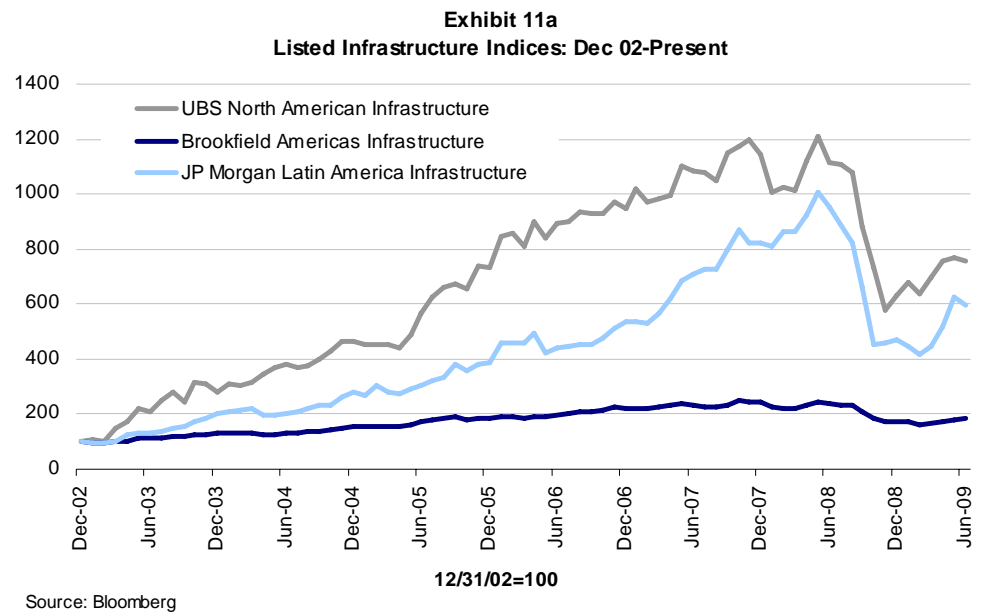


Source: Preqin

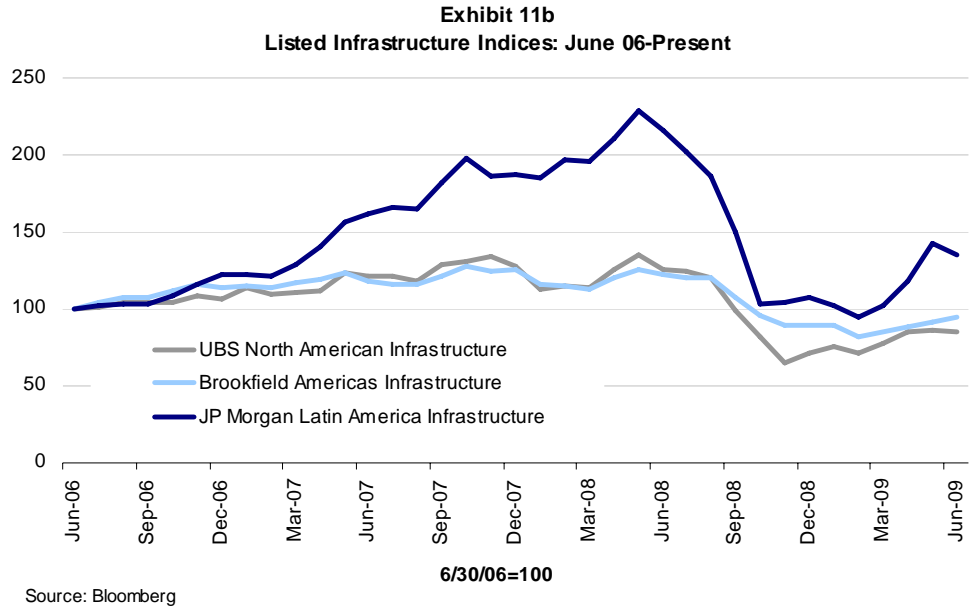
Performance of Infrastructure Investments

The privatization of infrastructure assets for investment purposes is a relatively recent phenomenon for the Americas region. Canada has had some experience undertaking large-scale privatizations, following the Australian and the UK models, but information on returns is closely-held and applies only for specific assets. As such, data on the performance of infrastructure assets for the Americas region is limited towards publicly listed fund indices. Although new private infrastructure benchmarks are in the development process, we will have to rely on the public market to make inferences on the entire regional asset class.

There are three diversified indices that track the performance of infrastructure in the region: UBS North American Infrastructure, Brookfield Americas Infrastructure and JP Morgan Latin America Infrastructure. Indexing prices back to the common start date of December 2002 (Exhibit 11a), we find that performance of North American and Latin America infrastructure has followed the same trajectory—constantly climbing through September 2007, dipping slightly and rising again over the next six months, and then precipitously falling through the end of December 2008. This closely mirrors the performance of the general public equity market and is a direct result of the current economic and financial turmoil. Indeed, the recent volatility in infrastructure is not so much an indicator of lower confidence or shaky fundamentals, but more a victim of stock market contagion.



Looking at all three indexes referenced back to the starting date of June 2006 in Exhibit 11b, we see that prices are almost back to their pre-crisis levels. In fact, the JP Morgan Latin America Infrastructure Index only went one month below 100 and has been on an upswing. The UBS North American Infrastructure Index and the Brookfield Americas Infrastructure Index both have performed in tandem with each other, nearly recovering to 2006 levels.



Overall, the performance of listed regional infrastructure assets has been solid over a medium- to long-term horizon. As shown in Exhibit 12, the five-year annual return for UBS, Brookfield and JP Morgan has been 17.2%, 4.7% and 15.5%, respectively. By comparison, the MSCI World Stock Index has had a five year annual return of -3.0% and the Lehman Global Aggregate Bond Index has had a five year annual return of 3.9%. The one-year and three-year returns for infrastructure assets have been poor, but still better than other public equity sectors. The good news is that infrastructure is still a defensible asset class with share prices clearly trending up.

Exhibit 12
Performance Characteristics
(As of March 31, 2009)

	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>
Stocks			
MSCI World	(42.2%)	(13.3%)	(3.0%)
Bonds			
Lehman Global Aggregate	(4.9%)	5.8%	3.9%
Public Real Estate			
FTSE EPRA/NAREIT	(59.1%)	(25.2%)	(9.3%)
Private Real Estate			
NCREIF	(6.5%)	8.1%	11.7%
Public Americas Infrastructure			
UBS North American Infrastructure	(31.6%)	(5.0%)	17.2%
Brookfield Americas Infrastructure	(24.6%)	(3.8%)	4.7%
JP Morgan Latin America Infrastructure	(48.1%)	(0.8%)	15.7%

Source: MSCI Barra, Barclays Capital Research, NCREIF, Bloomberg

Market Spotlight

The following is an update on what is currently affecting the infrastructure market of three key economies: Brazil, Canada and the US.

Brazil

FIFA World Cup Spurs New Development

In addition to constructing and remodeling football stadiums, Brazil's Transportation Ministry announced a high-speed train project for the World Cup connecting Campinas, São Paulo and Rio de Janeiro costing US\$11 billion. Brazil is also to invest US\$2.5 billion upgrading its airports to manage the hundreds of thousands of tourists expected in 2014. A significant amount of the money will be allocated to overhauling the airports of São Paulo and Rio de Janeiro.

BNDES Bank Partners in Financing

The state development bank, BNDES, has been the largest source of funding for infrastructure projects in the region. Most recently, the government announced plans to offer US\$2.5 billion in emergency loans through BNDES to companies engaged in government-sponsored infrastructure projects that are struggling to obtain credit. Commercial banks are typically unable to compete with BNDES on lending terms; however, club deals involving both parties have been pursued.

Canada

'PPP Canada' Begins to Take Shape

PPP Canada will manage and invest the Government of Canada's C\$1.25 billion Public-Private Partnerships Fund (P3 Fund), will advise the Government of Canada on the execution of P3 projects and will assess P3 options for major projects seeking federal funding in excess of C\$50 million. The program initially encountered a lack of momentum but is finally getting off the ground with new hires and office space.

Gas Tax Fund Becomes Permanent

Budget 2008 announced that the Gas Tax Fund will be extended at C\$2 billion per year beyond 2013–14 and become a permanent measure. This will allow all municipalities, both large and small, to better plan and finance their long-term infrastructure needs that contribute to cleaner air, cleaner water and reduced greenhouse gas emissions. Municipalities can pool, bank and borrow against this funding, providing significant additional financial flexibility.

United States

American Society of Civil Engineers Gives Infrastructure a 'D'

The overall grade given by the "report card" is the same as it was four years ago; nevertheless, the projected cost of repairing the nation's infrastructure has grown to US\$2.2 trillion over the next five years. Furthermore, ASCE's estimates that even with the stimulus package, the nation's infrastructure will face a deficit of approximately US\$1.1 trillion. The categories of infrastructure in most need of attention are drinking water, wastewater, inland waterways, roads and levees.

Obama Plans for a National Infrastructure Bank

As originally proposed in 2007 by Chris Dodd and Chuck Hagel, a national infrastructure bank would encourage local public agencies to "partner" with private for-profit entities to develop projects worth at least US\$75 million each. The intent is to leverage the investment through bonds and private sector participation. The bank is to have up to a total of US\$625 billion in authorized capital for financing capacity.

Regional Opportunities

The opportunities for the infrastructure market lie in three main themes. The first is aligning interests with objectives set forth in national stimulus plans. Exhibit 13 is a summary of how planned stimulus funds will be earmarked for infrastructure projects. These are the sectors the government deems most crucial for investment and a source of efficiency, revenue and job creation. By working with the local government on these initiatives, the private sector can become a partner in redeveloping the region and benefiting from future returns on investment.

**Exhibit 13
Infrastructure Spending Plans**

Country	Amount	Where Money is Being Allocated
Canada	CAD\$ 12 billion (US\$ 10.4 billion)	A quarter of the funds earmarked to restore aging roads, bridges, and other "shovel-ready" projects Via Rail services (CAD\$ 407 million) Restoration of federally-owned buildings (CAD\$ 323 million) Repairs to Montreal's Champlain Bridge (CAD\$ 212 million) Long-overdue maintenance projects at colleges and universities (CAD \$2 billion) Green infrastructure projects and expanding broadband internet access (CAD \$1 billion) The \$12 billion overall amount supplements the previously announced \$33 billion Building Canada Plan, which focuses on longer-term projects
United States	US\$ 180 billion	US\$ 180 billion for infrastructure over two years Roads and bridges (US\$ 30 billion) Rail and transit (US\$ 10 billion) Health information technology (US\$ 20 billion) Broadband for underserved areas (US\$ 6 billion) Projects aimed at "greening" America: Smart electrical grids (US\$ 11 billion) Energy efficiency of public buildings at the federal, state and local level, as well as low-income family homes (US\$ 53 billion) Other investment areas include: Construction, repair and upgrade of schools and hospitals (US\$ 23 billion) Environmental projects such as flood control, sewage & water treatment systems (US\$ 19 billion)
Mexico	MXN\$ 2.5 trillion (US\$ 200 billion)	Spending over the next five years, and including: Roads (MXN\$ 287 billion) Railroads (MXN\$ 49 billion) Airports (MXN\$ 59 billion) Hydro-agriculture and flood control (MXN\$ 48 billion) Ports (MXN\$ 71 billion) Drinkable water and drainage (MXN\$ 154 billion) Telecommunications (MXN\$ 283 billion) Refining, gas and petrochemical (MXN\$ 379 billion) Electricity (MXN\$ 380 billion) Hydrocarbons production (MXN\$ 822 billion)
Argentina	ARSS\$ 71 billion (US\$ 20.7 billion)	The plan focuses on two broad areas: 60% allocated to road infrastructure projects and social improvements 40% dedicated to improving and expanding the power, natural gas and public transport sectors
Brazil	BRL\$ 503.9 billion (US\$ 212.6 billion)	Projects will be focused in three areas: Logistics (railways, roads, ports, airports and seaways) Energy (electric generation and grids, oil and gas, renewable energies) Social infrastructure (sanitation, housing, urban transportation, access to electricity and potable water)
Chile	US\$ 700 million	New projects include: Improving the country's road network Schools and stadiums New hospital construction Other projects for consideration include: Hydraulic (irrigation systems, water canals and reservoirs) Port, airport and general architectural initiatives
Peru	US\$ 3.3 billion	Spending on ports, highways, airports, agro-industrial projects, energy transmission and production, renewable energies, and a variety of projects in health, sanitation, education and construction

Source: Foreign Affairs and International Trade Canada, January 2009

The second opportunity comes from investing in innovation. An abundance of capital has been dedicated to restoring deteriorating assets and providing short-term fixes to long-standing inadequacies. However, real long-term growth is sustained by investing in innovative projects such as renewable energy, smart grids and high-speed railways. Exhibit 14 provides a list of current projects in the Americas region that utilize modern technology to provide more progressive solutions to current infrastructure challenges.

**Exhibit 14
Infrastructure Investment in Innovation**

Geography	Category	Project Name	Value of Project (Millions)	Project Description	Start Date	Est. End Date
Argentina	Energy	Thermal Power Plant	USD\$ 185	Construction of a thermal power plant and an Aeolian park in Dolavon		2008
	Transportation	Argentine High-Speed Railway	USD\$ 700-1000	Construction of a 310-km high-speed rail route between Buenos Aires and Rosario	2007	2009
Brazil	Energy	Ethanol Plants	USD\$ 648	Construction of three new ethanol plants in south-central Brazil, which will produce up to 420-million liters of ethanol and will generate electricity for 400,000 homes		
	Energy	Wind Turbine Blades Factory	USD\$ 120	Expansion of a wind-turbine blades factory by establishing new product lines	2008	
Canada	Transportation	RAV Canada Line	CAD\$ 2000	A 19.5 km long rail rapid transit line between Richmond, the Vancouver International Airport and downtown Vancouver (RAV)	2005	2009
Chile	Energy	Central Termica Andino	USD\$ 600	Construction of an energy plant that will work with a mixed cycle of diesel and carbon	2007	2010
	Other	Chilean Optical Earth Observation System	n/a	Design, construction and testing of the Sistema Satelital para Observación de la Tierra (SSOT) high-resolution satellite	2008	
Columbia	Energy	Wind Power Plant	n/a	Construction of a 90-turbine wind power plant with a capacity of 234MW	2008	
Mexico	Energy	120MW Wind Generating Plant	USD\$ 300	Construction of a wind-generating plant with 40 generators. Each turbine will have a capacity of 3MW.	2008	2009
	Energy	250MW Wind Generating Plant	n/a	Construction of a wind-energy plant with a capacity of 250MW. The plant will have 300 wind turbines.	2008	2010
Peru	Energy	Peru Wind Plant	USD\$ 240	Construction of a 240MW wind power plant that will provide electricity for approximately 80,000 families	2008	2010
Uruguay	Energy	ZAP Electric Vehicle Assembly Facility	n/a	Construction of an electric vehicle manufacturing facility over an area of 43,000 square meters	2008	

Source: Global Insight

Third, opportunities stem from assets that have fallen victim to the credit crunch. Debt has become a scarce resource to finance deals—spreads have increased, leverage levels are down, and terms and conditions have tightened. Meanwhile, the use of short term debt or equity bridge loans has closed down making the equity market unavailable. At best, this has resulted in a longer execution period for deals but in many cases deals have been withdrawn completely. Furthermore, the credit crunch has culminated in failed IPOs, particularly in renewable energy, utilities and transport. Some listed fund managers are being forced to monetize assets for redemptions, valuation purposes and de-leveraging. There have been sales by conglomerates of non-core infrastructure assets for liquidity and strengthening of balance sheets. Also, some pre-emptive selling of assets ahead of debt contract renewal has occurred. These events have all provided opportunities for investors to acquire assets at discounted prices.

Conclusion

The infrastructure market in the Americas region is on a trajectory towards significant growth and improvement. These past two years have been pivotal in terms of defining infrastructure needs, tackling the spending gap through stimulus plans, addressing the funding gap through privatizations and assessing infrastructure as a viable investment opportunity. In the next few years we will witness ideas turn into actions and eventually, the successes and occasional failures of these initiatives will be examined. In the meantime, there is widespread optimism for what infrastructure can contribute to global economic growth and individual prosperity.

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