

# The fix is in

**Pension funds are turning to non-core infrastructure in search of higher returns**

By *Yaldaz Sadakova*

“These Canadians own your town,” *Fortune* magazine declared in December 2015, referring to the massive infrastructure and real estate investments Canadian pension funds have made around the world.

But Canadians don't just own these towns. They're also increasingly rebuilding them and fixing them up.

Why? Because the global competition for traditional infrastructure assets — operational facilities that don't require improvement — is fiercer than ever. Defined benefit pension funds love these assets because the long-term, steady returns they produce can help cover future obligations to retirees. The returns also provide a great source of income in times of low interest rates, as is the case today. But the intense competition for these assets has driven up their prices and suppressed their returns.

Despite a reputation for being conservative investors, Canadian pension funds have been embracing the risk of building new facilities from scratch through greenfield projects or snapping up existing brownfield assets that are in need of improvement at lower prices. The strategy is no longer the exclusive domain of sophisticated world-renowned players, such as the \$171-billion Ontario Teachers' Pension Plan.

“The asset class is overheated on a worldwide basis,” says Hugh O'Reilly, president and chief executive officer of

OPTrust, in reference to core infrastructure assets. Such assets are typically located in developed markets and immune from fluctuations in supply and demand because they're regulated or protected by contracts.

Jim Keohane, president and chief executive officer of the \$64-billion Healthcare of Ontario Pension Plan, feels the same way about current infrastructure prices. “The risk-return trade-off is not very attractive. It's not to say we wouldn't own infrastructure; at the right price, we would,” he said at a recent press conference in Toronto. “For the past few years, asset prices have been quite high, and it's been challenging to find the things we've wanted to invest in.”

Ross Servick, head of Canadian distribution at Schroder Investment Management Ltd., is seeing a similar attitude among the Canadian defined benefit pension plans he works with. “A number of plans we've spoken to have slowed their investments towards [core] infrastructure because the rates have come down so significantly as asset prices have performed so well that the yields just aren't what they were,” he says.

To be sure, pension funds are still

active in core infrastructure. In February, three major Canadian pension funds won the bid to buy Britain's London City Airport, a downtown facility primarily serving the city's business executives. The winning consortium included the Ontario Teachers' Pension Plan; the Alberta Investment Management Corp., which invests money on behalf of public pension plans in Alberta; and Borealis Infrastructure, the infrastructure arm of the Ontario Municipal Employees Retirement System.

The consortium that lost the bid included PSP Investments, a Canadian asset manager that invests money on behalf of several branches of the federal public service, including the Canadian Forces and the Royal Canadian Mounted Police.

The price tag for the airport was a hefty £2 billion (about \$3.64 billion). The previous owner “paid a third of that price a decade ago to buy the airport,” the *Guardian* reported. The only way for the new owners to make a return on such a large investment would be to increase fees for the airline companies that operate out of the airport, sources told the *Guardian*.

O'Reilly says the deal was too expensive for his pension fund, the \$18.4-billion OPTrust, which is Ontario's fifth-largest public pension plan. “We look at infrastructure opportunities with a smaller price tag,” he says. “Because of our size, we're not competing for large infrastructure projects. We're more of a mid-market investor.”

The reason core infrastructure assets such as the London City Airport are so expensive is there simply aren't enough of them to meet global investor demand. There's about \$100 billion of capital that's yet to be deployed in core infrastructure funds worldwide, according to a 2015 estimate by Prequin, a provider of alternative asset data.

## 'Going out on the risk curve'

As the core space becomes more crowded and costly, some pension plans are “going out on the risk curve” in the realm of infrastructure, says Servick.

That means venturing into the non-core, opportunistic area in which investors buy assets that require improvements or build them from scratch.

“We tend, at this point in time, to advise our clients to consider opportunistic,” says Todd Nelson, an investment practice

leader in Willis Towers Watson's Toronto office. "There's less competition when you're buying the asset, so you can hopefully get a better price."

Also, he adds, if a company decides to sell the infrastructure asset after improving it, it can offer it in the competitive core market at a higher price.

Billy Bishop Toronto City Airport is an example. Canada's ninth-busiest airport has a great location in downtown Toronto, but it needs a bigger terminal so it can

serve more passengers and accommodate more planes, says Brandon Prater, co-head of private infrastructure at Partners Group, a Switzerland-based money-management firm focusing on private markets. Partners Group was part of the consortium that bought the airport's passenger terminal last year.

Another challenge at the Billy Bishop airport is the fact that passengers can't get border clearance there, something the new owners

have been working on changing. Having border clearance will allow "somebody who has a meeting in New York City [to] clear U.S. customs and get out on the other side at LaGuardia [Airport], where you can't land right now," says Prater. Those passengers will be more willing to fly out of Billy Bishop if it has border clearance and they can thereby bypass the challenges of getting to Pearson International Airport on the edge of Toronto, Prater adds. (The owners may soon

## TOP 5 | FASTEST GROWING (%) - LESS THAN \$1.0 BILLION

CPA = CANADIAN PENSION ASSETS / ASSETS (MILLIONS) AS OF DEC. 31, 2015

COMPANY	2015 CPA	2014 CPA	VARIANCE
1  Global Alpha Capital Management Ltd. (A Connor, Clark & Lunn Financial Group Company)	\$25.7	\$13.3	↑ 93.2%
2  Nuveen Investments Canada	\$305.7	\$181.2	↑ 68.7%
3  Acorn Global Investments Inc.	\$6.0	\$4.0	↑ 50.0%
4  Victory Capital Management Inc.	\$123.7	\$89.0	↑ 39.0%
5  Janus Capital Group	\$994.2	\$763.1	↑ 30.3%

## TOP 5 | FASTEST GROWING (%) - \$1.0 BILLION TO \$10.0 BILLION

CPA = CANADIAN PENSION ASSETS / ASSETS (MILLIONS) AS OF DEC. 31, 2015

COMPANY	2015 CPA	2014 CPA	VARIANCE
1  Sun Life Institutional Investments (Canada) Inc. <sup>1</sup>	\$1,720.4	\$7.6	↑ 22,536.8%
2  NISA Investment Advisors, LLC	\$1,062.4	\$90.2	↑ 1077.8%
3  Fiera Properties Ltd.	\$1,399.5	\$849.8	↑ 64.7%
4  Investec Asset Management Ltd.	\$1,499.6	\$1,006.6	↑ 49.0%
5  Arrowstreet Capital LP	\$5,416	\$3,906	↑ 38.7%

## TOP 5 | FASTEST GROWING (%) - GREATER THAN \$10.0 BILLION

CPA = CANADIAN PENSION ASSETS / ASSETS (MILLIONS) AS OF DEC. 31, 2015

COMPANY	2015 CPA	2014 CPA	VARIANCE
1  Brookfield Asset Management	\$19,707.0	\$16,302.0	↑ 20.9%
2  Wellington Management Group LLP	\$16,013.0	\$13,813.0	↑ 15.9%
3  Franklin Templeton Institutional*	\$16,714.1	\$14,955.7	↑ 11.8%
4  Fiera Capital Corp.	\$29,512.3	\$26,723.4	↑ 10.43%
5  TD Asset Management	\$88,306.6	\$79,995.0	↑ 10.39%

### Notes:

\*Restated 2014 figures

1. Sun Life Institutional Investments (Canada) Inc. was formerly known as Sun Life Investment Management Inc. The rebrand was effective April 1, 2016. Figures in this report are based on responses provided by the survey participants. Benefits Canada assumes no responsibility for the accuracy of the data provided. All totals are subject to a +/- variance due to rounding.

Source: Firms participating in the Canadian Institutional Investment Network's spring 2016 top 40 money managers survey

# TOP 40

# MONEY MA

<b>TD ASSET MANAGEMENT</b>	<b>1</b>
Rank 2014: 1	↑ 10.4%
2015 CPA:	\$88,306.6
2014 CPA:	\$79,995
<b>Total Assets 2015:</b>	<b>\$256,209.5</b>

<b>FIERA CAPITAL CORP.</b>	<b>6</b>
Rank 2014: 7	↑ 10.4%
2015 CPA:	\$29,512.3
2014 CPA:	\$26,723.4
<b>Total Assets 2015:</b>	<b>\$74,287.3</b>

<b>GREYSTONE MANAGED INVESTMENTS INC.</b>	<b>11</b>
Rank 2014: 11	↓ 0.5%
2015 CPA:	\$20,518.2
2014 CPA:	\$20,631
<b>Total Assets 2015:</b>	<b>\$31,097.9</b>

<b>FRANKLIN TEMPLETON INSTITUTIONAL*</b>	<b>16</b>
Rank 2014: 17	↑ 11.8%
2015 CPA:	\$16,714.1
2014 CPA:	\$14,955.7
<b>Total Assets 2015:</b>	<b>\$48,504.7</b>

<b>BLACKROCK ASSET MANAGEMENT CANADA LTD.</b>	<b>2</b>
Rank 2014: 2	↑ 6.2%
2015 CPA:	\$82,354.8
2014 CPA:	\$77,513.6
<b>Total Assets 2015:</b>	<b>\$149,755</b>

<b>CONNOR, CLARK &amp; LUNN FINANCIAL GROUP</b>	<b>7</b>
Rank 2014: 8	↑ 3.5%
2015 CPA:	\$27,458.5
2014 CPA:	\$26,527.3
<b>Total Assets 2015:</b>	<b>\$58,631.2</b>

<b>BROOKFIELD ASSET MANAGEMENT</b>	<b>12</b>
Rank 2014: 15	↑ 20.9%
2015 CPA:	\$19,707
2014 CPA:	\$16,302
<b>Total Assets 2015:</b>	<b>\$56,516</b>

<b>WELLINGTON MANAGEMENT GROUP LLP</b>	<b>17</b>
Rank 2014: 20	↑ 15.9%
2015 CPA:	\$16,013
2014 CPA:	\$13,813
<b>Total Assets 2015:</b>	<b>\$21,268</b>

<b>PHILLIPS, HAGER &amp; NORTH INVESTMENT MANAGEMENT</b> <small>(RBC Global Asset Management)</small>	<b>3</b>
Rank 2014: 3	↑ 5.2%
2015 CPA:	\$56,869.2
2014 CPA:	\$54,034.3
<b>Total Assets 2015:</b>	<b>\$260,702</b>

<b>STATE STREET GLOBAL ADVISORS, LTD.</b>	<b>8</b>
Rank 2014: 6	↓ 7.1%
2015 CPA:	\$24,967.9
2014 CPA:	\$26,871.1
<b>Total Assets 2015:</b>	<b>\$44,442.9</b>

<b>FIDELITY INVESTMENTS CANADA ULC<sup>1</sup></b>	<b>13</b>
Rank 2014: 14	↑ 8.5%
2015 CPA:	\$18,675.5
2014 CPA:	\$17,208.8
<b>Total Assets 2015:</b>	<b>\$112,768.5</b>

<b>BNY/MELLON ASSET MANAGEMENT LTD.*</b>	<b>18</b>
Rank 2014: 21	↓ 4.8%
2015 CPA:	\$15,131
2014 CPA:	\$15,899.1
<b>Total Assets 2015:</b>	<b>\$23,938</b>

<b>MANULIFE ASSET MANAGEMENT</b>	<b>4</b>
Rank 2014: 4	↓ 4.0%
2015 CPA:	\$33,862.5
2014 CPA:	\$35,263.1
<b>Total Assets 2015:</b>	<b>\$94,057.2</b>

<b>CIBC ASSET MANAGEMENT INC.</b>	<b>9</b>
Rank 2014: 10	↑ 7.0%
2015 CPA:	\$22,302.2
2014 CPA:	\$20,841.8
<b>Total Assets 2015:</b>	<b>\$131,366.2</b>

<b>MFS INVESTMENT MANAGEMENT CANADA LTD.</b>	<b>14</b>
Rank 2014: 12	↓ 1.8%
2015 CPA:	\$17,357.5
2014 CPA:	\$17,678.6
<b>Total Assets 2015:</b>	<b>\$27,352.6</b>

<b>BENTALL KENNEDY (CANADA) LP</b>	<b>19</b>
Rank 2014: 19	↑ 2.8%
2015 CPA:	\$14,214
2014 CPA:	\$13,828
<b>Total Assets 2015:</b>	<b>\$23,035</b>

<b>BEUTEL, GOODMAN &amp; COMPANY LTD.</b>	<b>5</b>
Rank 2014: 5	↓ 12.3%
2015 CPA:	\$30,890
2014 CPA:	\$35,211
<b>Total Assets 2015:</b>	<b>\$37,270</b>

<b>J.P. MORGAN ASSET MANAGEMENT (CANADA) INC.</b>	<b>10</b>
Rank 2014: 9	↓ 12.4%
2015 CPA:	\$20,580.3
2014 CPA:	\$23,495.7
<b>Total Assets 2015:</b>	<b>\$24,509.2</b>

<b>LETKO, BROUSSEAU &amp; ASSOCIATES INC.</b>	<b>15</b>
Rank 2014: 13	↓ 2.6%
2015 CPA:	\$16,975.7
2014 CPA:	\$17,433.6
<b>Total Assets 2015:</b>	<b>\$27,482.1</b>

<b>JARISLOWSKY, FRASER LTD.</b>	<b>20</b>
Rank 2014: 18	↓ 7.8%
2015 CPA:	\$12,983
2014 CPA:	\$14,080
<b>Total Assets 2015:</b>	<b>\$32,690</b>

**Notes:** \*Restated 2014 figures

**1.** Fidelity Investments Canada ULC was listed as Pyramis Global Advisors (A Fidelity Investments Company) in the 2015 report. The rebrand was effective November 2015.

# NAGERS

CANADIAN ASSETS (MILLIONS) UNDER MANAGEMENT AS OF DEC. 31, 2015  
CPA = CANADIAN PENSION ASSETS

↑ ↓ Indicates an increase or decrease in variance from 2014 to 2015

## PIMCO CANADA CORP. 21

Rank 2014:	23	↑ 4.2%
2015 CPA:	\$12,908	
2014 CPA:	\$12,389	
<b>Total Assets 2015:</b>	<b>\$26,456</b>	

## GLC ASSET MANAGEMENT GROUP LTD. 22

Rank 2014:	16	↓ 16.3%
2015 CPA:	\$12,773.1	
2014 CPA:	\$15,258.8	
<b>Total Assets 2015:</b>	<b>\$35,605.5</b>	

## LEITH WHEELER INVESTMENT COUNSEL LTD. 23

Rank 2014:	22	↓ 6.7%
2015 CPA:	\$11,880.4	
2014 CPA:	\$12,733.1	
<b>Total Assets 2015:</b>	<b>\$16,395.5</b>	

## ADDENDA CAPITAL INC. 24

Rank 2014:	25	↓ 7.5%
2015 CPA:	\$9,527.3	
2014 CPA:	\$10,302.2	
<b>Total Assets 2015:</b>	<b>\$24,688.9</b>	

## SUN LIFE GLOBAL INVESTMENTS 25

Rank 2014:	29	↑ 22.7%
2015 CPA:	\$9,335.4	
2014 CPA:	\$7,610.9	
<b>Total Assets 2015:</b>	<b>\$12,280.5</b>	

## BAILLIE GIFFORD OVERSEAS LTD. 26

Rank 2014:	28	↑ 9.8%
2015 CPA:	\$8,958.8	
2014 CPA:	\$8,160	
<b>Total Assets 2015:</b>	<b>\$13,427.6</b>	

## GOLDMAN SACHS ASSET MANAGEMENT, LP 27

Rank 2014:	N/A	↑ 17.0%
2015 CPA:	\$8,750.3	
2014 CPA:	\$7,481	
<b>Total Assets 2015:</b>	<b>\$9,212.7</b>	

## BURGUNDY ASSET MANAGEMENT LTD. 28

Rank 2014:	32	↑ 23.1%
2015 CPA:	\$8,502.9	
2014 CPA:	\$6,905.2	
<b>Total Assets 2015:</b>	<b>\$20,269.6</b>	

## MERCER GLOBAL INVESTMENTS CANADA LTD. 29

Rank 2014:	30	↑ 17.8%
2015 CPA:	\$8,344.6	
2014 CPA:	\$7,082	
<b>Total Assets 2015:</b>	<b>\$10,030.3</b>	

## ABERDEEN ASSET MANAGEMENT PLC 30

Rank 2014:	26	↓ 17.2%
2015 CPA:	\$8,183.1	
2014 CPA:	\$9,884.1	
<b>Total Assets 2015:</b>	<b>\$12,562.8</b>	

## SPRUCEGROVE INVESTMENT MANAGEMENT LTD. 31

Rank 2014:	27	↓ 14.8%
2015 CPA:	\$8,096.6	
2014 CPA:	\$9,502.3	
<b>Total Assets 2015:</b>	<b>\$11,874.4</b>	

## MORGUARD INVESTMENTS LTD.\* 32

Rank 2014:	24	↓ 0.5%
2015 CPA:	\$8,062.5	
2014 CPA:	\$8,103.4	
<b>Total Assets 2015:</b>	<b>\$13,205.9</b>	

## MAWER INVESTMENT MANAGEMENT LTD. 33

Rank 2014:	34	↑ 17.0%
2015 CPA:	\$7,970.9	
2014 CPA:	\$6,815.4	
<b>Total Assets 2015:</b>	<b>\$34,506.6</b>	

## INDUSTRIAL ALLIANCE GROUP 34

Rank 2014:	33	↑ 8.6%
2015 CPA:	\$7,481.8	
2014 CPA:	\$6,886.6	
<b>Total Assets 2015:</b>	<b>\$78,892.6</b>	

## HEXAVEST INC. 35

Rank 2014:	35	↑ 3.4%
2015 CPA:	\$6,937.5	
2014 CPA:	\$6,707.2	
<b>Total Assets 2015:</b>	<b>\$7,920.6</b>	

## GUARDIAN CAPITAL LP 36

Rank 2014:	31	↓ 5.1%
2015 CPA:	\$6,595.7	
2014 CPA:	\$6,949.8	
<b>Total Assets 2015:</b>	<b>\$21,493.2</b>	

## INVESCO 37

Rank 2014:	37	↑ 10.8%
2015 CPA:	\$5,937.1	
2014 CPA:	\$5,357.1	
<b>Total Assets 2015:</b>	<b>\$34,129.1</b>	

## BMO GLOBAL ASSET MANAGEMENT 38

Rank 2014:	41	↑ 31.4%
2015 CPA:	\$5,817.3	
2014 CPA:	\$4,427.6	
<b>Total Assets 2015:</b>	<b>\$92,181.3</b>	

## ALLIANCE BERNSTEIN CANADA INSTITUTIONAL INVESTMENTS 39

Rank 2014:	42	↑ 32.2%
2015 CPA:	\$5,587.9	
2014 CPA:	\$4,226.2	
<b>Total Assets 2015:</b>	<b>\$12,489.7</b>	

## ARROWSTREET CAPITAL LP 40

Rank 2014:	N/A	↑ 38.7%
2015 CPA:	\$5,416	
2014 CPA:	\$3,906	
<b>Total Assets 2015:</b>	<b>\$6,946</b>	

**2015 Top 40 Total** \$752,460.6

**2014 Top 40 Total** \$728,994.0

**Variance** ↑ 3.2%

Figures in this report are based on responses provided by the survey participants.

Benefits Canada assumes no responsibility for the accuracy of the data provided.

All totals are subject to a +/- variance due to rounding.

Source: Firms participating in the Canadian Institutional Investment Network's spring 2016 top 40 money managers survey

get their wish following a recent agreement in principle, announced during Prime Minister Justin Trudeau's visit to Washington, that would allow passengers to clear customs at Billy Bishop airport.)

### Building from scratch

Building assets from scratch also brings advantages. "If we were to buy an existing renewable wind farm in, let's say, Texas . . . it would probably be eight- to 10-per-cent gross equity return. If we were to build that, take the construction risk and the time it takes to build it, we would probably get between two and four per cent more return," says Prater.

"You get that extra return and you can transfer a lot of the risk to more appropriate holders of that risk — in this case the people that are constructing it or the wind turbine suppliers," he adds.

OPTrust believes that risk equation works, which is why it joined a \$450-million project to construct the third-largest wind farm in Australia last summer.

The pension fund joined up with Partners Group, utility giant General Electric and Britain-based Renewable Energy Systems to supply 75 wind turbines for the creation of a 240-megawatt wind farm in southwestern Victoria.

The Ararat wind farm is expected to become operational in 2017 and produce enough electricity to supply 123,000 homes, or six per cent of the state's households, annually. Its life-span will be 25 years.

Prater predicts the return will be five per cent more than an existing wind farm would yield.

The construction team will absorb much of the risk associated with the project, he says. "So it's delivered to us operational, and if it isn't, there are a lot of warranties and guarantees. If they don't perform, we can replace them and get new contractors. And that's where the risk comes. If you have to replace the guys, you do have a delay and lose some of that pickup in return."

The project also comes with a guarantee from the Australian capital territory government to buy 40 per cent of the energy produced at Ararat.

Ensuring there will be buyers or users before construction starts is key for managing the risks of greenfield infrastructure projects, says Prater.

"We wouldn't build a new toll road somewhere without knowing that a car was going to drive up and down it. So you want a bit of protection, from whoever wanted you to build that road or airport, that patronage would be a caveat."

### Concentration risk


Apart from the obvious risks of not having enough business to justify the investment or paying more than expected to build or fix an asset, investors in opportunistic infrastructure need to be aware of the concentration risk.

That's particularly true when they use an external asset manager instead of investing directly. "The deals that a manager thinks are attractive today are probably the deals they're going to find in the next few years. So you're picking up a sector bias or a geography bias," says Nelson.

"For example, we see a lot of energy projects as being attractive today. So

if you're investing in an opportunistic strategy, you might say, 'I like this energy deal.' If you like that energy deal, there's another one down the street and you can just keep chasing them. And now you've ended up with an unintended bias towards the energy sector."

As a result, Nelson suggests investors are better off using different managers to get sufficient diversification.

Because of the risks associated with non-core infrastructure, the pension funds that allocate money to it typically have experience with core assets. "It's very unusual to see any client start with opportunistic," says Nelson. "[But] core was new and exciting 10 years ago. If you already have core running in your program, it's definitely not going to be, 'I need more core,' because of the competition." 

**Yaldaz Sadakova is associate editor of *Benefits Canada*.**

## THE APPEAL OF DISTRESSED ASSETS

When it comes to embracing risk, Canada's defined benefit pension plans aren't just looking at infrastructure. Chronically low interest rates — and the resulting low bond yields — and anemic global growth are also motivating some to consider distressed assets.

Such risky assets typically include securities that produce high returns because credit rating agencies consider them to be below investment grade. The price is usually lower than their market value.

The distressed asset class also includes businesses that have major issues affecting their balance sheets. Investors that buy these companies aim to turn them around. "We're like firefighters in the capital markets," says Patrick Blott, founder of Blott Asset Management in New York City, a firm whose focus includes distressed investments. "We focus on fixing the company, so it's more like venture capital."

The Healthcare of Ontario Pension Plan sees value in distressed

and opportunistic assets. "We're looking at all those things," said Jim Keohane, the pension fund's president and chief executive officer, during a recent press conference in Toronto. "A lot of times . . . the asset is high quality, but the seller may be distressed and they sell at attractive prices."

One of the main risks associated with distressed assets is company management, something that's likely "the single most important risk determinant in terms of whether you're going to make money or not," says Blott.

"You can take the best company and the best assets in the world and you put the wrong CEO or the wrong team in place and, in very short order, you can ruin that value. You can take marginal assets and put the right person there and do wonderful things."

But Blott cautions that when investors are assessing potential companies, it can be tricky to figure out how good the management is, particularly if they're focusing on the low price of the asset.