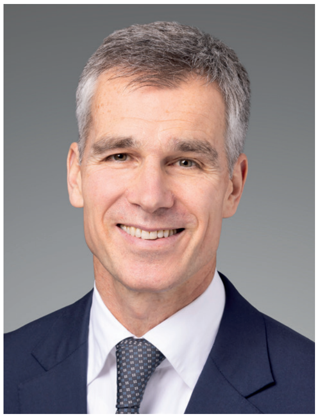
KEYNOTE INTERVIEW

Here for the long haul



Faced with an uncertain world, Morgan Stanley Infrastructure Partners' Markus Hottenrott explains the importance of long-term value creation in infrastructure investing

Heightened geopolitical and macroeconomic uncertainty is causing many investors to reconsider which infrastructure assets to include in their portfolios. The overwhelming short-term noise and frequent bouts of volatility mean that there is a growing onus on identifying infrastructure assets tied to long-term themes that can outlast potential headwinds or short-term volatility. Against this backdrop, Morgan Stanley Infrastructure Partners' chief investment officer, Markus Hottenrott, discusses how to identify the best assets as well as strategies to unlock long-lasting value creation opportunities.

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Q Are there specific thematics that will drive infrastructure investing over the next decade?

The big trend everyone is talking about right now is obviously data growth and digitalisation. We're seeing a huge increase in data volumes, which is driving greater appetite for broadband connectivity, mobile towers and data centres. Add to that the significant impact of artificial intelligence.

Everyone is, of course, focused on data centres and the fact that significantly more power will be required to meet demand. Some extraordinary figures are already being thrown around when it comes to the investment need associated with AI. OpenAI recently said it may need up to $7 trillion to build out and scale its AI hardware and infrastructure. This covers everything from chip fabrication plants, energy needs, data centres to full stack AI deployment.

In terms of data centre-related power demand, in 2023, 4.4 percent of US electricity use was derived from ex-crypto data centres. This figure is set to grow with the US Department of Energy projecting it to increase to 12 percent by 2028. At the same time, there's also the general electrification trend and, in this environment, power is a focus for us.

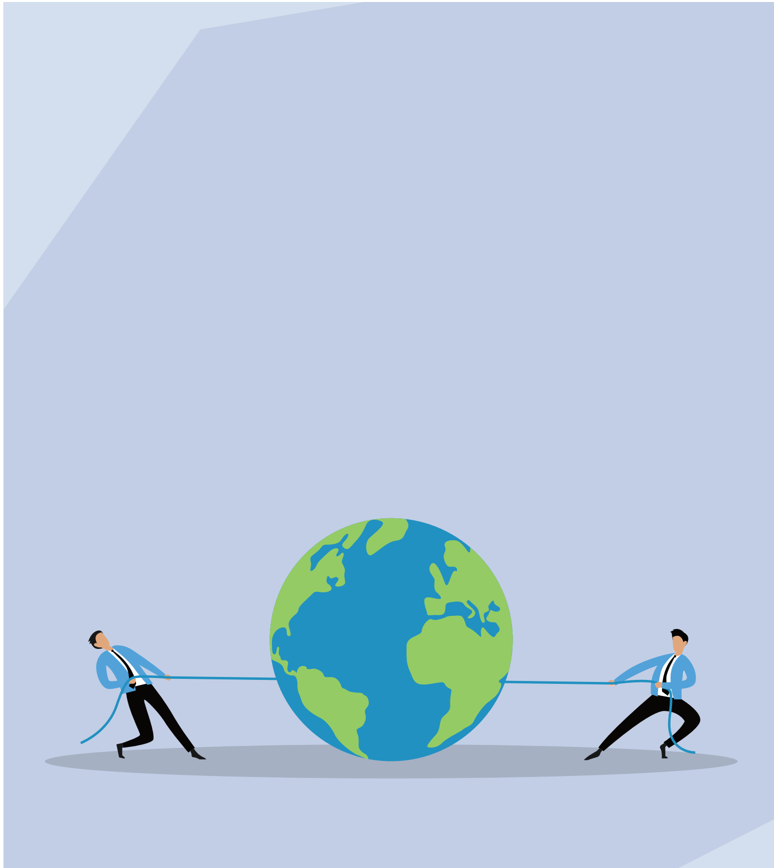
Relatedly, but also separately, the energy transition will remain an area of focus for us. It's fair to say that priorities have shifted somewhat around sustainability and green energy, as many countries face a cost-of-living crisis. There's also been a significant political focus on keeping energy costs as low as possible.

> *"In an environment of persistent political volatility, infrastructure investors may need to be selective about assets that rely heavily on subsidies, economic regulation or governments as counterparties"*

We believe that there's still a huge energy transition opportunity. Between now and 2030, there are estimates for global investment needs of up to $5.6 trillion per year. Tying into the theme of data centres and electrification, it's clear that the energy transition remains a key focus.

While intermittency remains a big challenge for most types of renewables, even with batteries, they're oftentimes the generation capacity that can be added in the shortest timeline. For fossil fuel-powered baseload, there are also often supply chain issues. For example, the gas-fired turbine market is constrained, and some projects are required to wait up to five years. Greenfield nuclear projects take even longer to get permitted and realised.

We're also continuing to look at the water sector. In certain parts of the



Q How do you view infrastructure investing in the context of the current global geopolitical backdrop?

There's a good chance that the elevated risk and uncertainty of today's geopolitics will persist. And even in countries that look relatively stable right now, polarisation and volatility could arise as widespread changes in public sentiment disconnect from political parties or coalitions currently in power. If the result is a materially different government taking office, this could result in the introduction of new policies, as well as scrapping existing ones. This dynamic would add to economic uncertainty.

Taking a step back, what would this mean for infrastructure? I would say two things. Firstly, you want to rely less on subsidy schemes. A government may be supportive of subsidising certain kinds of technology and sectors, but equally the next government might not be. And secondly, many governments are already under financial pressures. Costly infrastructure projects could be called into question under a different government.

The upshot is that, in an environment of persistent political volatility, infrastructure investors may need to be selective about assets that rely heavily on subsidies, economic regulation or governments as counterparties. Indeed, since the sovereign debt crisis in Europe, we've been pivoting towards private infrastructure. For example, assets that are contracted with private counterparties and/or are used primarily by private customers.

world, there's been a rising focus on water conservation, wastewater treatment and desalination, particularly with climate change and agricultural needs rising. Desalination, for example, is quite energy intensive and there'll be power implications as a result.

Aside from climate change, there are a few other factors driving water consumption needs. For one, data centres have significant cooling needs, and in particular older facilities can heighten water stress at a given location. Related power generation may further consume water and we're seeing water scarcity concerns that need to be reconciled.

For example, there's a lot of talk about the 'mega-drought' region in the US, which covers the Southwest, California and the Colorado River basin. Less well known is that, according to the European Drought Observatory, as of May 2025, over 33 percent of the EU27 territory, plus the UK, was under 'Warning' conditions and 4 percent under 'Alert' conditions. This brings into sharp focus the strain on our water infrastructure, making it abundantly clear more investment is needed.

Ultimately, as with any thematic, it's key to have a differentiated viewpoint. This means being targeted and finding sub-regions or subsectors with disproportionate tailwinds. It's about looking for opportunities with an upside skew, and situational dynamics where we have an edge due to a relationship or our carve-out expertise.

> *"Between now and 2030, there are estimates for global [energy transition] investment needs of up to $5.6 trillion per year"*

Q How do you see the market evolving over the next few decades?

We believe that the infrastructure market is going to continue to grow, with ever more institutional money flowing into the sector. Our estimate is that institutional investors are on average 4-5 percent allocated to infrastructure. As an indicator for the scale of expected growth, in many of the most mature pension markets, this average is much higher, with some very large pools of capital well into the double-digit percentages.

At the same time, we're currently seeing slower exits. And this is especially the case with the very largest deals. At a time when LP infrastructure portfolios are increasingly maturing, there's an increased focus on distributions to paid-in capital (or DPI) as a metric. GP interest alignment is likely going to become more relevant as people try to deal with this DPI pressure. With this in mind, our disciplined and continued standing in the middle market allows us to have more routes to exit.

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Q Where exactly do you see value creation in such a context?

With more capital flowing in, the creation of new infrastructure assets such as from carve-outs, but also the "infrastructurisation" of existing assets, is going to be value accretive. What does this mean exactly? For us, it means the sourcing of opportunities, structuring of deals and contractual risk transfer, as well as the ultimate enhancement of assets in preparation for the buyer at exit.

It also means negotiating certain contractual protections, such as long-term volume commitments, ensuring contractual inflation pass-through and so forth. Likewise, it can require negotiating a liquidation preference or an earn-out. Market participants tend to think of us when solutions are required, and when there's some structuring required.

Ultimately, I think that our strategy to have a broad, flexible mandate in terms of sectors, with the focus on providing solutions, whether for corporates that need capital or for families, via carve-outs, will continue to be an effective approach. ■