The Current Opportunity in Infrastructure Part 2: Infrastructure Renewal

Starlight Global Infrastructure fund

Hisham Yakub, CFA

Senior Portfolio Manager
Infrastructure

Investment in infrastructure that is essential and foundational to the functioning of the economy is a catalyst for productivity, growth and increased societal well-being. Yet, developed economies in North America and Western Europe have underinvested in infrastructure for many years. Infrastructure investment has declined as a share of GDP in 11 of the G20 economies since the global financial crisis, despite glaring gaps and years of debate about the importance of shoring up foundational systems. Former US Treasury Secretary Larry Summers referred to the decade following the Great Financial Crisis as a period of secular stagnation, due to sluggish growth, low interest rates and an absence of inflation. He identified the cause to be lack of public investment in infrastructure in excess of depreciation, implying that on a net-basis there was no net investment happening at all. Years of chronic underinvestment have now caught up with countries around the world. If these gaps continue to grow, they could further erode future growth potential and productivity. In a report published in 2016, McKinsey estimates that the world needs to invest about 3.8 percent of GDP, or an average of $3.3 trillion a year, in economic infrastructure just to support expected rates of future growth[1].

Much of the infrastructure we rely on in our urban centres are still in use beyond their useful life. The American Society of Civil Engineers estimates that the median expected lifespan of physical infrastructure to be about fifty years. A lot can change in that period of time. Over the last fifty years, the US population has increased by 59% and GDP (inflation-adjusted) increased 272%. Countless innovations have come to pass and facilitated modern life but roads, airports, sewer and water systems are still in use decades after the end of their projected life spans and are aged and decaying. Climate change has compounded the process of decay. Over the last 50 years, global temperature rose at an average rate of about 0.13°C per decade – almost twice as fast as the 0.07°C per decade increase observed over the previous half-century. The world had its warmest August in at least 174 years, increasing the odds that 2023 will go down as one of the hottest years on record. As weather grows more severe, old vulnerabilities continue to worsen and new ones are exposed.

Given the demands of a larger population, increased productivity and a harsher climate, it is unfathomable that we have chosen to defer the replacement of critical public assets. The oft-cited reason for deferring infrastructure spending is the ballooning national debt, but Summers pointed out that just a 1% increase in infrastructure spending would actually spur GDP growth such that debt to GDP would actually decrease.

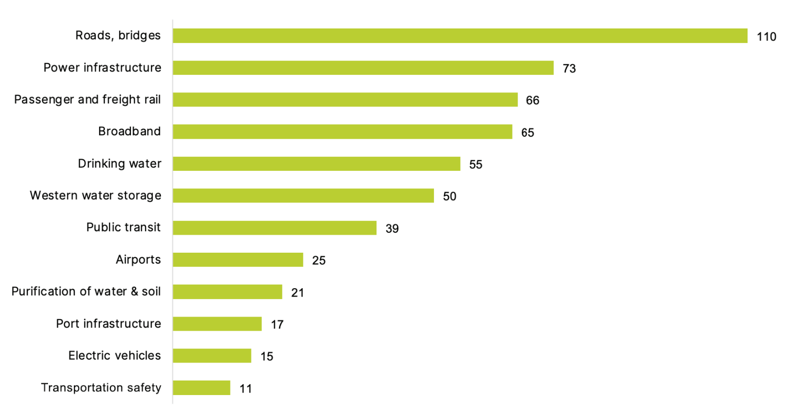
Despite being an identified area of dire need for many years, meaningful action was not taken on bridging the infrastructure gap at the national level until President Biden passed the Infrastructure Investment and Jobs Act

[1]McKinsey&Company. McKinsey Global Institute. Bridging Global Infrastructure Gaps. June 2016.

in November 2021 to renew existing infrastructure over the next decade. The bill is expected to address known infrastructure gaps across the country where the need is highest and specifically mentions:

- **Roads and Bridges:** 1 in 5 miles of highways and major roads, and 45,000 bridges, are in poor condition.
- **Water Systems:** up to 10 million households and 400,000 schools and childcare centers lack safe drinking water.
- **Public Transportation:** 24,000 buses, 5,000 rail cars, 200 stations, and thousands of miles of track, signals, and power systems are in need of replacement.
- **Airports:** no U.S. airport ranks in the top 25 of airports worldwide.

Exhibit 1: Infrastructure Investment and Jobs Act ($bn)



Source: American Society of Civil Engineers.

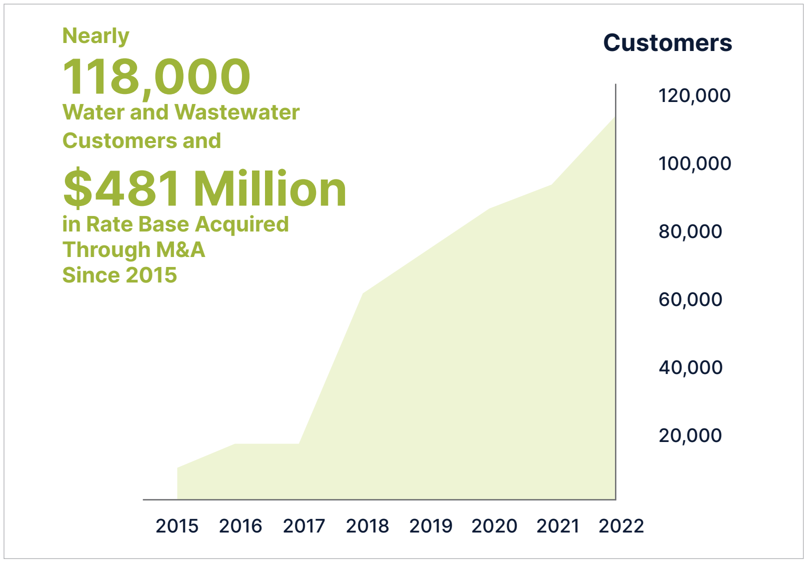
Given the prolonged period of underinvestment, it follows that the current opportunity to invest in renewing infrastructure is generational. Governments and their constituencies have come to embrace private investment in public infrastructure as a viable funding strategy – and there has never been so much private capital earmarked for infrastructure renewal. The asset class is large enough to absorb the capital and deploy it into assets that produce stable, inflation-indexed returns over the duration of the assets' useful life which, at a median of about fifty years, is unmatched by most other asset classes.

Below are a few illustrations of how we are investing in infrastructure renewal in the **Starlight Global Infrastructure Fund**.

Essential Utilities – Water and Wastewater

The drinking water infrastructure system in the US consists of 2.2 million miles of pipes, with much of it buried deep under cities. The American Society of Civil Engineers estimates that a water main break occurs every two minutes and an estimated 6 billion gallons of treated water is lost each day. Facing failing infrastructure, an aging workforce, and increasingly stringent water quality and environmental mandates, a growing number of municipal governments no longer want to run their own water and wastewater utilities. The voluntary sale of municipal water and wastewater systems to dedicated water professionals is a proven way for local governments to access the resources and expertise needed to address their water utility challenges. Essential Utilities ("Essential") is a Pennsylvania-based company that is consolidating the market for local water

Exhibit 2: Cumulative Additions of Customers Through Acquisitions Since 2015



Source: Essential Utilities.

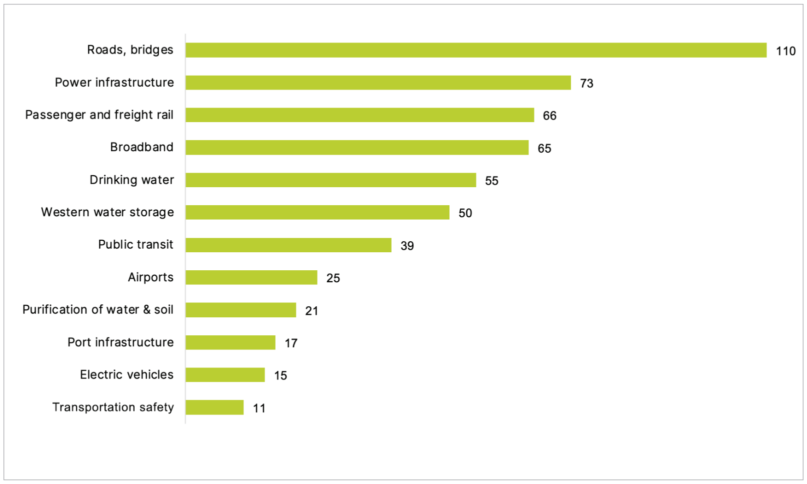
utilities. Municipalities that are unable to comply with state and federal regulations can voluntarily sell their water and wastewater as an effective way to offload risk, monetize assets, and focus resources on other local needs. After Essential completes an acquisition, it invests the necessary capital to bring the system's infrastructure up to standard while also optimizing operations. State utility commissions allow Essential to earn a fair return on their capital through a regulated rate setting process. While customers ultimately bear the cost of infrastructure upgrades, Essential's expertise and efficiency has enabled it to deliver cost improvements such that some customers have seen their water rates fall by as much as 40% even as the major infrastructure upgrades were implemented. Since 2015, Essential has increased their customer base by almost six-fold. Significant runway for privatizations remains as about 75% of water utilities are still publicly-owned.

Ferrovial SA – Highways and Airports

HIGHWAYS

As urban areas become more congested, governments are increasingly turning to the private sector for creative solutions to increase mobility in their cities. Ferrovial specializes in building and operating highly complex transportation infrastructure projects for fast-growing urban centres. Its main assets historically were a 43% stake in the 407 ETR toll road in Toronto and a 25% stake in London's Heathrow Airport. More recently it has been building out 'Managed Lanes' in the US, which are express toll lanes within an existing public highway. These lanes are convenient for drivers as it allows them to make a real-time decision to bypass congestion without having to make a significant detour. Tolls on Managed Lanes are adjusted every five minutes to optimize traffic flow on the entire highway and maintain a minimum speed of 50 miles per hour in the toll lanes. Managed Lanes solve traffic congestion problems by allowing their users to save time, have certainty in their daily commutes and increase the economic productivity of their regions of influence. Ferrovial's first two Managed Lanes assets in Texas generated earnings growth in excess of 30% compounded annually from 2015 to 2019 while the average trip cost users only $3.50 and 90% of trips were less than $10. Ferrovial has completed construction on three new managed lane assets over the past year in Charlotte, Virginia and Texas. After investing in building out this portfolio over the past five years to six Managed Lane assets, Ferrovial is entering a harvesting period during which the cash flow produced by these assets is expected to rise substantially through the end of the decade.

Exhibit 3: Dividends to Ferrovial from its core assets



Source: Company data and Santander estimates.

AIRPORTS

No US airport is currently ranked in the Top 10 globally by SkyTrax, a UK-based air travel consultancy[2]. Even prior to the pandemic, flight delays were increasingly problematic. In 2019, 100 million minutes per day were lost to flight delays. While several factors influence delays, airport infrastructure continues to grapple with capacity needs to serve the growing passenger base. According to the Airports Council International–North America (ACI-NA), all categories of airports will require investments in terminal buildings, access to terminals, airfield capacity, and airfield reconstruction over the next few years. The largest portion of the investment need at large, medium, and small airports is for terminal buildings and ranges from 30% to nearly 50% of total needs.

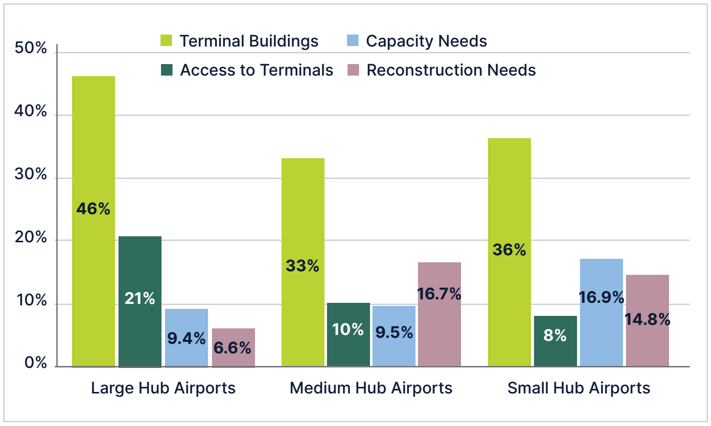
[2]Skytrax World Airport Rewards. World's Top 100 Airports 2023.

230922-6

Exhibit 4: Flight Delays Over Time

Source: Bureau of Transportation Statistics.

Exhibit 5: Top Four Investment Needs as a Portion of Total Needs for Large, Medium and Small Airports



Source: Airports Council International–North America, "Terminally Challenged: Addressing the Infrastructure Funding Shortfall of America's Airports: 2019-2023."

Last year, a consortium 49% owned by Ferrovial won a bid to build, finance, operate and maintain the New Terminal One at John F. Kennedy International Airport in New York. The facility replaces three old terminals with a structure three times the size, four times the retail space and capable of serving 23 million passengers daily by the time it is complete in 2028. The $19 billion redevelopment project also includes preparing for more extreme weather events by relocating sensitive electrical equipment to rooftops to protect it from flooding, reinforcing runways to handle extreme temperature swings and revving up air conditioning as climate change complicates operations.

Very few companies have the unique set of financing, development and operational capabilities to execute these highly complex projects. Once constructed, these transportation assets become a means to alleviate congestion, boost throughput and spur economic growth while also allowing Ferrovial's shareholders to earn a return commensurate with risks associated with the project.

Change is Constant and Inevitable

The world will continue to change in dramatic ways that are difficult to imagine. Continued rural to urban migration means that by 2050, 6.7 billion people will reside in megacities, up from 4.6 billion today. About 52% of the world's population will reside in regions prone to water stress. One in six people will be over the age of 65. Three billion more cars will be on the road. Approximately 10 billion passengers (2019: 4.5 billion) will be carried by air some 22 trillion kilometres (2019: 8.9 billion) each year[3]. It is often stated that 75% of the infrastructure in place by 2050 does not exist today. That infrastructure will be tasked with serving a growing urban population with greater mobility and connectivity needs.

The human brain is not wired to conceptualize broad, far-reaching and radical change. In advanced economies, we are in the midst of a renaissance of investment in physical infrastructure. It is often said that we tend to overestimate the change that will occur in the short-term and underestimate the change that will occur in the long-term. The most probable originator of this dichotomy is Roy Amara, a Stanford computer scientist, who mentioned it in the context of technological innovation. Developers of long-duration assets, including physical "built" infrastructure, also need to overcome their inherent limitations to envision the future world even though it may not yet be very apparent. The capital deployed over the next few years presents a generational opportunity for investors to earn strong risk-adjusted returns and participate in building the foundation upon which the economy will grow over the next several decades.

[3]ICAO. The World of Air Transport in 2019.

The **Starlight Global Infrastructure Fund** is a concentrated portfolio of companies that provides essential and foundational services in a supply-constrained manner for the basic functioning of society. The culmination of our bottom-up investment process is a selection of resilient business models managed by skilled operators that have exposure to the broad secular trend of *infrastructure renewal*. The holdings in the Starlight Global Infrastructure Fund comprise companies that produce cash flows from the construction, operation, and maintenance of long-duration assets. **The Starlight Global Infrastructure Fund yields over 5.50% annually and the distributions are paid to unitholders on a monthly basis. The distribution is supported by strong dividend growth from the underlying portfolio holdings. Over the last twelve months through the end of June 2023, the fund experienced 23 dividend increases with an average increase of +12.1%**.

We invite you to partner with us.

Starlight Real Assets Mutual Fund & ETF

Real Assets
Starlight Global Infrastructure Fund (SCGI)
Inception – 2018 **Investment Objective** To provide regular current income by investing globally in companies with either direct or indirect exposure to infrastructure. **Fund Codes:** Series ETF (SCGI) Series A (SLC102) Series T6 (SLC152) Series F (SLC202) Series FT6 (SLC252) Series O (SLC402) Series O6 (SLC452) Series I (SLC902) **Distribution Frequency** Fixed Monthly

About Starlight Capital

Starlight Capital is an independent Canadian asset management firm with over $1 billion in assets under management. We manage Global and North American diversified private and public equity investments across traditional and alternative asset classes, including real estate, infrastructure and private equity. Our goal is to deliver superior risk-adjusted, total returns to investors through a disciplined investment approach: Focused Business Investing. Starlight Capital is a wholly-owned subsidiary of Starlight Investments. Starlight Investments is a leading global real estate investment and asset management firm with over 360 employees and $25B in AUM. A privately held owner, developer and asset manager of over 77,000 multi-residential suites and over 9 million square feet of commercial property space. Learn more at www.starlightcapital.com and connect with us on LinkedIn at www.linkedin.com/company/starlightcapital/

Invest With Us

For more information on our investment solutions, learn more at **starlightcapital.com** or speak to our Sales Team.

Important disclaimer.

The views in this update are subject to change at any time based upon market or other conditions and are current as of August 31, 2023. While all material is deemed to be reliable, accuracy and completeness cannot be guaranteed.

Certain statements in this document are forward-looking. Forward-looking statements (“FLS”) are statements that are predictive in nature, depend upon or refer to future events or conditions, or that include words such as “may,” “will,” “should,” “could,” “expect,” “anticipate,” “intend,” “plan,” “believe,” or “estimate,” or other similar expressions. Statements that look forward in time or include anything other than historical information are subject to risks and uncertainties, and actual results, actions or events could differ materially from those set forth in the FLS. FLS are not guarantees of future performance and are by their nature based on numerous assumptions. Although the FLS contained herein are based upon what Starlight Capital and the portfolio manager believe to be reasonable assumptions, neither Starlight Capital nor the portfolio manager can assure that actual results will be consistent with these FLS. The reader is cautioned to consider the FLS carefully and not to place undue reliance on FLS. Unless required by applicable law, it is not undertaken, and specifically disclaimed that there is any intention or obligation to update or revise FLS, whether as a result of new information, future events or otherwise. Commissions, trailing commissions, management fees and expenses all may be associated with investment funds. Please read the prospectus before investing. Investment funds are not guaranteed, their values change frequently, and past performance may not be repeated.

The content of this document (including facts, views, opinions, recommendations, descriptions of or references to, products or securities) is not to be used or construed as investment advice, as an offer to sell or the solicitation of an offer to buy, or an endorsement, recommendation or sponsorship of any entity or security cited. Although we endeavour to ensure its accuracy and completeness, we assume no responsibility for any reliance upon it. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the offering documents before investing. Investors should consult with their advisors prior to investing.

Starlight Capital
1400–3280 Bloor Street West
Toronto, Ontario, Canada M8X 2X3
info@starlightcapital.com
1-833-752-4683
starlightcapital.com

Starlight™ CAPITAL
Focused Investing