EXPERT COMMENTARY

Social infrastructure has a vast funding gap and could form the market's next frontier, say Augustin Schneider-Maunoury, asset management director, and Aymar de Tracy, investment director, at InfraVia Capital Partners

Grand plans for social infrastructure

Over the past decade, infrastructure funds have been able to identify new sectors of investment that were out of scope for the asset class in the 2000s. Active GPs have demonstrated an ability to increase the transactional opportunity by identifying new sectors while staying loyal to the underlying infrastructure thesis, and therefore capturing an early-mover premium. This success has been confirmed both by the rising deal count from infrastructure investors in these new sectors, such as data centres or fibre optics, but also by the now tangible successful exit track record.

The same realisation is happening in the social infrastructure space, where private investors are starting to line up

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to address the widening investment gap faced by healthcare or educational assets. Current investment in social infrastructure in the EU has been estimated at approximately €170 billion per annum by the European Commission, while the minimum infrastructure gap in social infrastructure investment is estimated at €100 billion to €150 billion per annum.

That represents a total gap of over €1.5 trillion over 2018-30. This investment gap results from the convergence of, firstly, stagnating public investments and, secondly, massive investment and transformation challenges.

The public sector has historically supported the vast majority of social infrastructure development. With the great financial crisis and the covid-19 crisis, governments have had to refocus on managing their balance sheets and have shifted their resource allocation from social infrastructure investment to social damage mitigation.

According to the Long Term Infrastructure Investors Association, shifts from fixed capital formation towards current expenditures, fiscal consolidation measures and soaring debt levels saw social infrastructure investments plummet by 11.4 percent in Europe

from 2009 to 2016. At the same time, the social infrastructure space is facing three massive investment and transformation challenges.

The sector's key challenges…

The first challenge is demographics. In the EU, according to Eurostat, the population of people aged 65 years or more is projected to rise from 91 million in 2019 to 130 million by 2050. In particular, people aged 75-84 are projected to expand by 56 percent.

This is expected to create massive demand for new social infrastructure capacity, notably hospitals and elderly care. At the same time, the urbanisation rate continues to grow. By 2050, 86 percent of the OECD countries' population will live in urban areas, compared with 80 percent today. Increased population density will challenge the resilience of our healthcare systems, as evidenced in the covid-19 crisis.

The second challenge is digitisation. Social infrastructure assets are facing the daunting digital challenge of reinventing themselves from the front line to the back-office, from nurseries to retirement homes, to step into the 21st century while at the same time controlling new risks arising from the digital era, such as cybersecurity, which has been a key challenge for hospitals recently.

The third challenge is inequality. Economic and gender inequalities have been at the heart of the public and academic debate recently. Social infrastructure, with its hospitals, nurseries and education facilities, has a key role to address those inequalities.

As said by Romano Prodi in the foreword of the European Commission social infrastructure taskforce report, "while European social policies and models are the pride of our continent and continue to be warmly embraced by our citizens, the enormous pressure exercised by the recent crisis and the new demands of the 21st century imply that they need to be expanded upon and modernised".

Social infrastructure is cherished as a solidarity safety net, and it needs profound transformation to continue to serve this purpose. Governments are starting to address the challenge, for example with the Biden administration in the US announcing a $1.8 trillion social plan directed notably to childcare and education.

The social infrastructure space is facing historical transformation and modernisation challenges, at the very moment when public bodies, which had been the predominant driving force behind the construction of this infrastructure historically, are slowing down. The gap we are seeing is not just quantitative but also qualitative; not only the level but also the adequacy of current investments appear insufficient considering future needs and expectations.

In that context, the private sector is poised to fill the gap. Over the past three years, we have witnessed an increasing flow of infrastructure capital in the healthcare infrastructure space. According to Mergermarket, there were 25 deals in 2019 totalling $4.3 billion, including the acquisition of French residential care groups Domidep and Colisée, the Regard Group, Hesley and Choice Care in the UK, Viamed Salud in Spain, and our acquisition of CareChoice in Ireland.

In the coming years, infrastructure capital is expected to accelerate investment in the education space, which includes nursery/preschool, school, higher education and professional training. Although other forms of long-term capital, such as pension funds and large family offices, are present in this sector, infrastructure capital has only started investing. The first notable examples are the acquisition of Babilou and Grandir, French specialists in nurseries and pre-school education in 2020 and 2021 by Antin Infrastructure Partners and ourselves.

… and why it is so attractive

We see six key reasons to invest in social infrastructure: resilient demand, capacity undersupply, private market momentum, consolidation opportunities, supportive regulation and digitisation opportunities. Our investment in Grandir provides a perfect example.

Grandir is a leading French and international childcare and early education player, operating around 600 centres and 30,000 seats for children aged 0 to 6 in five G7 countries. Since 2000, it has been contributing to better work-life balance for more than 200,000 families.

Through its well-recognised brand Les Petits Chaperons Rouges, Grandir is the number one operator in France

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by number of nurseries and a pioneer of the development of the French private nursery market. In more recent years, it has grown internationally and selectively entered into Canada, the US, the UK and Germany through the acquisition of leading and recognised operators benefitting from an excellent reputation locally and nationally.

- **Resilient demand:** The parental culture is undergoing a profound change and nursery is becoming the norm as a day-care solution for children. Nursery care is becoming an essential service in the sense that: the availability of efficient and affordable childcare drives natality, generation replacement and ultimately the long-term socio-economic health of the country; it contributes to gender equality by helping caregivers (often women) remain active in the job market throughout their working lives; and it contributes to building the competitiveness of future society by helping children grow their abilities.

Over the long term, governments see the provision of good quality, reliable and professional childcare as an essential tool, as demonstrated by the massive support given to US nurseries in Joe Biden's American Families plan. The corporate segment is also encouraging this shift given the proven benefits of providing childcare to employees.

- **Structural capacity undersupply:** There is a large undersupply of nursery seats in most of Grandir's geographies with nursery demand being 15-20 percent above current capacity. With the long-term development of the employment rate of women as well as families' preference for nurseries versus other childcare options, it is estimated that 700,000 seats would be missing in 2030 in Grandir's geographies based on current capacity. This offers large capacity-creation potential for private operators.
- **Strong private market momentum:** For the past 10 years, private nursery operators such as Grandir have outperformed public and non-profit nurseries in filling the supply gap. In France, the private sector accounted for 80 percent of 2010-20 seats created while still only representing 20 percent of total seats, making Grandir and other private operators ideally positioned to contribute to future growth.
- **Strong consolidation opportunities:** The private nursery market remains fragmented with the top five players representing around 10-15 percent in the UK, Germany and Canada. Market fragmentation offers a deep M&A reservoir with both independent and platform consolidation opportunities. The M&A reservoir is estimated at around one million seats across Grandir's global footprint.
- **Supportive regulation:** Regulation has supported the creation of new seats with operating and capex funding for nursery operators, tax incentives for families and employers, and the definition of operational standards. Regulation is expected to remain supportive across Grandir's footprint, an efficient co-ordination being put in place between public bodies designing operational standards, providing funds or incentives, and monitoring care quality, and the private sector taking care of new nurseries development, commercialisation and operations on the ground.
- **Digitisation:** Like other social assets, nursery networks have engaged for a few years on a digitisation journey encompassing marketing and sales, relationships with families, as well as internal processes automation. This ambitious digital agenda comes with the opportunity to leapfrog competition, but also with new risks such as cybersecurity, which must be managed with the highest standards.

Overall, the typical infrastructure investment thesis in social infrastructure relies on the attractive capex investment opportunity; consolidation opportunities in what are still often very fragmented industries; capex, contractual or regulatory barriers to entry; and the ability to optimise internal efficiencies and win market share through digital transformation. We believe that in doing so, infrastructure capital provides more efficient funding with a longer-term business view versus traditional LBO investors and can thus aspire to superior value creation. ■

Smart play: InfraVia's investment in nursery business Grandir exemplifies the six key attractions of social infrastructure