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Water Is An Overlooked Part Of Infrastructure Investing

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Chuck Jaffe, in The NAVigator podcast interviewed Nick Holmes, portfolio manager for the Tortoise Essential Assets Income Fund. Read the Q & A below as Nick discusses how investing in water infrastructure is mostly lumped in with other infrastructure plays, which he considers a mistake, noting that water is viewed differently as an asset class around the world than it is in the United States. He explains why his fund gets involved in private investments, how it was hit harder than most closed-end funds during the market's 2020 decline, and why he thinks both the fund and water assets are poised for success moving forward.

Nick Holmes

The podcast can be found on AICA’s website by clicking here: <https://aicalliance.org/alliance-content/pod-cast/>

**CHUCK JAFFE:** Nick Holmes, manager of the Tortoise Essential Assets Income Fund, ticker TEAF, he’s here and we’re talking infrastructure investing and more now on The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator’s brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you’re looking for excellence beyond indexing, The NAVigator’s going to point you in the right direction. And today it’s pointing us in the direction of Nick Holmes, he is manager of the Tortoise Essential Assets Income Fund. He is portfolio manager for TortoiseEcofin and specifically oversees their water infrastructure team but also does more there. If you want to learn more about the firm, TortoiseEcofin.com. If you want to learn more about investing in closed-end funds and business-development companies check out AICAlliance.org, the website for the Active Investment Company Alliance. Nick Holmes, welcome to The NAVigator.

**NICK HOLMES:** Thanks Chuck, excited to be here to talk a little bit more about TEAF.

**CHUCK JAFFE:** What you’ve got, essential assets is another way of saying infrastructure, but it really talks more about specifically water. And water, fascinating story right now because we all think about it in terms of well it’s always there for us. But what’s been happening with water utilities and the water structure and everything else, well it’s not just what’s going on with the water, it’s what’s going on generally with utilities, the kind of scary regulatory stuff we saw in Texas recently and more. So let’s start with the water picture and why water right now is particularly interesting, not just to you but to kind of everybody.

**NICK HOLMES:** Yeah, good question Chuck. The water asset class is really an emerging asset class in the U.S. It’s a little more known in Europe specifically but we’re excited about some of the trends we see in the sector. Specifically you mentioned utilities, there’s a long runway of capital deployment needed in both developed and emerging markets within the water infrastructure space both on clean water pipelines and also wastewater treatment. But another aspect of the water asset class that we’re extremely excited about, and we’ve actually seen an acceleration of this as a result of Covid, is really the technology adoption within the space. Things like Smart Water Networks, smart meters, real-time leak detection, remote operation, and efficiency measures that are being put in place. Really it is an exciting time to be looking at the water sector, which is obviously a component of what we have in our sustainable sleeve in TEAF, as well as renewable energy that’s helping decarbonize the grid. So extremely excited about the runway of growth we see in the water structure, both on the infrastructure and technology side.

**CHUCK JAFFE:** And yet the space was particularly hammered in 2020. I mean, closed-end funds in general of course suffered significantly and discounts got massively wide, but it was a very difficult space. And there’s a lot of talk about, hey, in spite of the fact that we’ve got Democrats controlling the House, the Senate, and the White House, that a lot of the infrastructure support is not going to be easy to pass. So as much as it’s of interest, what’s a reasonable expectation in the infrastructure space going forward?

**NICK HOLMES:** Yeah Chuck, you’re absolutely right and we saw this with TEAF in the port performance, all equities were hammered in the spring of 2020 as and a result of Covid dislocations in the markets. TEAF in terms of the discount blew out to about 25%, which was well wide of where it had been trading since IPO. And I think TEAF being a Tortoise backed product was lumped into broader energy infrastructure closed-end funds, and the fund really traded to those discounts that we saw in the midstream energy infrastructure space. In reality that’s actually a very small component of TEAF, we’re really focused on sustainable infrastructure. Those are global utilities that are focused on decarbonizing the grid through the buildout of renewable energy, including solar, wind, and increasingly more talk about opportunities in hydrogen to help decarbonize some industries, as well as transportation. And we also in the fund in terms of infrastructure, we have an allocation to what we call social infrastructure. This is really fixed-income investments, directly originated loans by our team of underwriters that invest in education facilities, senior living facilities, and some project financing that are really helping drive the circular economy, which includes waste to energy, waste to value type projects. So really exciting opportunities within TEAF that we think it’s a really differentiated fund that was unfairly bucketed with some of the other closed-end fund universe that resulted in, in our view, an unwarranted discount. And we’ve seen that close some as we get out to the market and podcasts like yours and really tell the sustainability story that the underlying investments that TEAF has. We think that discount will continue to narrow because it really is a differentiated product in the closed-end fund market space.

**CHUCK JAFFE:** Well, let’s talk a little bit about the underlying assets. Because one of the things that you do at Tortoise Essential Assets Income Fund, at TEAF, is you are looking to do a lot of direct investments, you’re looking at private deals, etcetera. That’s not something that people are going to necessarily find in an open-ended mutual fund structure. So explain what it is that you’re looking for and how that differentiates your fund from simply being somebody that’s buying straight stocks and doing the things that I think most investors normally expect out of a fund.

**NICK HOLMES:** Yeah, good question. And that was one of our key differentiating points when we put TEAF together and brought it to the market, is we wanted to provide retail investors with access to those private investments that you’re talking about that they may not typically have in other vehicles. Specifically on our sustainable infrastructure side, we invest directly in private renewable projects. We’ve got several operating solar assets in the portfolio today with long-term power purchase agreements with investment grade rated counterparties that really provide stable income. Typically you would have to be in a locked up infrastructure fund, in a GP LP structure to have access to those types of investments. So we really feel that TEAF provides that unique access to private investments. We stand today, just to give you a sense where the portfolio is, at about 45% private investments, 55% public, publicly listed equities. And our long-term target, which we hope to achieve here in the next quarter or two, is to be about 60% private, 40% public securities.

**CHUCK JAFFE:** You talked about how the fund kind of rode the coattails of Tortoise’s other funds, of its sisters which are more the energy space, and that that pushed out the discount. But does the discount on a fund like yours, as the manager of it do you think it sometimes winds up getting wider because, hey, you’ve got all that private equity sort of things? Those situations that are much harder for the market to evaluate and say, hey, what’s a fair value for it? Does that contribute at times to why this fund might run a slightly bigger than average discount?

**NICK HOLMES:** Yeah, that’s a great question and one we have gotten over the past several quarters from investors as the discount blew out. We do have level 3 assets in the fund. But if you look at the mark to market on those private investments, we have independent third-party valuation groups that market specifically our renewable projects on a quarterly basis. Our social infrastructure projects are investments which are those directly originated loans to education facilities, senior living, and then some project finance. Most of those are actually CUSIPed and you can see pricing on a daily basis. So I think there is some concern around those private investments and the true valuation underlying the investments in the fund that can contribute to the wider discount, but like I said, the mark to market is on a regular basis by third-party valuation experts. And fortunately, specifically on the renewable projects which as I mentioned are long-term contracted cashflows with solid counterparties, those really helped during the volatility in the general equity markets that we saw during Covid last year. Because of the mark to market and the stability of the cashflows, we really didn’t have a lot of volatility in there. So I think when you saw the discount blow out, it was because of some of those private investments where you just don’t have that public market volatility because the cashflows are very stable, that provided some NAV stability relative to some other closed-end funds in the market place.

**CHUCK JAFFE:** Lastly, you talked a little bit about how water infrastructure really is a global story, one that is more coming to the United States, that has drawn more attention internationally. For you from an investment standpoint, how much does that mean you want to be allocating internationally because the market for infrastructure investments and water infrastructure investments specifically is more mature elsewhere?

**NICK HOLMES:** Yeah, I’ll tackle that in two ways. First I think TEAF has a huge component of sustainability in our underlying investments, whether it’s decarbonizing the power grid through the buildout of renewables, helping build out water infrastructure and water treatment facilities. And then on the social side, educating children, caring for the elderly, and then also helping create a circular economy through some of those waste to energy projects. And I think that the ESG and sustainability movement that has seemed to really accelerate over particularly the last 18 to 24 months in the U.S., I would say that the European markets have been well ahead of that. I commonly say, five years ahead of the U.S. in terms of ESG and sustainability investing. We think those tailwinds are only going to get stronger in the U.S. and as retail investors are looking for unique ways to access ESG sustainability related investments, TEAF is a perfect vehicle for that with the underlying investment characteristics of both the private and public securities. On your question relating to global opportunities, whether it’s decarbonizing the grid or building out water infrastructure and deploying technology to help combat water scarcity, water quality issues, it’s truly a global story. And you see the way our portfolio, specifically on the listed equity side is built out and we have a truly global portfolio, we’re investing in utilities across the globe in Europe, U.S., Asia that are helping decarbonize the grid. We’re investing in water utilities, infrastructure companies that are helping build out infrastructure in emerging markets but also helping upgrade legacy infrastructure in developed markets that have been undermaintained that contributes to some of those water quality scarcity issues that we’re talking about. So I think infrastructure investing is definitely a global opportunity and that’s the way we’ve constructed the portfolio.

**CHUCK JAFFE:** Nick, great stuff. Thanks so much for joining me to talk about it.

**NICK HOLMES:** Chuck, thank you for having me. Appreciate the opportunity to talk a little bit more about TEAF. We truly think we have a differentiated closed-end fund that allows investors to access both private and public securities in the sustainable universe. And we think tailwinds are only growing stronger as the appetite for those types of investments increases in the United States.

**CHUCK JAFFE:** The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I am Chuck Jaffe and you can check out my show on your favorite podcast app or at MoneyLifeShow.com. To learn more about closed-end funds, interval funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. They’re on Facebook and LinkedIn @AICAlliance. Thanks to my guest, Nick Holmes, portfolio manager at TortoiseEcofin. He runs the Tortoise Essential Assets Income Fund, ticker TEAF. Learn more about the firm and its funds at TortoiseEcofin.com, on Twitter @TortoiseEcofin. The NAVigator podcast is new every Friday, please subscribe on your favorite podcast app and join us again next week to learn more about investing with closed-end funds.

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