Real Assets Outlook

AMP Capital entered 2020 celebrating an anniversary year. In 2010, after some initial forays, we committed to building a team to invest in European infrastructure assets and a major landmark on our journey of being a global investment manager was made. With our real assets heritage, AMP Capital had been investing in Australian real estate since the 1960s and infrastructure since the 1980s.

In 2010 as the world emerged from a financial crisis, there was a huge opportunity blossoming in global infrastructure investing, for both debt and equity investors. Real assets turned out to be among the biggest winners of the decade, offering attractive yields in an ongoing low-rate environment. High-quality real estate was sought after, and infrastructure matured into a mainstream asset class, with both attracting increasing institutional allocations.

But 2020 threw a curve ball: a pandemic with effects that changed the way we live and work, and a sharp recession which destabilised the global economy and led to increased monetary stimulus, the latter driving additional capital to the dry powder already seeking real assets. In a more positive development, a commitment to confronting climate change and heightened social awareness became entrenched as crucial issues.

Disruption has accelerated changes underway in modern living – and the pandemic is still far from over. 2021 is a different and uncertain landscape. From across AMP Capital's global offices, our **Infrastructure Equity, Infrastructure Debt, Real Estate**. **Listed Real Estate** and **Listed Infrastructure** teams share their key themes for the year ahead and how investors can access the opportunities that emerge.

DIGITAL TRENDS ACCELERATED BY COVID-19

Emma Haight-Cheng

Partner,
Infrastructure Debt

London

Building out fibre to meet new needs

The last twelve months have focussed minds on the importance of connectivity which facilitates working remotely and reducing the need for travel. While in some industries activity was put on hold in 2020, there's been no slowing of digital infrastructure deal flow. We believe that changes to work structure will be lasting and will open up a more flexible future workplace. This reinforces the need for both home connectivity and cloud infrastructure.

Connectivity's role as an essential service has been cemented by the pandemic and underserved areas need to catch up, leading to increased government support for the rollout of fibre. Countries which were already supportive of fibre rollouts are ramping up their efforts, notably in Europe: Scandinavia, France and Spain are attractive to fibre investors from a policy perspective. First mover advantage is still very attractive: laying fibre is expensive, but can be aided by subsidies in some countries where it is providing a necessary solution. Future competitors will be best served by using existing lines rather than overlaying fibre, reinforcing the sector's strong barriers to entry.

Adam Ringer

Principal,
Infrastructure Equity

London

Open access fibre

Over the past few years, digital infrastructure became classified as essential infrastructure; now there can be no doubt that connectivity is an essential service on a par with other utilities. As old copper infrastructure is replaced by fibre-to-the-premise by both established players and altnets, increased regulation and potential unbundling – like other utilities – will likely become a key factor if local vertically integrated de-facto monopolies are created. Open access fibre, where any broadband provider is allowed to use infrastructure, is a good sub-sector for long-term investors to establish a position in as it will promote competition and consumer choice, as well increase take up and reduce future risk of overbuild for infrastructure providers.

Andrew Quade

Head of Logistics,
Real Estate

Sydney

The explosion of e-commerce

Governments responded to Covid-19 by urging people to stay at home and restricting movement, which disrupted traditional retail and supply chains. The logistics sector stands to benefit from both of these situations: e-commerce has escalated, benefiting the logistics sector over retail, while retailers evaluated the resilience of their supply chains and capacity to serve their customers.

This trend was quickly observed and bought into by investors: it's the acceleration of a longer-term thematic. As we enter 2021 with a lot of capital chasing a small sector, being selective is key. Attractive logistics assets include those strategically placed near customers and in areas which are highly populated with high spending. For a defensive long-term play, investors can mitigate valuation risk by focussing on areas with scarce land which means a higher underlying land value for assets compared to the alternate traditional sectors.

Giuseppe Corona

Head of Global Listed Infrastructure

London

Growing data demand and 5G

The Covid-19 pandemic accelerated secular trends such as e-commerce penetration, video streaming, working from home and provided a tailwind for continued rapid growth in data usage which we had already been seeing over the last few years. This growth is a key driver for investments in the communications infrastructure sector. Whilst the 4G investment cycle will continue over the coming years, 5G will be the focus of much activity this year. Carriers are increasingly focussed on 5G and are competing aggressively to establish nationwide 5G networks as they seek to attract new customers and monetise the new technology.

A CHANGING CONCEPT OF THE WORKPLACE

James Maydew

Global Head, Listed Real Estate

Sydney

Flexible working is the future

Covid-19 has accelerated trends that were already well underway in real estate markets. The global workforce has gone through the largest remote working experiment ever conducted. The advances in technology and how it is used in the workplace have led to more efficient ways of operating, leading to a greater balance between remote working and the need to be in the office full time. In a world where there is such a war for talent, being able to offer flexible working arrangements is likely now the new normal. The office is likely to evolve and will always be an important factor in the corporate world to build culture, collaboration and high-performance teams, however this likely is now based around collaborative space as opposed to the need for a desk five days a week.

The industrial revolution created the 9 to 5 working week; now the combination of digitalisation, technology and an event like COVID-19 have created this new way of working for the foreseeable future.

Luke Briscoe

Managing Director – Office & Logistics, Real Estate

Sydney

Quality and technology: what offices need to offer

The office sector has experienced a structural change this year. The future of the office and flexibility is a major topic of debate that we're still exploring, but wherever we end up the fact remains that employees need a place to belong, for productivity and collaboration. In 2020, high quality office assets continued to fare well. We're optimistic about a broad recovery for offices in 2021 as the impact of Covid-19 recedes. We have always had a strong view of investment into assets in order to differentiate them, particularly in the quality of amenity and tech specifications, and this will be more important than ever as the role of the office shifts. For example, flexible working may mean less desks, so we expect to have more businesses in our buildings and will need the technical specifications to facilitate that.

Kylie O'Connor

Head of Real Estate

Sydney

A healthier, safer and environmentally-friendly workplace

Active asset management will provide opportunities for office assets to differentiate themselves. Stability of occupation for offices depends on tenant satisfaction, and we have been heavily engaging with tenants to identify priorities. Hand in hand with a commitment to ESG across the asset class, we have seen an increasing focus on wellness, and utilising technology for efficiency – the intersection of these themes can be seen in our recent HVAC (heating, ventilation, and air conditioning) initiative where we became the first organisation in the world to install an autonomous AI HVAC system from AI innovators Brainbox across our real estate portfolio, which aims to minimise energy waste and optimise wellness.

MAJOR MACRO DRIVERS

Patrick Trears

Global Head of Infrastructure Debt

New York

A new US administration and economic impetus could mean new hope for infrastructure

2021 will bring yet more capital into infrastructure debt, and as we commence Biden's presidency we are cautiously optimistic the US will open up more opportunities for deployment. However, every administration over the last decade has said infrastructure is its top priority but has fallen at the significant hurdle posed by the bureaucratic processes which obstruct the flow of private capital into public assets; Trump failed to get a bill through despite much noise, and Obama also failed to gain traction on the issue. There is a requirement for capex to update and build essential infrastructure and this is an economic strategy: a society can build its way out of recession and create jobs by investing in infrastructure. With or without political support, nascent sectors, eg cold storage assets that benefit from logistics changes, and strong sectors like digital infrastructure offer plenty of opportunities. And one meaningful change that Biden's administration brings is a reversal of Trump's cynicism about renewables: clean energy remains one of our preferred sectors.

Matthew Hodgkins

Head of Americas Listed Real Estate

Chicago

Moderate Democrat control suggests a balanced approach to stimulus

Despite a chaotic post-election period, President Joe Biden has been inaugurated into the White House. Furthermore, control of the Senate has allowed Democrats to complete the 'Blue Wave', as they will control all 3 judicial arms of Government. In terms of market impact, we continue to believe that monetary policy will remain loose and fiscal stimulus will be forthcoming. Biden's nominees thus far have been primarily Centrists, with the left wing of the party largely left out in the cold, suggesting the most progressive policies will not be implemented. The confirmation of prior Head of the Fed, Janet Yellen to Treasury Secretary would however suggest continued and prolonged fiscal support.

For REITs that are ending 2020 with depressed earnings and multiples, the combination of accommodative fiscal and monetary policy and recovering economic momentum courtesy of the vaccine distribution should lead to a banner year of absolute performance.

Kylie O'Connor

Head of Real Estate

Sydney

Selective allocations to defensive real estate

Although 2020 brought uncertainty to core real estate, investors still appreciate the compelling return the asset class offers in the low-rate environment. But the uncertainty means we need a much more cautious approach to managing and pricing risk. Opportunities will come from selectively choosing assets in the right sectors with long-term, defensive cashflows.

Australian real estate is viewed favourably by global investors, because of the relative position of the Australian economy and its efficient management of Covid-19 compared to other developed economies. Regarding sectors, logistics has performed very well for us and has great long-term fundamentals, but due to high prices it's a tricky sector to enter now. Adding defensive alternatives alongside select core retail and office assets is a diversified strategy to ride out short-term uncertainty.

Giuseppe Corona

Head of Global Listed Infrastructure

London

A supportive macro picture for listed infrastructure companies

Infrastructure assets – frequently long-duration and highly leveraged assets – tend to perform strongly in a low rate environment as valuations are very sensitive to changes in interest rate expectations. The underlying characteristics of listed infrastructure, in which long-term total return is supported by an above average dividend yield, is particularly attractive in a low-rate environment. Therefore, current low interest rates and commitments from central banks to hold them at these lower levels are a very supportive dynamic for infrastructure.

Ryan Watson

Head of European Listed Real Estate

London

QE's impact on real estate yields

The direct implication of the last decade of quantitative easing has been lower cost of capital, as yield curves have been manipulated lower by central banks. This has meant the yield on offer for real estate, including its level, reliability and duration, has been highly attractive and sought after; increasing demand and pushing valuations up and yields down. Importantly though, the spread between base rates and the yield has remained in line with or above history. As we have seen even more QE following the devastation created by the Covid-19 pandemic, in general we expect to see the current spread tighten.

There are many important factors that determine real estate yields beyond the local base rate, for example the level and sustainability of market rents. These differentiators will also play a key part in whether yields tighten and by how much. If buyers believe there is substantial risk to rents then they are unlikely to immediately follow the yield curve lower and will want to be compensated for this risk with higher yields. This is particularly evident in the retail space at present.

Office has been a tale of two markets where yields in long-let, high-quality, prime city assets have traded in line or slightly lower than pre-covid, while secondary markets with leasing risk are not trading, as there is a big gap between buyers' and sellers' expectation of pricing. Meanwhile in the logistics market, yields have fallen below pre-Covid levels as demand has skyrocketed due to higher ecommerce penetration.

Boe Pahari

Global Head of Infrastructure Equity

London

Emerging market infrastructure goes mainstream

Disruptions accelerate change. As the global crisis hit, the USA and Europe were seen to mishandle the pandemic and this prompted some subtle geopolitical changes. Relative attractiveness of markets shifted, and investors began to think truly globally. We have been selectively looking at emerging markets for years as infrastructure returns in developed markets have become commoditised. Meanwhile, growing economies are looking to international investors to help build world-class infrastructure. In 2020, boosted by supportive government policies – a drive for green procurement in Latin America and infrastructure-investor friendly vehicles in India – we made two major EM investments: an e-mobility platform, and a power transmission network aimed at growing the distribution of green energy, in the respective markets. Both the true globalisation of the infrastructure asset class, and the scale of the opportunity for emerging countries to lead the energy transition, are creating opportunities into 2021.

Jessica Koh

Head of Asian Listed Real Estate

Hong Kong

Logistics and data centres in China - an emerging markets highlight

With low foreseeable US rates and a weakening dollar, the outlook for capital flows to EM markets remain strong. China can look forward to more conventional trade negotiations under a Biden administration, which should help to stabilise trade agreements going forward. For 2021, we remain positive on modern logistics and data centre sectors in China. Within the logistics market, we expect capitalisation rates for Chinese modern logistics warehouses to continue to compress supporting higher asset values, due to restrained supply and elevated demand as the secular growth of higher e-commerce penetration from rising consumption expenditure and modernisation of supply chains accelerates. Within the data centre space, demand is propelled by continued use of cloud services and data storage. China's data generation is expected to grow 30% CAGR from 2018 to 2025, supported by the exceptional growth witnessed in the public cloud market[1]. Covid-19 will only accelerate these structural trends and will continue as the world normalises after the pandemic.

Andy Jones

Portfolio Manager, Listed Infrastructure

London

Covid-19 recovery: Valuation opportunities

Although airports have had an incredibly challenging year, a confluence of reasons means they are now looking attractive. Firstly, after years of expensive valuations, listed airports are offering selective opportunities after seeing poor stock price performance. Secondly, air travel – particularly tourism and visiting friends and relatives – is unlikely to be impacted long-term; we can look to China, where domestic air travel has already surpassed 2019 levels in some months[2], or Mexico, where despite ongoing Covid-19 issues domestic demand is back to around 70%, even above 100% in some cities[3]. While the challenges of airlines are also highly apparent, we expect there to be a number of structural changes which will enable growth to resume with lower cost bases (and lower ticket prices). Finally, surviving today's challenges will have whipped the sector into shape, with airports investing in technology for a safer and seamless airport experience and resetting relationships with regulators and retailers to refocus on building back an industry which is even more traveller-centric.

[1] Goldman Sachs Equity Research, 'China Data Centres,' 21 April 2020
[2] Bank of America Equity Research, 'Nowcast #21: High frequency travel reads across Asia Pacific aviation,' 3 December 2020
[3] Monthly traffic reports, Grupo Aeroportuario del Pacifico and Volaris

Emma Haight-Cheng

Partner,
Infrastructure Debt

London

Covid-19 recovery: Bespoke debt to see assets through their recovery

In the unexpected turmoil of 2020, we benefited from our lack of exposure to transport assets, but the dramatic impact of Covid-19 on the sector has created a relative value opportunity. In 2021, we will continue to explore the opportunity of providing liquidity facilities for transport assets affected by Covid-19. As subordinated debt investors with an investment approach underpinned by a focus on originating and structuring bespoke debt, we are well-positioned to structure loans which are sufficiently creative to respond to the needs of the asset and its sponsors, but prudent enough to provide investor protection through this uncertain period. We are considering investments with airports, rail, ports and roads, looking for assets in a strong strategic position with limited competition and prudent long-term leverage levels.

ESG IN REAL ASSETS

Roopa Murthy

Partner,
Infrastructure Debt

London

ESG: Rising to the top of the LP checklist

One of the most noticeable trends of 2020 was the popularity of ESG. While institutional investors have been taking it into account for years, we saw a remarkable shift this year in how fundamental it has become to investors. From the GP perspective, this has translated into the deals we are looking at as we seek opportunities of scale in new green subsectors, and also develop the reporting and monitoring of our portfolio and its supply chains.

Sectors in Europe like EFW (energy from waste) and district heating offer attractive opportunities; digital infrastructure assets can be overlooked but can have a positive social impact, although the environmental impact (laying fibre; data centres' water use) must be thoroughly assessed.

A key trend to access the ESG opportunity in 2021 will be electrification. Electric vehicle charging could be attractive, but current business models tend not to separate infrastructure from the services business, so we'll be watching as that model evolves. It's part of a broader, forward-looking smart cities theme, where infrastructure and technology will reshape cities to be more efficient. In the meantime, a simpler way into electrification is investing directly in the energy transition: 'phase out' power deals have been popular this year, where investors support the transition of an existing energy asset to a cleaner energy source – if they can get comfortable with the upfront environmental risk.

Michel Debs

Portfolio Manager, Listed Infrastructure

London

A year of decarbonisation

We believe the energy transition will create significant opportunities for infrastructure assets. While in the past energy policy focused on safety of supply and cost, environmental impacts are now at the front and centre. Reducing the carbon footprint will require a coordinated deployment of new policies, regulations and infrastructures leveraging a mix of technologies. We see infrastructure investment opportunities in:

- Power infrastructure (renewables, networks, metering, storage)
- Gas and hydrogen infrastructure (production of Hydrogen and renewable gas, networks, industrial and district heat)
- Carbon capture and storage
- Transportation (with pricing innovation to incentivise aligned behaviours)
- Energy efficiency

Anthony Hadley

Investment Director, Infrastructure Equity

California

Transportation: the next stop on the pathway to decarbonisation

Electricity production - our greatest contributor to global greenhouse gas emissions - has witnessed a dramatic shift toward low-emission sources of power during the past decade which continues to accelerate unabated. The same mega-trends driving this “once-in-a-generation” transformation of the electricity supply chain are now on the cusp of redefining the transportation segment of our economy. With around a quarter of the world’s CO_2 emissions produced from transportation, the need to decarbonise this segment of the economy is critical if we are to meet our medium- to long-term climate goals. As a result, we are seeing significant policy developments from governments and municipalities which are creating tailwinds for zero emission modes of transportation. Coupled with continued technological advancements, these trends are set to drive increased capital flows into areas such as e-mobility during the next 12 months and beyond.

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