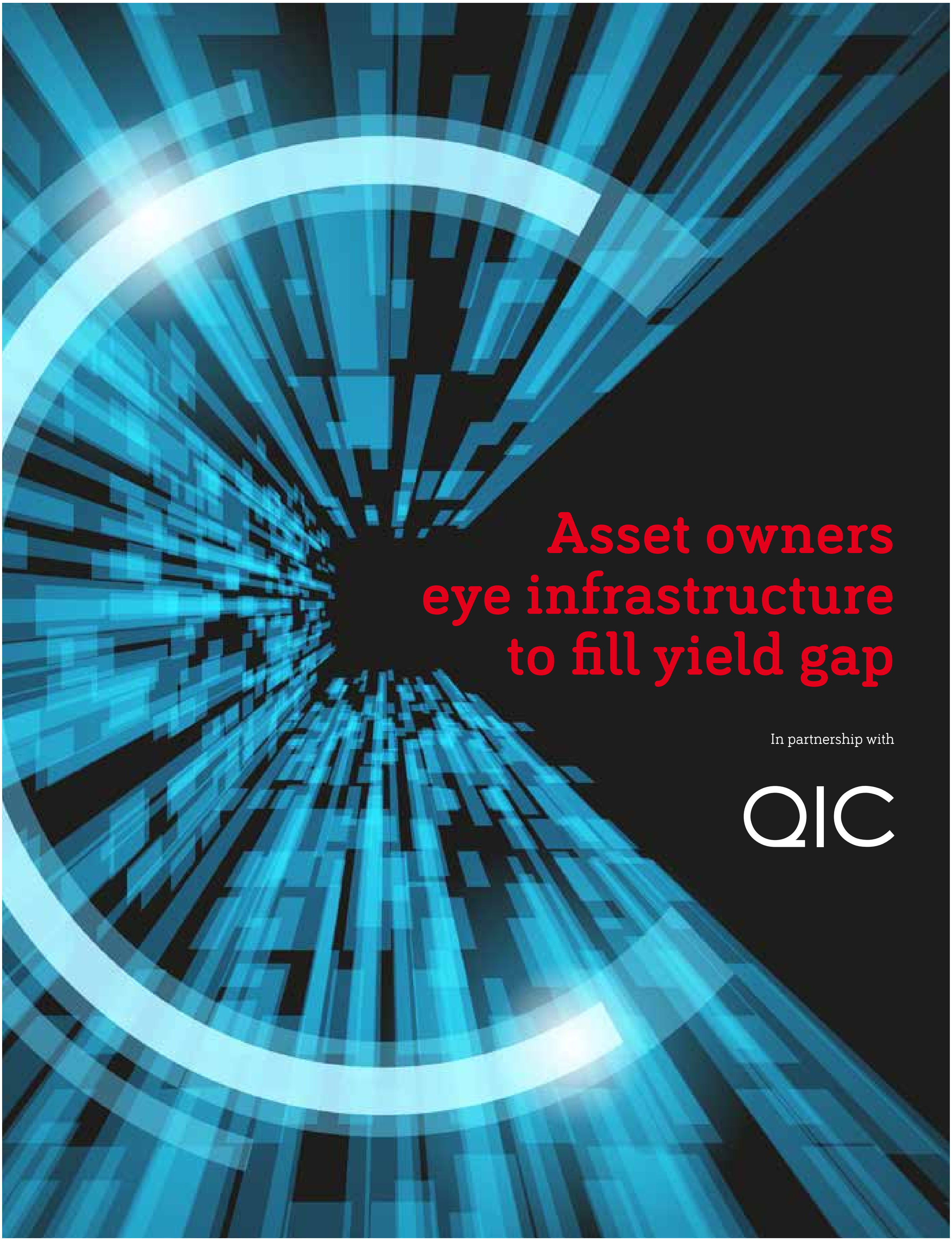


Asset owners eye infrastructure to fill yield gap

In partnership with

QIC

Across Asia Pacific, investment appetite among insurers, pension funds and other institutions bodes well for unlisted infrastructure – especially sustainable assets in Asia, within mandates managed by professionals with experience, finds the latest survey by AsianInvestor and QIC.

Today's new investment normal looks like heralding a new era for the role of infrastructure in institutional portfolios.

In short, asset owners are grappling with the impact of muted interest rates, along with continued short-term volatility and unpredictability in markets. As a result, the desire for robust assets that offer diversification, reliable income and uncorrelated returns across sectors, geographies and lifecycles suggests infrastructure exposure will grow.

This is based on the views of senior executives at leading insurance companies, pension funds, government entities, sovereign wealth funds and other investors – with collective assets under management (AUM) of well over $3 trillion.

Key take-aways from this poll by AsianInvestor and QIC, run during October and November 2020 across Hong Kong, Australia, Japan, Singapore, South Korea, Taiwan, Thailand, the Philippines and Malaysia, include:

- There is relatively low exposure within the region to unlisted infrastructure, with an allocation equivalent to less than 2% of total AUM for 59% of respondents
- Yet in the wake of Covid-19, just under half of asset owners have either increased their allocation to infrastructure, or plan to do so at some point
- The desire for new sources of income plus much-needed portfolio diversification are the two main drivers for investing in infrastructure
- Nearly 60% of respondents prefer to gain exposure to unlisted infrastructure assets via pooled funds – with manager performance the priority when they select a pooled vehicle
- Sustainability linked energy and renewables are the assets of choice for 2021
- Insurers and pension funds are most concerned about valuations of infrastructure assets
- Assessing an external manager's track record, along with an experienced and stable team, are the top selection criteria when outsourcing infrastructure mandates

Several tailwinds are fuelling this potential. For example, infrastructure assets leverage megatrends across decentralisation, digitalisation, decarbonisation and democratisation. "These thematics present a growing opportunity that tilt investors towards real assets," says Ross Israel, head of global infrastructure at QIC. "This underpins a strong investment case for Asian investors to expand their exposure further into infrastructure."

There is also high-level support – for instance, a report by the IMF in October 2020 on proposed fiscal policies to spur recovery, recommended governments invest in infrastructure spending as a response to the pandemic to boost growth and prepare economies for the future.

"The Asia-US route is seeing strong growth, of 10%-20% up year-on-year, with a spill-over into all trade lanes. This is underpinning logistics and port infrastructure in the region"

"The hunt for yield in this 'new world' is increasing competition for core assets and has shifted some investor strategies to find the value from growth-orientated infrastructure assets and build to core," adds Ravi Sriskandarajah, executive director, client solutions and capital at QIC.

SHIFTING ALLOCATIONS

Covid-19 has certainly sharpened investors' attention on their exposure to infrastructure. In particular, the survey highlights a new appetite for these assess among roughly half of all respondents as a direct result of the current environment – although it hasn't yet made a difference for the majority of the rest.

This paves the way for a much-needed boost to the role of unlisted infrastructure within the overall portfolios of many assets owners who completed the survey.

With 59% confirming that less than 2% of their AUM is in these assets, and a further 16% saying their total allocation is between 3% and 5%, these asset owners will need to increase their exposure if they hope to achieve their goals of income and portfolio diversification.

More specifically, insurance companies have conservative infrastructure allocations, according to survey findings. However, the poll showed they are slightly more bullish than their counterparts within other types of institutions when it comes to plans to boost their allocations to infrastructure assets going forward. Among public pension funds, meanwhile, those respondents with the largest allocations are based in Australia and South Korea.

EMERGING DEMAND

The poll results also reflect the accelerating interest in the broad theme of sustainability.

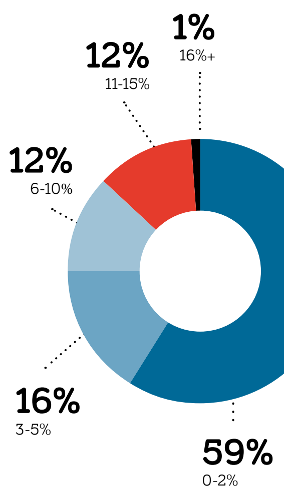
This is evident from the fact that by far the most appealing infrastructure assets for 2021 among respondents are a mix of sustainability-linked energy, energy transition and renewables.

This is aligned with QIC's focus, too. The firm is striving for net zero emissions for assets in its portfolio, and while steering such a sustainable investing focus within the investment process takes time, it plays an important part in shaping how the firm originates, acquires and manages infrastructure assets.

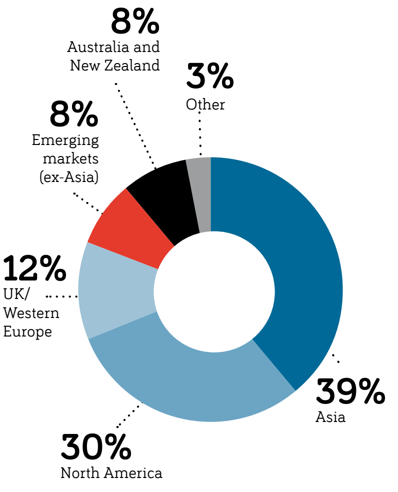
At the same time, digital assets such as cell towers, fibre and data centres are also in high demand, based on survey findings.

In terms of geographic priority, the 2020 survey highlights a notable regional bias among Asia-based asset owners towards infrastructure assets close to home. The only other market of any real interest over the next 12 months is North America.

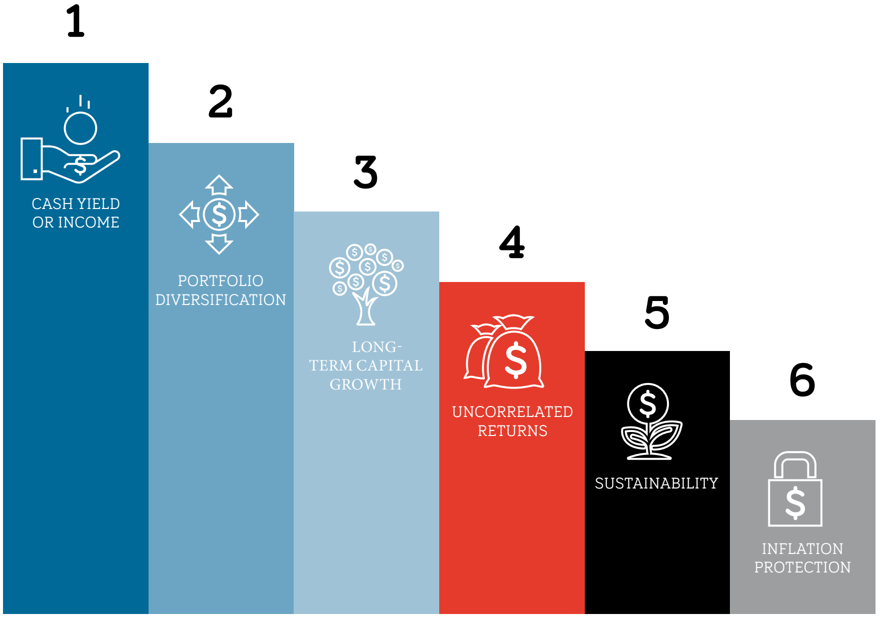
CURRENT % OF TOTAL AUM ALLOCATED TO UNLISTED INFRASTRUCTURE



PLANNED GEOGRAPHIC EXPOSURE IN 2021



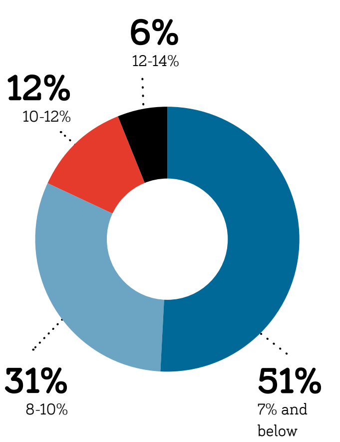
BIGGEST DRIVERS TO INVEST IN INFRASTRUCTURE



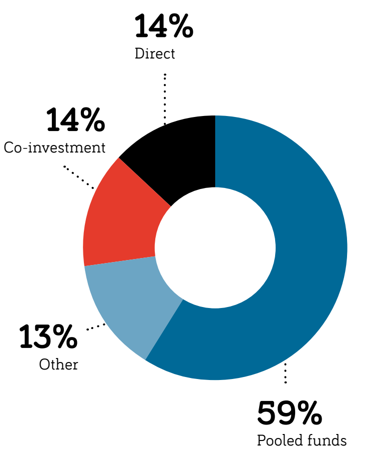
"Asian economies, we believe, will continue to be resilient amid this services-led recession," says Israel. His view is based on the recovery in the economy for goods, reflected in activity in the ports and surging global container shipping rates.

For example, the cost of shipping 40-foot containers is reaching all-time highs due to a mix of demand for container freight in recent months, spikes in inventory restocking demand in the US and Europe, limited air freight capacity and container scarcity at key export hubs, he explains. "The Asia-US route is seeing strong growth, of 10%-20% up year-on-year, with a spill-over into all trade lanes. This is underpinning logistics and port infrastructure in the region."

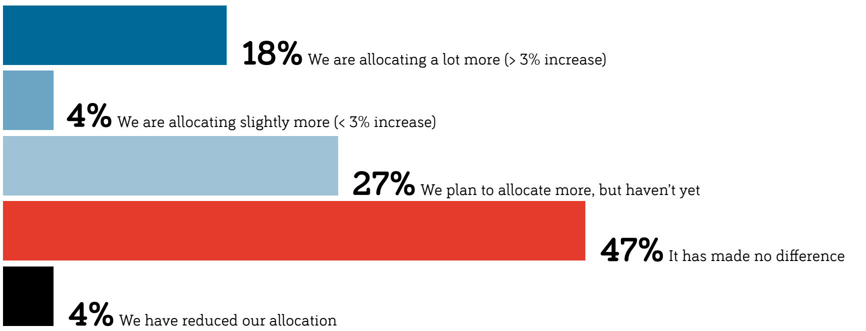
RETURN EXPECTATIONS FROM UNLISTED INFRASTRUCTURE PORTFOLIO



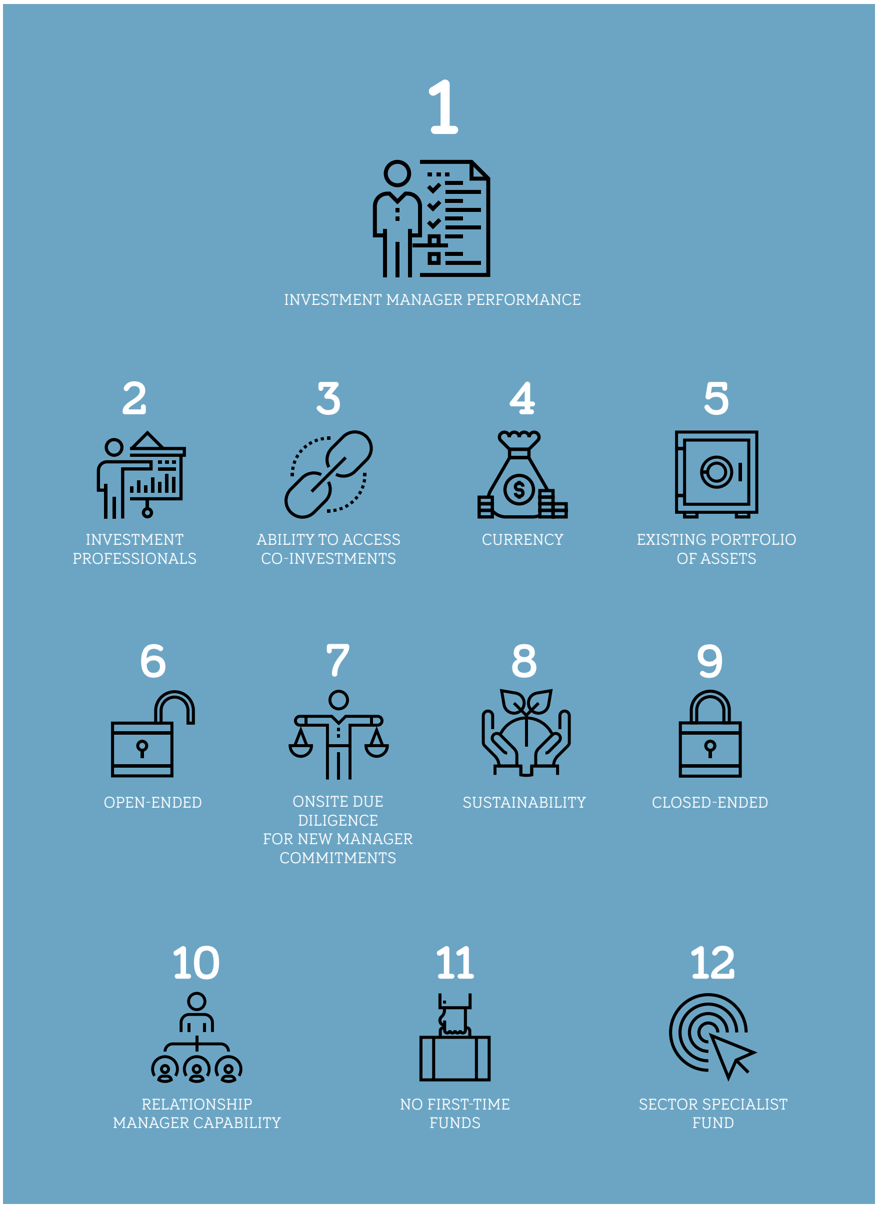
PREFERRED WAY TO GAIN EXPOSURE TO UNLISTED INFRASTRUCTURE ASSETS



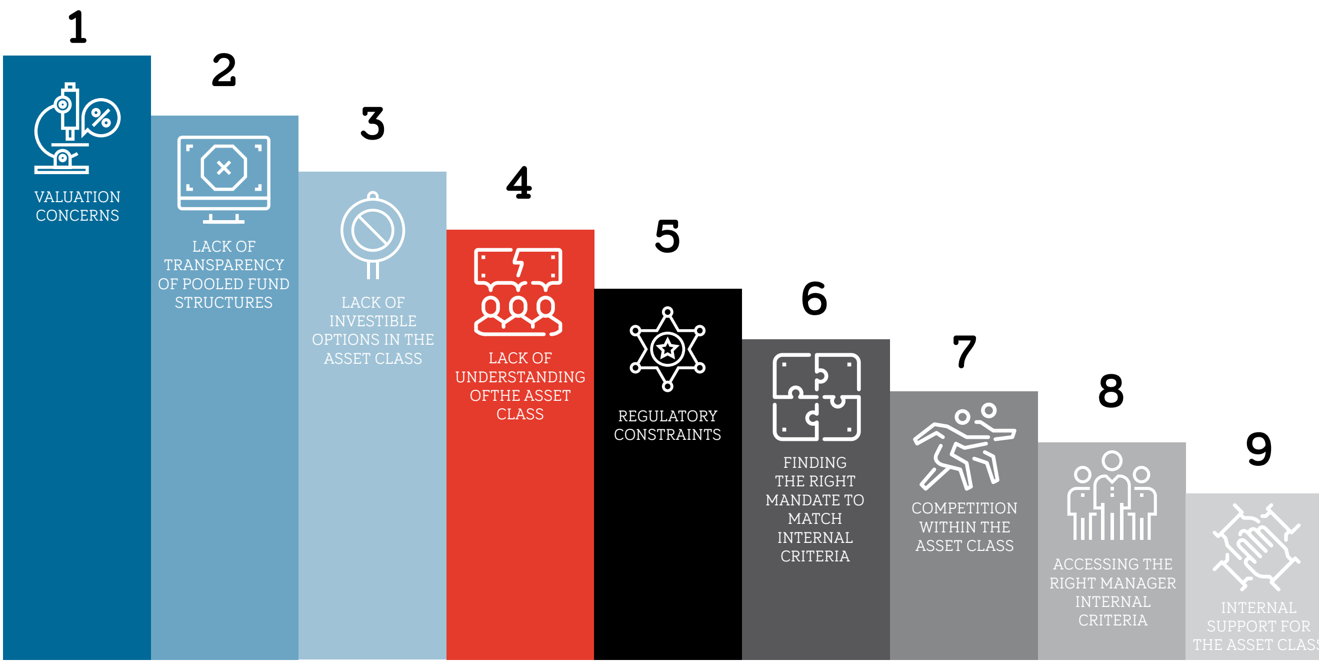
IMPACT OF COVID-19 ON EXPOSURE TO INFRASTRUCTURE



KEY ATTRIBUTES WHEN SELECTING A POOLED VEHICLE



TOP CHALLENGES WHEN INVESTING IN INFRASTRUCTURE ASSETS



FOLLOWING A TRODDEN PATH

To gain the exposure they desire to unlisted infrastructure assets, asset owners continue to prefer a pooled product – 59% of respondents opt for this route, a marked increase on the 48% preference from an equivalent poll by AsianInvestor and QIC conducted in early 2018.

This has risen in importance relative to direct investing and co-investment, although the latter is more popular for public pension funds than for other types of institutions.

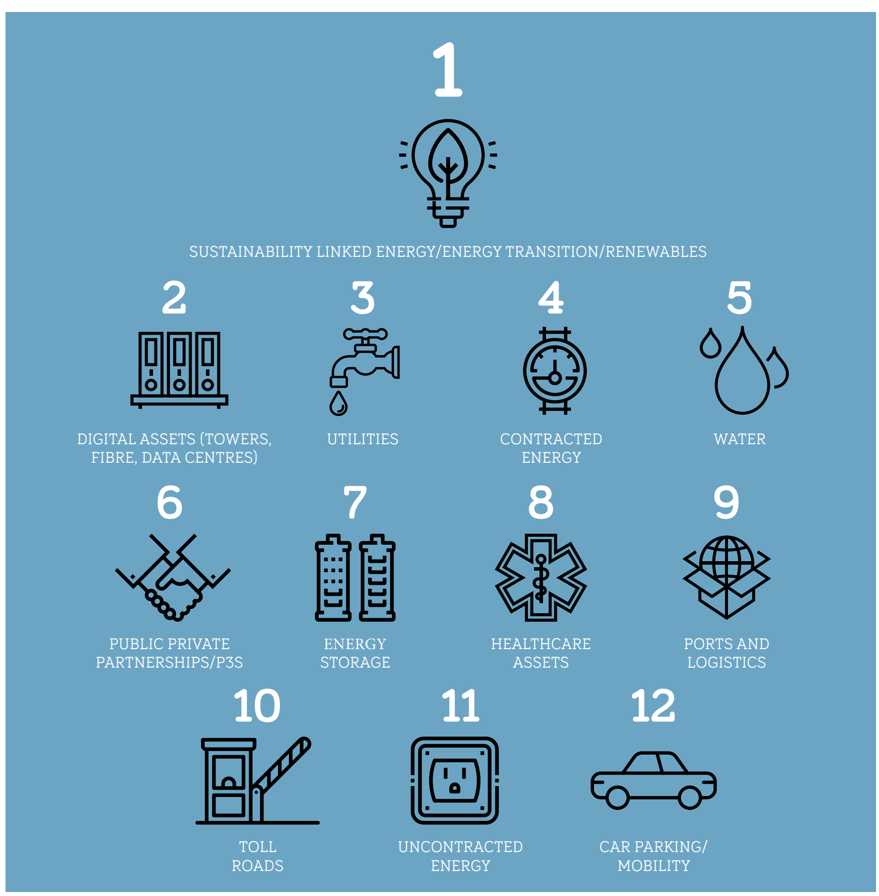
This desire for pooled funds is line with one of the big impacts of Covid-19 on potential access to infrastructure assets – the challenge in conducting due diligence.

In line with this, for those asset owners eyeing exposure to infrastructure assets via pooled funds, the performance of the investment manager is paramount when choosing a vehicle.

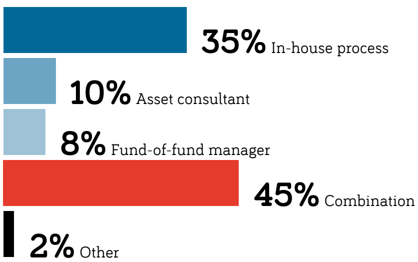
Yet these investors will also need to gain greater comfort when it comes several key hurdles they perceive when investing in infrastructure assets. They pinpoint valuations as the main challenge, closely followed by the transparency of pooled fund structures.

Specifically for insurers, respondents also highlight regulatory constraints as a big issue, as is finding mandates to match internal criteria.

MOST APPEALING INFRASTRUCTURE ASSETS FOR 2021



PREFERRED APPROACH TO CHOOSING AN INFRASTRUCTURE MANAGER



SHIFTING THE SPOTLIGHT

There are several other notable comparisons between the 2020 survey and the poll from two-and-a-half years ago.

For example, at that time, before the lower-for-longer environment became so entrenched, portfolio diversification was the biggest driver behind allocation decisions in the infrastructure space, followed by cash yield or income.

Further, currency was a more important attribute in 2018 when selecting a pooled vehicle. The ability to access co-investments, meanwhile, has risen in significance, given that it was barely a factor previously.

In addition, Western Europe and Australia were more firmly on the radar of asset owners in the 2018 survey.

A MEASURED APPROACH TO OUTSOURCING

In terms of assessing investment opportunities, respondents seem to either rely on their in-house process (35%) – which is especially common for public pension funds – or they leverage a combination of their own due diligence with advice from asset consultants and, possibly, a fund-of-fund manager (45%).

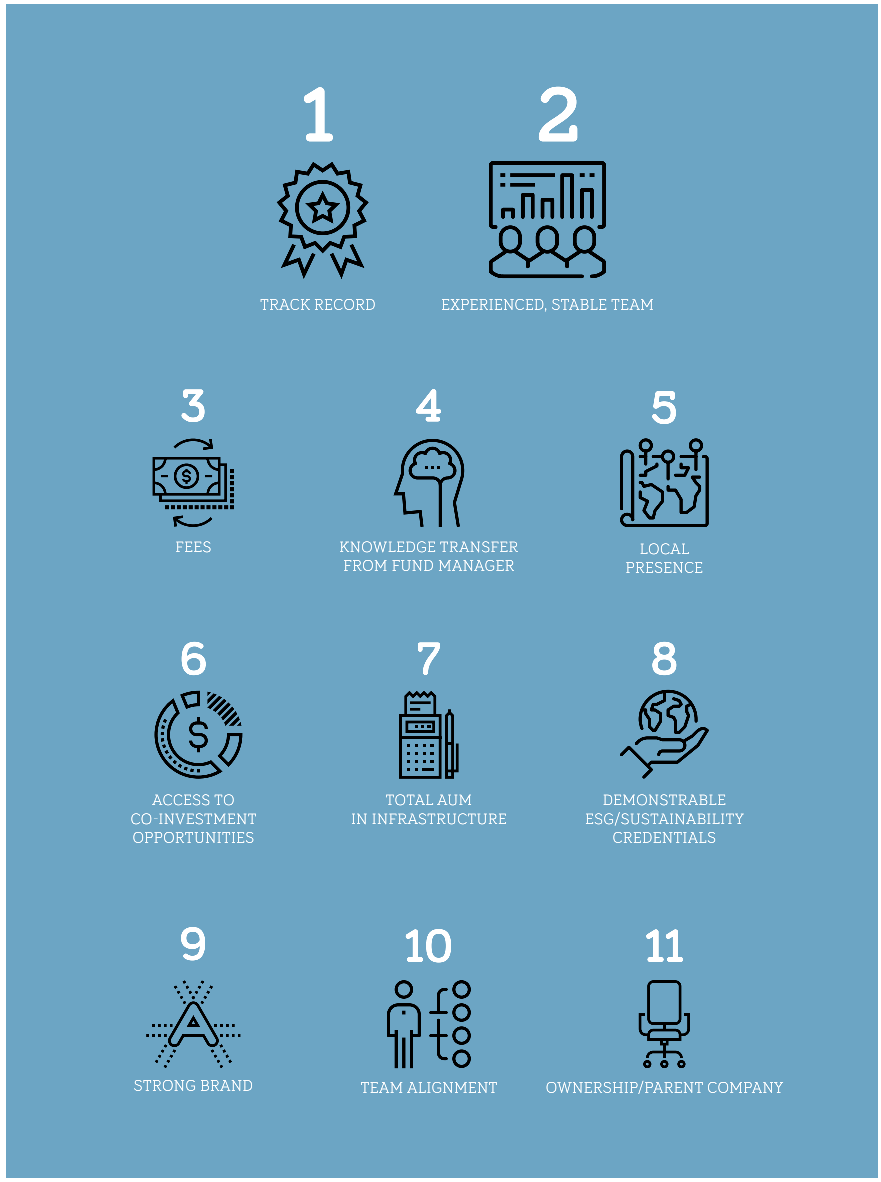
Travel restrictions potential account for why investors now say they prefer to use a combination of asset consultants with in-house expertise when assessing investment opportunities, adds Israel.

Meanwhile, the selection criteria for external managers is based on tried-and-tested metrics – the manager's track record in this asset class, coupled with the experience and stability of the investment team, outweigh every other attribute by a long way. This is also consistent with the findings in the 2018 survey.

The pandemic has certainly played a key role in focusing a spotlight on track records and stable teams. "Asset owners are seeking managers who have delivered on mandates over time and can prove their capabilities," explains Israel. "By contrast, Covid has made it challenging to due diligence new managers and build new relationships. "

At the same time, while Sriskandarajah says there is a key role for core infrastructure assets, active management is essential in helping to extract maximum value from an asset. "In this way, stringent business planning for infrastructure has never been as important as it is in this low-rate environment and post-pandemic landscape, where the long-term impacts of over a 30- to 50-year time horizon are still unknown."

TOP SELECTION CRITERIA FOR EXTERNAL INFRASTRUCTURE MANAGERS



"Asset owners are seeking managers who have delivered on mandates over time and can prove their capabilities"