CAMRADATA

Real Assets Whitepaper

DECEMBER 2021

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Contents

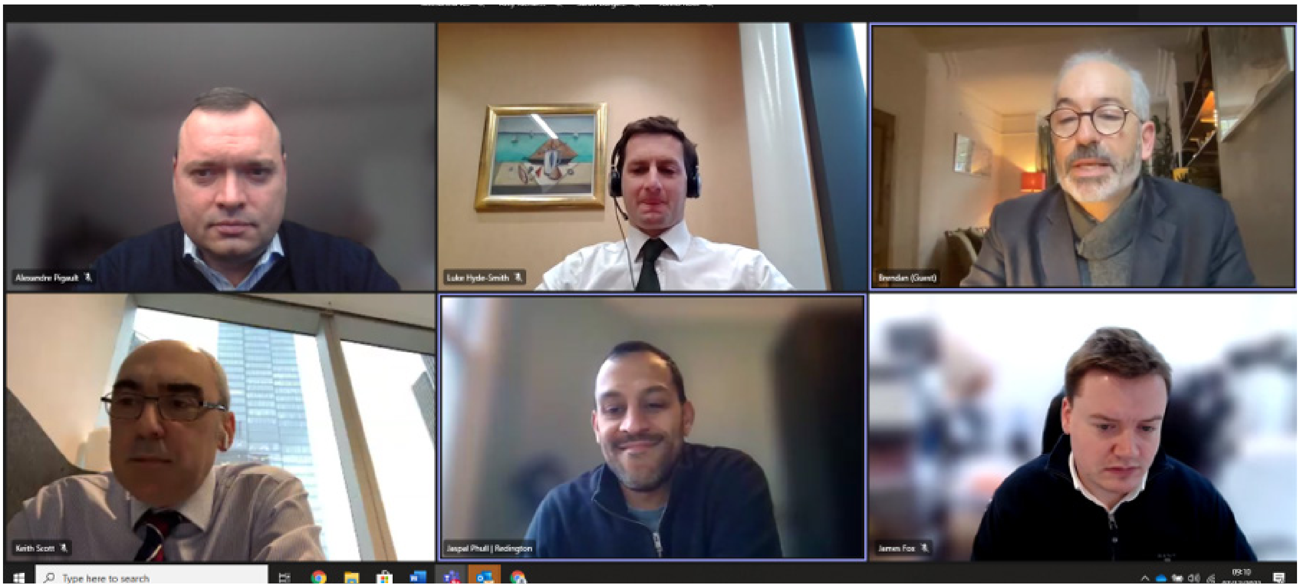
Welcome to CAMRADATA's Real Assets Whitepaper

Real Assets have always held an important role in institutional investment portfolios as diversifiers. The first question for 2022 is what diversifying characteristics Real Assets hold, ie what are they diversifying from? This is not an easy question to answer. Interest rates look lower for longer but the cost of containing the pandemic has introduced fears of rising inflation. Some years ago markets were convinced that central banks would reduce the debts on their balance-sheet incurred from the Global Financial Crisis by means of well-paced inflation. For 2022, investors in real assets have to mull their defensive capabilities against rising inflation that may or may not be well managed by central banks and national policy response to the pandemic.

A longer-term perspective on real assets is how they meet society's needs as the rich world ages, decarbonisation takes hold and national security has to take into account not just armaments and energy but also food, water and weather. This CAMRADATA panel will look at what infrastructure, buildings and commodities we need for the decades ahead.

Real Assets Roundtable

The CAMRADATA Real Assets Roundtable took place virtually in London on 7th December 2021.



The CAMRADATA Real Assets roundtable of winter 2021 began by asking panellists how they define and categorise Real Assets. The Centrica Pension Fund, with more than £11bn in total under management, has been investing for nearly 10 years in various Real Assets, notably infrastructure, renewables, Long Leases as well as ownership of commercial and residential real estate. Alexandre Pigault, senior manager research specialist at the Centrica Pension Fund said the purpose of real assets was to hedge long-term liabilities by generating income that is inflation-linked but also to deliver returns in excess of gilts. "Originally, the idea was to achieve Internal Rates of Return (IRR) of 6-8%," Pigault told the CAMRADATA panel. "Over time these assets' spreads have compressed so now we are looking at 4-6% IRR."

Pigault distinguished between the nature of the revenue from Long Lease and renewables infrastructure, two major types of investment. In the latter, the Centrica fund holds amortizing, contractual cashflows to maturity and they generate high cashflows from year one.

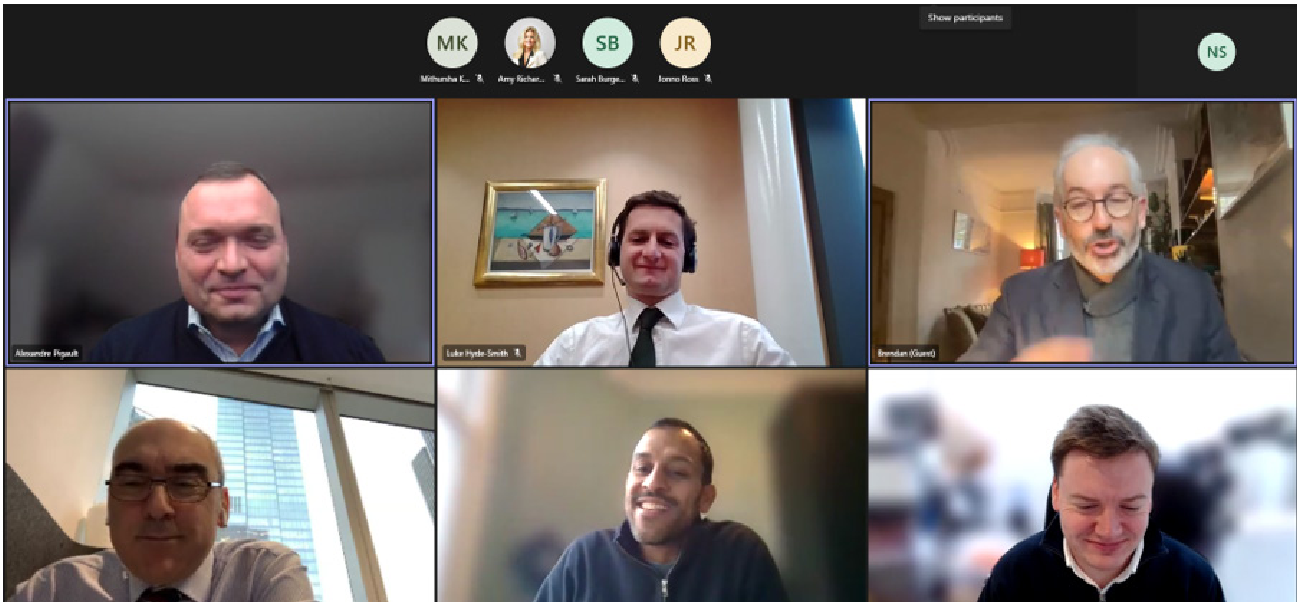
" We have been looking at managers who focus on smaller types of assets" he said. "The kind of opportunities that larger investors in this sector would typically ignore."

Long Lease, on the other hand, offers some aspect of capital appreciation when you realise them. Returns from this category have been "more than decent" according to Pigault and the effects of COVID last year reopened the basket of opportunities. "We have been looking at managers who focus on smaller types of assets" he said. "The kind of opportunities that larger investors in this sector would typically ignore."

Jaspal Phull, real assets manager researcher at Redington, a pension fund consultancy, said his firm, like the Centrica fund, had been looking at Long Leases since 2015 to help clients meet inflation-linked liabilities. Other Real Assets Redington has recommended include UK core property; some build-to-rent residential, although this did not catch on as much as expected with pension fund clients; renewables, starting with UK core for stable contractual cashflows. Phull said that the compression in yields in this last sector, however, meant he didn't see value here currently. Redington was instead turning clients' attention to renewables further afield. There has also been a focus in the last 12 months on investing in natural capital via agriculture and forestry funds. Phull noted that this sector has seen a big increase in the number of new managers offering products.

On the legal nature of real asset products, Phull said that Redington clients had been directed mostly to closed-end funds in infrastructure, including renewables, and natural capital. Property investments, on the other hand, tended to be in open-ended funds, often with quarterly redemptions.

Pigault said that the Centrica fund's policy was to be able to continually invest; being able to benefit from opportunities as they arise within a vehicle's ambit. This



"The appeal of Real Assets was that it was almost impossible to get sufficient inflation-linked cashflows from public markets these days at a reasonable price."

means a preference for evergreen strategies over closed-end funds "where you force deployment during investment periods."

Centrica's ideal is a structure with the same life as those of the assets. "We have liabilities going out more than 25 years, so if we believe in an asset's capability to generate inflation-linked income, then we want to benefit from that for as long as possible. If we have to turn over the portfolio, that introduces cashflow issues."

Pigault also noted that Centrica fund's use of evergreen structures came with no performance fees.

Keith Scott, a professional trustee at Law Debenture to half a dozen pension schemes, said that his clients were accessing similar Real Assets to the other panellists. He noted that the appeal of Real Assets was that it was almost impossible to get sufficient inflation-linked cashflows from public markets these days at a reasonable price.

Luke Hyde-Smith, portfolio manager of the Waverton Real Assets fund, then listed its five categories of real assets: property, infrastructure, commodities, asset finance,and specialist lending. Specialist lending would be underpinned by real assets, although he noted that that term has widened over the years, including now Intellectual Property and income streams from royalties.

On the nature of the vehicle, Hyde-Smith accepted that a UCITS-compliant daily-dealing fund bore some constraints that do not apply to evergreen strategies. But he emphasised that the Waverton fund was well-diversified.

On benchmarking, Hyde-Smith said Waverton's parameters for long-term performance were a return of UK CPI +4% with two-thirds of the volatility of the equity market, roughly 10-12% per annum. He noted that the returns should come from both the underlying real assets and management execution (for example, there is a go-to protection strategy managed in-house if markets become stormy).

Hyde-Smith explained that the benchmark was devised by reference to the historical returns of the five categories of real assets as defined by Waverton as well as historical performance achieved by the team prior to fund launch.

He did acknowledge that with a daily-dealing fund, unlike less liquid real asset vehicles, the Waverton fund was carrying price risk. This was evident in the last major moment of stress in Q1 2020. He noted, however, that while one-third of FTSE companies cut or postponed their dividends, his strategy managed to retain its resilience and distribute 4% in 2020.

James Fox, a principal at AMP Capital, started by noting its Infrastructure Debt funds are more specialist and focused than Waverton's, although the geographical ambit is wide: AMP Capital Infrastructure Debt backs projects in OECD countries around the world. Fox said that key characteristics of infrastructure included long-term contracted cashflow; high barriers to entry; defensiveness with regard to the business cycle. By type, AMP has financed digital infrastructure including towers, 5G fibre roll-out and datacentres; energy and utilities including transmission; district heating; wastewater and treatment as well as transportation assets. "Digital infrastructure has become quite strong for us in the last 18-24 months," said Fox. AMP Capital has always had a strong presence in transport hubs, notably ports and airports. Fox agreed, however, with the other CAMRADATA panellists that finding value in renewables was becoming

“ The CAMRADATA panel then addressed the concern that investors are overpaying for many real assets.”

increasingly challenging: “New pricing is tighter unless you are lending into the construction stage or more complex jurisdictions.”

AMP Capital’s vehicles for infra debt are closed-end funds with a 10-year cycle and a track record of 9-10% IRRs, which has been consistently delivered over the last decade. “We are focused on the junior part of the capital structure, which enables these returns,” said Fox.

“When we are evaluating a potential asset, we reference a matrix comprising our minimum funding requirements; adjustments for secured risk and jurisdiction risk,” said Fox. “We also take a view based on what else we see in the market. It is art as much as science.”

Fox said AMP saw strong deal flow through its London and New York offices. He agreed that there had been compression in senior lending but said this effect was less pronounced in the junior space.

How to evaluate real assets

Scott said it has always been difficult to measure real assets. He accepted that IRRs are about the best measure “but you never know until you get to the end of the investment.”

Phull said Redington’s focus was on IRRs. “An absolute benchmark return for clients in real estate is easier: you can compare UK core property. But measuring inflation-linkages across different types of real asset becomes more difficult.”

He acknowledged EdhecInfra’s new TICCs taxonomy as one of a new wave, attempting to solve that problem.

Pigault said that the Centrica fund has duration matched gilt-related benchmarks for its real assets programme.

Otherwise, where there is no explicit inflation-linkage in returns, the Centrica fund does not consider these holdings to be real assets. For private debt, the target IRR is 8-10%. For private equity, the target IRR is 10-15%.

On timberland, Pigault said the issue is that there is no explicit inflation-linkage.

What about publicly available indices? Hyde-Smith said that just about everything is being indexed at the moment. However, indices for listed real assets are still few and far between. “S&P has produced one but it is US-centric,” he said, “which does not suit our sterling-based strategy.”

The CAMRADATA panel then addressed the concern that investors are overpaying for many real assets. Hyde-Smith started on this topic by reminding the panel of the bigger picture: in public markets, just 1% of constituents of the global fixed income market currently yields 5% or more, down from 80% at the start of this century. Meanwhile, one-fifth of constituent issues, worth c.$17trn, were yielding less than 0%. “And that is nominal, so you can then add in inflation,” he said.

That gave context to what is going on in private markets. Fox said that junior debt was driven by equity valuations: “if they go higher, that means there is more space in the capital structure for junior debt. What worries us is leverage trending up.” But Fox said that surprisingly, signs of ill-discipline here have been far fewer than in previous cycles. “We have seen some loosening, for example in district heating in the Nordics. Banks may be doing deals on skinny margins for the sake of relationships, but institutional lenders don’t do business for the same reasons.” He said the likes of AMP Capital could build more bespoke structuring if necessary but generally speaking, Fox was pretty happy with terms and pricing in the junior debt space and said discipline was being maintained in terms of overall leverage.

Scott agreed with other panellists on the struggle to find value in public markets, especially gilts. Pockets of concern for him in real assets included too much money chasing too few ESG-worthy projects. “There is a lot more pressure on pension schemes to invest sustainably but only a finite number of projects,” he said.

Phull said he was amazed at the number of forestry funds being launched. “Commercial forestry is a niche. We are looking for people with long-term knowledge of the sector," he said.

In renewables, he agreed with other panellists on the compression of returns. "It is a strange world right now. We have spoken with managers on both sides of a deal: buyer and seller. Both can seem very happy with the price. We don't know what to make of that."

On real estate, Phull noted that "beds and sheds" was the name of the game as investors shunned office and retail for residential and logistics. He observed that people follow themes, even if yields on logistics were fairly low already and tightening.

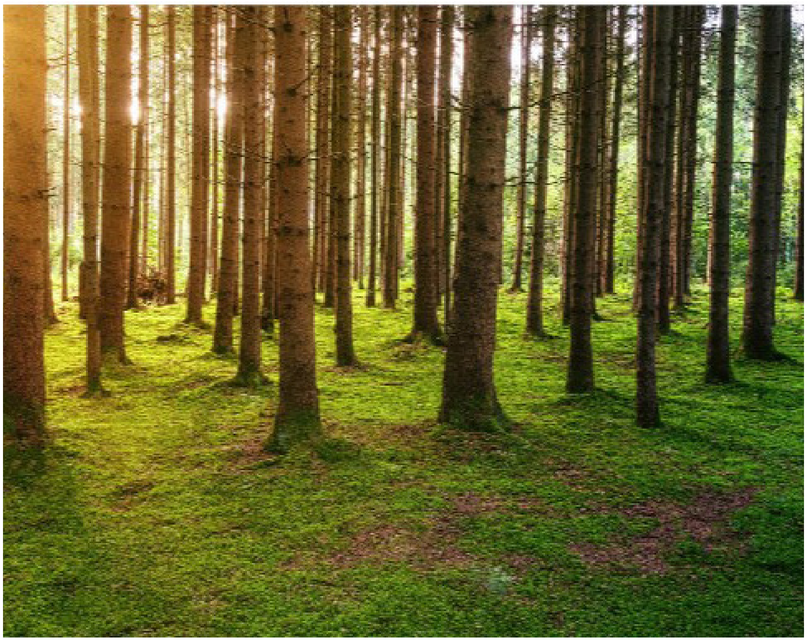
In renewable energy, Phull said that merchant pricing risk was Redington's major concern. "It has the potential to be bigger than construction risk - after all, building a solar farm is not that complicated." When conducting due diligence, Phull said that Redington wants to know how a manager thinks about merchant pricing risk under future scenarios and how this gets incorporated into cashflow assumptions.

Pigault said that the Centrica fund seeks to take only subsidized price exposures in wind and solar deals. "We want to avoid the volatility of power pricing fluctuations as much as possible" he said. "However, new assets in wind and solar now only come with merchant pricing risk. Only legacy assets are subsidized."

He agreed with Phull that when it comes to merchant pricing, the crucial issue is how developers forecast the power price risk. He acknowledged that in the future the Centrica fund was likely to have more exposure to this risk, even if it has been mostly avoided thus far.

Hyde-Smith noted the volatility in merchant pricing for power over the last 12 months. Analysts have long championed the decline in costs of producing renewable energy, but the shocks of 2021 suggested to Hyde-Smith that the energy transition would be longer, more disorderly and – for some – more expensive than predicted.

Fox said that AMP Capital wasn't comfortable taking on full merchant risk within the energy space. "Across sectors, we are still able to generate



good returns for investors without exposure to merchant risk."

On current prices, Pigault agreed with other CAMRADATA panellists that renewable energy assets were expensive compared to history. He added that as IRRs have fallen, construction risk has become a bigger issue. Finally, he made the point that in terms of financing real assets, especially new types such as in digital infrastructure and renewables, the UK has proven an innovative arena for structuring deals. He contrasted other Western European jurisidictions, where investors were often corralled into paying upfront for levered assets without much leeway for negotiation.

Because all its liabilities are in sterling and the inflation element is based on UK prices, the Centrica fund has a strong bias towards UK assets anyway. Hyde-Smith noted that inflation in OECD countries broadly moved in step. The Waverton Real Assets Fund nevertheless had a maximum exposure to non-sterling securities, even if some of the underlying businesses were global in nature. Waverton controls for variety by categorising underlying assets by the linkage between their revenues and inflation. The most attractive category has linkage of 80% or higher; the second category has linkage of between 50-80%. These two are where Waverton hunts for opportunities.

Hyde-Smith added that currency risk could be removed by two means: explicitly by the Treasury team inhouse or indirectly by the underlying businesses themselves.

Regarding overpaying, Hyde-Smith noted that oil majors such as BP and Shell are moving at great speed into renewables. This was changing the nature of both their business and established players in renewables. Picking up on an earlier comment of Scott's on the pressures on pension funds to invest sustainably, Hyde-Smith referenced a recent survey of 400 institutional investors, of which only one had a policy that permitted direct investment in the Oil & Gas sector. Given this absence of traditional capital, he suggested that the energy transition to decarbonisation would be both longer and more expensive than many have predicted.

On geographical spread, Fox said that AMP Capital's global infra debt strategy had exposure within Europe in the UK, France, Nordics

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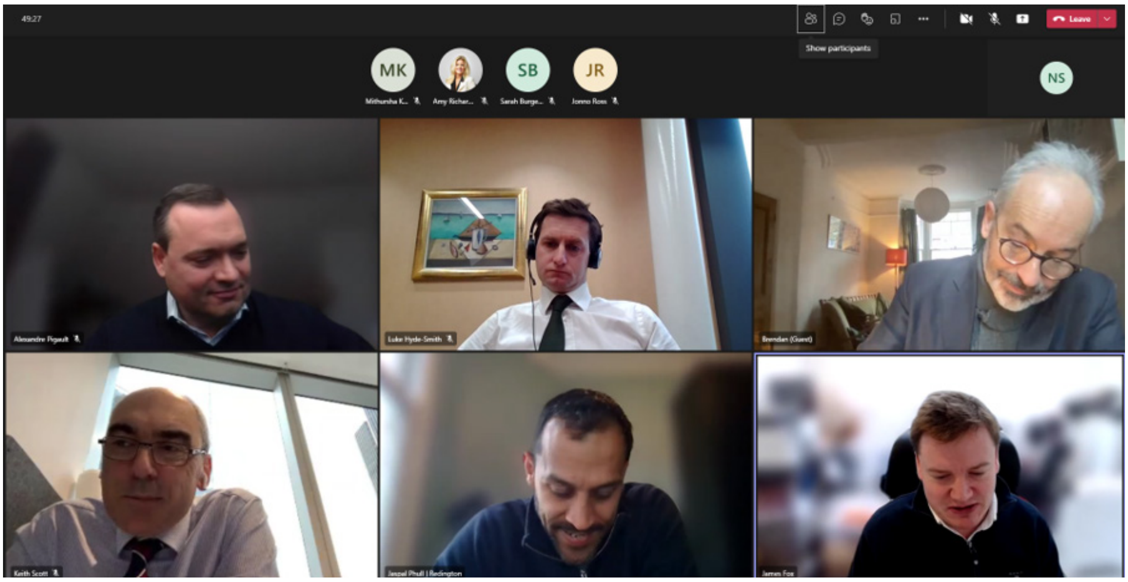

and Italy in particular. "We also have significant exposure across North American as well as dome exposure in Latin America and Asia." He also noted the second layer of diversification that comes from borrowers with a global footprint. He gave the concrete example of Phoenix Towers International, which the fund lent on in 2021, which has operational assets in 17 different countries. "We were able to offer an attractive structure to the borrower because we had the experience inhouse and through our advisers," said Fox. "We aren't going up the risk curve. It just takes a lot more time and effort compared to five years ago."

Scott said that there could be governance issues with overseas investments. "Things can get more complicated in foreign jurisdictions. We were working on three schemes unifying their arrangements under a single sponsor. Simply re-registering the names of beneficiaries proved difficult – we had to get tax advice in Colombia. There are big advantages to real assets but governance headaches too."

Scott continued with a general concern on the structure of Limited Partnerships. "Power rests with the General Partner. It's difficult to influence much; you have to take their terms and pricing. In public markets at least you can vote."

Phull said that Redington sought to cure this predicament by building up relationships with General Partners so as to have confidence in their overall ability. "We are speaking to GPs even if we are not planning to invest with them. It is a good way to understand what is going on in the market. We also speak to historical investors to find out how the GPs have dealt with previous LPs," he said. "That is a good barometer of their character."

Pigault said: "we have been hurt by behaviours of some General Partners. How did we address that? We didn't give up. We fought back by teaming up with other LPs."

Pigault said it was not an easy or painless process. "But if you want to take control back, you have to be willing to make it happen." He added that you have to do due diligence but sometimes it isn't enough. "For example, we have requested amendments so that if the General Partner does not act in the best interest of investors, then we can take back control." But he added that there could be a cost to taking back control: the General Partner would ask to be paid some sort of compensation. Nevertheless, he said some pension funds seem to not always keep sight of the fact that they do have power to negotiate and obtain terms that enforce stronger governance.

Pigault suggested that within pension funds, analysts seek to engage with managers to define their actual needs and negotiate such terms. He feared that some pension funds may not always devote the required energy to negotiate better investment terms and stronger governance structures. The on-going demand and flows into closed-ended funds could be a consequence of this lack of upfront engagement with managers.

Fox agreed that asset managers ought to be listening to their investors. "Equity funds must be based on long-term partnerships." He explained that AMP Capital uses closed-end vehicles because lending on a five-to-seven-year basis is what borrowers want. "We might go up to 10 years but even there, the Weighted Average Life is circa five years," he said.

Hyde-Smith said that Waverton as a firm had been mulling how best to structure real asset investment vehicles, including how to access return streams from underlying closed-end funds. "We have institutional clients who don't need daily liquidity so we are in the process of launching our own investment company – The Endowment Fund – to access Private Markets opportunities ourselves," he said. Lorenzo Marchioni, previously at Clayton Dubilier & Rice, has been hired to head up the firm's private markets capabilities.

"Asset owners want more control and co-investing: it is getting harder to justify big fees and carry," said Hyde-Smith. "Instead, there will be more engagement between managers and investors. Private markets investing cannot just be a remuneration programme for managers."

Note: AMP entered into an agreement to sell its Infrastructure Debt platform to Ares since this roundtable took place.

IN FOCUS

CAMRADATA ROUNDTABLES

CAMRADATA BRINGS TOGETHER EXPERT FUND MANAGERS WITH CAREFULLY SELECTED INVESTORS IN A STREAMLINED VIRTUAL FORMAT

"I have taken part in several roundtables over the last 18 months and this was the best orchestrated by far"

Investment Director, UK Consulting firm

"Just a note to say thank you for organising the panel and having me on it. I found the full group discussion super informative."

Portfolio Manager, Global Asset Manager

"The CAMRADATA virtual roundtable went really well, as well as the live events, which was quite surprising! It was informative and interesting, and I know our Fund manager enjoyed being a part of it."

Business Development Manager, UK Asset Manager

CAMRADATA

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To find out more – **Natasha Silva** (Natasha.silva@camradata.com) would be delighted to speak to you.

Roundtable Participants

James Fox

Principal – Infrastructure Debt

Personal Profile

James Fox is a Principal in the Investment Team having joined the London office in April 2014. Mr Fox is primarily responsible for the sourcing, execution and asset management of infrastructure debt investment in Europe.

Mr Fox joined from British Land where he was a member of the Residential Development and Investment team. Prior to that, he was with PricewaterhouseCoopers where he qualified as a Chartered Accountant (ACA). Whilst at PricewaterhouseCoopers he worked in their Corporate Finance Advisory team on a number of infrastructure projects with a particular focus on transport, social infrastructure and healthcare.

Mr Fox began his career at J.P. Morgan within a specialised equities team. Mr Fox holds a first-class Bachelor of Science with Honours in Business Management and a Master of Arts in Middle East & Mediterranean Studies from King's College London.

AMP Capital

Company Profile

AMP Capital is a global investment manager with a heritage and strength in real estate and infrastructure. AMP Capital has been investing in infrastructure since 1988 and has US$20bn infrastructure equity and debt assets under management as at 30 June 2021.[1] AMP Capital has been ranked in the top 10 infrastructure managers globally, based on total capital raised.[2] AMP Capital is owned by AMP Limited, which was established in 1849, and is one of Australia's largest retail and corporate pension providers.

[1] As at 30 June 2021. Figure consists of the Net Asset Value of certain funds and clients managed by AMP Capital taking into account all of the assets less any liabilities. This includes cash and liquidity of such funds in addition to any committed but undrawn capital.

[2] Derived from the 2020 Infrastructure Investor 50. Ranking based on the amount of infrastructure direct investment capital raised by firms between 1 Jan 2015 and 31 Aug 2020

Roundtable Participants

Luke Hyde-Smith

Fund Manager & Head of Third Party Fund Selection

Personal Profile

Luke joined Waverton in February 2017 as the Head of Third Party Fund Selection. He is the co-manager of the Waverton Real Assets Fund and Waverton Absolute Return Fund and member of the Multi-Asset Investment team.

Prior to working at Waverton he was at Brompton Asset Management where he built and developed their collective investment selection process and was a key team member who focussed on managing a range of multi-asset class strategies.

Luke has also worked at New Star Asset Management and SG Private Bank. He has a BA Hons degree from Manchester University and is a CFA Charterholder.

Waverton

Company Profile

Waverton is an independent, award-winning investment management house dedicated to creating high-quality investment solutions for Private Clients, Charities, Intermediaries and Institutions.

Roundtable Participants

Alexandre Pigault

Principal Pension Investment Specialist

Mr Pigault is responsible for all liquid and real assets investments, as well as ESG and Climate Change initiatives at Centrica Pension Funds.

Prior to Centrica, Mr Pigault worked for pension fund consultants where he headed manager research and due diligence, across both liquid and private markets, including alternatives and hedge funds.

Prior to this, Mr Pigault managed global investments in hedge funds and advised investors on portfolio asset allocation and risk management.

Mr Pigault has been in the financial industry for over 20 years.

Jaspal Phull

Senior Vice President, Manager Research

Jaspal sits within the illiquid markets segment. He is responsible for manager research across Real Estate and Infrastructure strategies.

Jaspal joined Redington in August 2019 from Riverside Capital, a Commercial Real Estate fund manager, where he was Head of research and strategy and was directly involved in over £500m of transactions across the UK.

Prior to Riverside, Jaspal spent 10 years in manager research at Stenham Advisors (FoHFs) where he was a PM responsible for covering equity L/S mangers and Real Asset strategies

Moderator

Keith Scott

Director

Keith currently acts as trustee director on five DB schemes and one DC scheme ranging from £150m to £3.5bn and is chair of numerous investment committees. Keith joined LawDeb in 2019 as a professional trustee and brings with him a wealth of experience in risk, investment and pension management and trusteeship.

Prior to LawDeb, Keith served as the Client Director of BMO Global Asset Management and as the European Pensions Director of IBM, managing an inhouse pension team responsible for assisting the IBM DB and DC schemes with all aspects of investment and pensions management. He was company nominated trustee on the IBM Ireland schemes and also spent a number of years in the US as an investment strategist for the IBM US DB plan.

Keith is a specialist in designing risk management and control frameworks for pension plans and has led a number of projects for schemes ranging from investment (asset allocation and investment manager selection), custody and administrator review and selection and set up of new DB and DC plans. A Chartered Accountant and CFA Charter holder with an MA (Hons) in Economics and Accounting, Keith is a self-confessed history buff and an avid explorer of castles and the Welsh countryside.

Brendan Maton

Freelance Jounalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country. Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees.He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles.

Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE. Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

Meet the Team!

Sean Thompson

Managing Director

Natasha Silva

*Managing Director,
Client Relations*

Amy Richardson

*Senior Director,
Business Development*

Sam Buttress

Associate, Business Development

Mithursha Kesavan

*Database and Publication Support
Associate*

Sarah Northwood

*Marketing and Events
Coordinator*

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