Insightspaper

AMP CAPITAL

REAL ASSETS GLOBAL OUTLOOK, 2018

Investor demand for real assets – infrastructure and real estate – has continued to strengthen in recent years thanks to favourable economic conditions and the historically low interest rate environment.

In this 2018 outlook, AMP Capital's investment leaders draw on their respective teams' deep research and insights to provide a snapshot of what to expect within the various segments for the year ahead.

Boe Pahari
AMP Capital Global Head of Infrastructure Equity

Last year saw record fundraises in infrastructure as investor interest continues to grow, a reflection of a maturing asset class and a trend we expect will continue over the coming year. As the asset class further evolves we expect investment activity will present new and interesting opportunities, particularly in the transport, communications, energy and social care sectors.

In **transport**, activity in the airports space has been reasonably strong and further investment opportunities are anticipated during 2018 including expected transactions in the UK, France and Belgium. Across Europe, investment opportunities during 2018 are also expected in the ports/marine, rail and car parks sectors. Rail and rail related infrastructure continues as a stable and growing sector, with a significant need for development to support the supply chain of the market in the US.

In **communications** infrastructure we see continued robust growth across the communications subsectors, such as tower companies, fibre optics companies and data centres, where the business models have stable and long-term recurring revenues, operating leverage, high margins and typically diversified and strong customer bases. The secular demand and growth in wireless and internet data, cloud computing, mobile phone usage and digital storage underpin a healthy outlook for telecoms infrastructure.

Large-scale thermal power plant development and investment continues to be hindered by low power prices in the **energy** sector as well as a lack of incentives by governments and regulators to provide dispatchable largescale power generation. Smaller scale decentralised power generation and battery storage have begun to fill the gap and provide much needed services to the grid in order to stabilise the system. As energy evolves into a more dynamic sector we continue to look for unique investment opportunities that will help to build out a more customer/demand focused energy infrastructure system.

Social care investment activity remains high in Europe despite being below its cyclical peak, thanks to strong underlying fundamentals, reasonable investor sentiment and a supportive credit environment. Further investment opportunities in this space are expected across Europe including a number of private equity owned assets that are expected to come to market during 2018.

We continue to monitor the potential impact of Brexit and policy developments in the US and how they might influence infrastructure investing and create opportunities going forward. In the US infrastructure is one of the few areas of full bipartisan political support and there continue to be initiatives, ranging in the billions, to speed up approvals for infrastructure projects. We are still to see more detail on these initiatives, but we expect the majority of this spend will be driven by state and local municipalities. With unanimous support and the need to develop and rebuild outdated assets in the US there is little doubt infrastructure will continue to be a growing asset class.

As investor appetite continues for more return seeking investments that still retain infrastructure themes, investors that differentiate themselves through deep sector expertise combined with the ability to actively manage assets will be the most successful.

Carmel Hourigan
AMP Capital Global Head of Real Estate

The weight of money chasing real assets remains high, which will keep upward pressure on pricing metrics for now. With low interest rates and government bond yields, real estate has become the asset of choice for yield-hungry investors with a lower risk appetite. Yield compression is anticipated to continue in 2018, compressing by an average of 12.5 – 25 basis points across all sectors **in the local Australian market**, however economic volatility and monetary policy changes may change this trajectory.

In Australia, three areas we're focusing on where we believe we can take advantage of themes as they play out this year include: high quality "core" CBD commercial assets, inner urban industrial on the back of the trend towards e-commerce, and the shopping centres as multipurpose social infrastructure trend. See House view for a more detailed snapshot of the Australian market.

Globally, competition for investor capital will heat up in 2018. As the cost of capital increases, we are anticipating investors to look for a more diverse range of investment options. The economic backdrop is improving rapidly, with global GDP forecast to reach a 10 year high of 3.7 per cent growth in 2018, according to the International Monetary Fund.

The US will be the market to watch in 2018. Rising GDP growth and substantial company and income tax cuts will spur new investor demand and wage growth over the medium term.

The US share market has been on a sustained growth trajectory for the past year. A rising share market environment in the US is good news for global real estate products, as fund managers will be more likely to lift their allocations to direct and listed real estate as their capital receipts increase.

As the cost of capital lifts on the back of rising interest rates, we are anticipating that global investors will move up the risk curve into higher yielding products. In the US, multi-family, suburban office and logistics sectors will be the biggest winners in the hunt for yield. In the large gateway markets, rising technology demand will be a key driver of income performance, with New York and San Francisco office markets to benefit most throughout 2018.

Giuseppe Corona
AMP Capital Head of Global Listed Infrastructure

2017 was a strong year for global listed infrastructure with the asset class recovering from a volatile 2016 and posting double-digit returns.

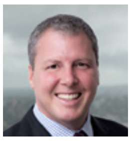
Within such a supportive backdrop, communication, transportation and utilities' robust performance was mostly driven by better than expected global economic growth, reduction of political risk and stabilisation of interest rates. On the contrary, energy infrastructure lagged throughout the year despite better industry fundamentals, likely weighed down by investors' preference for higher-growth sectors.

We believe that 2018 will remain a supportive environment for the segment with industry-wide structural investment thematics continuing to provide tailwinds to the growth of the sector.

In particular, increased data usage and the need for industry rationalisation will continue to drive communication infrastructure, while investments in the utilities sector will be supported by higher penetration of renewable energy. Transportation infrastructure will continue to benefit from a resilient economic growth environment and favourable demographics in emerging markets.

Finally, higher US oil and gas production will support capital investment in the energy infrastructure sector.

Despite the strong performance of the last 12 months, we believe that the asset class, on a global basis, is still attractively valued, both in terms of economic internal rate of return measures as well as dividend yield. Moreover, as active managers, we continue to monitor our listed infrastructure investment universe trying to identify and exploit any material dislocation between fundamentals/value and price.



Andrew Jones
AMP Capital Global Head of Infrastructure Debt

Following on from an extremely active market in 2017, this year looks like it will be another positive year with many of the fundamentals in place to support a high level of transactions.

In terms of liquidity in the market, we are still seeing plenty of "dry powder" in infrastructure equity funds targeting core assets in developed markets which, combined with continued strong demand from banks and institutional investors targeting senior debt, is supporting a healthy pipeline of M&A activity.

The drivers for asset sales continue to be portfolio optimisation within large corporate groups and increasingly the liquidation of portfolios by closed-end funds as they approach the end of their fund life. Geographically, we are expecting to see a steady flow of opportunities coming out of the European market and continued growth in the North American opportunity set.

Spreads in senior infrastructure debt markets remain tight on a historic basis and we don't see any market dynamic that would materially change this over 2018.

In the less crowded junior or mezzanine sector, returns have held up well and, again, absent any dramatic shift in the appetite for risk globally we expect this to continue through 2018.

One of the interesting shifts in the market at the back end of 2017, which we expect to continue during 2018, is the emergence and acceptance of newer areas of focus for infrastructure investors globally. These include sectors such as telecommunications generally and data centres specifically as well as in the aged care space.

As is the case with all infrastructure assets, the devil is in the detail, with many opportunities in these sectors portraying characteristics that attract lenders to the infrastructure sector while others can exhibit more volatility than we would normally expect from a "core" asset. As is always the case, having an experienced team who can identity these factors will be critical in determining positive investor outcomes.

James Maydew
AMP Capital Head of Global Listed Real Estate

We expect global listed real estate companies to continue to enjoy a favourable outlook in 2018, supported by low interest rates and reasonably positive economic sentiment.

There are some areas, however, that we're expecting to perform particularly well during the year due to their exposure to long-term secular growth trends in these three areas.

Datacentres

The proliferation and dependency of data globally is driving the internet ecosystem of the cloud to new levels of mainstream adoption. In the end, all the data being generated by users in the digital world needs a secure home that can be easily accessed by consumers with minimal latency. That's where datacentres play a vital role in connecting the global population to the internet and charging rent and connection fees for the privilege. Between 2015-2020, it is anticipated that global datacentre workloads will increase by 27 per cent compound annual growth rate and this will continue to drive demand for the real estate and infrastructure that house the network especially in markets such as North Virginia in the US where 70 per cent of the global internet traffic flows through. As landlords to the internet and the cloud, datacentres are well positioned to continue to capitalise and deliver outsized growth.

Ecommerce

Consumption trends are shifting dramatically and have been for many years. We all know about the disruption of the retail world by ecommerce players, such as Amazon and Alibaba, and have heard the horror stories of "the death of the US mall". There are also winners in the real estate market from this trend that benefit from this structural shift. Logistics facilities have been nicknamed "cheap malls" in certain real estate circles as they are now a vital cog in any ecommerce transaction and play the same role as malls have always done via storage and access to goods for sale. The UK is a prime example of this trend, with ecommerce penetration (ex food) approaching 40 per cent, and forecast to move towards 50 per cent in the coming three to five years. This is driven in part by the proliferation of mobile technology with 47 per cent growth in online sales via mobile devices in 2016. This is all occurring at a point in time where industrial floor space supply has been shrinking due to the conversion of land to "better and higher use" real estate such as residential.

Demographics

The first Baby Boomers turn 70 this year and, over the next two decades, will all start to retire from the workforce and begin allocating more of their capital to goods and services that assist their changing lifestyles. Demographics drive everything and we have an impending aging population crisis on the horizon in many Western countries as this massive cohort stop accessing credit, spending on consumption and begin drawing down on it through retirement. Unfortunately for the Baby Boomers, they will also be allocating a greater proportion of this finite capital to their growing healthcare needs. Given the population of +65 year olds is projected to grow 100 per cent between 2010 and 2050, this will create huge pressure on the existing healthcare infrastructure and is a massive tailwind for real estate owners that offer high quality health care facilities that match this demand such as medical office buildings.