Private assets post divergent performance but new opportunities arise

Key points

- Essential services such as contracted power, water and logistics have weathered the impact of COVID-19 relatively well.
- Niche infrastructure sectors such as data centres could do well in the future as digital demand continues to increase.
- Processes to review and revalue assets are challenging and would benefit from greater consistency and flexibility.

The impact of the COVID-19 pandemic on private asset valuations has been hard to predict but new pockets of opportunity are beginning to appear, according to investors at the Frontier Conference.

Infrastructure assets such as airports, tolls roads and car park infrastructure were hit hard by the downturn, but other sectors such as electric, gas and water utilities, power generation, and telecoms infrastructure have proved more robust. Retail real estate materially underperformed in a continuation of a pre-existing trend, however the logistics sector has performed well to date on the back of the strength of online retailing.

Many companies were quick to pivot towards digital operating models to keep trading amid widespread restrictions.

"E-anything has caught a massive tailwind through this, whether that's electronic commerce in the real estate space playing into logistics, or whether that's anything to do with the digitised world," Future Fund Deputy CIO, Wendy Norris, said.

"You'll see great things to pursue in the data and the towers space and those niches I think will become more prevalent in the infrastructure market as we go forward."

Frontier Advisors Head of Real Assets, Isabelle Demir, said the Australian market for niche real assets sub-sectors was limited but had been around for many years in the US and Europe.

"Health sciences, social housing, multifamily, data centres have been around for the last decade and the sector is worth $US2 trillion in the US."

Regulation can offer protection but at a price

While the pandemic lockdown caused a sudden, sharp downturn across portfolio valuations, specifically for GDP-linked assets, Norris cautioned investors against targeting more heavily regulated private assets for protection.

"Regulatory risk is more unpredictable than you think," she said. "In fact, what regulation does is create a cap on your returns… a cap on the upside without a commensurate cap on the downside."

Demir said regulated assets had performed quite well in this downturn, despite governments pushing electricity, gas and water distribution companies to give discounts to customers experiencing hardship.

"The real issue with regulated assets globally is that there's been a perception of excess returns under private ownership, and in response regulators have reduced returns to such low levels that I think they're looking less and less attractive."

The Future Fund has about one-third of its $160 billion portfolio allocated to private markets, including private equity, property, infrastructure and timberland.

Diverse approaches to valuations

Norris and Demir said there were notable divergences in how private equity, property and infrastructure managers had valued their assets in response to the downturn.

IFM Investors CEO, David Neal, said valuations were based on a robust, repeatable process but nonetheless, were not a precise science. IFM has agreements with its investors that ensure valuations are conducted by independent valuers.

"Those things aren't easy and they're not cheap. So, all of this stuff has to be balanced against the cost and resources that it takes to do more frequent valuations. I think it would be good if we could develop industry-wide standards for how we're going to go about this tricky challenge."

Frontier Advisors Principal Consultant, Tom Frederick, said some investors would have liked to have made their own valuation adjustments as the pandemic struck but their existing policies didn't allow it, which is something they may consider changing in the future.

Not only has COVID-19 affected the relative appeal of different investment opportunities, it will also reshape the policies and processes used by investors and managers going forward.

Key questions the panellists answered

- *(37.50m) What have investors learned about the frequency of valuations, and broader valuation policies and procedures, in the wake of COVID-19?*
- *(42.30m) Should investors target more regulated private assets to protect against risk?*
- *(46.30m) The Future Fund has a competitive advantage regarding liquidity because it does not have to manage investors coming in and out of the fund – can it use this advantage to target niche investment areas?*
- *(51.40m) Will the uncertainty caused by the pandemic change attitudes to traditional gearing levels used in these asset classes?*