a.s.r. real assets investment partners

The energy transition beyond Renewables

In its Houseview, a.s.r. real assets investment partners identifies several megatrends that will shape the opportunities and risks in real assets investments in the coming years. This article focuses on the megatrend ESG & climate change and how infrastructure investments can capitalise on this trend.
It particularly looks at alternative investment opportunities in addition to the widely accepted category of renewables.

Positive Outlook

a.s.r. real assets investment partners is fundamentally positive about investment opportunities in most underlying real asset (sub-)markets. The risk-return profile of infrastructure remains attractive, partly due to lower interest rate sensitivity from long-term contracts, inflation compensation, and inelastic demand. Additionally, rising interest rates have increased expected returns; net cash yields for core investments are currently around 4-5%. Investments with a higher risk-return profile (core+/value add) have the highest risk-adjusted value according to a.s.r. real assets investment partners. For these investments, absolute return is an important measure. Depending on the type of asset, a.s.r. real assets investment partners expects net returns of >10% for investments categorized as core+. Due to the large supply of projects and the still high demand for scarce capital, valuations are expected to remain stable in the near future.

Megatrends

a.s.r. real assets investment partners identifies four megatrends that are crucial for investments in real assets: ESG & Climate change, Demographic changes, Technology & Innovation, and Economic shift.

ESG & Climate change

Demographic changes

Technology & Innovation

Economic shift

According to a.s.r. real assets investment partners, infrastructure can respond to these megatrends in various ways, potentially in combination with other real asset investment categories. Translating these long-term trends into opportunities for infrastructure investments results in the following possibilities, among others:

Investment Opportunity	Sector(s)	Megatrend
Supporting electricity networks through energy storage	Utilities and Energy	ESG & Climate change
Development and expansion of district heating networks	Utilities	Economic shift
Generation of renewable energy and further energy applications	Energy	ESG & Climate change
Development of new and expansion of existing data centers	Digital	Technology & Innovation
Expansion and sustainability improvements of physical infrastructure (roads, rail connections) around distribution locations	Transport	Economic shift

The houseview on real assets by a.s.r. real assets investment partners delves deeper into the above examples.

Beyond renewable energy

To achieve energy efficiency and responsible energy consumption, a.s.r. real assets investment partners sees investment opportunities in smart meters and ‘behind-the-meter’ technologies. Investments in smart meters are supported by plans from the European Commission (Digitalisation of Energy Action Plan, October 2022). This category includes investments in installing smart meters (buying and merging installation companies to achieve efficiency) and managing and offering additional services such as integration with EV (de)charging and control of household appliances. The revenues from such investments are secured in long-term contracts with rates automatically adjusted for inflation. Returns also come from building platforms and creating larger and more efficient companies, such as installation companies. a.s.r. real assets investment partners categorizes such investments as core+.

Characteristics of smart metering investments:
- Long-term contracts with very low customer turnover;
- Contracts with inflation compensation;
- High barriers to entry;
- Contribution to SDG’s.

As part of the energy transition, investments are needed in utilities such as energy storage to support the growth of renewable energy. Batteries are an obvious choice, and developments in this area are progressing rapidly, but heat, hydrogen, and water can also store energy. For example, a.s.r. real assets investment partners sees developments in hydropower plants where water is pumped back into the basin for reuse (so-called ‘pumped hydro’). Batteries support electricity networks by absorbing short-term demand shocks. Purchase contracts are still mostly short-term, but long-term contracts with availability as the basis for income are clearly growing. Energy storage, particularly in batteries, is also categorized as core+ by a.s.r. real assets investment partners.

Finally, a.s.r. real assets investment partners sees significant opportunities in the transport sector. Sustainability will help reduce CO_2 emissions from this sector. This includes investments in electric public transport such as trams and trains (both equipment and networks), as well as charging points for both private and freight transport. For freight transport, opportunities arise from the installation of charging points at distribution centers, combined with local sustainable energy generation and battery storage to absorb peak loads. The revenues from such investments are often based on availability, unlike EV charging for private transport, where revenues depend on the use of the facility. Investments in sustainable fuels such as sustainable aviation fuels (SAFs) and hydrogen can also be interesting, although this category is still largely in the development phase and practical applicability has yet to be proven. These latter investments are categorized as value-add by a.s.r. real assets investment partners.

Conclusion

ESG & climate change is one of the major fundamental drivers of investments in the infrastructure market. To implement this theme in investment portfolios, there are increasing investment opportunities. This can be done through relatively widely accepted investments in renewables such as wind and solar parks, but a.s.r. real assets investment partners believes there are more attractive opportunities. Examples such as sustainable investments in smart meters, energy networks, and transport assets have a slightly higher risk profile but add corresponding value to an institutional investment portfolio.

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Publication date: 20 january 2025

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