What Opportunities Lie Ahead in Real Assets?

Stockholm (HedgeNordic) – Many institutional investors have embarked on a structural shift towards higher allocations to real assets. In the current unusual low-yield environment, real assets and value-add properties, in particular, represent a very attractive hunting ground for institutional investors, reckons real assets specialist Teresa Farmaki.

Farmaki, co-founder and partner at real assets co-investment platform Astarte Capital Partners, is noticing that real assets as a group "represents the fastest-growing segment in the alternatives space." The main demand driver is institutional investors, who are "creating a dedicated allocation to real assets for portfolio construction, which was not the case before," argues Farmaki.

Although too much capital may be chasing real assets at the moment, Farmaki reckons that the increased appetite is "warranted because real assets have a very distinct role in portfolios." Because real assets "are tangible assets with low correlation with other assets classes, this asset class has a significant role to play in developing a diversified portfolio for institutional investors." Furthermore, real assets are longer-term and normally yielding assets. "In terms of the nature of returns and time horizon, real assets meet the profile of pension fund programs," continues Farmaki.

Too Much Capital Chasing Core Real Assets?

Low yields and diminished return expectations in traditional asset classes are boosting the appetite for real assets, with investors being at risk of having their allocations stranded at low returns. "Most investors having the pressure of meeting the cost of capital or return requirements are increasingly turning their attention to real assets," argues Farmaki. This increased demand has substantial effects on specific areas of real assets, particularly core real assets that offer stable, long-term cash flows.

"In large-sized transactions in core infrastructure assets, yields are being literally crushed," warns Teresa Farmaki. "You do see very competitive processes, and you see yields going significantly down, which makes you wonder if there is a pressure to deploy capital as a result of increased liquidity and if this environment is sustainable," she ponders. "I would say, probably not." Yet, Farmaki and her team are seeing longer-term opportunities in real assets. "There are still a lot of areas that are not explored, which is why we chose to focus on areas that are under the radar of big managers," Farmaki explains.

Using a unique co-investment platform model, Astarte Capital Partners predominantly invests in value-add real assets overlooked by larger assets managers either due to size or operational complexity. "Because there is so much capital flowing into core assets, value-add and opportunistic real assets are extremely attractive," says Farmaki. Explaining Astarte's focus, Farmaki says, "in the spectrum from core to opportunistic, we are more value-add or opportunistic."

Compared to the more passive core infrastructure investments, Astarte's "contractual cash flows may be shorter-term, or we may have to implement value-add development to materialize long-term stable contracts, or we may take a bit more operational risk." This operational risk or complexity represents the core of generating returns in real assets going forward. "Operational capability is a significant value contribution."

Astarte’s Unique Structure and Future Plans

Astarte’s unique structure involves forming partnerships with specialist asset operators, committing seed capital alongside additional institutional backing, and supplying the people and working capital for the operation of these partnerships. Astarte, the asset operators and the external institutional investors, all contribute capital to each project and collaboration, with all sharing the upside, the costs and downside of each project. Nonetheless, Farmaki argues that the “proposition of the underlying investment [opportunistic value-add investments] is there” even without this unique structure.

“We do not do what we do for the structure,” says the co-founder of Astarte, stressing that the “structure is just the right enabler, the right framework.” Most institutional investors are less enthusiastic about embracing new models of accessing real assets, with Farmaki acknowledging that “we do know that in the beginning there will be a smaller percentage of investors who will adopt or embrace our model, but that’s like with every new model.” Yet, the team at Astarte “felt that we do want to make a positive impact in the industry; we do want to help do things better.” Combing forces and binding interests into a precisely defined set of opportunities can create value for all parties involved.

In mid-April this year, Astarte Capital Partners announced a partnership and the establishment of a £400 million investment platform focusing on opportunistic prime infill and edge-of-prime real estate in London, aiming to transform these assets into institutional-quality future core assets. This platform is “especially exposed to hospitality, healthcare, and urban regeneration, which are very specific themes playing out in metropolitan cities” according to Farmaki. “Other areas we are looking actively at are senior housing, sustainable farmland, waste energy, and special transportation.”

Key to Success in Real Assets Investing

Terresa Farmaki argues that investing in real assets requires two essential attributes that are underestimated. “One is having the right operating expertise,” says Farmaki, adding that “real assets investing is not just having the money to buy them, you need to know what to do with them.” That is where the money is made or lost, according to Farmaki. “Exactly because you need to work with an operating partner, you need to build the right alignment of interest and know how to structure the operating framework with them because they are smarter in that space than you,” she points out the second attribute. “Misalignment of interests never leads to good results.”