DECEMBER 2024

New infrastructure needs new capital

According to a study by the Global Infrastructure Investor Association, only 38% of people worldwide were satisfied with their infrastructure in 2023[1]. We are experiencing everyday problems with the existing infrastructure, which is very often outdated and requires further development. In addition to modernising existing roads, trains and tracks, distribution networks, and communication infrastructure, we must start now to build the infrastructure of tomorrow.

Some experts say that up to 70% of the infrastructure of 2050 does not exist today[2]. The development of new infrastructure is key for the future viability of Europe. The focus here is on managing the energy transition, digitalization, and demographic developments. The decarbonization of many industries, securing the energy supply and the digital participation of the population cannot wait. Just recently, Former President of the European Central Bank Draghi pointed out in a report for the European Commission that Europe needs additional spending of around EUR 800 million a year to remain competitive, socially stable, and to meet climate targets.

Driving Decarbonization

The energy transition is on top of the agenda of most governments and companies in Europe, who often commit to net-zero targets. This transition was further accelerated by the energy crisis caused by Russia's invasion of Ukraine and the resulting embargo on Russian energy, which has heightened the importance of energy supply security. The energy transition has the potential to significantly reduce Europe's dependence on (fossil fuel) energy imports and replace them with green electricity and green molecules produced in Europe. A key component of the energy mix could become green hydrogen. AllianzGI is already invested in green hydrogen projects in the Nordics to support this development.

Hydrogen can play a role not only in energy supply, but also in heavy goods transport, aviation, and shipping. Electricity is required to produce hydrogen. There is a consensus that the increased demand for electricity for hydrogen production should be covered by renewable energies, making it green hydrogen.

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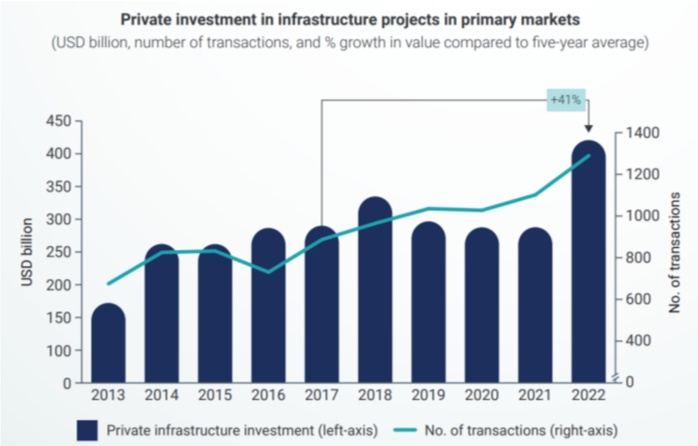


Source: GI Hub Infrastructure Monitor based on Realfin data , 2023.

Another important driver of decarbonization is the transport sector, with its decreasing reliance on fossil fuels and increasing usage of green electricity. Also, the further development of public transport, aimed at replacing some of people's personal cars usage. The challenges posed by climate change and increasing urbanization require massive investment and innovation in the transport sector. Some of AllianzGI´s projects in this area have been financing hybrid ferries, battery-powered trains to replace Diesel trains or the refurbishment of local trains.

Ever since the pandemic, it has become apparent that digital infrastructure is critical infrastructure. However, many countries in Europe are still lagging when it comes to broadband connectivity. Home office, video streaming, video conferences, and more digitized processes require more fibre optic networks and data centres. According to a report by the European Commission, additional investment of up to EUR 200 billion is required to achieve EU-wide gigabit coverage and 5G coverage in all populated areas[3]. Again, this goal should be achieved in line with the goals of climate-neutrality.

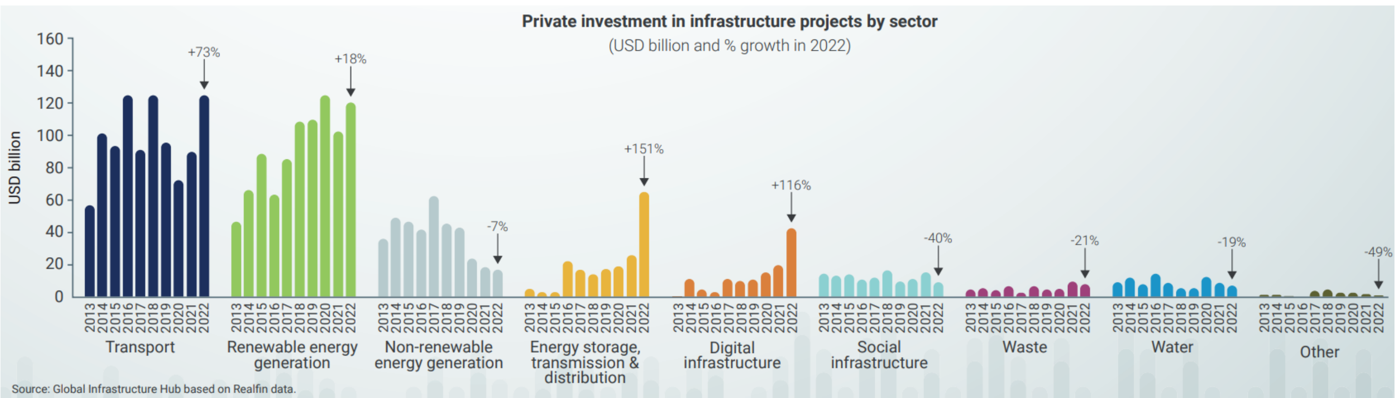
More energy needs more grids

Decarbonization, digitalization and the demographic change come with an increasing demand for clean energy. The European Commission estimates that the electricity consumption is expected to increase by around 60% between now and 2030[4]. The expansion of electricity grids, distribution stations, but also storage technologies and gas grids (for the transport of green gases such as green hydrogen) is the prerequisite to be ready for tomorrow. The existing infrastructure in many European countries isn´t ready by far. Approximately 40% of Europe's distribution grids are over 40 years old and must be modernized. It is estimated that c. EUR 400bn need to be invested in Europe´s distribution grids is necessary by 2030[5].

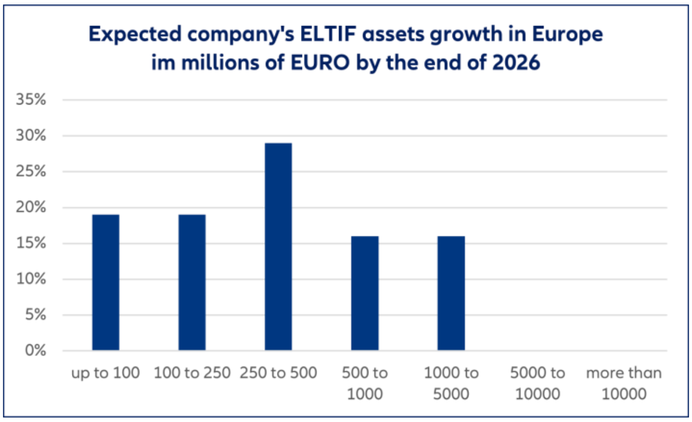
The power of private capital

The range of projects that need to be tackled is broad, the investments needed for these mammoth projects huge. According to the infrastructure monitor of GI Hub, global demand for infrastructure investment is estimated at USD 94 trillion by 2040[6]. However, state budgets have come under pressure. Private capital can play a decisive role in building tomorrow´s infrastructure. Until recently, it was primarily institutional investors, such as insurance companies and pension funds, who were able to invest in large infrastructure projects such as utilities, data centres and train services, since experience, expertise, and appropriate market access are required to navigate the complexity of investing in unlisted, or private, infrastructure.

The European Union launched the ELTIF (European Long-term investment fund) back in 2015 with the aim of giving private investors access to unlisted, private market investments. However, while the take-up of this investment



Source: GI Hub Infrastructure Monitor based on Realfin data , 2023.



Source: Scope Fund Analysis, 2024.

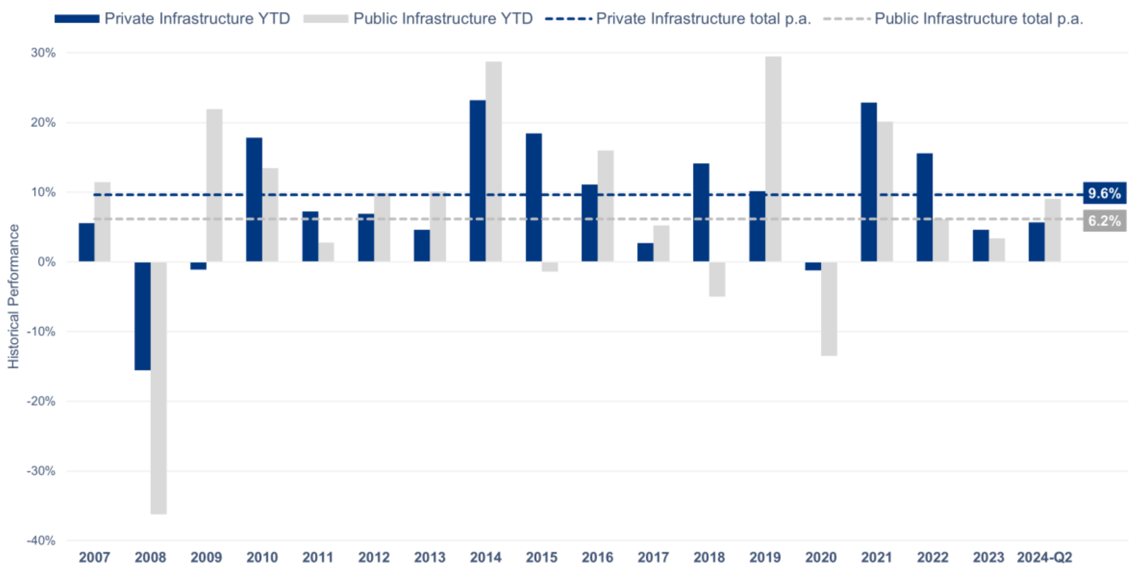
vehicle has been rather slow, the latest amendments to the law, dubbed ELTIF 2.0., introduced several simplifications as of January 2024. This is expected to lead to an increase in product supply. New market entrants, like AllianzGI, have just recently launched their first ELTIFs. Scope estimates the ELTIF volume to reach between EUR 30bn and EUR 35bn by the end of 2026, with at least 20 new ELTIFS on the market within the next year[7] .

Some of the recent ELTIFs launched have an infrastructure focus. What are the benefits of unlisted infrastructure from an investor's point of view? First, the need for investments in this area is evident, leading to many deal opportunities available. Also, private infrastructure benefits from an extra return compared to listed infrastructure, compensating for the complexity and illiquidity of the asset class. Furthermore, the infrastructure asset class has successfully weathered some challenging macroeconomic times in recent years, from the pandemic to the energy crisis and rising inflation.[6] Critical infrastructure in particular – such as utilities, water supply, mass transportation, telecommunications networks to name just a few – provide essential services to the public and can usually generate relatively stable returns due to its strong market position (with high barriers to entry in asset-heavy, highly regulated low-competition markets) and potential for regulated or long-term contractually secured revenues. Also, often-times infrastructure revenues are directly or indirectly linked to inflation, providing a useful portfolio protection against rising prices. These features make infrastructure an attractive potential addition and diversifier to an investor's portfolio.

However, while return opportunities are attractive, one is well advised to also consider the characteristics and risks associated with private market investments, such as the longer investment horizon and the specific risk profile, and rely on good advice and information when considering an ELTIF for their portfolio. The illiquid nature of these investments means one should treat them as a long-term investment, not one that provides short-term liquidity. In addition to illiquidity, private markets carry specific other risks, which investors need to understand – by relying on appropriate advice and information – and properly consider in the light of their own portfolio objectives.

New infrastructure needs new capital – and the range of projects and companies that private capital could finance is enormous. By investing in an ELTIF as a long-term addition and diversification to an otherwise liquid portfolio, private investors can make a threefold contribution – to a modern infrastructure, a sustainable society, and their own wealth creation.

IRR performance of private and public infrastructure equity by calendar year



Source: Allianz Capital Partners, 2024. Bloomberg and Burgiss data as of 06/30/2024. Pooled YTD net IRRs in EUR across all vintages. * Latest available data as of Q2-2024.This is for illustrative/discussion purposes only and no guarantee of expected results or indicative of future allocation. Past performance does not predict future returns.

Sources

1) https://giia.net/news/new-infrastructure-attitudes-study-flags-urgent-need-investment

2) https://www.siemens.com/de/de/unternehmen/stories/infrastruktur/2019/zukunft-der-staedte-interview-mit-martina-otto-unep.html

3) Source: European Commission, Stand der digitalen Dekade (europa.eu), September 2023.

4) Questions and Answers on the EU Action Plan for Grids (europa.eu)

5) Questions and Answers on the EU Action Plan for Grids (europa.eu)

6) https://www.gihub.org/infrastructure-monitor/

7) A new era (scopeexplorer.com)

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