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RE-Infra: Investing at the nexus of real estate and infrastructure

Tom Parker, Institutional Real Estate, Inc.'s executive vice president and publisher, recently spoke with **Phoebe Smith,** head of Funds Management RE-Infra, PATRIZIA, about investing where infrastructure and real estate converge. Following is an excerpt of that conversation.

Phoebe, what is your role at PATRIZIA?

I'm head of Funds Management RE-Infra, and I have been with PATRIZIA Infrastructure for 13 years, deploying and managing investments in our European mid-market fund series and our Smart Cities Infrastructure Fund. My background is infrastructure investing, originally in Australia, but for the past 13 years, here in London, with investments in Europe and North America.

What is RE-Infra? And what are the key drivers behind this convergence of the two sectors?

RE-Infra is PATRIZIA's name for the convergence of real estate and infrastructure, as elements of these two asset classes increasingly overlap. The same global megatrends – decarbonization, urbanization and digitalization – are driving investment in both spaces, providing investment opportunities that span both infrastructure and real estate. The result is a convergence of real estate and infrastructure in the underlying assets. For example, data centers are infrastructure housed in real estate and land. They have infrastructure characteristics in the way the contracts are structured, in their operational elements, and in the development and construction of those businesses. But they also have real estate elements. Another example is a logistics park, where the logistics buildings and facilities themselves might fall into a real estate portfolio, but the investment still requires all the infrastructure surrounding it to make it a suitable logistics location, such as proximity to a port, for instance. Infrastructure and real estate work together to solve some of the big challenges the global megatrends pose.

What are examples of successful RE-Infra projects, and how did the convergence create additional value?

From an investor perspective, we're starting to see pension funds merging their real asset allocations across real estate and infrastructure and managing those under one team, with a single allocation to both sectors. Increasingly, I think investors will move in that direction. At the same time, from an investment opportunity perspective, there are more opportunities for overlap – for instance, a transaction large enough that it requires multiple sources of capital. In recent data center deals, investors have put both their infrastructure and their real estate funds into the same transaction. Typically, that would require some structuring. You might put the real estate investors into an asset company and the infrastructure capital into the operating company or the development company to ensure the cash flows each produce are more suited to a given type of capital. But ultimately, they are investing in the same business. Here at PATRIZIA, we are already seeing RE-Infra across our portfolios; with €10 billion [$11 billion] in infrastructure assets under management and €46 billion [$50 billion] in real estate assets under management, there are opportunities to enhance the value of both portfolios through solutions such as EV charging being rolled out across real estate portfolios among others.

How can RE-Infra investments contribute toward sustainable communities?

One of the largest challenges our generation is facing is how to decarbonize our cities. The built environment is obviously a huge part of that. Cities currently consume 75 percent of global primary energy and emit 50 percent to 60 percent of global greenhouse-gas emissions. The International Energy Agency [IEA] estimates this will increase to 74 percent by 2030. That's a huge problem for us all to tackle. If you look at one part of that – just the infrastructure or just the real estate – you're not going to find a solution for that decarbonization challenge. We must approach it together to be able to find solutions effectively. For PATRIZIA, that brings about smart-city opportunities because, by their very nature, smart cities are all about creating efficiencies, whether that's through electric vehicles, through smart street lighting, smart buildings and utilizing technology to ensure the building itself is being run as efficiently as possible. Doing that across the spectrum of infrastructure and real estate will best contribute to creating those sustainable communities.

Tell me, what actually defines a "smart city"?

To us, a smart city is a city that utilizes technology to improve efficiency. It's something all cities should be doing. Cities are at different points along that journey, but, over time, it's going to be essential all cities take this on. That might mean something relatively simple, such as rolling out LED streetlighting and adding sensors – so, at two o'clock in the morning, when there's no one around, they automatically dim to a low level, but if they sense motion, they grow brighter to ensure safety. Such actions improve services for local residents, which makes them feel safer, but at the same time, save energy. All these smart-city applications are intended to improve services, but in a much more efficient way by utilizing technology.

Equally important are smart-building solutions. Is your HVAC running as efficiently as it can? Are there security measures you can utilize? And then, how do we integrate all these efforts so the technologies can "talk to each other," so instead of a number of stand-alone solutions, they create the smart city as a whole.

What trends or predictions do you have for 2025 with emerging RE-Infra opportunities?

Kinland social-infrastructure assets in Finland

RE-Infra is still going to be in its infancy in 2025 as it continues to develop as an asset class. But as more investors start to explore these possibilities, more opportunities will arise for investment. The most likely opportunities in the near term include some of the examples we were discussing earlier – data centers and social infrastructure. These are often crossover areas between infrastructure and real estate. Renewable-energy communities, rooftop solar and similar types of investments can naturally fit as an advantageous addition to a real estate portfolio, which also has infrastructure characteristics.

Can you transition a real estate asset to an infrastructure asset, or vice versa, and create value in that process?

Absolutely. We've done this in our own infrastructure portfolio. For example, we acquired our Nordic social infrastructure platform, Kinland, in 2019. It was a carve-out. It was being held as real estate, and we turned that portfolio of 173 individual properties into an infrastructure business. We created a company, a management team, introduced an infrastructure-style financing package and continued to build out the platform, consolidating that market. When we acquired them, they were all individual real estate assets. We turned it into a much larger infrastructure business that has grown very substantially in our portfolio, to now comprising 366 facilities. When we do choose to exit, it will likely continue to attract infrastructure investors.

Similarly, in the data center space, many data centers are being developed and grown as infrastructure portfolios, but once they're more mature, they are either being carved out into asset companies or development companies. We are also starting to see a trend of IPOs to go into the large, listed REIT market, which is the more natural home for those large hyperscale businesses once they're built, operational and contracted.

What is driving this convergence? Is the pension fund team shrinking, or are they trying to be more of a sharpshooter?

Part of the reason PATRIZIA expanded into infrastructure was that investors were telling us they want to deal with fewer managers across multiple real asset products. That's where part of this journey started, and most managers are now providing more than just real estate or just infrastructure. A number of the large pension fund investors are also wanting to do more direct investing. It's not necessarily shrinking teams, but rather growing expectations of the team they have. At the same time, from a portfolio-construction perspective, with these overlapping sectors – if you have a pocket of capital here and a pocket of capital there – you may not be keeping an eye on the risk profile across the entire portfolio, because similar assets are kept entirely separate. An investor can run into difficulties, where they inadvertently have doubled the risk rather than diversified their holdings.

There is a significant benefit from a portfolio-construction perspective to treat it all as one real assets bucket, eventually. Does it matter if a data center is real estate or infrastructure? Rather, the focus should be on the attractiveness of the underlying risk-return profile. And for that you need the right manager to execute on a range of opportunities across that real assets spectrum.

CONTRIBUTOR

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Phoebe Smith is leading PATRIZIA's RE-Infra strategy, including the Smart Cities Infrastructure Fund, and continues to source and execute U.K. and European investments, as well as ongoing asset management of portfolio investments in Europe and North America. Smith has experience across a wide range of infrastructure sectors globally.

CORPORATE OVERVIEW

With around 900 professionals and 27 offices globally, **PATRIZIA** has been active as a real assets investment manager since 1984. The firm manages around €56 billion ($61 billion) of real estate and infrastructure assets for more than 500 institutional clients. For more information, see **www.patrizia.ag**

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