AVIVA INVESTORS

QUARTERLY UPDATE ON DRIVERS IN ILLIQUID ASSETS Q2 2018

In our regular update on alternative income assets, we highlight equity investment opportunities in infrastructure, and the relative appeal of long income from real estate. We also provide insights into the sensitivity of an unlevered versus levered approach to real assets in a rising rate environment, alongside our regular update on the spreads achievable across private assets of varying credit quality.

Key theme: Seeking resilience in long income strategies

Infrastructure equity: opportunities in fibre optic networks

INFRASTRUCTURE EQUITY: OPPORTUNITIES IN FIBRE OPTIC NETWORKS

Interest rate volatility has increased opportunities to acquire private infrastructure assets, with a number of asset owners looking to realise value before financing costs move higher. This has contributed to a strong pipeline of solar PV and wind transactions in the secondary market.

Another area of focus is the roll out of fibre broadband, a key part of the UK government's Next Generation Network Infrastructure Deployment Plan. The installation of capacity-enabling fibre optic cable currently lags continental neighbours such as Spain and France. With growing demand for bandwidth from internet users, we see investment opportunities in providers targeting rural areas that are not being prioritised by large incumbents.

Several smaller, alternative network (altnet) providers are seeking to lay full-fibre cable directly into homes and businesses, giving providers a 'first mover' advantage, while their customers benefit from significantly faster, more reliable digital services (about 40 times faster data transfer compared with traditional copper cables). Although the models for delivery are still under discussion – for example, via public-private partnerships or regional monopoly – successful fibre optic networks could be effective value generators.

Real estate long income: sustained demand for index-linked leases, income strips and commercial ground rents

REAL ESTATE LONG INCOME: SUSTAINED DEMAND FOR INDEX-LINKED LEASES, INCOME STRIPS AND COMMERCIAL GROUND RENTS

Despite upcoming changes to International Financial Reporting Standards, a number of corporates and local authorities continue to explore property sale-and-leaseback transactions, which will allow them to utilise their existing assets more effectively. Local authorities have been particularly active in seeking ways to release capital for investment in large regeneration projects, given current budgetary pressures.

Meanwhile, investor interest in long RPI-linked leases remains strong, particularly for high-quality assets, given concerns over the return of inflation coupled with long-dated inflation-linked liabilities. We expect this interest to continue; unlevered long income assets are more resilient in a volatile interest rate environment (as highlighted over the page), and the government's commitment to pare back borrowing is expected to reduce the supply of index-linked gilts.

Recently, intense demand for amortising leases, or 'income strips' (which effectively remove the cash flows from the underlying lease) has driven strong performance in student housing and local authority sector.

It is also worth noting that interest in commercial ground rents (regular payments paid by leaseholders to the owners of a freehold) has been sustained, while the political uncertainty about residential ground rents has reduced activity in the residential sector. Ground rents can be particularly useful for matching purposes, given their long-term, highly-secured nature.

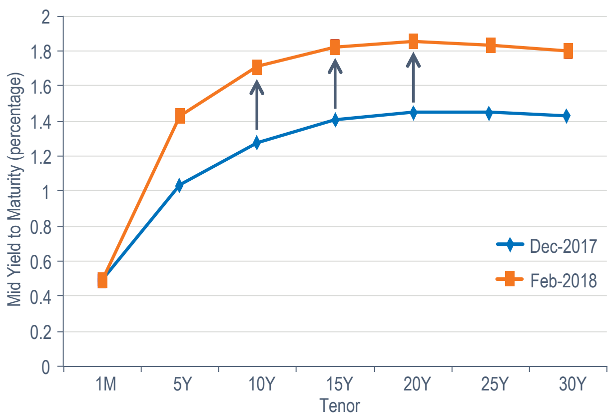
RISING INTEREST RATE SCENARIOS: Unlevered assets can provide greater resilience in a rising interest rate environment, and therefore are more suited to help meet long-dated liability streams.

Investors commonly purchase real assets through one of the following approaches:

1. An unlevered equity investment (i.e. own the asset outright)
2. An equity investment, funded by taking on leverage (i.e. levered equity)

For a given asset, we summarise the **impact of a 0.5% increase in long term interest rates** on future expected cash flows and asset value under each approach, assuming an interest rate rise at year 10 of 25-year asset (refinancing date).

STERLING SWAP CURVE: Highlighting rising interest rate expectations



Source: Aviva Investors, as at 30 March 2018. For illustrative purposes only

Unlevered: no debt financing payments to make, cash flows remain unchanged.

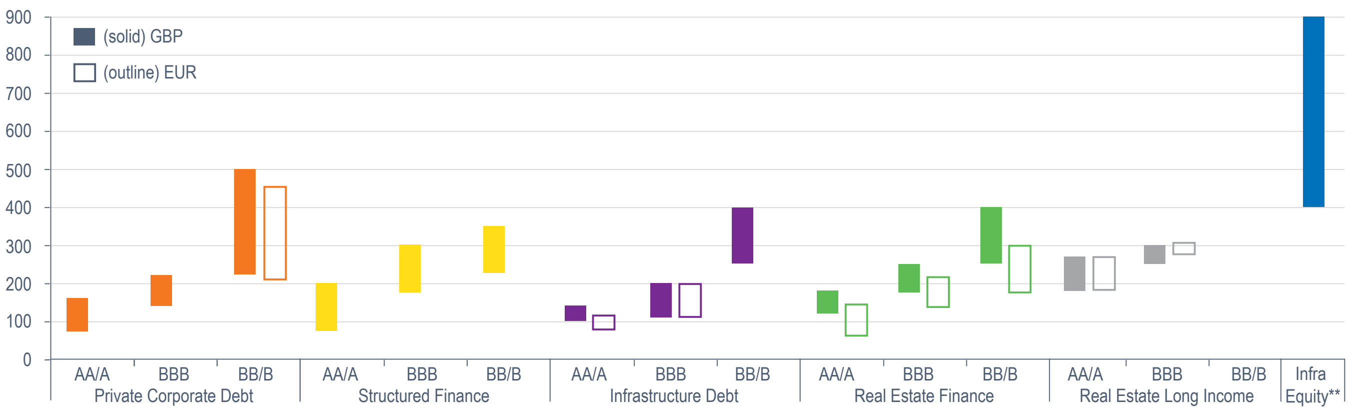
Levered: Cost of debt increases, reducing cash available to pay equity holder.

Expected impact on regular cash flows	
1. Unlevered	2. Levered
No Change	-10%
Impact on asset value	
1. Unlevered	2. Levered
-3%	-10%

Unlevered: small decrease in NAV, given higher interest rate to discount future cash flows.

Levered: Larger fall in asset value given lower future cash flows and higher discount rate used to discount future cash flows.

INDICATIVE SPREADS P.A.*

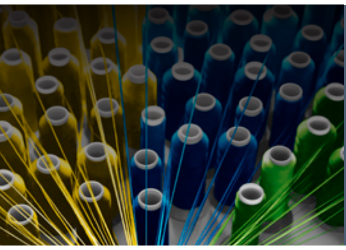


*Additional yield above comparable government bonds **High quality: unlevered infrastructure with largely predictable cash flow. Source: Aviva Investors (for illustrative purposes only). All data as at 30 March 2018. The future returns and opinions expressed are based on Aviva Investors internal forecasts and should not be relied upon as indicating any guarantee of return from an investment managed by Aviva Investors nor as advice of any nature.

RISKS

ILLIQUIDITY: Alternative Income assets are significantly less liquid than assets traded on public markets. Where funds are invested in infrastructure/real estate, investors may not be able to switch or cash in an investment when they want because infrastructure may not always be readily saleable. If this is the case, we may defer a request to redeem the investment.

VALUATION: Investors should bear in mind that the valuation of real estate/infrastructure is generally a matter of valuers' opinion rather than fact. The value of an investment and any income from it may go down as well as up and the investor may not get back the original amount invested. Past performance is not a guide to future returns. The value of an investment and any income from it may go down as well as up and the investor may not get back the original amount invested. Past performance is not a guide to future returns.



FIND OUT MORE:

If you wish to know more about our Alternative Income Solutions, please contact your usual representative or our Global Client Solutions team:

Telephone:
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Or visit us at:
www.avivainvestors.com

Important information