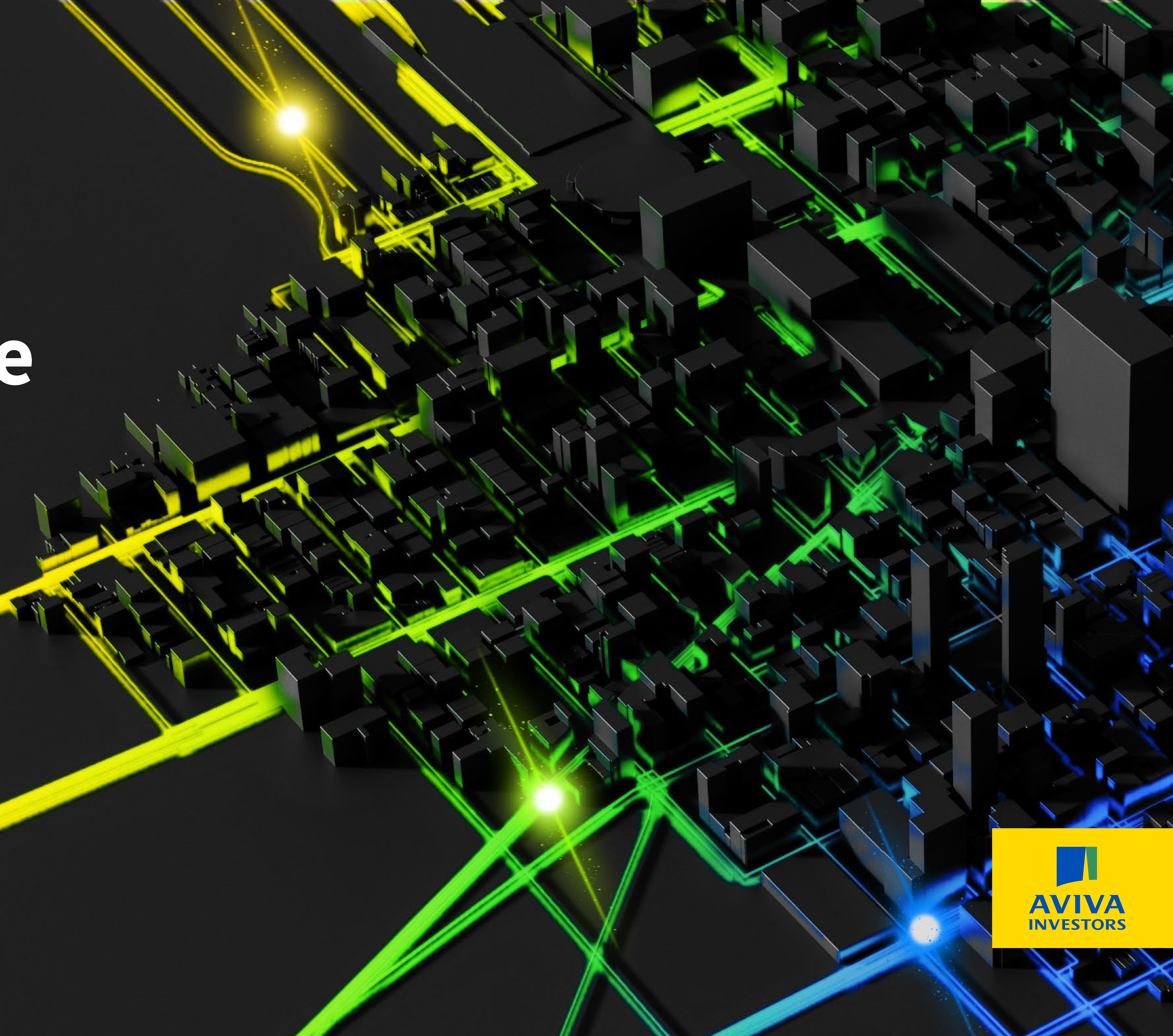
REAL ASSETS STUDY 2023

Sustainable real assets in the spotlight

The time is now,
the question is how



AVIVA INVESTORS

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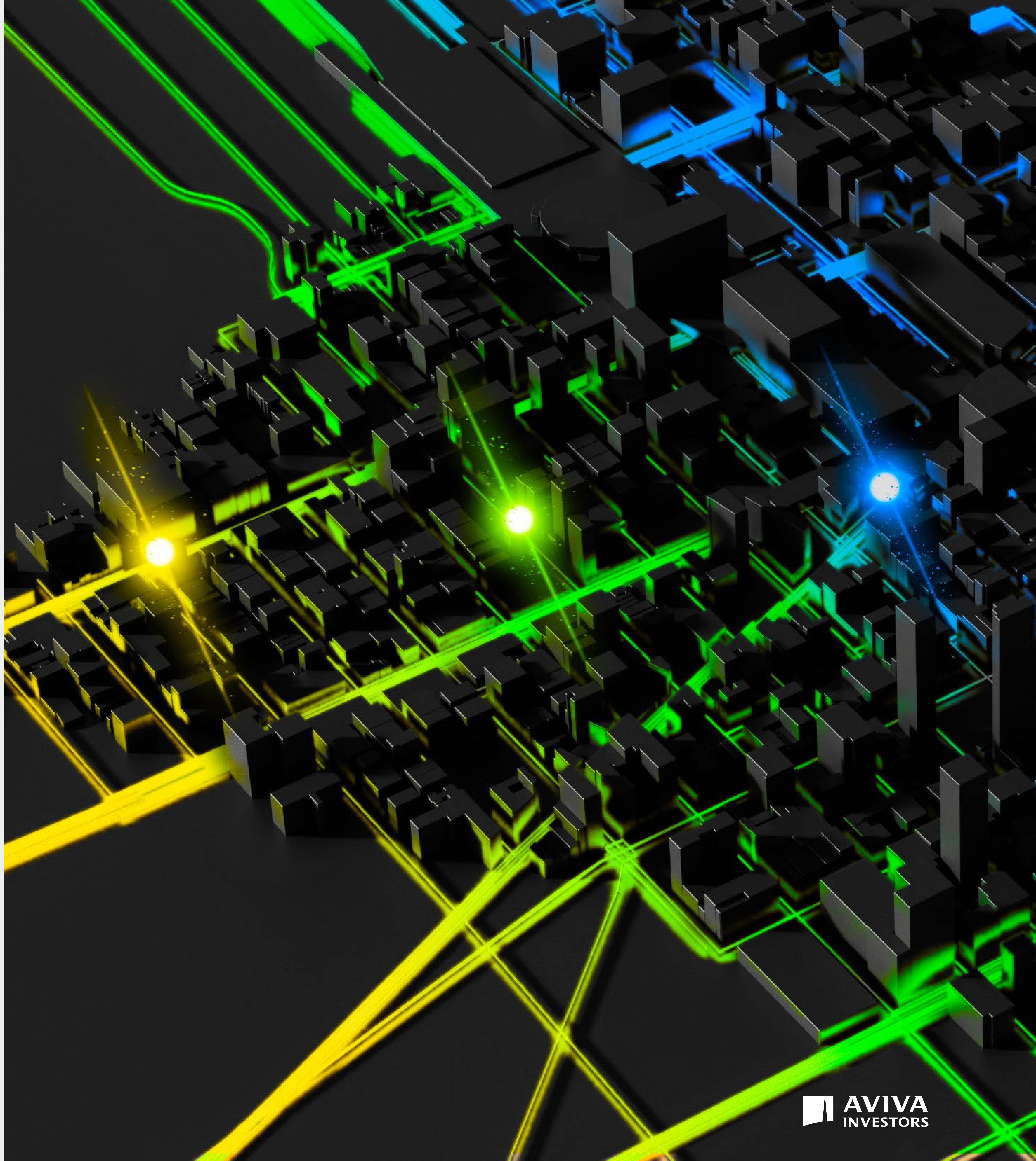

REAL ASSETS STUDY 2023

Foreword

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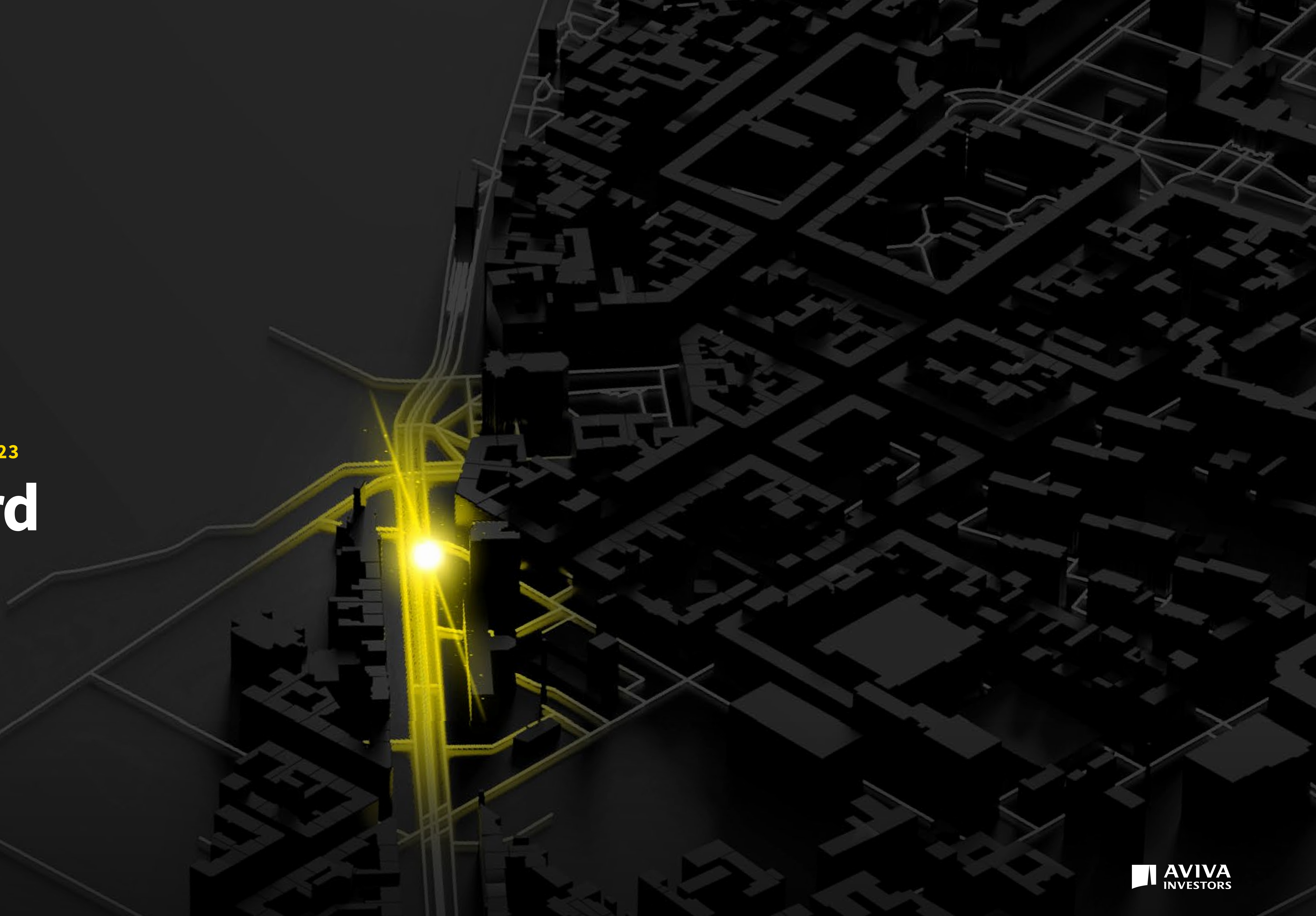

AVIVA INVESTORS

Foreword by Daniel McHugh

Just when we thought things were returning to normal after the social, economic and market upheaval caused by the pandemic, 2022 presented new challenges for investors.

After years of benign macro conditions and supportive monetary policy, which helped fuel the boom in real assets, 2022 brought geopolitical uncertainty and rampant inflation, with central banks aggressively hiking interest rates in a bid to counter the latter.

There were few places for investors to hide as global equity and bond markets tanked in unison. Many parts of the real assets universe held up relatively well for much of the year, but were by no means immune from the fallout. As the year came to a close, we were starting to see evidence of some assets seeing significant repricing, such as commercial real estate.

Throw into the mix the backlash against ESG – a seriously misguided development in the face of climate change, biodiversity loss and social inequality – and, yes, 2022 was quite the year.

It was in that context in late 2022 that we took the pulse of key investment decision makers at 500 institutional investors representing a combined $3.5 trillion of assets.

Reflecting that investor interest in real assets is broadening, we have expanded the types of clients polled in this year's survey from pension schemes and insurers to also include official institutions, global financial institutions and endowments and foundations.

As well as getting their insights on asset allocation, risks, opportunities and preferred routes to market, this year's survey features a deep dive into attitudes towards sustainable real assets. This covers everything from net-zero targets to whether investors see a trade-off between achieving ESG impact and financial returns. The results throw up clear regional disparities.

The main report focuses on the overall global and regional results. Specific analysis based on the responses of pension schemes, insurers, global financial institutions, official institutions, and endowments and foundations can be found at: **https://www.avivainvestors.com/real-assets-study/**

I hope you enjoy reading the analysis and please get in touch if you would like to discuss any aspects of the study.

Daniel McHugh
Chief Investment Officer, Aviva Investors Real Assets

"The results throw up clear regional disparities."

REAL ASSETS STUDY 2023

Executive summary

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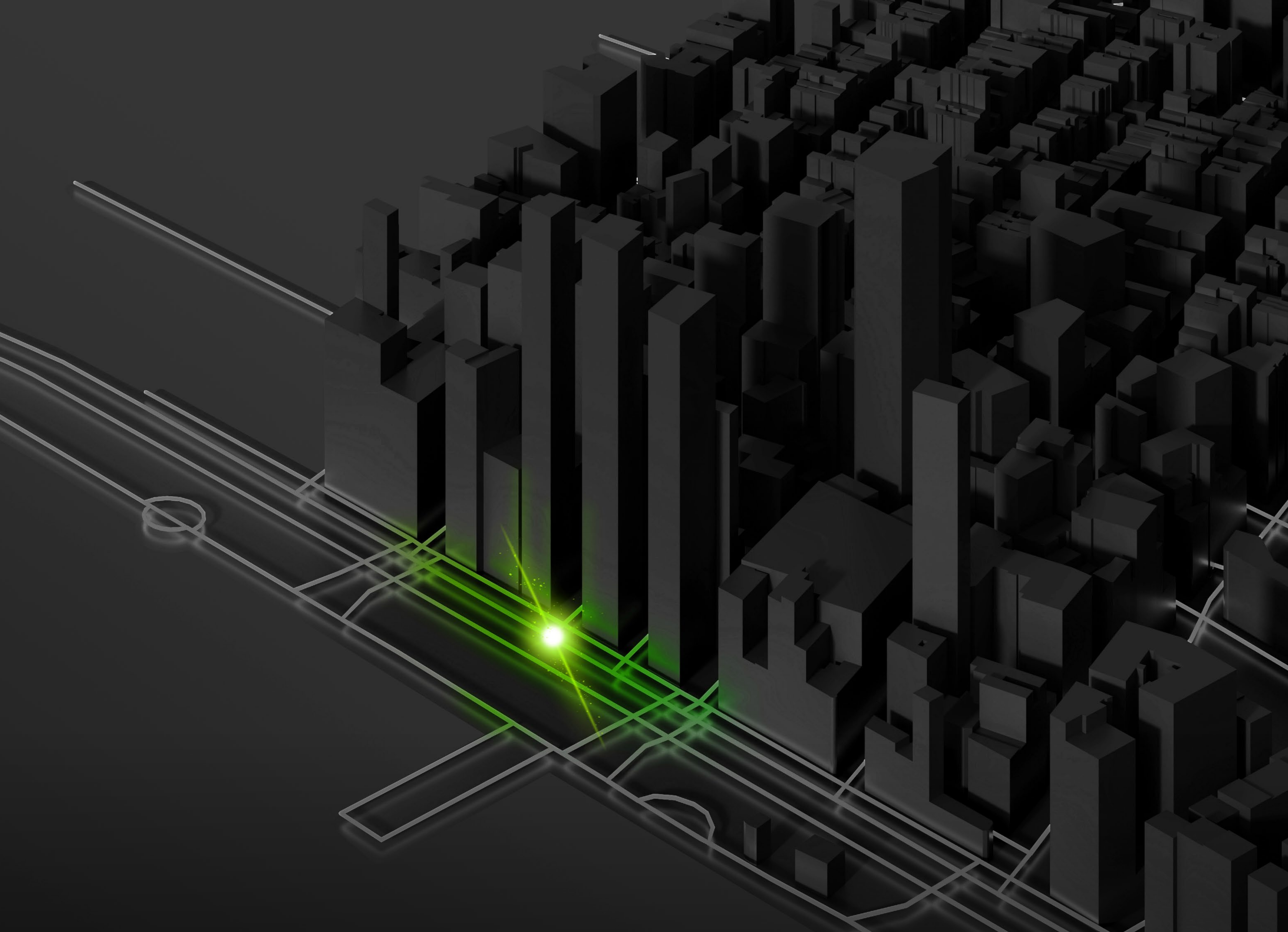


Executive summary

Institutional investors continue to embrace real assets with vigour, driven by rising appetite for inflation-linked income and, in part, sustainability reasons. Our poll of 500 institutional investors — drawn from the UK, Europe, North America and Asia Pacific region, with US$3.5 trillion of assets under management collectively — reveals almost two-thirds of organisations plan to increase their allocations to real assets in the next two years.

For many institutions, this is evolution rather than revolution: 47 per cent reported existing real asset allocations of up to ten per cent. Furthermore, investors intend to take a measured approach to increasing allocations: 46 per cent expect to lift their exposure by up to ten per cent.

Real estate equity remains comfortably the most popular real assets strategy. However, its use has edged slightly lower, dropping from 31 per cent two years ago to 30 per cent today, where it is expected to stay in two years' time. By contrast, infrastructure equity allocations are on a gently upward trajectory, rising from 12 per cent two years ago to 13 per cent today, and projected to nudge higher to 14 per cent in two years.

Diversification key but inflation and ESG increasingly important

Diversification remains the number one driver for investing in real assets. However, the proportion of institutional investors citing diversification as their primary reason for allocating to the asset class has dropped, from 64 per cent three years ago to 57 per cent today.

By contrast, with inflation looming large in the economic landscape since mid-2021 and acutely in 2022, the attraction of real assets' ability to provide inflation-linked income has jumped. Three years ago, one-third of investors allocated to real assets mainly to generate inflation-protected income. Today, that figure has risen to 53 per cent; within Europe, inflation-linked income has overtaken diversification as the primary reason behind allocations, while 63 per cent of North American institutional investors cited inflation-protected income as the dominant driver.

The use of real assets to make a positive ESG impact has also climbed, from 17 per cent three years ago to 28 per cent today. However, there is a clear regional variation beneath this headline number. Around one-third of investors in Europe and Asia mainly employ real assets for positive ESG outcomes, compared to just ten per cent of North American investors.

Three years ago, one-third of investors **allocated to real assets mainly to generate inflation-protected income** – today, that figure has risen to

53%

Executive summary (cont'd.)

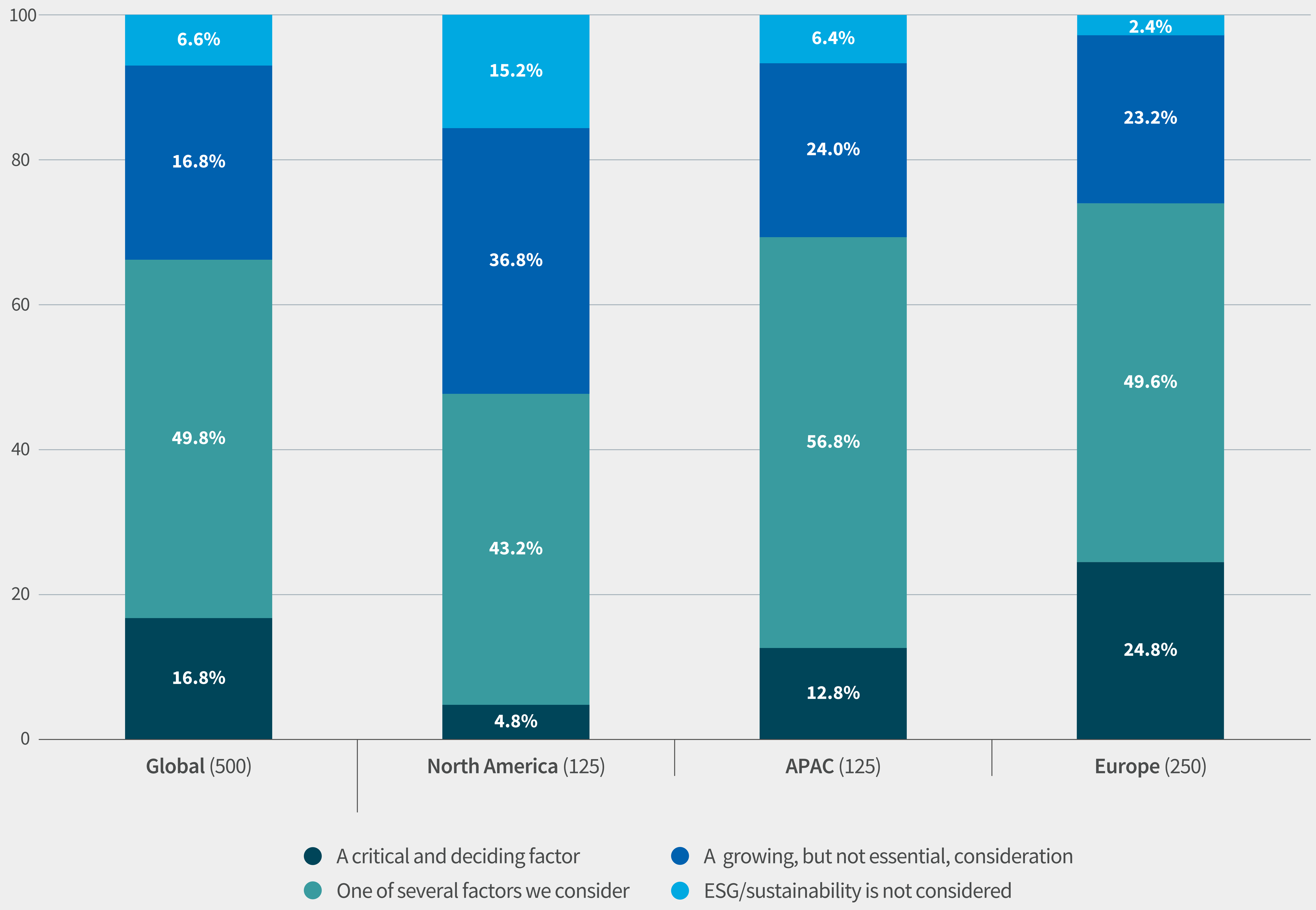
Beware greenwashing and inflated valuations

The sea change in attitudes towards ESG and sustainable investment approaches, albeit less prevalent in North America, has perhaps been the biggest structural trend in the investment industry in recent years. This has extended to the real assets arena. Nine out of ten (93 per cent) of institutions consider ESG a factor in investment decisions involving real assets. For 17 per cent, ESG and sustainability matters are a critical factor.

But does the ESG walk match the talk? Interestingly, beliefs over the importance of sustainable investing are running slightly ahead of perceptions of the impact potential of sustainable real assets. Two-thirds of our respondents reported their organisation has a responsibility to invest sustainably, but only one-half believe real asset investments can have a more direct ESG impact versus listed equities and credit.

For institutions drawn to sustainable real assets, key motivations include alignment with corporate values (60 per cent), risk management (58 per cent) and increasing evidence of improved financial performance from investing sustainably (54 per cent). Meanwhile, greenwashing (52 per cent) represented the biggest material risk to investment in sustainable real assets. High valuations (44 per cent) and difficulty in evidencing or measuring positive impacts (43 per cent) completed the trio of top-ranked risks.

Which of the following best describes your organisation's approach to ESG/sustainability when making investment decisions within real assets?



Executive summary (cont'd.)

When it comes to sustainable investments, returns still matter most

Moving beyond the broad motivations and risks associated with sustainable real asset investment to the approaches, 79 per cent of investors favour a fund or strategy that prioritises financial returns while also integrating ESG factors. Again, regional differences are evident. Whilst 90 per cent of North American investors prefer a returns-led approach, this preference was lower among European (71 per cent) and Asian investors (82 per cent), with both regions more receptive to strategies with a pure ESG focus.

Direct investment (46 per cent) and multi-asset pooled funds (40 per cent) were the most popular means of accessing real assets, while investors tipped impact pooled funds with a specific ESG goal as likely to experience an uptick in interest in the coming year. Despite growing awareness of investors' environmental and societal responsibilities, returns still matter most: a fund manager's performance record (81 per cent) was the most important criterion when selecting managers for sustainable mandates, coming ahead of managers' ability to evidence ESG impact (72 per cent).

Net-zero nervousness

While one-half of institutional investors polled have made a net-zero commitment, just under one-quarter (24 per cent) have not and have no plans to do so, as was the case for 39 per cent of North American investors.

There is also an apparent lack of confidence in net-zero actions and the role real assets can play toward meeting this ambitious goal. Over one-half (56 per cent) of institutions were unsure or lacking confidence in their ability to meet their long-term net-zero and sustainability commitments from real asset investments.

Recession fears, inflation and rates biggest risks

Looking ahead, institutional investors identified a global recession (63 per cent), inflation and interest rate rises (62 per cent) as the biggest potential threats to real assets over the next 12 months.

Meanwhile, our cohort highlighted difficulties in finding suitable investment opportunities (53 per cent), high transaction costs and asset valuations (both 50 per cent) as the greatest barriers to new or additional investment in real assets.

56%

of institutions **were unsure or lacking confidence** in their ability to meet their long-term net-zero and sustainability commitments

REAL ASSETS STUDY 2023

Asset allocation trends

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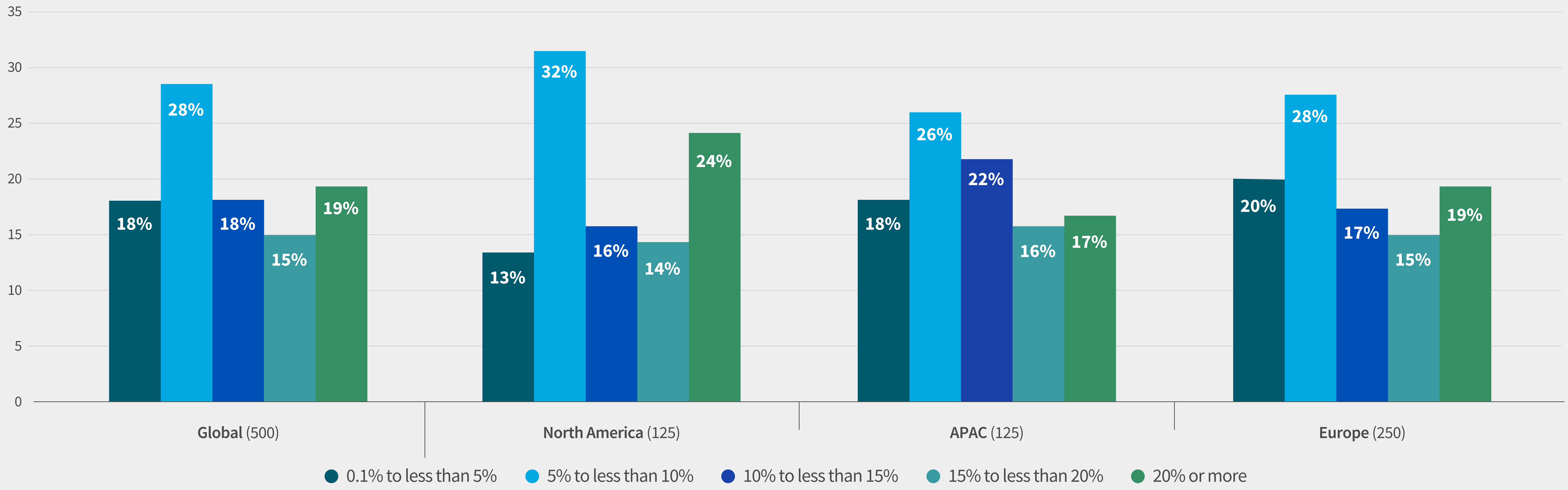
Asset allocation trends

For many institutions, real assets already play a meaningful role in their portfolios. Among investors with real assets investments, 47 per cent currently maintain allocations of up to ten per cent, while one-fifth have exposure of at least 20 per cent. By region, North American investors are the biggest users of real assets at scale: almost one-quarter of North American-based institutions have 20 per cent or greater exposure in their portfolios.

North American investors are the biggest users of real assets at scale

What portion of your institution's investment portfolio is currently invested in real assets?



Inflation-proofing on the climb

Our survey suggests there will be steady growth in demand from this solid base. Almost two-thirds of investors plan to increase their allocations to real assets in the next two years, with 23 per cent expecting to do so by less than five per cent and the same proportion forecasting between five and ten per cent growth. Only 12 per cent intend to reduce their exposure.

Diversification (57 per cent) remains the primary driver for investing in real assets. However, its importance has declined from three years ago (64 per cent). By contrast, with once-dormant inflation front of mind for most investors, the ability of real assets to provide inflation-linked income has come to the fore: 53 per cent use real assets to inflation-proof their portfolios, up from 33 per cent three years ago.

This trend is evident across all regions. Within Europe, inflation-linked income has overtaken diversification as the primary reason behind allocations (53 per cent), while 63 per cent of North American institutional investors reported inflation-protected income was the major reason behind their use of real assets, just behind diversification (70 per cent).

> More than one-half use real assets to inflation-proof their portfolios

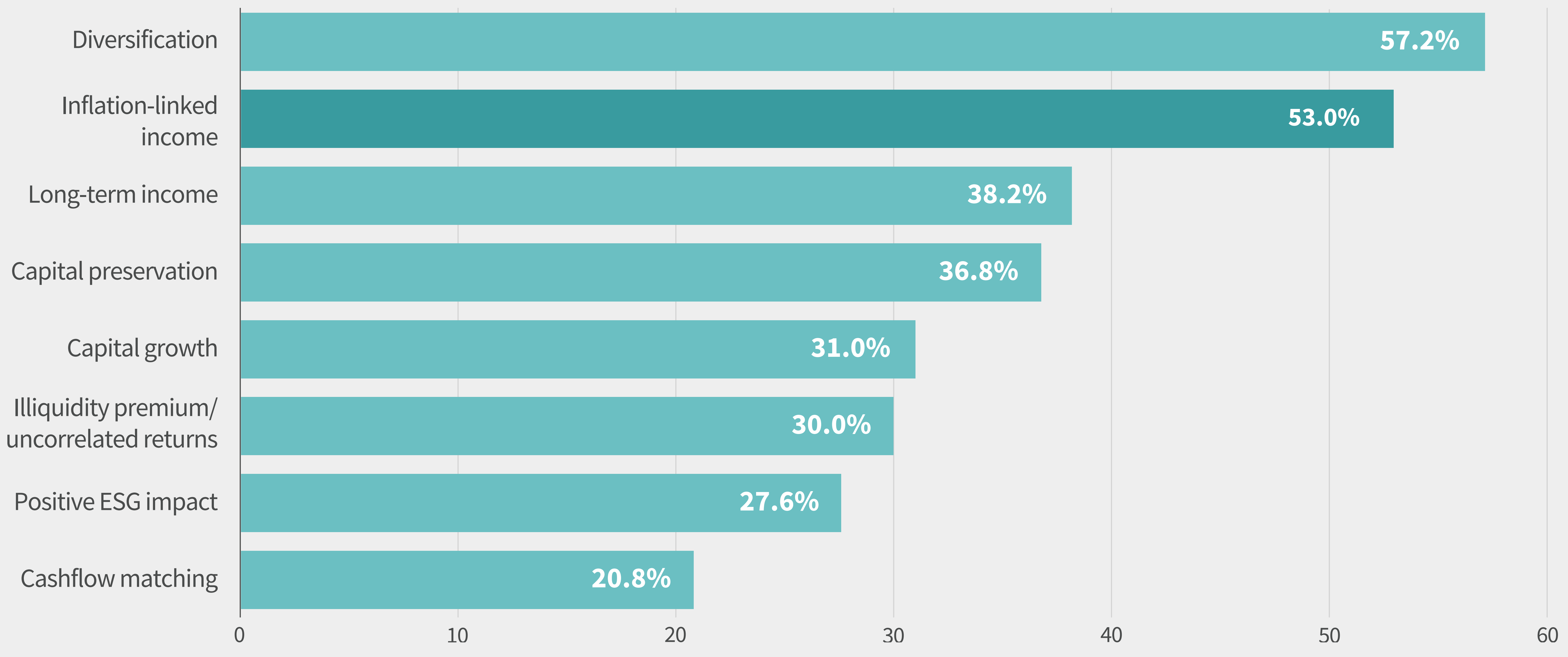
There was also a sizeable uptick in Asia Pacific institutions citing inflation-linked income as the main influence on real assets allocations (42 per cent, up from 27 per cent).

Investors are also increasingly looking to real assets for capital preservation. Over one-third (37 per cent) of institutions named capital protection as their main reason for using real assets, up from 31 per cent three years ago.

Elsewhere, long-term income generation was a similarly common reason, although its popularity has dipped from 42 per cent in 2019 to 38 per cent today.

The use of real assets for cashflow-matching is also in decline, dropping from 29 per cent to 21 per cent.

What is your primary reason for allocating to real assets?



ESG's importance rising, but still muted in North America

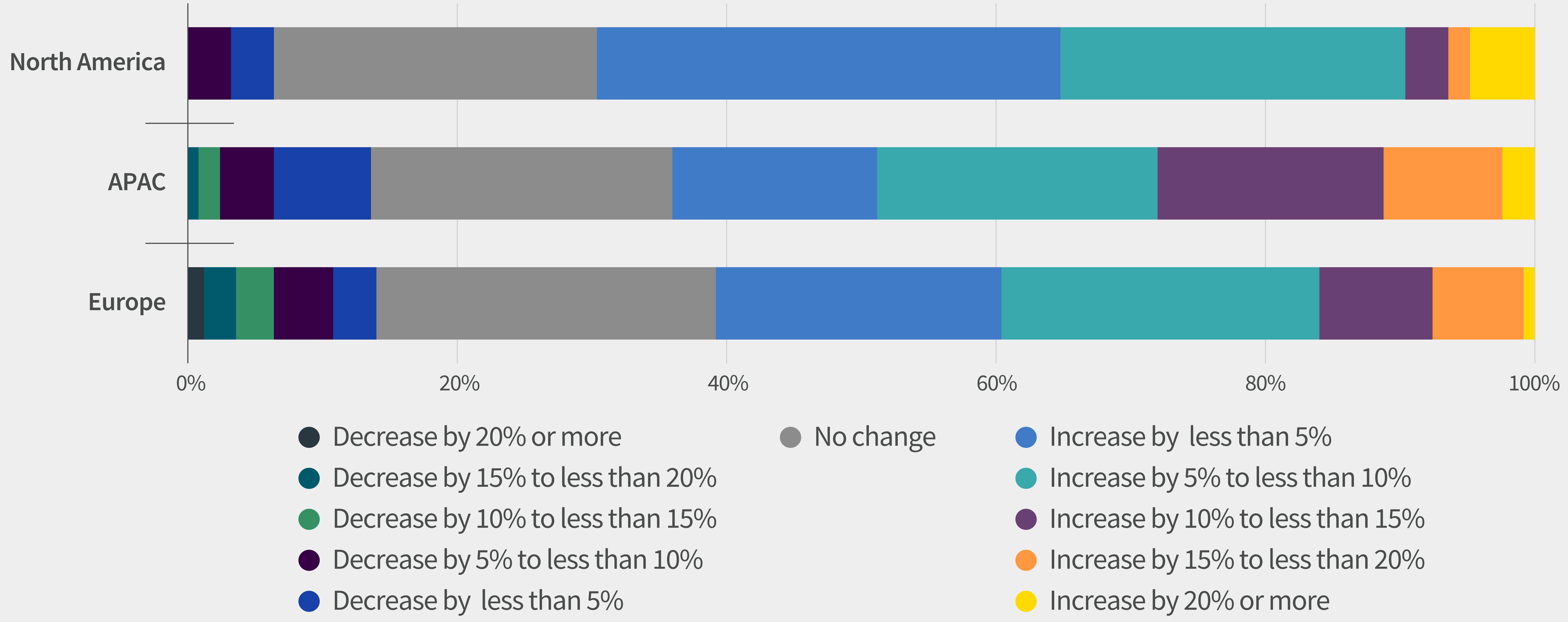
Given responsible investment's shift from the margins to the mainstream, it is unsurprising the use of real assets to create positive ESG impacts has also risen, from just 17 per cent in 2019 to 28 per cent today.

But regional preferences are pronounced, and the pace of change has varied considerably. While 35 per cent of European investors and 31 per cent of Asian investors named positive ESG impacts as a primary reason for allocating to real assets (up from 19 per cent and 22 per cent, respectively, three years ago), just ten per cent of North American investors highlighted this driver, compared to nine per cent in 2019.

Reflecting a narrower return-focused mentality, North American institutions set greater store (40 per cent) in the illiquidity premium and uncorrelated returns associated with real assets than their European (27 per cent) and Asian (26 per cent) counterparts.

The use of real assets to create positive ESG impacts has risen, from just 17 per cent in 2019 to 28 per cent today

Do you expect to increase or decrease your allocation to real assets over the next 24 months and, if so, by how much?



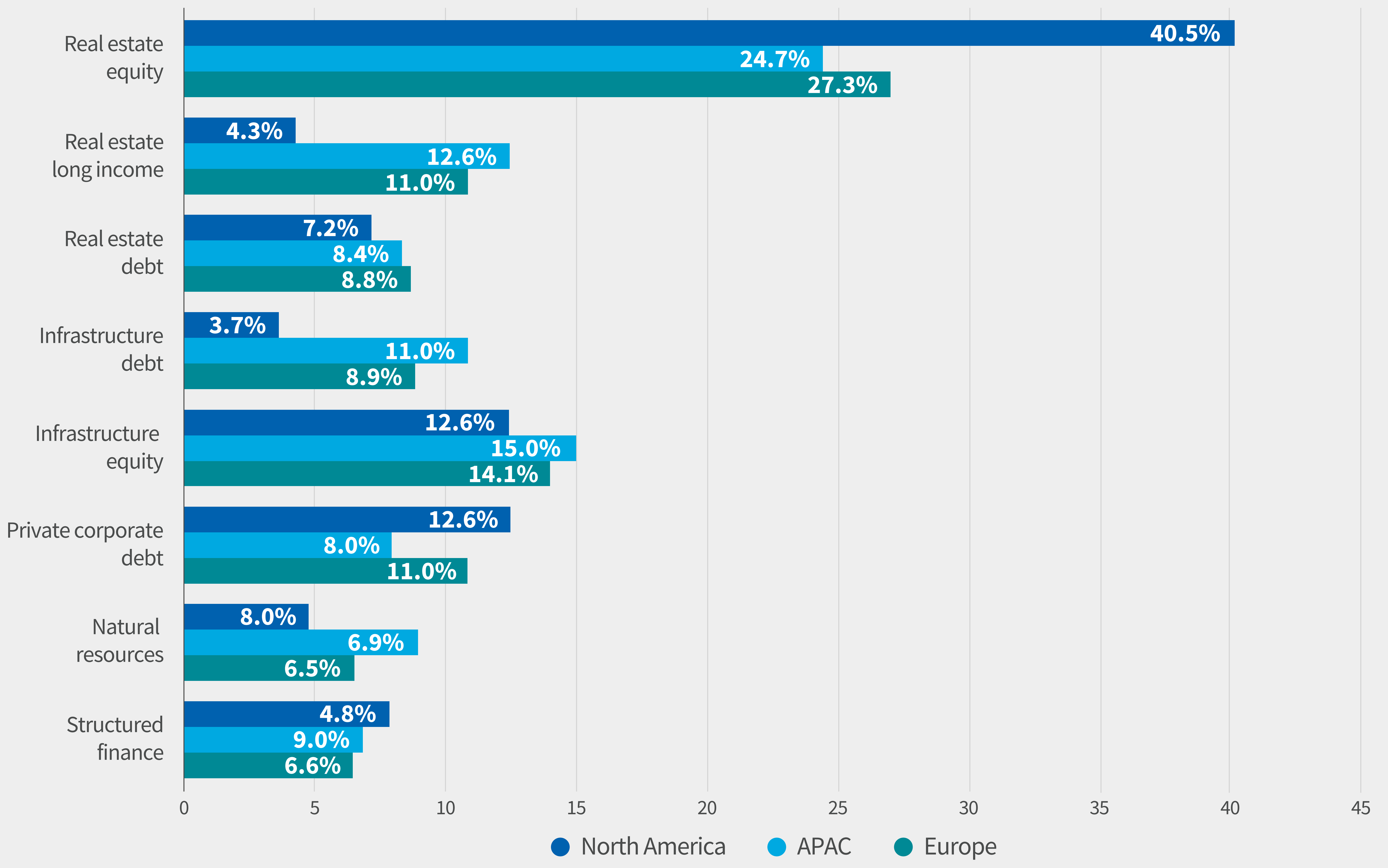
Infrastructure equity gaining traction

Real estate equity remains the asset class of choice within the broad real assets universe. However, its popularity seems to be waning slightly with North American investors, falling from 44 per cent in 2020 to a 40 per cent projected allocation in 2024.

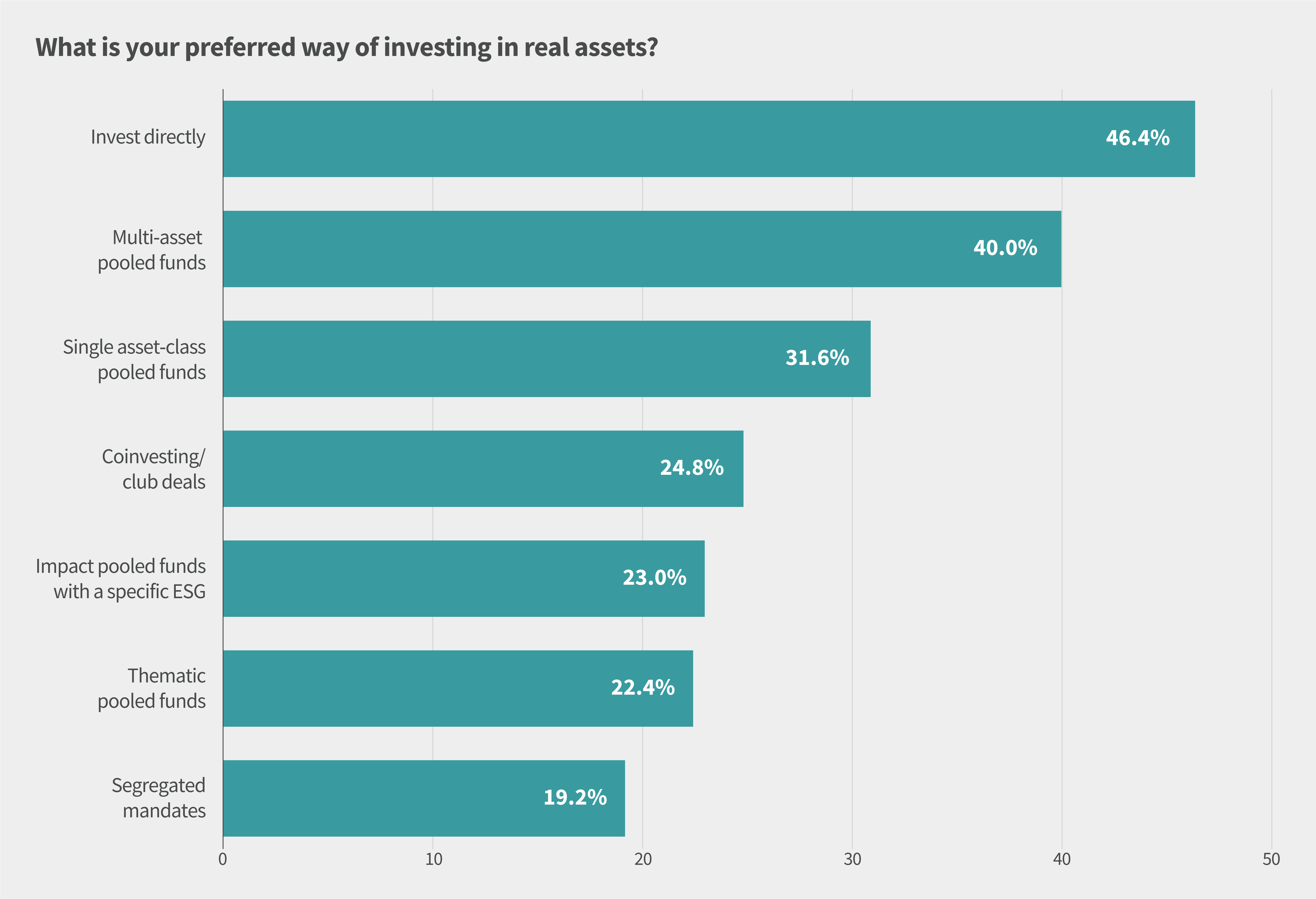
By contrast, infrastructure equity allocations are edging upwards, rising from 12 per cent two years ago to 13 per cent today, and expected to hit 14 per cent in two years from now. Private corporate debt also showed a minor increase in use since 2020, ticking up from ten per cent to 11 per cent today, where it is expected to remain in two years' time.

> Real estate equity remains the asset class of choice

How is your institution's real assets portfolio allocated today?



Direct approach favoured



Moving from the why to the how, direct investment (46 per cent) and multi-asset pooled funds (40 per cent) are the most popular methods for gaining exposure to real assets. Single asset class-pooled funds (32 per cent) completed the top three approaches. Looking ahead, 45 per cent of investors picked out impact pooled funds with a specific ESG goal as likely to grow in use over the next 12 months.

46%

Believe direct investment is the best method for gaining exposure to real assets

ESG: Performance and impact

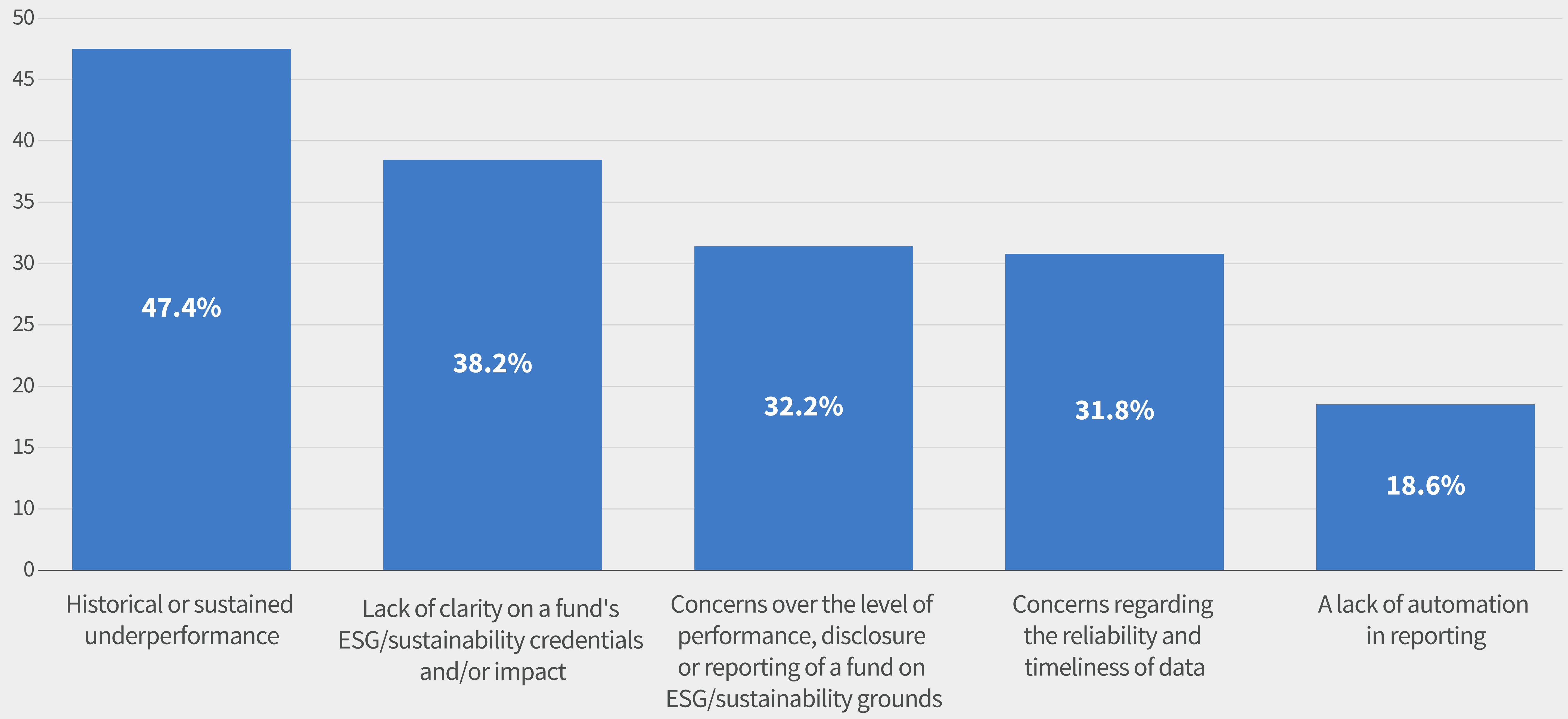
Despite the greater investor focus on ESG factors, proven investment performance (81 per cent) is the most salient influence on manager selection for sustainable real assets mandates. Encouragingly, most managers seem to be delivering on this front: 77 per cent of our cohort were satisfied with their managers' performance.

A fund manager's ability to evidence ESG impact (72 per cent) was also an important consideration. But here there was less satisfaction: only 58 per cent felt their manager could adequately evidence ESG impact.

Historical or sustained underperformance (47 per cent), followed by a lack of clarity on a fund's ESG or sustainability credentials and impact (38 per cent), were the leading reasons why institutional investors reject investment opportunities or divest. Meanwhile, one-third of investors would not invest in or allocate more to real assets due to concerns over a fund's ESG reporting (32 per cent), or because of discomfort with the timeliness and reliability of data (32 per cent).

Only 58 per cent of investors felt their fund manager could adequately evidence ESG impact

Has your organisation ever rejected or divested from a real assets investment opportunity due to any of the following concerns?



Gatekeepers matter

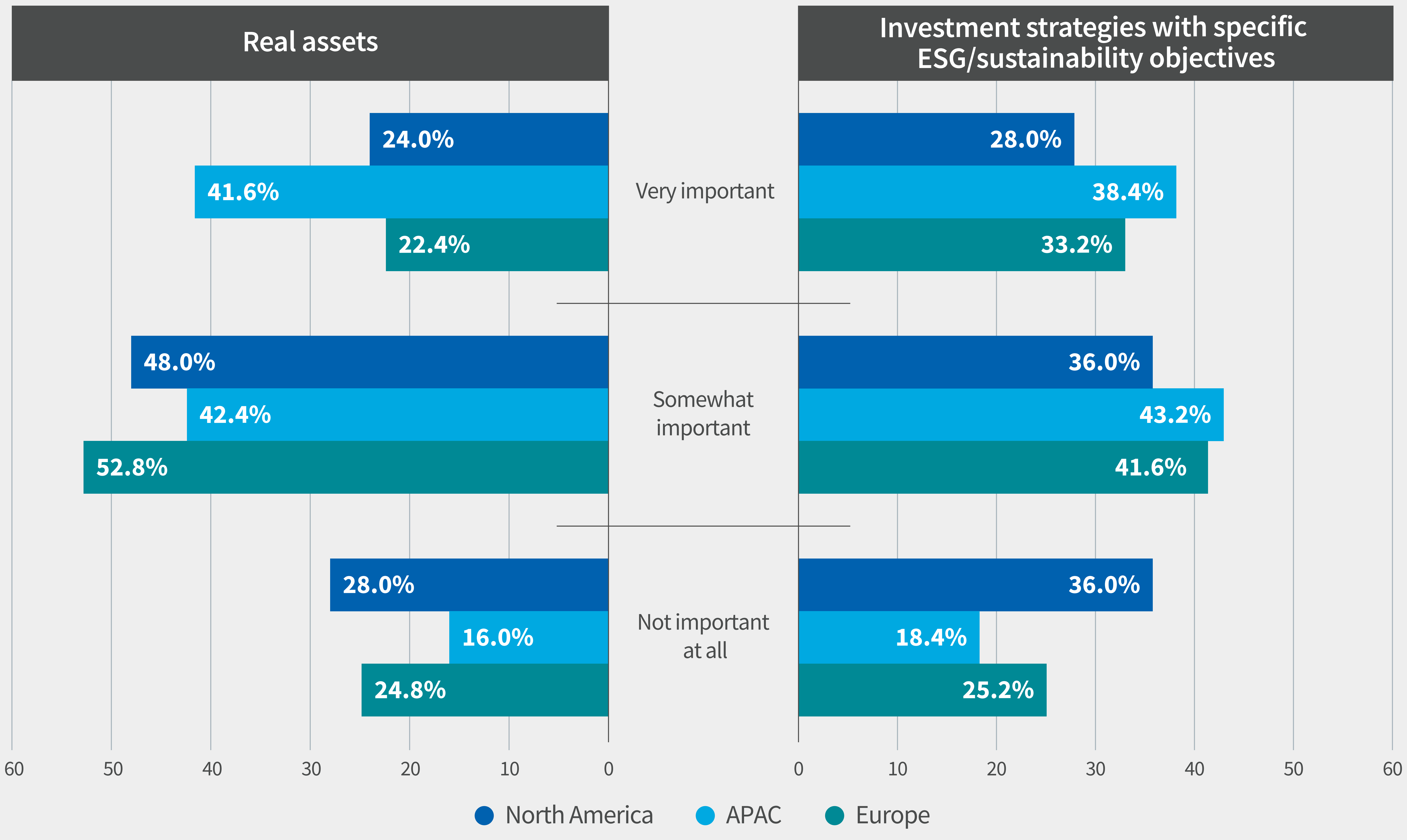
Real asset and sustainable investment approaches are arguably better understood than in the past. Nonetheless, the nuances of picking managers to fulfil these specific mandates mean investment consultants continue to play a key role in manager selection. Over three-quarters (77 per cent) of our cohort believe consultants are vital when picking a real assets manager.

Similarly, 74 per cent of investors saw an important role for consultants when looking for sustainable investment managers. The latter is despite growing ESG resources at institutions: 39 per cent of institutional investors surveyed have dedicated ESG staff within the overall investment team, while 12 per cent have dedicated ESG investment professionals within their real assets teams.

74%

Of investors saw an important role for consultants when looking for sustainable investment managers

How important a role do investment consultants or other external advisors play in determining the asset manager you choose?



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Investor views on sustainability

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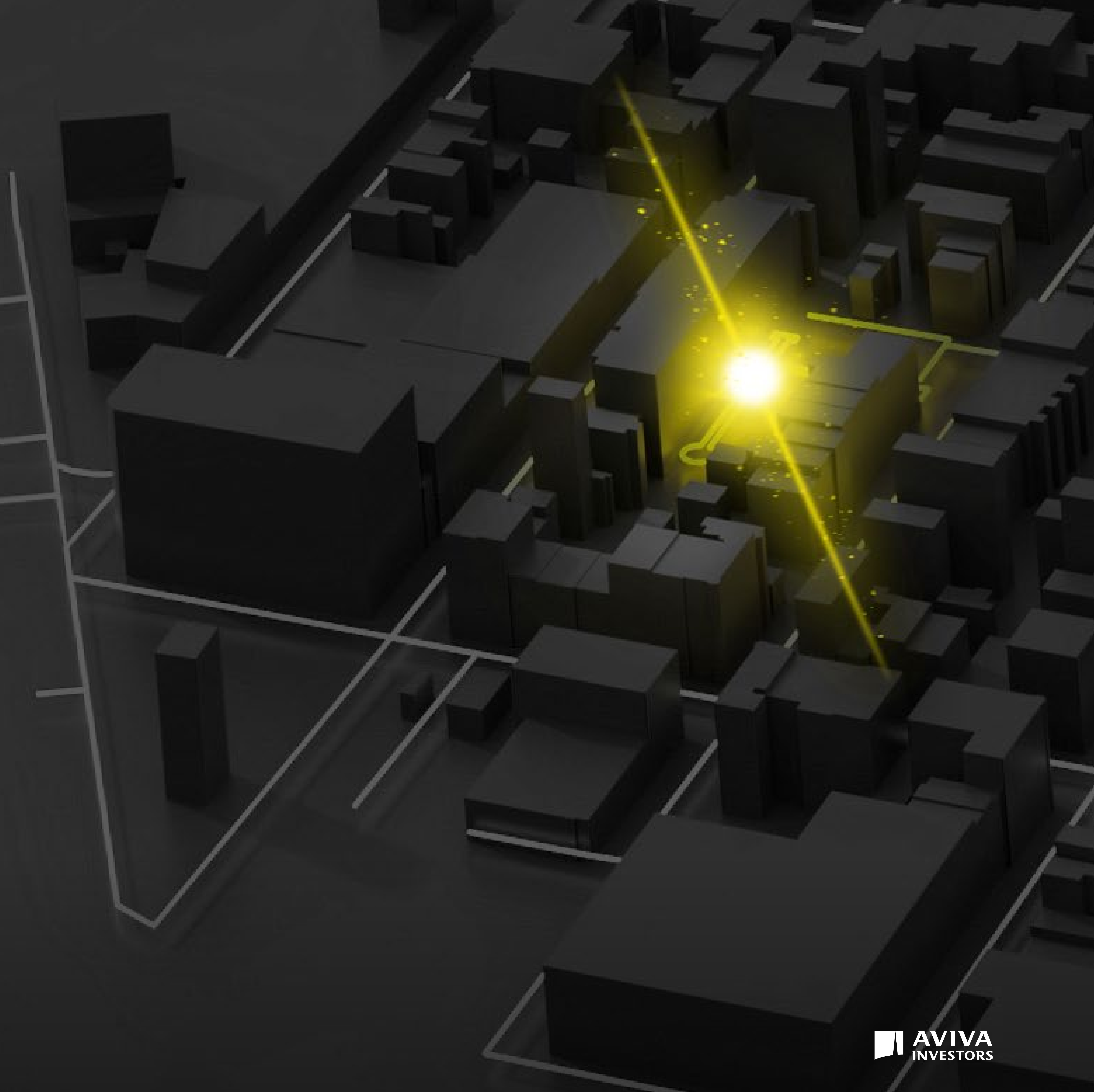

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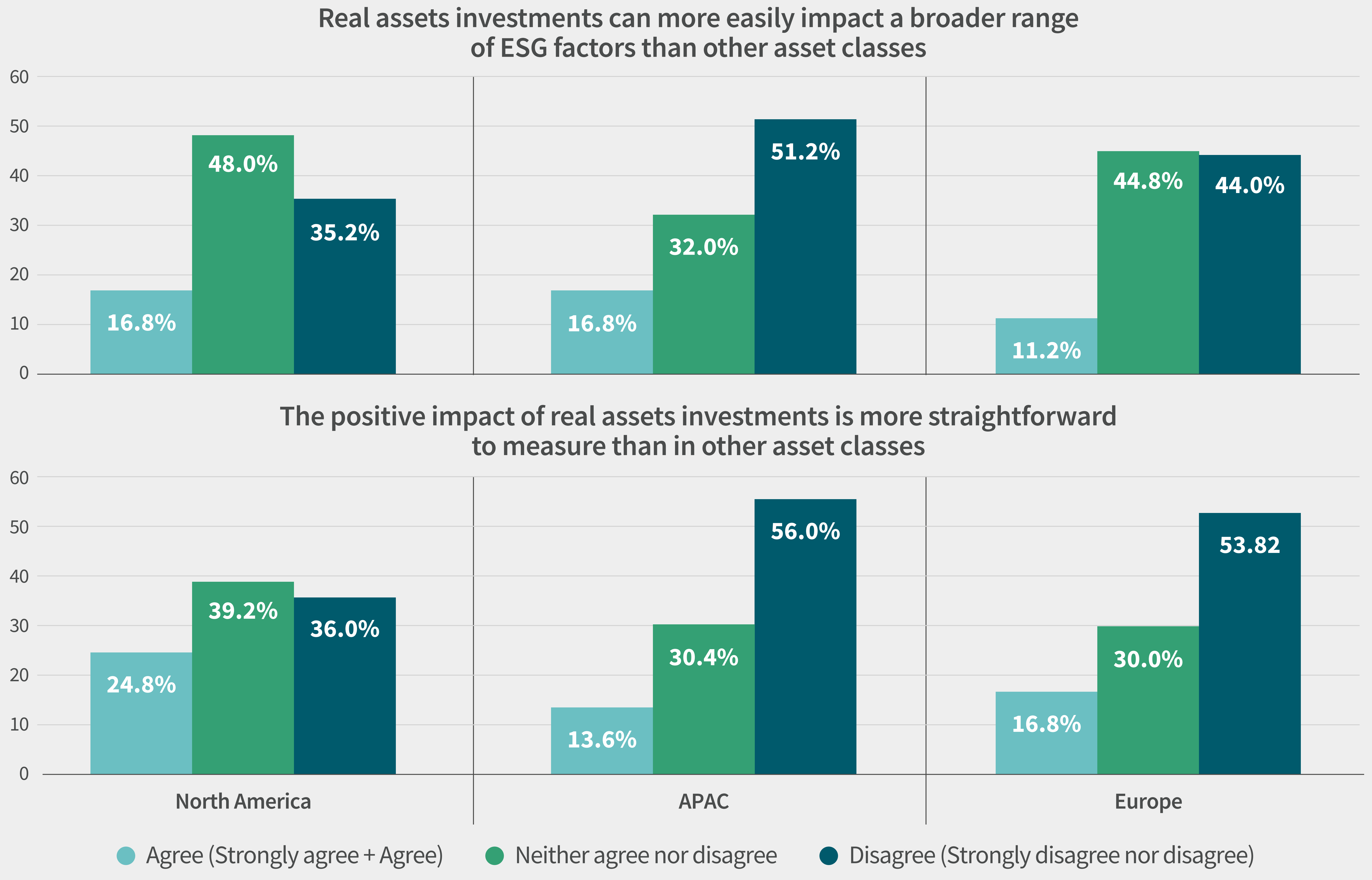
Investor views on sustainability

Institutional investors within Europe and Asia have widely embraced responsible investment in recent years, while attitudes in North America to a topic that has become highly politicised, certainly in the United States, are more divided.

Just seven per cent of our cohort indicated they do not consider ESG and sustainability factors when investing in real assets. At the other end of the spectrum, 17 per cent labelled ESG and sustainability issues as a deciding influence upon their real assets investment decisions. For one-half of our cohort, ESG is less paramount but one of several factors considered.

Despite the surge of investor interest in ESG issues, there is evidence of a disconnect between sustainability principles and real-world outcomes. While 67 per cent of investors consider they have a responsibility to invest sustainably, belief in the positive and direct ESG impacts of real assets is not as widespread, albeit it was still significant at 50 per cent of those surveyed.

To what extent do you agree or disagree with the following statements?



Values and risk management biggest drivers of the ESG embrace

A variety of considerations underpin institutions' decisions to invest in or increase allocations to sustainable real assets. Using a weighted score of the top three reasons cited by respondents, alignment with organisational values and responding to pressures from investment committees or boards was the leading driver (60 per cent), followed by risk management (58 per cent) and increasing evidence of improved financial performance (54 per cent).

Interestingly, industry and regulatory pressures (39 per cent and 38 per cent respectively) lagged, highlighting the shift to sustainable investment practices is more often motivated by internal forces. As with all investors approaches, sustainable real assets carries its own risks. Our cohort were particularly alert to greenwashing, with one-half deeming it a material risk.

Meanwhile, on the back of volatile markets in 2022, 44 per cent identified high valuations as the biggest threat. Difficulty in evidencing or measuring positive impacts (43 per cent) was also seen as a meaningful challenge.

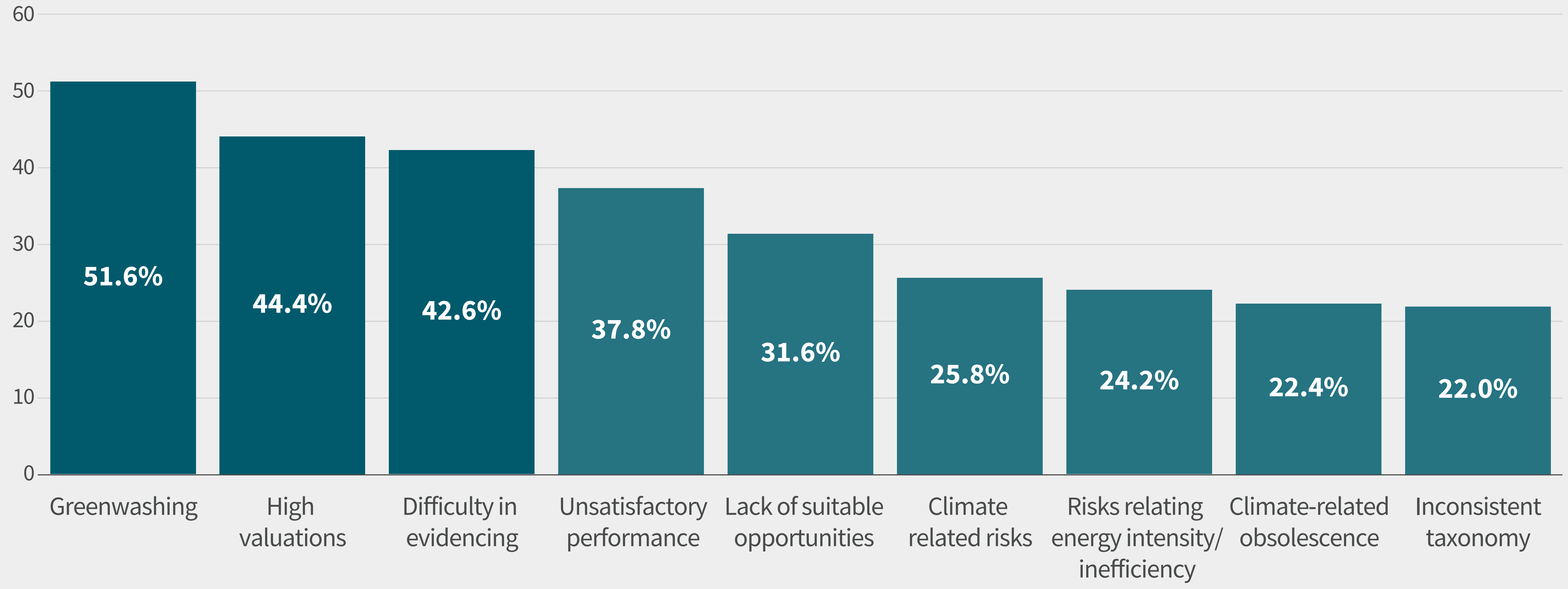
What is the single-most influential factor driving your organisation to invest in, or increase your overall allocation to, sustainable real assets?

21.7%
Increasing evidence of improved financial performance

21.4%
Alignment with corporate values/committee or board pressure

16.7%
Ability to evidence ESG/sustainability related impact

What do you see as the most material risks to investing in sustainable real assets?



The importance of ESG targets when picking managers

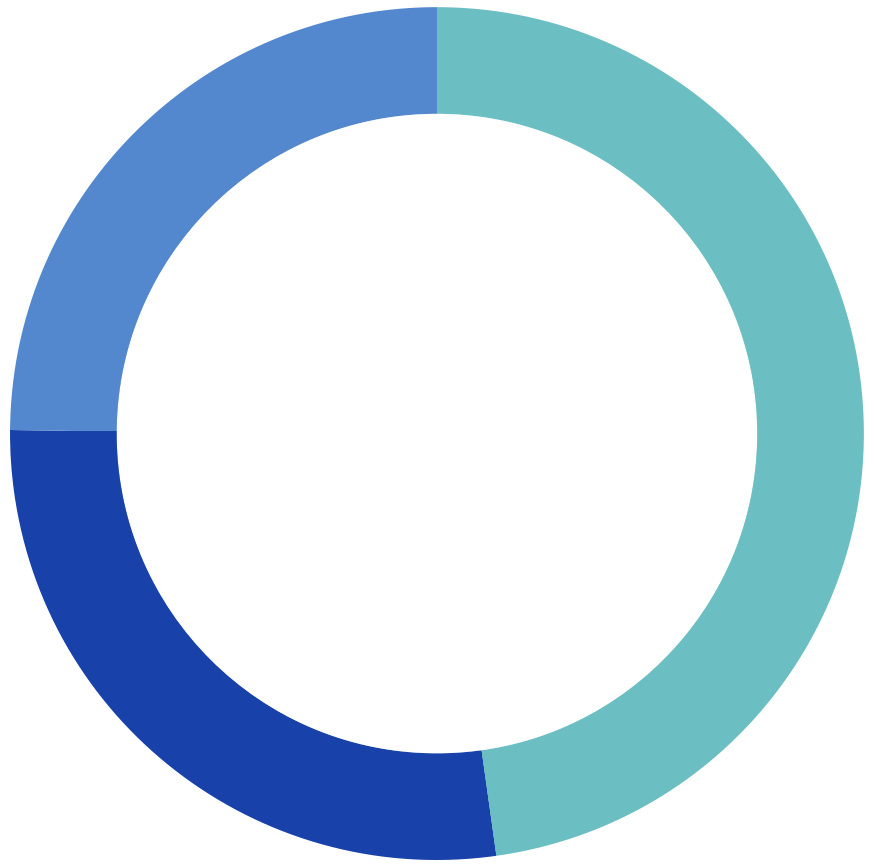
Nearly half (47 per cent) of respondents reported strategies with ESG/sustainability targets were of most interest when investing in sustainable real assets through an asset manager.

Strategies seeking "already green" assets and investment opportunities (27 per cent) and climate transition-focused multi-asset solutions (25 per cent) also saw noticeable support.

Overall, 79 per cent of investors favoured sustainable real assets funds or strategies that prioritised financial returns while also integrating ESG factors.

However, whilst 90 per cent of North American investors preferred such an approach, 71 per cent of European and 82 per cent of Asian investors cited this.

When considering how to invest in sustainable real assets through an asset manager, what is of most interest to your organisation?



- Strategies with specific ESG and/or sustainability targets and improvements attached to them **47.4%**
- Strategies seeking "already-green" assets and investment opportunities **27.1%**
- Climate transition-focused, multi-asset solutions **24.7%**

> A fund manager's performance record was the most important criterion when selecting managers for sustainable mandates

47%

reported strategies with ESG/sustainability targets were of most interest when investing in sustainable real assets

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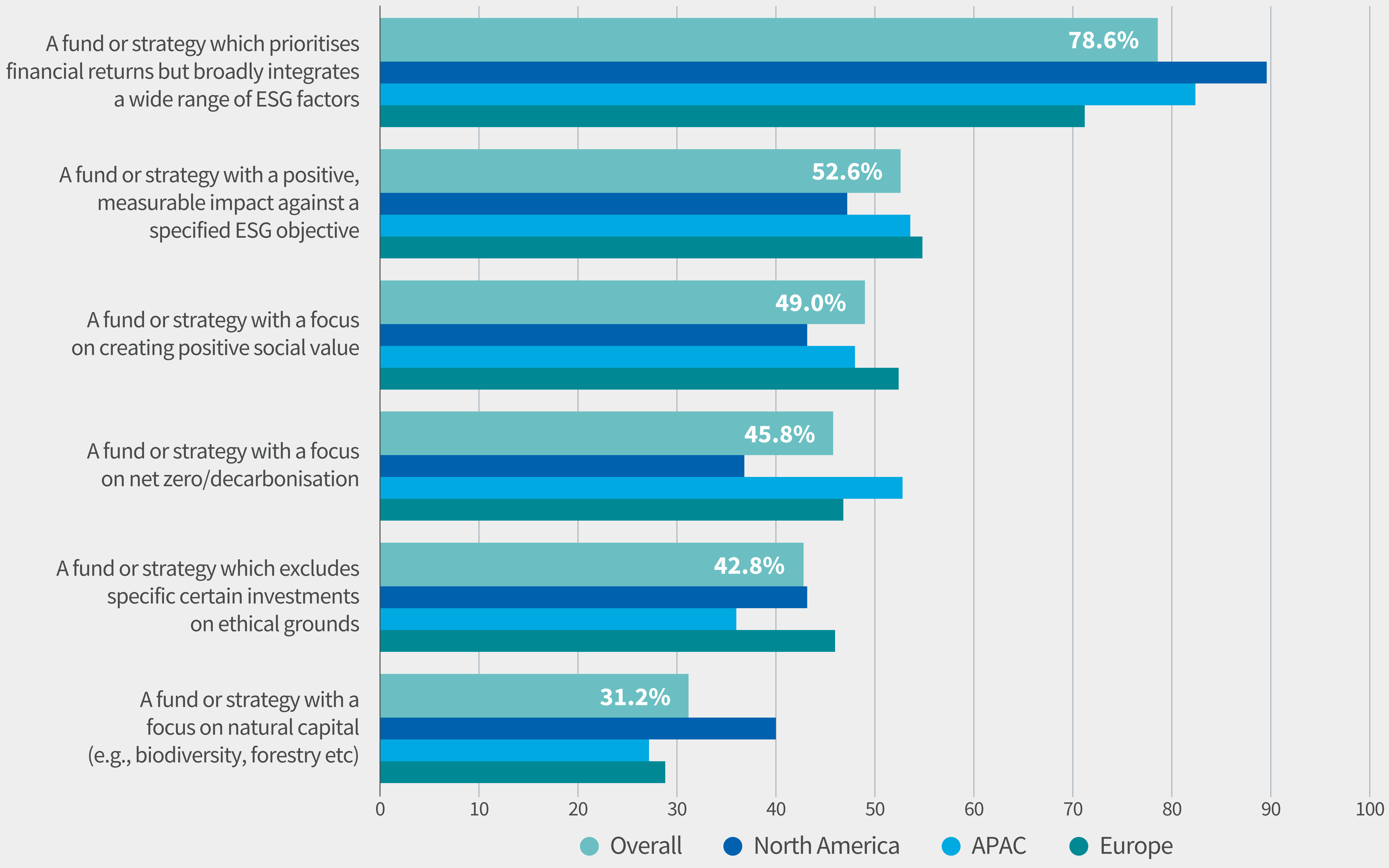
The importance of ESG targets when picking managers (cont'd.)

By comparison, and perhaps unsurprisingly, European and Asian investors were more open to approaches with a pure ESG focus. For example, 53 per cent of Asian institutional investors surveyed described real assets strategies with a net-zero or decarbonisation emphasis as appealing; only 37 per cent of North American institutions shared this view.

> European and Asian investors were more open to approaches with a pure ESG focus

Which of the following are most appealing when investing in sustainable real assets?



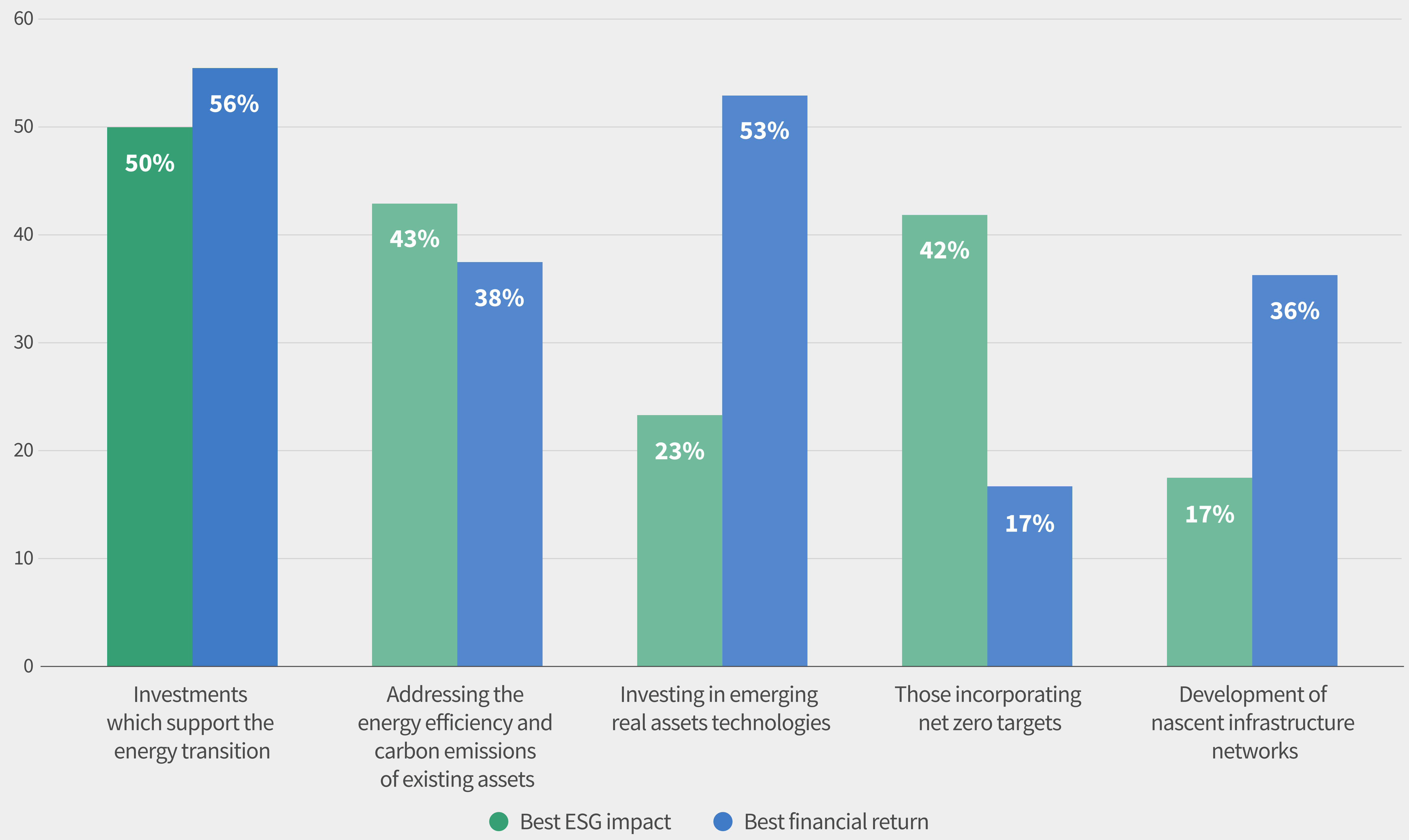
ESG: Impact versus return

As noted, investment strategies that combine the potential for attractive long-term financial returns with positive ESG effects found the greatest support. For many of our cohort, supporting society's transition to low-carbon energy sources is a theme that best hits this sweet spot. Investors deemed real assets investments that promote the energy transition as having both the best ESG impacts (50 per cent) and financial returns (56 per cent).

Themes with net-zero targets proved almost as popular in terms of perceived ESG impact. However, investors generally saw net-zero approaches as having limited financial return potential. By contrast, our respondents identified investments in emerging technologies and infrastructure networks as offering good return potential but only modest positive ESG impact (23 per cent and 18 per cent, respectively).

> Investors deemed real assets investments that promote the energy transition as having both the best ESG impacts and the best financial returns

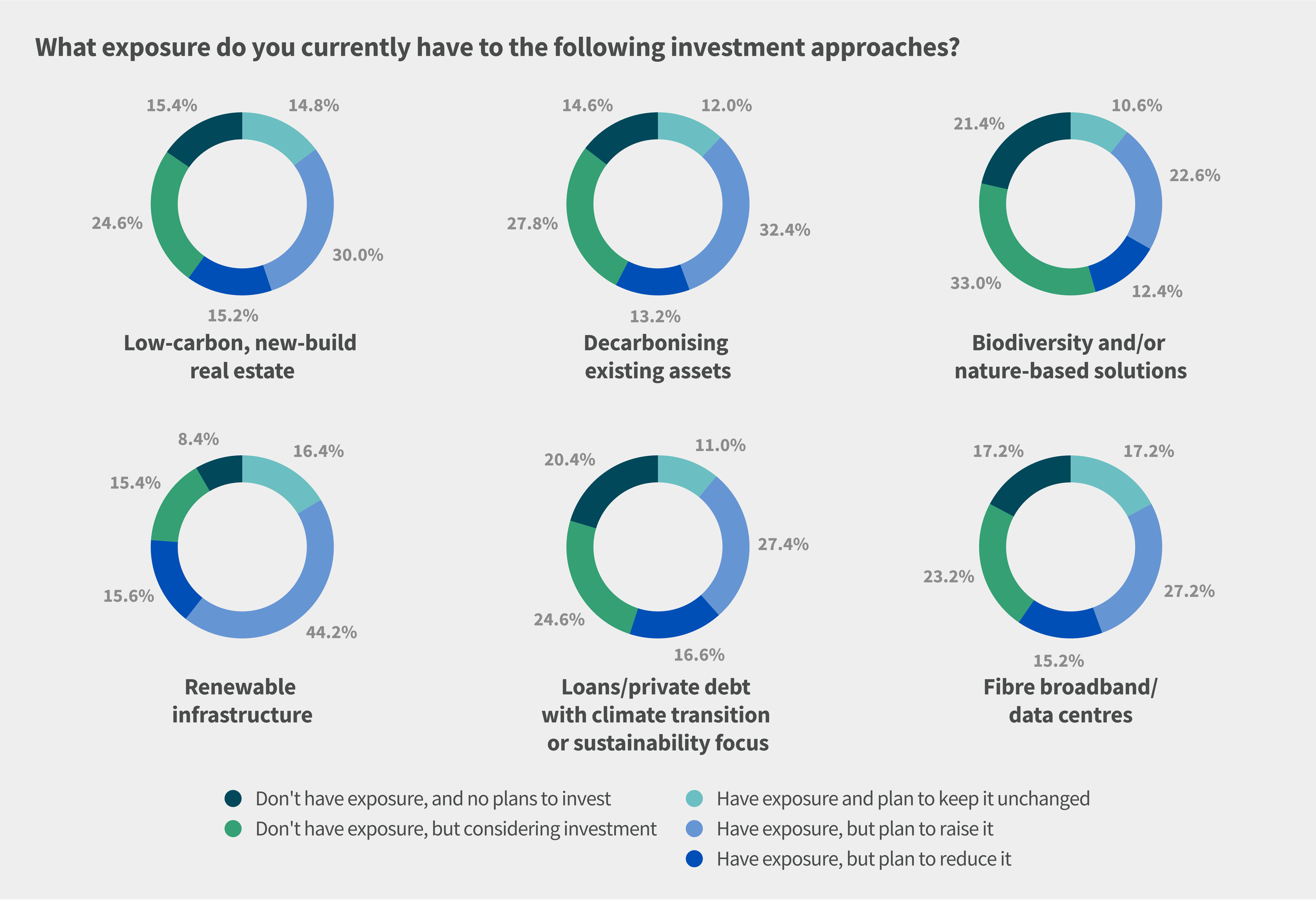
Which themes do you see as providing best ESG impact and which the best financial returns?



Sustainable real assets: Investment intentions

As for their investment intentions, 27 per cent of institutions plan to increase their exposure to sustainable real assets. Renewable infrastructure is set to be the biggest beneficiary, with 44 per cent of investors already having exposure to this asset type but plan to up their weightings. Among institutions with existing exposure to low-carbon new-build real estate, 30 per cent are looking to allocate more capital. Meanwhile, 32 per cent of institutions that hold decarbonising real assets want to do more in this space.

> Over one-quarter of institutions plan to increase their exposure to sustainable real assets



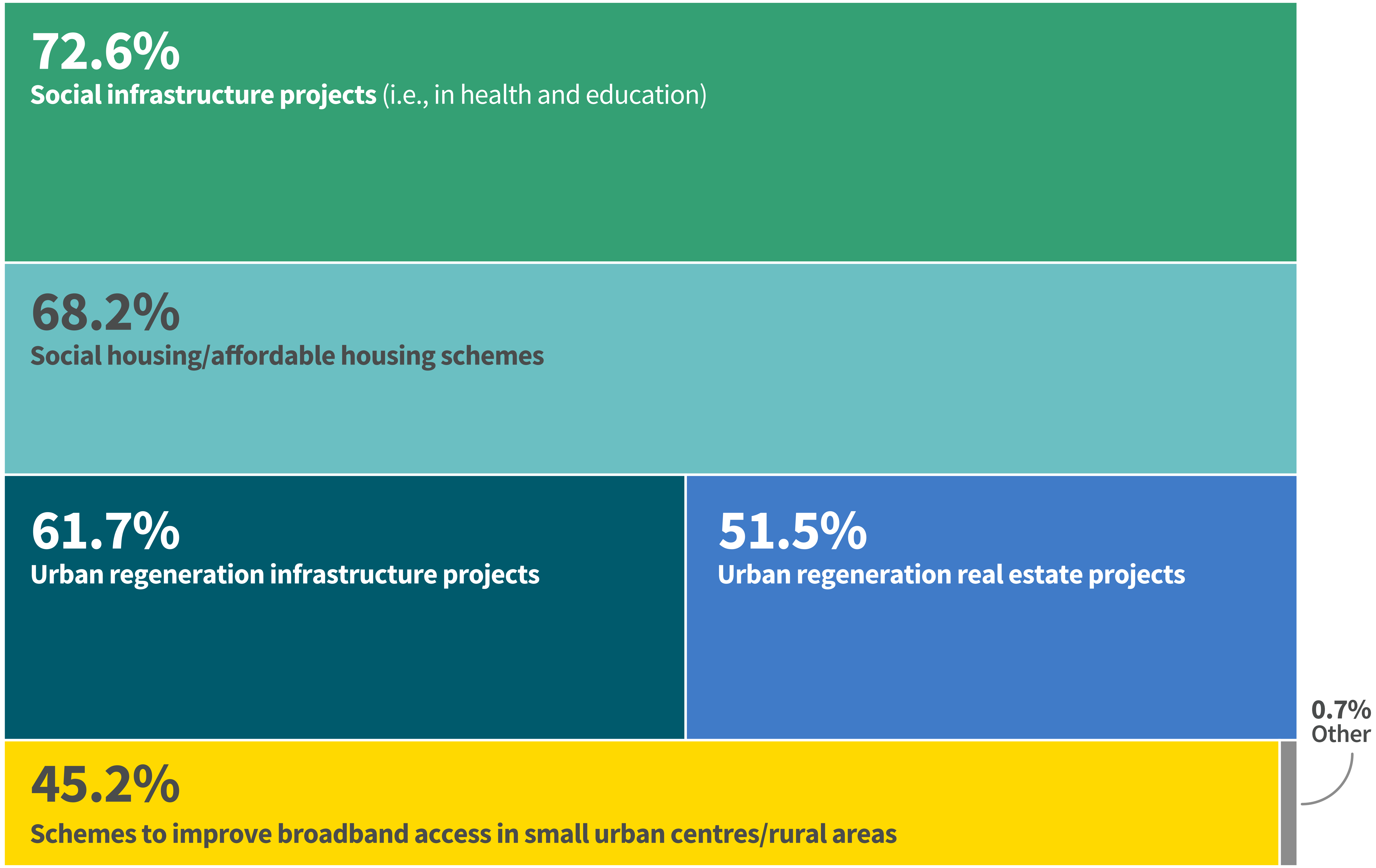
Social impact

In terms of investments seeking a positive social impact, 73 per cent of investors picked social infrastructure projects, for example linked to healthcare and education, as their preferred option. This was followed by social housing (68 per cent) and urban regeneration infrastructure projects (62 per cent).

Investors highlighted risk-adjusted returns potential, diversification and alignment with organisational values as the main influences when picking real assets to make a positive social impact. Each driver commanded the support of two-thirds of our cohort.

Our survey produced similar findings when examining the criteria investors use to select fund managers in the wider real assets category. Investors cited several key reasons for picking an asset manager's sustainable real assets offering, with expected returns (73 per cent) and diversification (67 per cent) top of the list.

When it comes to real asset investments offering the potential to achieve a positive social impact, which are the most appealing?



Striving for net zero: Different journeys, different timetables

Almost half of institutions polled have committed to achieving net-zero carbon emissions in their investment portfolios. However, 24 per cent have not made such a commitment and have no plans to do so, while 26 per cent are exploring the feasibility of such a pledge and its associated implications.

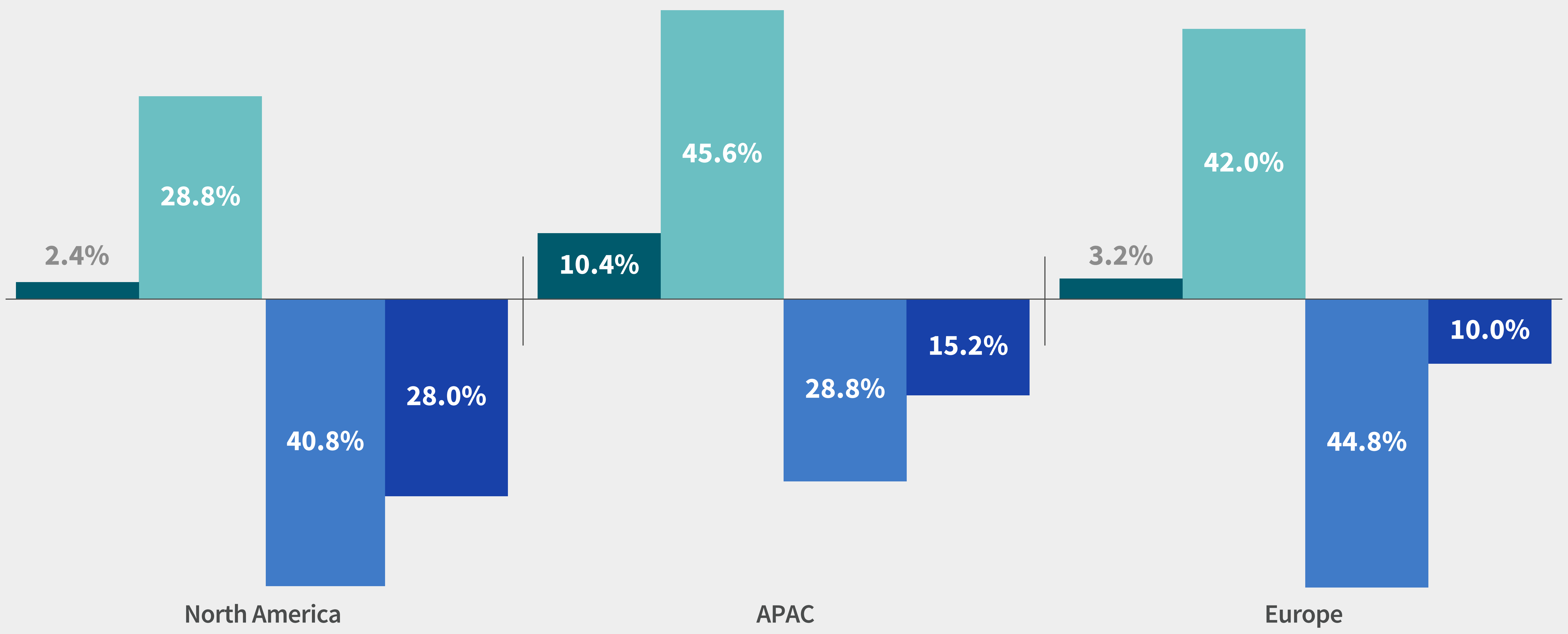
Again, our study reveals significant regional disparity: 39 per cent of North American institutional investors have not made a net-zero commitment and do not intend to do so.

Meanwhile, Asian (61 per cent) and European institutions (58 per cent) reported a commitment to a net-zero future. However, there is considerable work to achieve this: only 15 per cent of Asian and 13 per cent of European respondents are already reporting on their progress towards net zero.

Uncertainty may lie behind their reticence. Over one-half of institutions surveyed are uncertain or not confident about the actions needed to meet their net-zero and sustainability pledges through real assets; only five per cent of respondents described themselves as "very confident". Meanwhile, 51 per cent preferred to link net-zero targets to their overall ESG allocations rather than specifically to real assets (44 per cent).

> Our study reveals a significant regional disparity: 39 per cent of North American investors have not made a net-zero commitment and do not intend to do so

How confident are you in knowing what actions are needed to meet long-term net zero and sustainability commitments with your real assets investments?



REAL ASSETS STUDY 2023

Risks

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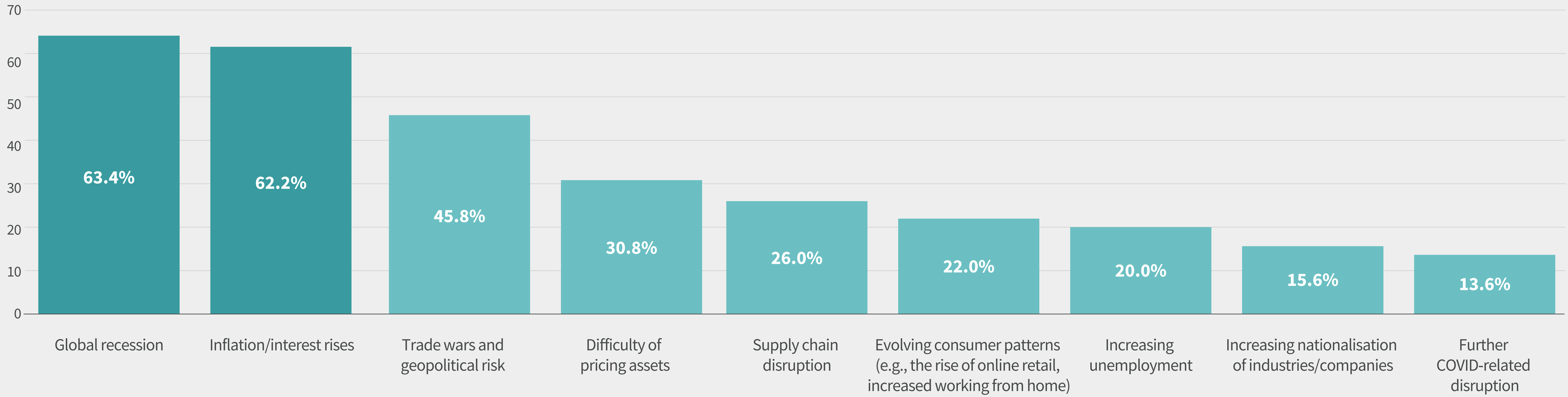
Risks

Real assets offer attractive long-term income and return opportunities, as well as a means of promoting positive ESG impacts and sustainability principles. Nonetheless, as with any asset class, there are risks and barriers for investors to consider.

Looking ahead, institutional investors identified a global recession (63 per cent), inflation and interest rate rises (62 per cent) as the biggest potential threats to real assets over the next 12 months. Trade wars and geopolitical risks (46 per cent) are also on investors' radars.

A global recession and interest rate rises are seen as the biggest threat to real assets over the next 12 months

Which of the following risks do you consider as being most concerning over the next 12 months?



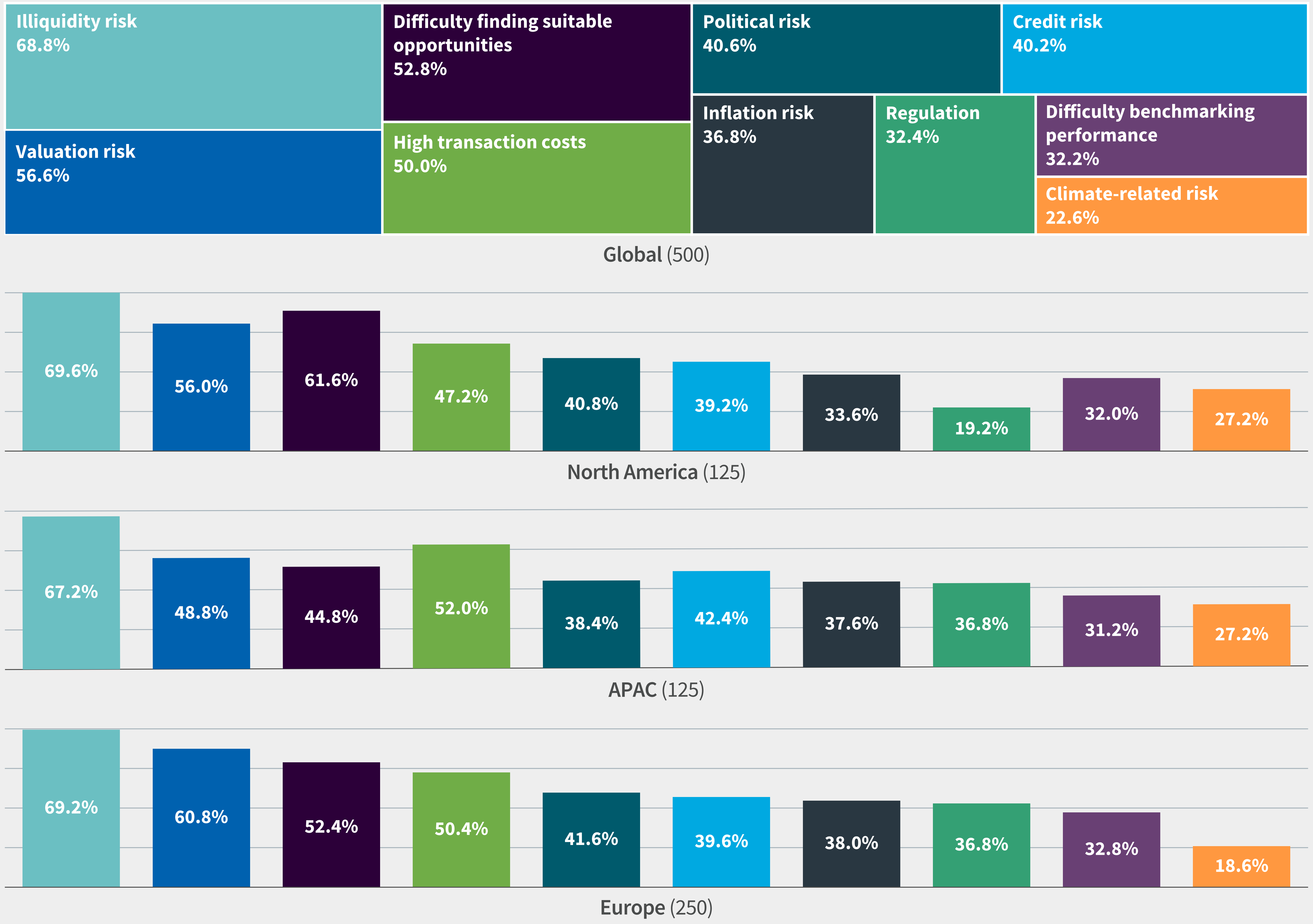
Risks (cont'd.)

Regionally, North America investors have the highest concerns over evolving consumer patterns (31 per cent versus 22 per cent overall). Meanwhile, Asia Pacific investors are most worried about supply chain disruptions (34 per cent versus 26 per cent overall).

Respondents cited the asset class's illiquidity (69 per cent) and valuation concerns (57 per cent) as the biggest risks to initiating exposure or adding to an existing allocation.

Lastly, investors highlighted difficulties in finding suitable investment opportunities (53 per cent), high transaction costs (50 per cent) and asset valuations (50 per cent) as the greatest barriers to new or additional investment in real assets.

What would you identify as the biggest barriers and risks to your institution either investing in, or increasing its allocation to, real assets?



REAL ASSETS STUDY 2023

Survey methodology and organisations covered

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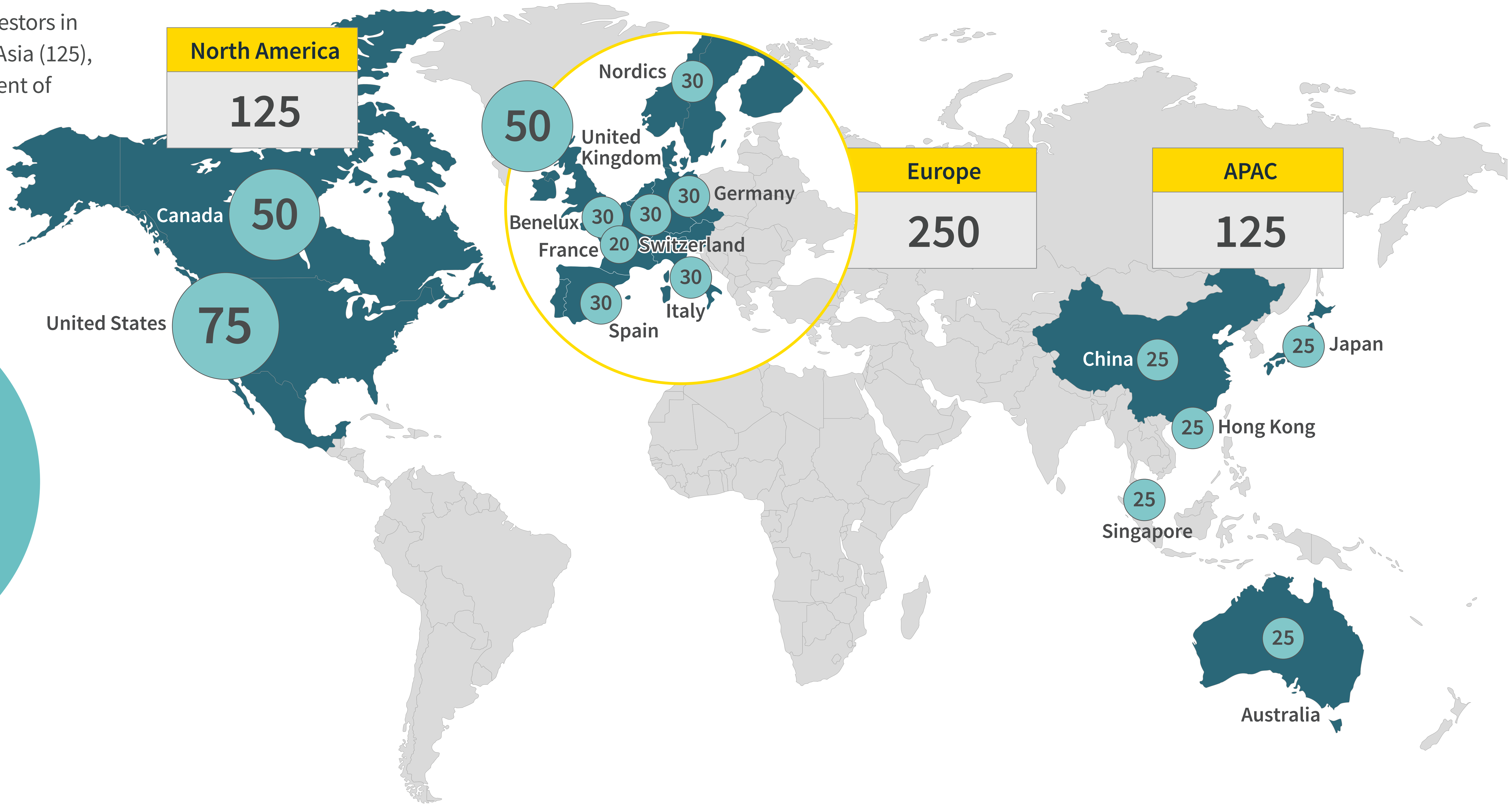
Survey methodology and organisations covered

This study was conducted by CoreData Research in September and October 2022, who questioned senior decision makers at 500 institutional investors in Europe (250), North America (125) and Asia (125), with combined assets under management of US$3.5 trillion.

Questioning **500** senior decision makers



Survey methodology and organisations covered (cont'd.)

Client type

This chart shows the type of institutional investors surveyed as part of this study.

Corporate DB pension scheme	61
Corporate DC pension scheme	59
Public sector pension scheme	82
Insurance company	189
Financial institution	73
Official institution	26
Endowment & foundation	10

Assets under management

	Overall	North America	APAC	Europe
Less than $1bn	5.8%	9.6%	3.2%	5.2%
$1bn to less than $5bn	19.8%	22.4%	12.8%	22.0%
$5bn to less than $10bn	14.8%	16.0%	14.4%	14.4%
$10bn to less than $20bn	16.0%	15.2%	16.8%	16.0%
$20 billion plus	43.6%	36.8%	52.8%	42.4%

Source: Aviva Investors.

Representing over

$3.5tn

AUM globally

AVIVA INVESTORS

Our real assets capabilities

7

Our real assets capabilities

over 130
investment professionals
across 4 locations

£41.2bn
Managed across real estate, infrastructure and structured and private debt*

*As at 30 September 2022

ESG integration is fully embedded
into our investment process and decision making

Real assets play a crucial role in shaping our evolving society. We deliver outcome-oriented solutions spanning real estate, infrastructure and private debt, leveraging our scale to access markets across Europe and deploy capital more efficiently.

If you have any questions on this report or would like further information on our real assets capabilities, please contact our Relationship Management Team.

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Important information

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