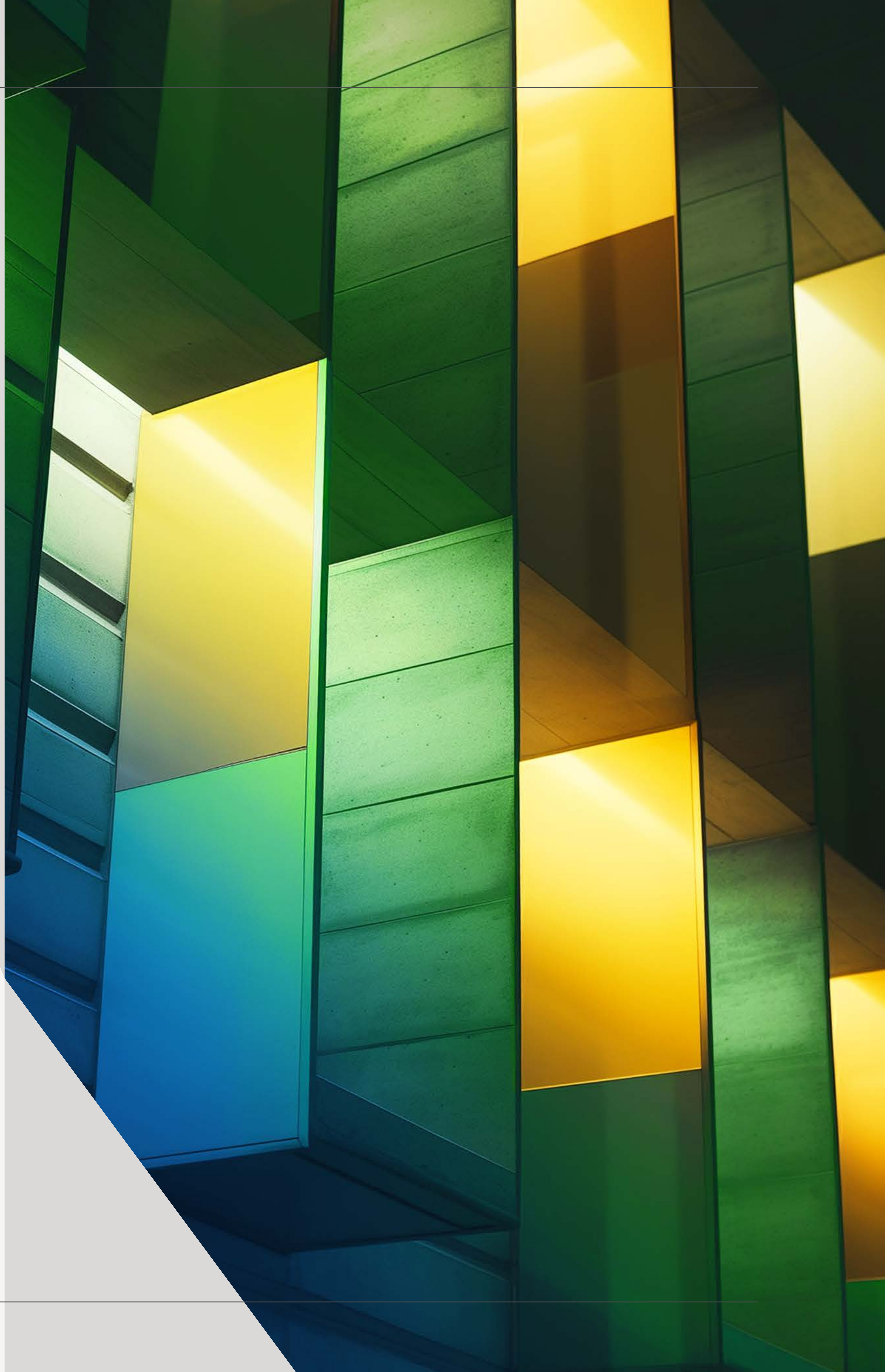
REAL ASSETS STUDY 2024

Real assets in a shifting landscape

Demand remains strong, but the investment drivers are changing

Contents



Foreword by Daniel McHugh

The past year has again been challenging for investors. Following the largest inflation shock in a generation, developed market central banks have increased policy rates to their highest levels since the global financial crisis.

Throw into the mix heightened geopolitical tension and international fragmentation, and it is easy to see why many investors chose to stay on the sidelines, with “the dash for cash” a prevailing theme of the year.

The challenging conditions impacted all asset classes, including real assets. For example, as the real estate market underwent a slow and, for some, painful repricing period in the UK and Europe, transaction activity fell significantly. But looking at this in a different way, a less crowded market presents opportunities to acquire assets at attractive valuations for investors with capital to spare and a long-term mindset.

Elsewhere, infrastructure debt held up well, with the asset class’s traditional defensive characteristics appealing to investors in tougher markets.

It was in this context in late 2023 that we took the pulse of key investment decision makers at 500 institutional investors in Asia, Europe and North America, representing a combined $3.8 trillion of assets.

As well as getting their insights on asset allocation, risks and opportunities, and preferred routes to market, the study also features a deep dive into investor 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. And, for the first time, the report includes expected return forecasts over one, three and five years from our respondents for real assets and public markets.

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

“We took the pulse of key investment decision makers at 500 institutional investors in Asia, Europe and North America, representing a combined $3.8 trillion of assets.”

Executive summary

On a year-on-year basis, institutional investors have marginally reduced their overall real asset allocations, likely due to recent market falls and perceived risks in certain sectors, such as parts of commercial real estate.

However, they continue to embrace the asset class, driven by the search for diversification, inflation-linked and long-term income and positive environmental, social and governance (ESG) impacts.

Our poll of institutional investors from Europe, North America and Asia Pacific (APAC) with allocations to real assets shows just over half (52 per cent) hold up to ten per cent of their portfolios in these investments, and a third hold ten to 20 per cent.

North American investors tend to have higher allocations, with almost a quarter holding 20 per cent or more of their portfolios in real assets.

And the appetite for future real asset investments remains strong. Globally, nearly two-thirds (64 per cent) expect to increase their allocations over the next two years, with investors in APAC most likely to add to their portfolios (69 per cent). However, while still high, the proportion of North American investors planning an increase in allocations has fallen since 2022 (from 70 to 60 per cent), while 13 per cent plan to cut allocations to real assets, up from six per cent a year ago.

Real estate equity remains the most popular strategy by far, though exposure has fallen slightly, from 31 per cent three years ago to 30 per cent last year and 27 per cent today. By contrast, allocations have risen for infrastructure debt (from eight per cent last year to 11 per cent today) and infrastructure equity (from 13 to 14 per cent), as they have for real estate long income (rising from ten to 12 per cent) and real estate debt (growing from nine per cent last year to 11 per cent today).

Diversification remains the key investment driver, but other factors are rising in importance

A majority of investors (64 per cent) continue to cite diversification as a primary reason for allocating to real assets, with 60 per cent seeing it as a key driver of their investments over the next two years. The tumultuous performance of markets in 2022 and much of 2023 likely reinforced the value of real assets as a source of uncorrelated returns in portfolios.

Meanwhile inflation protection is expected to dip in importance – while 50 per cent cited it as a key driver of investment today, 43 per cent said it would be important over the next two years. Cashflow matching is also set to fall steeply in importance, with only 15 per cent of respondents citing it as a key driver in two years, compared with 28.2 per cent who see it as important today.

On the other hand, long-term income and a positive ESG impact are expected to rise in importance, being seen as key drivers in two years' time by 51 per cent and 39 per cent of investors respectively (versus 38 per cent and 28 per cent today).

Defined contribution (DC) pension funds – half of which already offer access to real assets through default funds – are increasingly likely to offer them, via default funds and other routes, in the future. This could give the majority of DC members the potential to invest in real assets. For these funds, capital preservation, diversification and capital growth are seen as the most appealing attributes of real assets, followed by long-term income, inflation-linked income and a positive ESG impact.

> **50 per cent** cited inflation protection as a key driver of investment today, but a lower proportion (**43 per cent**) said it would be important over the next two years

64%

of institutional investors globally see diversification as a primary reason for allocating to real assets

Investors expect higher returns over time

We canvassed respondents' expectations for real asset returns over one-, three- and five-year time horizons. On an annualised basis, investors expect to see improving returns over longer periods across asset classes. For example, on average, respondents expect real estate equity returns to be around 3.2 per cent over one year and reach 6.3 per cent over five years.[1]

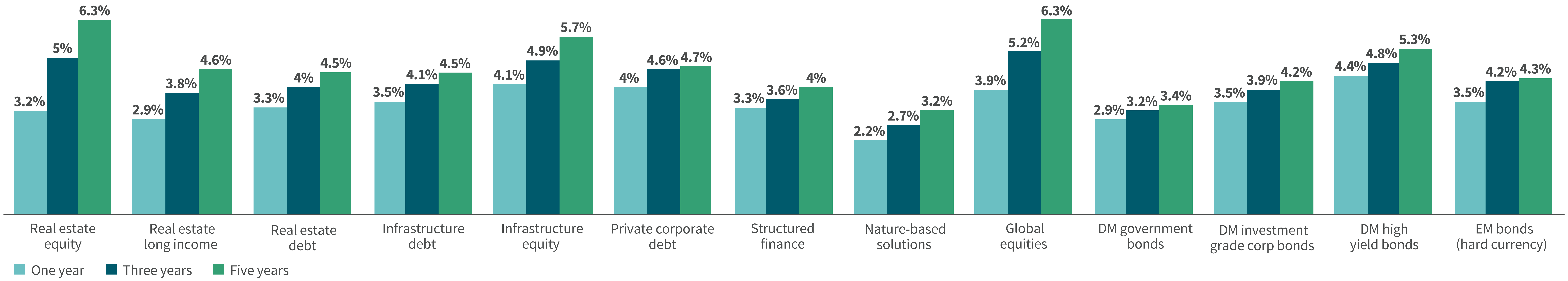
Over time, investor views on the asset classes expected to deliver the highest returns tend to coalesce.

Respondents generally anticipate higher long-term returns in equity than debt (depending on the risk level), with global equities expected to return 3.9 per cent over one year, and 6.3 per cent annualised over five years. Infrastructure equity and debt both see return expectations rise significantly too, which could reflect emerging markets' substantial infrastructure needs and global requirements to build the necessary infrastructure for climate change mitigation and adaptation.

On the other hand, given questions over the path of inflation and interest rates in the coming years, it is perhaps understandable that return growth seems more uncertain over three and five years for other forms of debt. However, respondents in APAC and Europe are more positive about high-yield and emerging-market hard currency bond returns than North American investors.

FIGURE 1

What annualised risk-adjusted returns do you expect for different real assets and public market asset classes over one, three and five years?



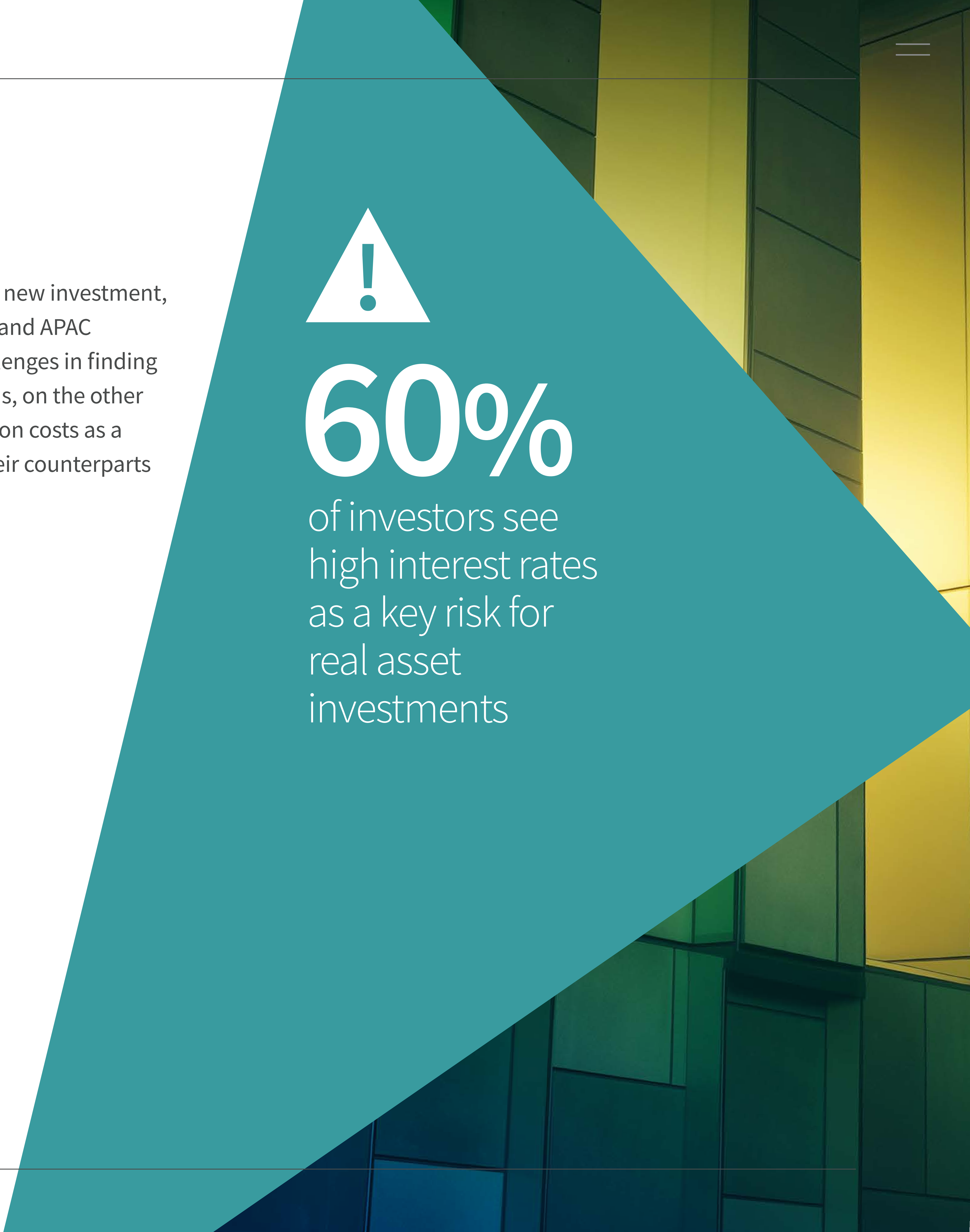
Note: These figures are based on weighted averages for expected returns, calculated using illustrative return bands (see Figure 11, p.21), and do not indicate actual returns.
[1] Please see page 19 for a full explanation of how these averages were calculated.

Macroeconomic issues are the key risks

Over the next 12 months, 60 per cent of investors see high interest rates as a key risk for real asset investments. Global recession is another pressing concern (51 per cent), particularly outside Europe. Just over a third name liquidity risk as a major worry, rising to nearly half (47 per cent) of North American investors.

When it comes to barriers to increasing allocations to real assets, respondents cite difficulty in finding suitable opportunities (46 per cent), high transaction costs (45 per cent) and asset valuations (43 per cent), while over a third see better opportunities in public markets. These factors are likely interrelated, given the current macro environment is challenging to navigate.

Looking at the regional data on obstacles to new investment, respondents in North America (58 per cent) and APAC (51 per cent) were most likely to report challenges in finding suitable opportunities. European institutions, on the other hand, were more likely to cite high transaction costs as a barrier (49 per cent), a higher figure than their counterparts elsewhere.



60%

of investors see high interest rates as a key risk for real asset investments

Investors want returns and sustainability

Fewer than five per cent of global institutions do not consider sustainability when making real asset investment decisions (although the figure is higher among North American institutions, at 16 per cent). For 17 per cent of investors globally, ESG is considered a critical and deciding factor, driven by aims to decarbonise portfolios and make a positive ESG impact.

The majority (57 per cent) of investors globally are also committed to net zero, even if some are yet to put this into action (citing a "soft commitment"). In addition, less than half (47 per cent) report being somewhat or very confident on the actions needed to meet long-term net-zero and sustainability commitments within real assets.

However, most institutions (73 per cent) also want to prioritise financial returns when investing in sustainable real assets. Investors cite the ability to show increasing evidence of improved performance (53 per cent) and a sustainability impact (51 per cent), followed by enhancing risk management (47 per cent), as the key reasons for investing in sustainable real assets.

This shows institutions want to deliver both investment performance and make an impact with sustainable real assets. Respondents find social infrastructure (57 per cent) and climate transition-aligned investments (55 per cent) the most appealing ways to create a positive impact.

> **Fewer than five per cent** of global institutions do not consider sustainability when making real asset investment decisions

FIGURE 2

73%

Say sustainable investments that prioritise financial returns but broadly integrate a wide range of ESG factors are appealing

REAL ASSETS STUDY 2024

Asset allocation trends

Asset allocation trends

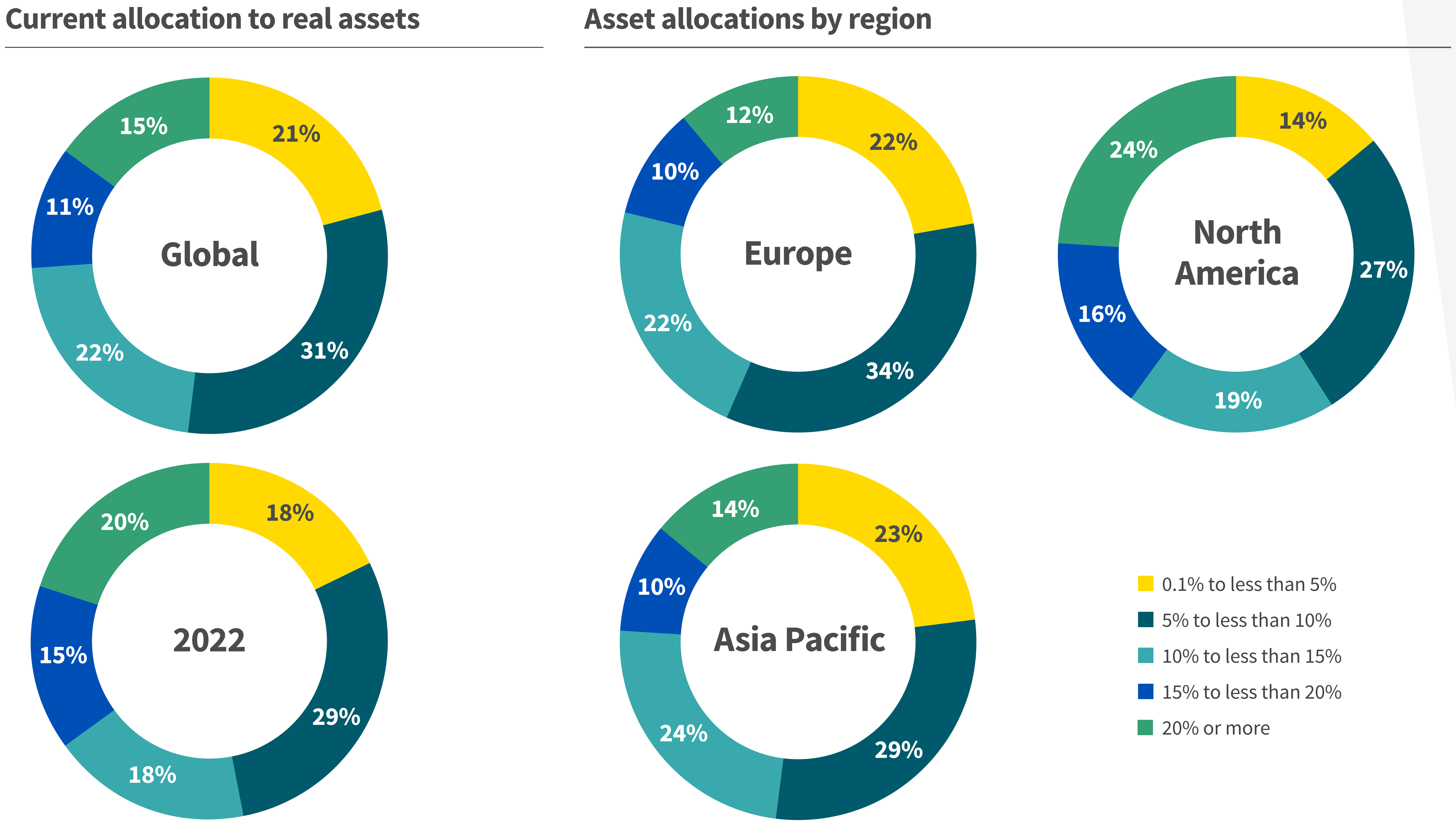
Real assets continue to play a significant role in the investment strategies of global institutions. Among those with an allocation to real assets, almost half (48 per cent) devote more than ten per cent of their portfolios to these investments, and 64 per cent of those polled plan to increase allocations in the next two years.

By region, North American institutions remain the biggest investors, with 24 per cent of this cohort allocating a fifth or more of their portfolios to real assets; 14 per cent of institutions in APAC and 12 per cent of those in Europe have this level of exposure.

> Real assets continue to play a significant role in the investment strategies of global institutions

FIGURE 3

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



The impact of higher interest rates

While appetite for real assets remains strong, overall allocations are marginally lower compared with the same period in 2022. This is likely due to the challenging macro environment and perceived risks in certain sectors, notably US commercial real estate, which came under pressure in 2023 due to the knock-on impact of higher interest rates, including the "mini banking crisis" that saw several regional US financial institutions collapse.

When asked about the biggest risks looming over the coming 12 months, 60 per cent of global institutions cited higher rates as a key concern, ahead of global recession (51 per cent) and liquidity risks (34 per cent). However, there are regional nuances. A higher proportion of North American investors (47 per cent) are more worried about liquidity than their counterparts in other regions, who tend to cite political risk (Europe) or market volatility (APAC) as greater threats.

FIGURE 4

When it comes to investing in real assets, which of the following risks do you consider most concerning over the next 12 months (choose the top three)?

Global		Europe		North America		APAC	
High interest rates	60%	High interest rates	61%	High interest rates	58%	High interest rates	60%
Global recession	51%	Global recession	47%	Global recession	58%	Global recession	55%
Liquidity risks	34%	Political risks	35%	Liquidity risks	47%	Market volatility	35%

47%

of North American investors flagged liquidity risk as a key concern

Real estate equity remains the most popular strategy

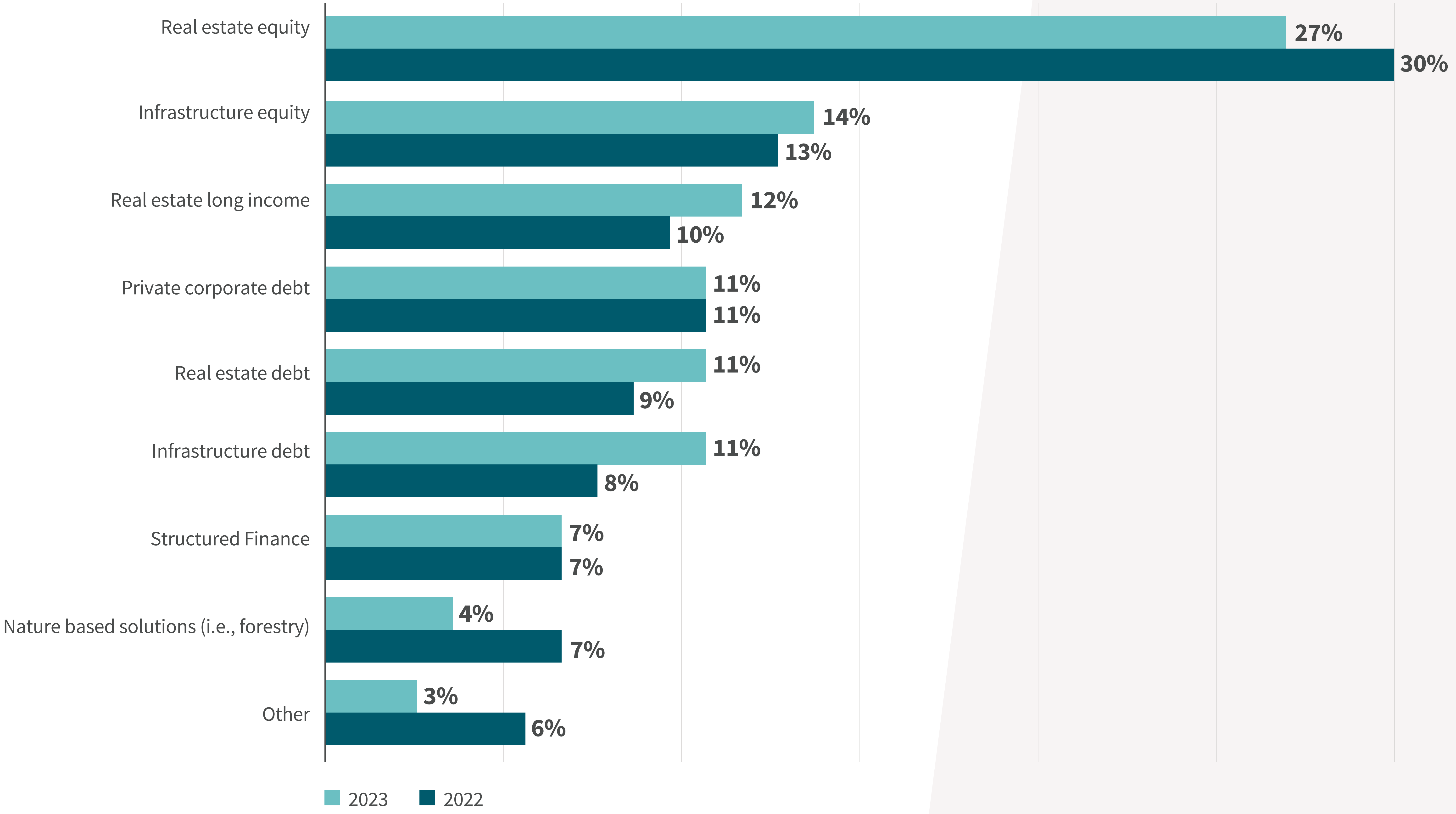
The market challenges of 2023 may be reflected in shifts in the composition of real asset portfolios over the last year. While real estate equity remains the most popular strategy, it takes a smaller share of institutions' portfolios (27 per cent) compared with a year ago (30 per cent). The reallocation away from real estate equity was observed consistently across all three regions.

Infrastructure debt (11 per cent) and infrastructure equity (14 per cent) now account for a larger share of real asset portfolios, however, while allocations to real estate debt (11 per cent) and real estate long income (12 per cent) have also risen since 2022.

> The market challenges of 2023 may be reflected in shifts in the composition of real asset portfolios over the last year

FIGURE 5

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



Real assets favoured for diversification

One consequence of the volatile market environment in 2023 has been to reinforce the value of real assets in providing diversification and uncorrelated returns. Institutions in all regions consistently report diversification as a primary reason for holding real assets.

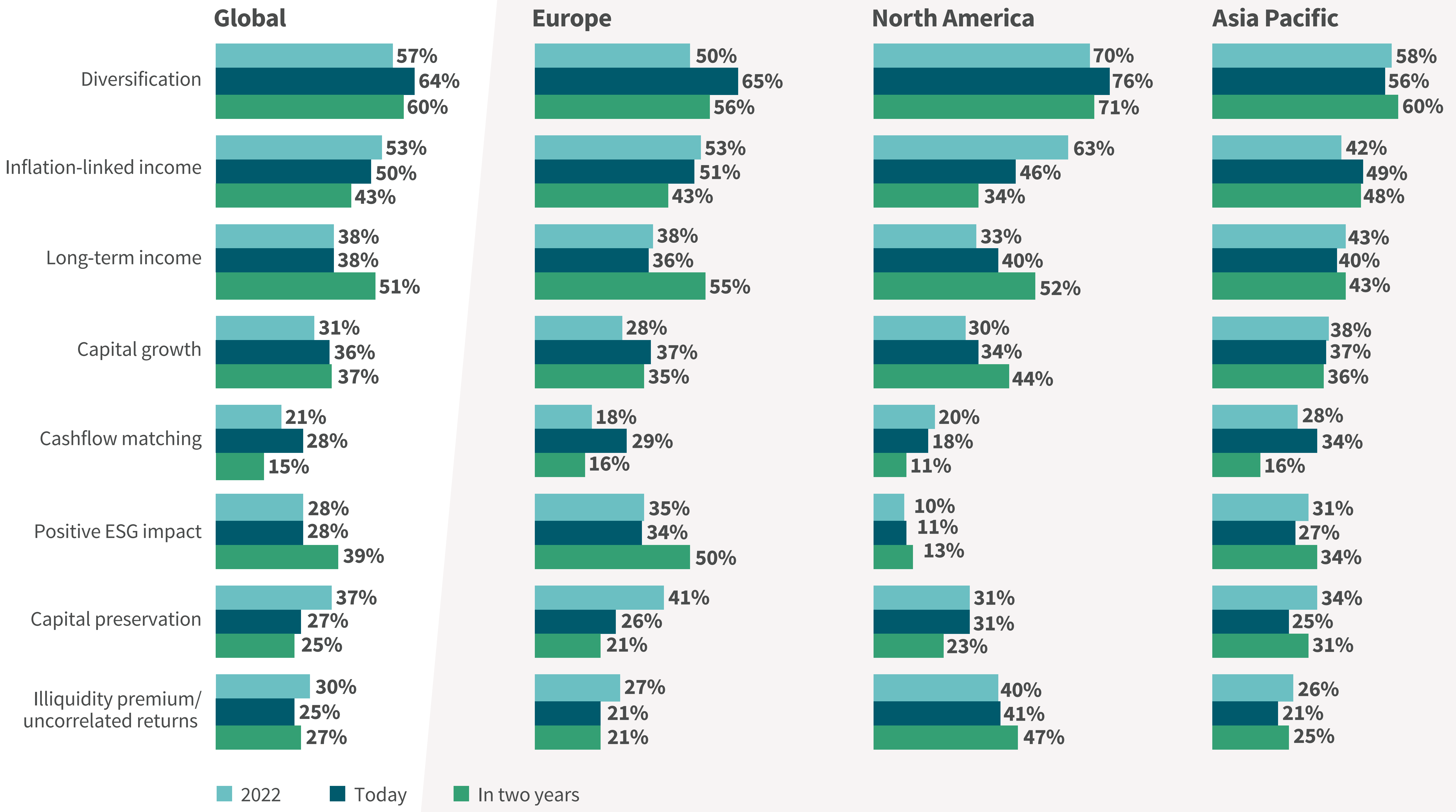
With inflation falling in major economies throughout 2023, the role of real assets in providing inflation-linked income is seen as less important than it was in 2022 by most global institutions (although the opposite is true in APAC, which may reflect differing inflation expectations in that region).

Around half of institutions (51 per cent) see real assets' ability to deliver long-term income as becoming increasingly important over the next two years, perhaps because of expectations around lower interest rates and therefore lower levels of income from fixed-income portfolios.

The ESG dimensions of real assets are growing in significance. Globally, 39 per cent of institutions surveyed cited positive ESG impact as a key reason for boosting their allocations, up from 28 per cent a year ago. Fewer institutions expect to use real assets for cashflow matching, however, with only 15 per cent reporting this as a key driver over the next two years (down from 21 per cent in 2022).

FIGURE 6

What is your primary reason for allocating to real assets today, and what do you expect to be the most important driver in the next two years (select the top three)?



North American investors more cautious on boosting exposure

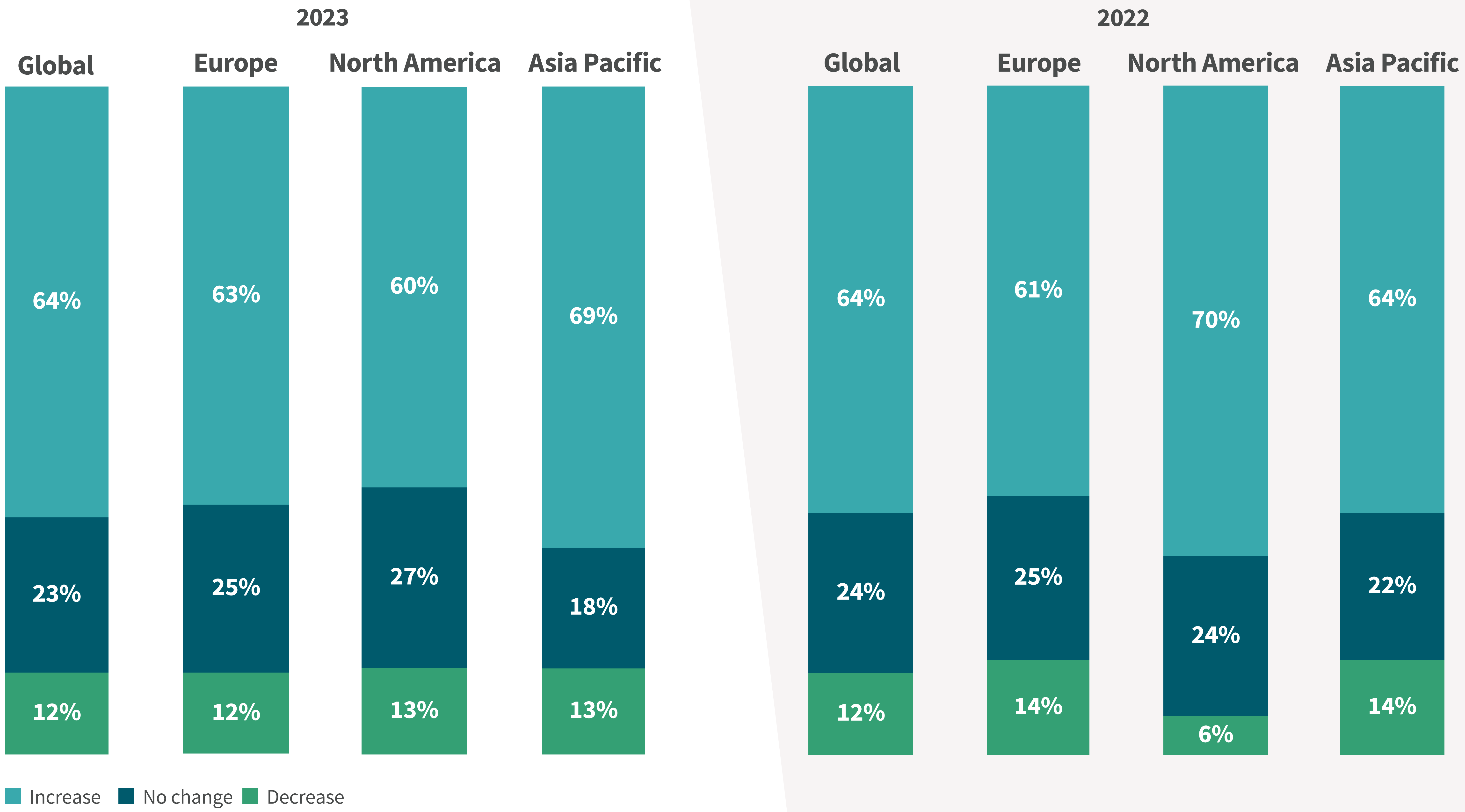
Despite the slight dip in overall allocations to real assets in 2023, most institutions remain committed to investing more in the asset class over the next two years. Globally, 64 per cent of institutions say they expect to increase allocations within the next 24 months.

However, our findings point to regional nuances. While the proportion of APAC and European institutions planning to boost allocations has risen over the past year, fewer North American institutions anticipate growth in their exposure compared with a year ago (60 per cent, down from 70 per cent). More North American institutions plan to trim exposure to assets (13 per cent, over double the six per cent figure recorded in 2022).

Our findings suggest reasons for this. When asked about the barriers preventing them from increasing their exposure, 58 per cent of North American institutions cited difficulties finding suitable opportunities (compared with 51 per cent in APAC and 40 per cent in Europe). North American institutions are also more likely to cite asset valuations as obstacles to investment than their peers elsewhere.

FIGURE 7

Do you expect to increase or decrease your allocation to real assets over the next 24 months?

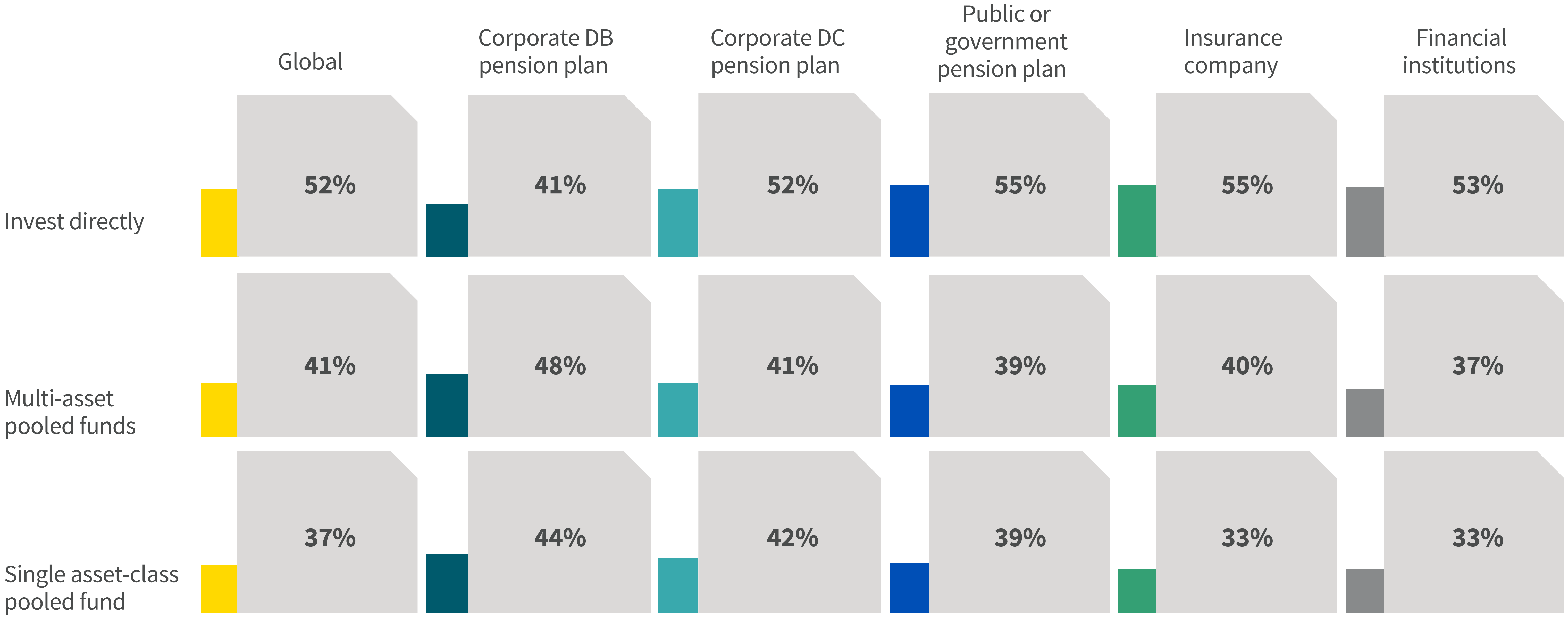


Direct investment continues to be favoured, but obstacles remain

Turning to expected shifts in allocation by institution type, by far the biggest change compared with last year's survey is the large increase in the proportion of DC pension schemes looking to boost their allocation to real assets, which now stands at 69 per cent, up from 51 per cent in 2022.

FIGURE 8

What is your preferred way of investing in real assets (select up to three options)?



Note: Chart shows top three answers selected by each investor type.

In part, this is likely to be a consequence of the steps regulators, governments and investors are taking to address the structural and operational considerations that have historically been seen as impediments to DC schemes' investing.

As to the question of how institutions are seeking to gain exposure to real asset markets, our study found direct investment continues to be the preferred option among most channels. Perhaps surprisingly, larger institutions are not necessarily more likely to seek to invest directly than their smaller peers.

Our study found direct investment continues to be the preferred option among most channels

Consideration of ESG factors varies across regions

ESG continues to form an important part of real asset investment. Globally, a slightly higher proportion of real assets investors report ESG and sustainability are “growing, but not essential” considerations when making investment decisions (29 per cent) than in 2022 (27 per cent).

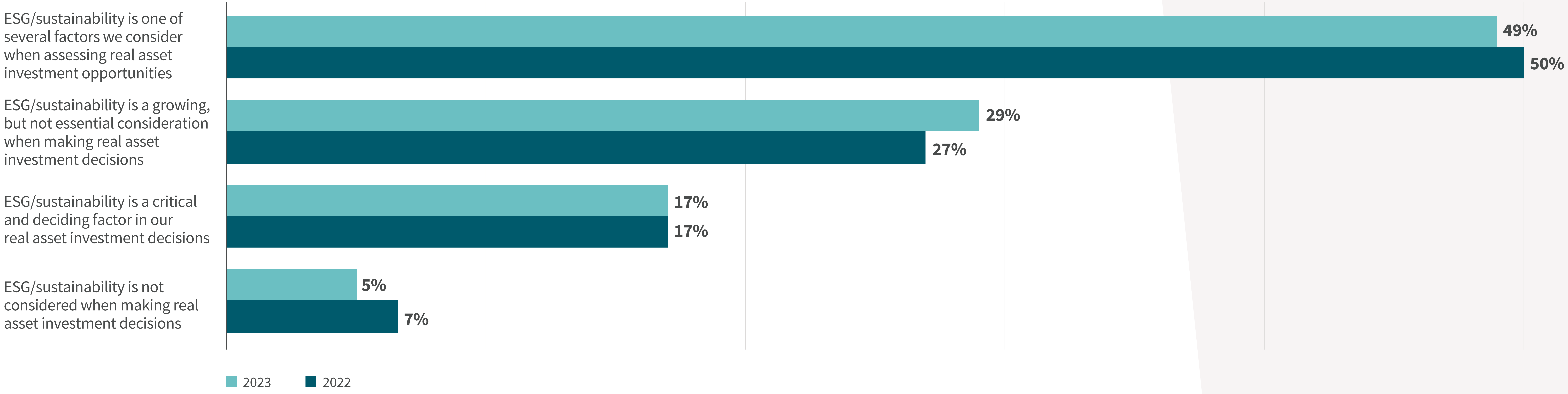
And only five per cent of institutions say they do not take ESG into account at all, down from seven per cent a year ago.

However, the picture varies through a regional lens. More than 15 per cent of North American institutions do not take ESG into account, compared with only four per cent of institutions in APAC and two per cent in Europe.

ESG continues to form an important part of real asset investment

FIGURE 9

Which of the following best describes your organisation’s approach to ESG/sustainability within real assets?



Investors seek performance and impact when selecting managers

Consistent with the findings of last year's study, global institutions continue to prioritise investment performance when selecting managers for their sustainable real asset strategies.

Performance is especially important among North American institutions, with 81 per cent putting it in their top three criteria when choosing a manager, higher than Europe and APAC (both 66 per cent). Institutions in all regions also cite the ability to evidence risk and/or impact and the quality of ESG integration processes as important.

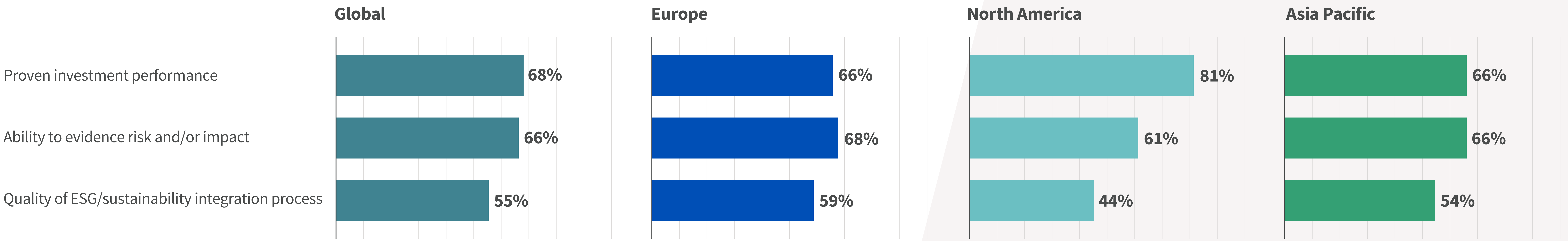
Most managers seem to be achieving these objectives, although there is room for improvement. Globally, 75 per cent of institutions say their asset managers are delivering on performance, with this figure broadly consistent across regions. On the whole, however, managers are deemed to be better at offering enhanced or tailored reporting (82 per cent) and providing access to granular holdings data (79 per cent) than they are at evidencing impact (72 per cent) or a high-quality ESG integration process (69 per cent).

75%

of institutions globally say their real asset managers are delivering on performance

FIGURE 10

When selecting an asset manager for a sustainable real assets investment, how important are each of the following?



Note: Chart shows top three answers selected by each investor type.

REAL ASSETS STUDY 2024

Return expectations

Return expectations

After recent market falls, investors expect to see improving returns over longer periods across asset classes. This is true for all regions, though North American respondents tend to be more positive, across both asset classes and time periods. This expected rise in returns assumes market resilience and recovery, particularly in real estate, which currently faces reduced demand in some sectors (e.g. offices and retail) and rising debt costs.

To gauge their return expectations, respondents were asked to choose between illustrative return bands, which are based on historic market data and take into account the potential for both positive and negative market conditions (see Figure 11 on p.21 and accompanying note).

Weighted average returns were calculated using the midpoint for each expected return band (e.g., for zero to 2.9 per cent, it is 1.45 per cent) multiplied by the percentage score for that band (e.g., 27 per cent for the zero to 2.9 per cent return band for one-year expected returns in real estate equity).

The total for all the return bands for a period was then used to give the weighted average return. For the "negative returns" band, a figure of -1 per cent was used, and 11 per cent for the "ten per cent or more" return band. The "don't know" responses were omitted for all weighted average return calculations.

After recent market falls, investors expect to see improving returns over longer periods across asset classes

Equities – real estate, infrastructure and global – as well as real estate long income (RELI) see the steepest rises in investors' return expectations although, as stated, real estate assets are starting from a lower base over one year (at 3.2 per cent for real estate equities and 2.9 per cent for RELI).

In addition to infrastructure equity, infrastructure debt also sees return expectations rise over time, from 3.5 per cent over one year to 4.5 per cent over five years (see comparison in Figure 1, p.6).

On the other hand, given questions on the path of inflation and interest rates, most forms of debt – private corporate debt (PCD), developed market (DM) bonds, high-yield (HY) bonds, DM investment-grade (IG) corporate bonds and emerging-market (EM) hard-currency bonds – are expected to deliver solid returns over one year, while return growth seems more uncertain over three and five years.

Interestingly, respondents in APAC and Europe are more positive about HY and EM bond returns than North American investors, large proportions of whom said they didn't know where returns might be headed (16 per cent for HY and 26 per cent for EM bonds).

Respondents' return expectations across regions and timeframes are lowest for nature-based solutions, although results are somewhat skewed by large numbers of respondents saying they "don't know" (more than 28 per cent overall, and almost half of North American respondents, for one, three and five years). The unfamiliarity of many investors with this nascent asset class may explain the skew in return expectations.

Infrastructure debt sees weighted average return expectations rise over time, from

3.5%

over one year to

4.5%

over five years

Expectations over one year

Over one year, as well as over longer timeframes, North American respondents generally have higher return expectations than Asian and European respondents, whose expectations cluster more around zero to 4.9 per cent returns, with fewer expecting over ten per cent.

European answers differ from other regions in a few areas over one year. In particular, at eight per cent, fewer European respondents expect negative returns in RELI than their North American (ten per cent) and APAC (12 per cent) counterparts. In contrast, more European institutions expect negative returns on infrastructure debt (nine per cent vs an average of seven per cent), PCD (ten per cent vs nine per cent overall) and DM government bonds (12 per cent versus an average of nine per cent).

In terms of asset classes, real estate equities and global equities are in the middle of the table for weighted-average expected returns. However, they garner the two highest proportions of negative expected returns over one year, but also large proportions of high returns. Investors' short-term expectations are especially scattered on these two asset classes.

On DM HY, North American respondents are more positive than those in Europe and APAC: 40 per cent expect to see returns between five and 9.9 per cent, while only nine per cent expect returns between zero and 2.9 per cent (against 21.5 per cent in Europe and 24.3 in APAC).

It is a similar picture for EM hard-currency bonds. Although 24 per cent of North American respondents don't know what returns to expect, those who gave a response expected higher returns than investors in APAC and Europe. For example, 64 per cent of Asian investors expected one-year returns between zero and five per cent.

FIGURE 11

What annualised risk-adjusted returns do you expect for different real assets and public market asset classes over one year?

	Real estate equity	Real estate long income	Real estate debt	Infrastructure debt	Infrastructure equity	Private corporate debt	Structured finance	Nature-based solutions	Global equities	DM government bonds	DM investment-grade corporate bonds	DM high-yield bonds	EM bonds
Negative returns	17%	9%	10%	7%	5%	9%	6%	10%	13%	9%	8%	7%	9%
0 to 2.9%	27%	31%	31%	29%	28%	25%	23%	26%	26%	34%	29%	20%	25%
3% to 4.9%	31%	35%	33%	31%	31%	26%	28%	23%	27%	41%	36%	30%	27%
5% to 9.9%	18%	15%	19%	23%	21%	28%	17%	11%	24%	11%	29%	32%	23%
10% or more	4%	1%	2%	2%	9%	6%	6%	2%	7%	1%	1%	6%	4%
Don't know	2%	9%	5%	9%	6%	6%	20%	28%	3%	4%	4%	6%	13%

Note: The return bands in the table are based on historic market data and take into account the potential for both positive and negative market conditions; the bands are intended to be illustrative and the weighted averages do not indicate actual returns.

Expectations over three years

Again, North American respondents generally expect higher returns over three years than their European and Asian counterparts. They are also unsure about the return outlook in several asset classes including structured finance (27 per cent), nature-based solutions (48 per cent) and EM bonds (24 per cent). More investors in APAC expect negative to low returns (less than three per cent) in real estate debt (35 per cent vs 28 per cent overall) and infrastructure debt (also 35 per cent vs 24 per cent overall). Asian respondents also expect lower three-year returns in structured finance and global equities (30 per cent expect returns below three per cent in the former and 26 per cent in the latter).

Meanwhile, European respondents are less positive on PCD (35 per cent expect returns of five per cent or more, vs 40 per cent overall), nature-based solutions (11 per cent expect negative returns, vs eight per cent overall), DM HY bonds (more Europeans expect negative returns and fewer expect returns of ten per cent or more) and EM hard-currency bonds (seven per cent of European respondents expect negative returns over three years versus five per cent overall).

In terms of asset classes, PCD and nature-based solutions have the highest proportions of negative expected returns, at six and eight per cent respectively.

However, many respondents also expect returns of five per cent or more in PCD, giving it weighted-average return expectations over three years of 4.6 per cent. Return expectations for global equities and infrastructure equity remain scattered, in contrast to real estate equity, which respondents expect to deliver returns between three and 9.9 per cent (as they do in DM HY bonds).

Large numbers of respondents don't know what to expect for three-year returns in structured finance (22 per cent) and nature-based solutions (29 per cent), leaving the rest of the answers scattered across return levels. Perhaps unsurprisingly there is greater consensus around return expectations for DM government bonds, with 79 per cent expecting between zero and five per cent annualised over three years.

FIGURE 12

What annualised risk-adjusted returns do you expect for different real assets and public market asset classes over three years?

	Real estate equity	Real estate long income	Real estate debt	Infrastructure debt	Infrastructure equity	Private corporate debt	Structured finance	Nature-based solutions	Global equities	DM government bonds	DM investment-grade corporate bonds	DM high-yield bonds	EM bonds
Negative returns	3%	3%	4%	4%	2%	6%	2%	8%	3%	5%	3%	4%	5%
0 to 2.9%	19%	24%	24%	20%	18%	19%	22%	20%	20%	32%	24%	14%	18%
3% to 4.9%	34%	41%	38%	37%	34%	30%	27%	26%	25%	47%	47%	34%	29%
5% to 9.9%	35%	20%	24%	28%	30%	33%	22%	15%	41%	12%	20%	34%	29%
10% or more	7%	3%	4%	3%	10%	7%	6%	4%	8%	1%	1%	7%	7%
Don't know	2%	9%	6%	8%	6%	6%	22%	29%	3%	4%	4%	6%	13%

Note: The return bands in the table are based on historic market data and take into account the potential for both positive and negative market conditions; the bands are intended to be illustrative and the weighted averages do not indicate actual returns.

Expectations over five years

Over five years, North American respondents expect higher returns across most asset classes, while Asian investors expect lower returns than the global average and European ones are close to the average. This is particularly salient for real estate equity and global equities, although European respondents gave more scattered expectations, with four per cent expecting negative returns and 64 per cent expecting five per cent returns or higher. APAC investors' responses were distinctly lower than their peers' on infrastructure equity, with 40 per cent expecting returns below five per cent.

European respondents expect lower returns than the average on RELI and PCD (six per cent expect returns of ten per cent or more in PCD over five years). North American investors are more positive, with ten per cent expecting five-year returns of ten per cent or more on RELI (although 18 per cent did not know what to expect). North American respondents are also more positive on DM government bonds, more of them expecting five-year returns of five to 10 per cent (20 per cent, vs 13 per cent of respondents overall), while most European and Asian investors expect returns between three and five per cent (42 per cent and 51 per cent respectively). Europeans are also the only ones to expect to see negative five-year returns (five per cent, vs zero in North America and one per cent in Asia).

Expectations are scattered across return levels for structured finance and nature-based solutions, where many respondents said they don't know what to expect, but also for DM HY bonds (where 16 per cent of North American investors don't know). In contrast, while there is also uncertainty around EM bond returns (17 per cent globally, and over 25 per cent in North America), most who gave an expectation grouped in the three to 10 per cent return brackets. More Europeans anticipate negative (four per cent) and low returns (19 per cent expect less than three per cent) than the average; fewer North American respondents expect returns of ten per cent or more (six per cent vs eight per cent overall).

FIGURE 13

What annualised risk-adjusted returns do you expect for different real assets and public market asset classes over five years?

	Real estate equity	Real estate long income	Real estate debt	Infrastructure debt	Infrastructure equity	Private corporate debt	Structured finance	Nature-based solutions	Global equities	DM government bonds	DM investment-grade corporate bonds	DM high-yield bonds	EM bonds
Negative returns	1%	1%	3%	3%	1%	4%	3%	5%	2%	3%	2%	2%	3%
0 to 2.9%	9%	18%	18%	14%	12%	17%	18%	19%	11%	33%	21%	14%	16%
3% to 4.9%	26%	35%	40%	40%	28%	31%	27%	25%	18%	44%	44%	29%	27%
5% to 9.9%	44%	29%	27%	28%	38%	33%	22%	17%	46%	13%	29%	39%	29%
10% or more	17%	7%	7%	6%	15%	8%	9%	7%	18%	2%	4%	10%	8%
Don't know	3%	10%	7%	9%	7%	6%	20%	28%	4%	5%	5%	8%	17%

Note: The return bands in the table are based on historic market data and take into account the potential for both positive and negative market conditions; the bands are intended to be illustrative and the weighted averages do not indicate actual returns.

Expectations tend to coalesce over time… but not always

The example of real estate equity return expectations shows these tend to become less diverse and more unified over longer periods, as well as rising on a weighted-average basis.

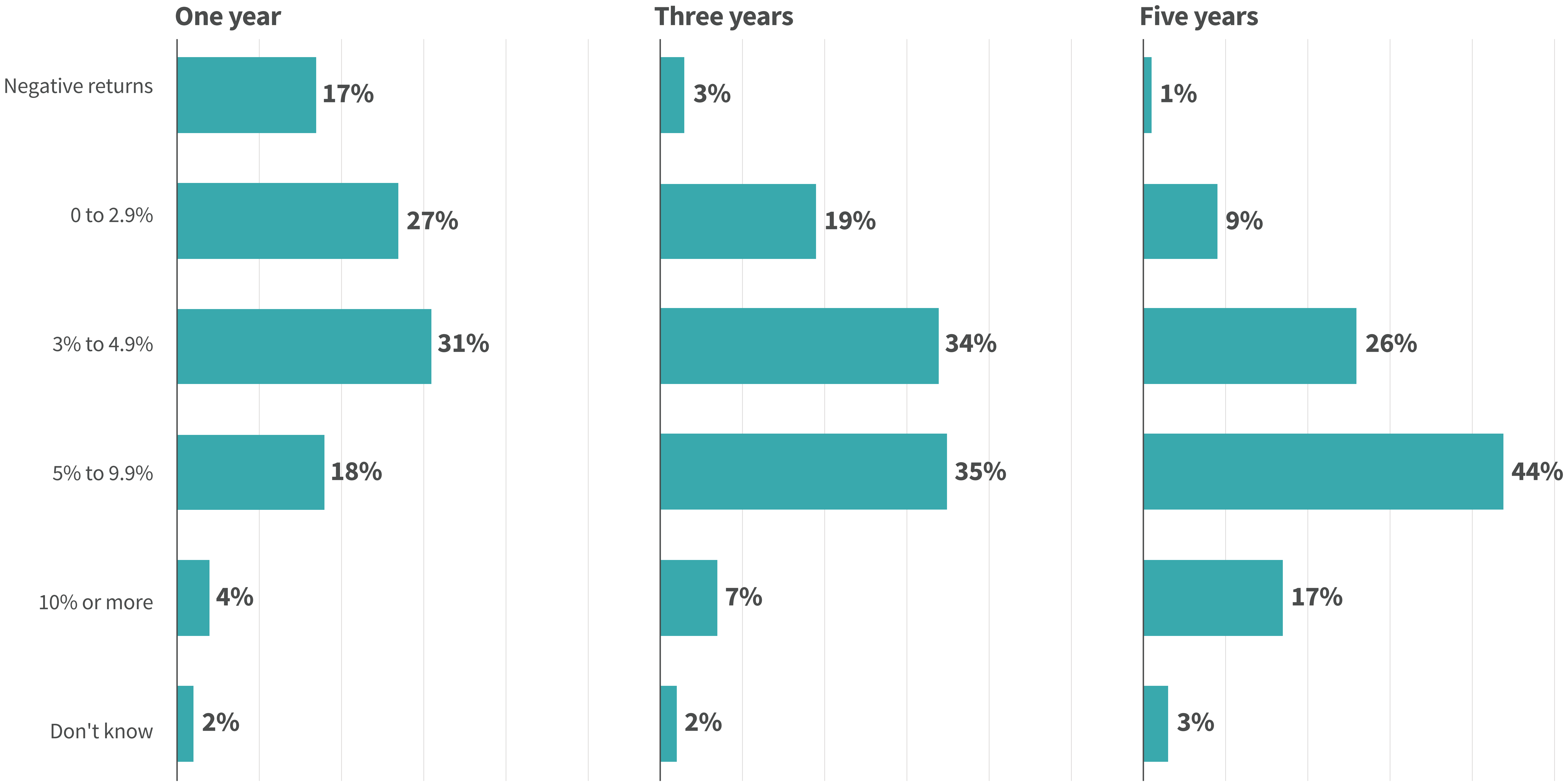
A similar pattern emerges for RELI, global equities and infrastructure equity, and bolsters investors' weighted-average return expectations over five years for these asset classes – to 4.6 per cent, 6.3 per cent and 5.7 per cent respectively.

However, this is not true for all asset classes. For instance, the uncertain path of inflation and interest rates means expectations for DM government bond returns remain scattered over all timeframes and geographies.

Some regional differences exist over timeframes. For example, APAC respondents are more positive on three-year returns (4.6 per cent weighted average) than five-year returns (4.5 per cent weighted average) for PCD, and North American institutions are similarly more positive on three-year returns (5.2 per cent weighted average) than five-year returns (five per cent weighted average) for DM HY bonds. As discussed, European institutions also remain more pessimistic on global equities, with four per cent expecting negative returns over five years.

FIGURE 14

What annualised risk-adjusted returns do you expect for real estate equity over one, three and five years?



Note: These figures are based on weighted averages for expected returns, calculated using illustrative return bands (see Figure 11, p.21), and do not indicate actual returns.

Patterns in return expectations

While one-year return expectations appear to be more random, a clearer trend appears with three and five-year returns, particularly on the three asset classes expected to deliver the highest returns. In line with conventional investment theory, equities are expected to provide higher returns over longer periods.

While return expectations for real estate equity are scattered over one year, they grow across regions over three and five years. For instance, 61 per cent of respondents expect returns of five per cent or more over five years, including 72 per cent in North America (with 26 per cent expecting returns of ten per cent or more), and 56 per cent in Asia.

Return expectations for infrastructure equity rise over time in all regions, particularly for returns of ten per cent or more, growing from nine per cent of respondents over one year to 15 per cent over five years. However, another 12 per cent of overall respondents still expect returns of zero to three per cent over five years. And despite more pessimism among European respondents, global equities also see a large rise in the proportion of all investors expecting returns of at least five per cent a year over five years, reaching 78 per cent globally (against 64 per cent in Europe).

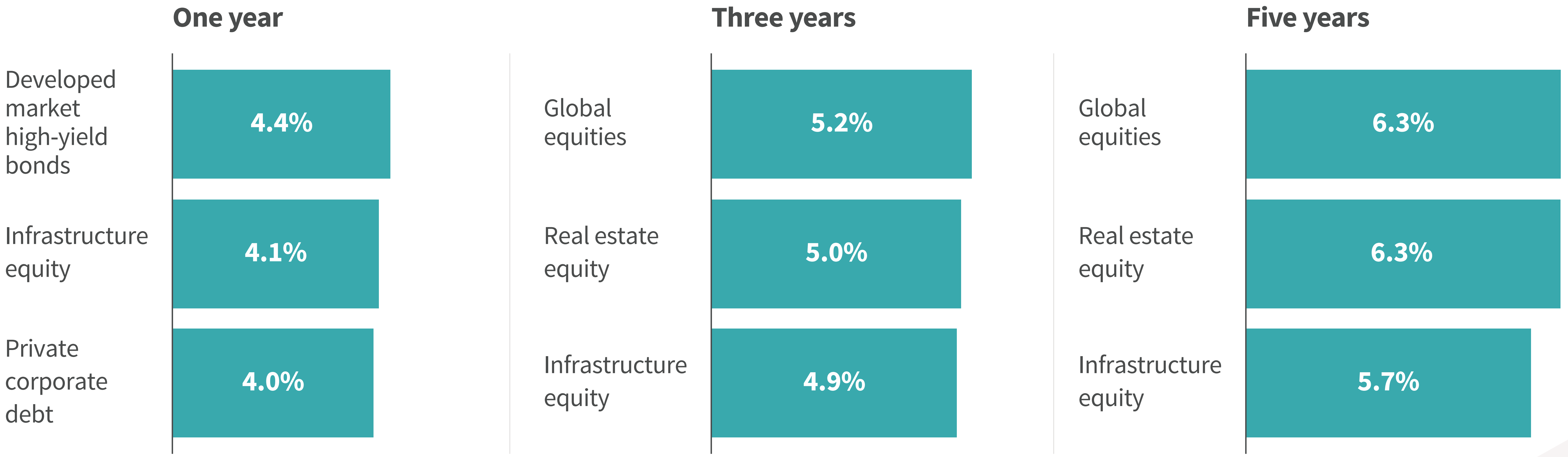
However, while not making the top three, many forms of debt also see strong rises in return expectations, leaning towards expectations of five per cent or higher over time.

This includes real estate debt, where expectations of three to 4.9 per cent returns and returns of ten per cent or more both rise significantly between one and five years (from 32 to 40 per cent and from two to seven per cent respectively).

It also includes infrastructure debt, particularly among North American respondents, one per cent of whom expect returns of ten per cent or more over one year, rising to seven over five years, while European expectations remain more scattered. PCD return expectations also rise, while all regions expect higher returns on DM IG bonds and DM HY bonds (five per cent or more) over time.

FIGURE 15

What annualised risk-adjusted returns do you expect for different real assets and public market asset classes over one, three and five years (top three)?



Note: These figures are based on weighted averages for expected returns, calculated using illustrative return bands (see Figure 11, p.21), and do not indicate actual returns.

The bottom three reveal more uncertainty

Similar to the three asset classes that garner the highest expected returns, those that reveal the lowest expectations are the same over three and five years – while two are also bottom of the league over one year.

RELI is a special case here, illustrating the current challenges in the real estate sector. Return expectations over three and five years recover significantly – to 3.8 per cent and 4.6 per cent weighted-average expected annual returns respectively.

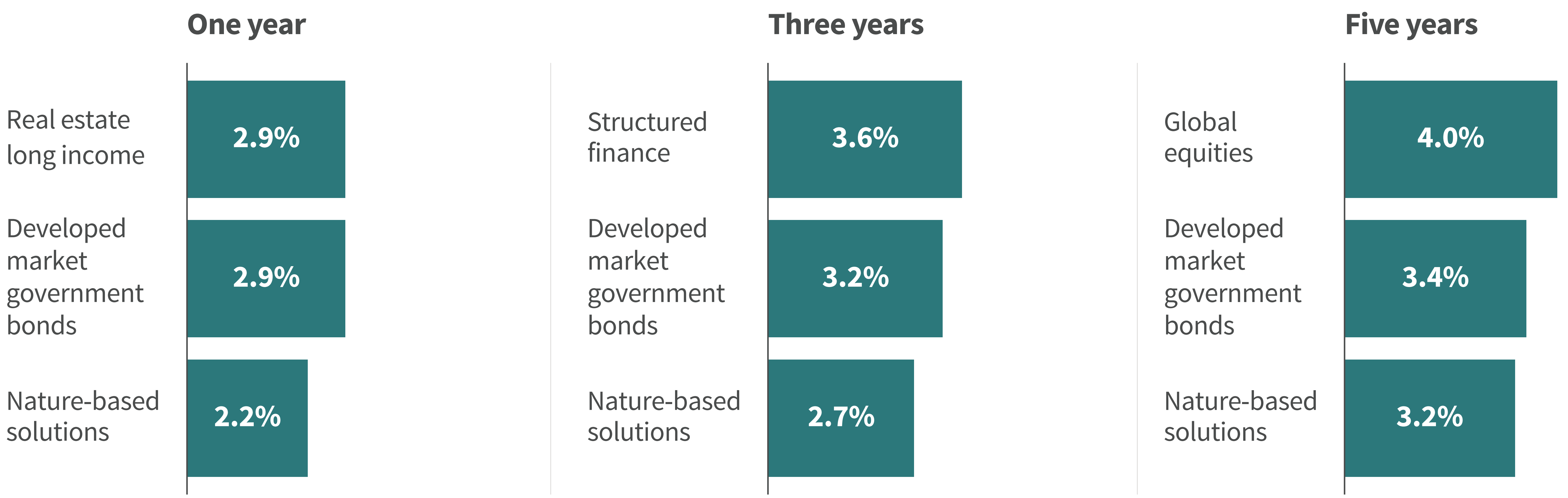
Meanwhile, as discussed earlier, the uncertainty around interest rates over the next few years impacts return expectations on DM government bond returns, which remain very scattered across timeframes and geographies. It is difficult to find a consensus when so much might change in markets, inflation and interest rates.

As for structured finance and nature-based solutions, respectively around 20 per cent and 28 per cent of respondents globally say they don't know what level of returns to expect over one, three or five years. This reveals a lack of familiarity with these asset classes but, among those who indicated an expectation, most anticipated a rise to five per cent or more annualised returns over five years for both.

North American respondents' expectations on nature-based solutions returns remained scattered, but with 50 per cent not knowing what to expect over five years, these results should be taken with caution. The asset class may yet reveal itself to be attractive as familiarity grows and more organisations seek solutions to decarbonise their portfolios.

FIGURE 16

What annualised risk-adjusted returns do you expect for different real assets and public market asset classes over one, three and five years (bottom three)?



Note: These figures are based on weighted averages for expected returns, calculated using illustrative return bands (see Figure 11, p.21), and do not indicate actual returns.

REAL ASSETS STUDY 2024

Investor views on sustainability

Investor views on sustainability

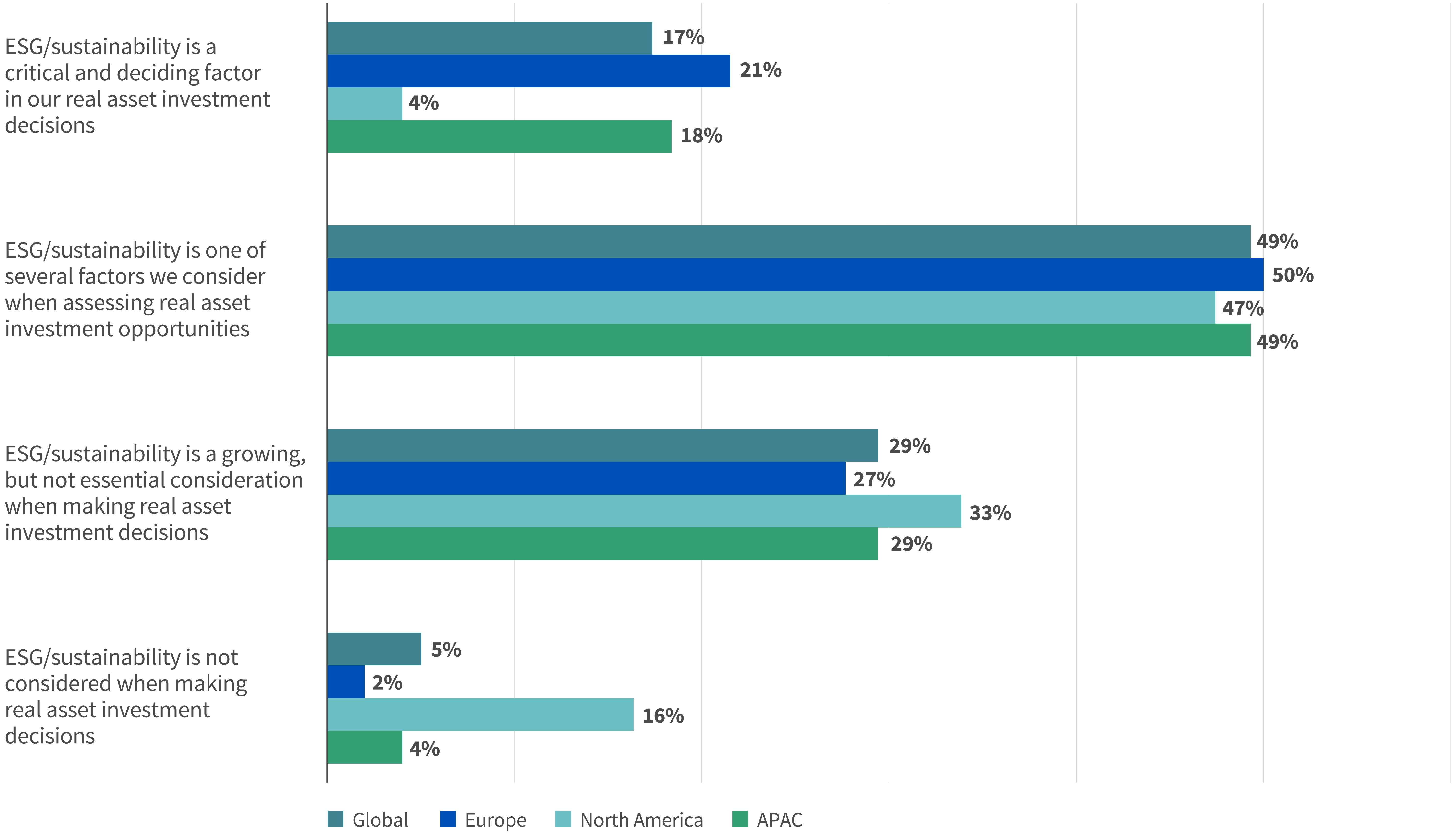
Institutional investors have made strides to address responsible investment. But how this is reflected in the allocation priorities and views of the 500 institutions we surveyed?

The key takeaway from our study, which is tilted towards larger organisations with over £20 billion of assets (44 per cent of respondents), is that ESG/sustainability factors are very important. Ninety-four per cent bear them in mind when investing (Figure 17). Of that group, 17 per cent say sustainability factors are a “critical and deciding” factor. Only a small minority (five per cent, the majority based in North America) give them no weight at all.

Most respondents from Europe, APAC and North America say their interest in sustainable real assets is driven by investment opportunity and the desire for risk mitigation, outweighing those prioritising ESG values.

FIGURE 17

Approach to ESG/sustainability within real assets



Combining returns with sustainability

When assessing the most salient features to consider when investing in sustainable real assets, our survey group highlighted the opportunities to generate financial returns alongside other ESG factors.

This was a key driver identified for 73 per cent of our respondents, ahead of potential to decarbonise (53 per cent) or exclude assets on ethical grounds (51 per cent).

When ranking the factors driving allocations to sustainable real assets, “attractive opportunities” were cited by more than a quarter of those polled (27 per cent). This perceived return potential got greater attention than any other factor, including the need to satisfy external regulatory pressures (nine per cent overall).

The focus on financial return was most evident in North America where 64 per cent see it as the primary appeal of sustainable real assets. It combined with lower interest in exclusion strategies than in any other region (13 per cent, versus 19 per cent in Europe) and low interest in creating social value (four per cent, versus 11 per cent in APAC). Decarbonisation also ranked as a lower priority (13 per cent) than in APAC (21 per cent) or Europe (19 per cent).

64%

of North American respondents see strategies that prioritise financial returns while integrating a wide range of ESG factors as the most appealing category

Identifying the most sought-after sustainable real asset investments

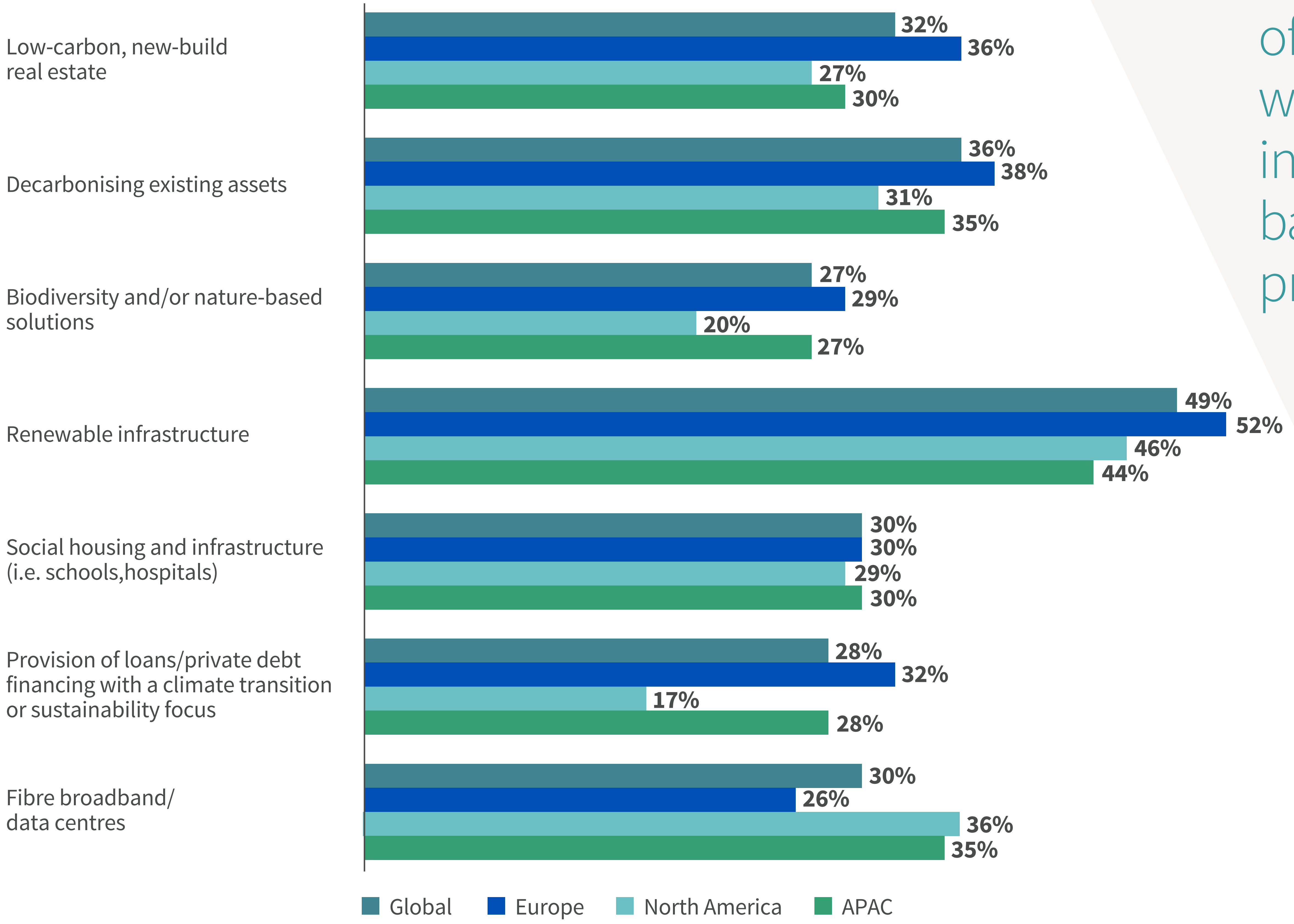
Our attempt to identify the most sought-after types of sustainable real assets delivered an important conclusion – interest is broad. Overall, those signalling they could be potential buyers of sustainable real assets significantly outweigh those seeking to trim back.

When we asked where respondents "had exposure but planned to raise it", the response was overwhelmingly positive across the global cohort. Between one quarter and one half of all respondents were looking to add. Renewable infrastructure (49 per cent already had exposure and were looking to increase it), decarbonising existing assets (36 per cent), low-carbon new-build real estate (32 per cent), social housing and infrastructure such as schools and hospitals (30 per cent), fibre broadband/ data centres (30 per cent), private debt financing with a sustainability or renewable focus (28 per cent) and nature-based solutions (27 per cent) all feature in this group.

Alongside these stakeholders sits another group who are yet to invest but are considering doing so. Interestingly, the nascent area of nature-based solutions saw the highest score in this area (25 per cent), followed by private debt financing with a sustainability or renewable focus (23 per cent).

FIGURE 18A

Existing asset holders planning to increase exposure



Up to **53%** of all respondents were looking to increase exposure, based on return prospects

FIGURE 18B

No exposure, contemplating investment

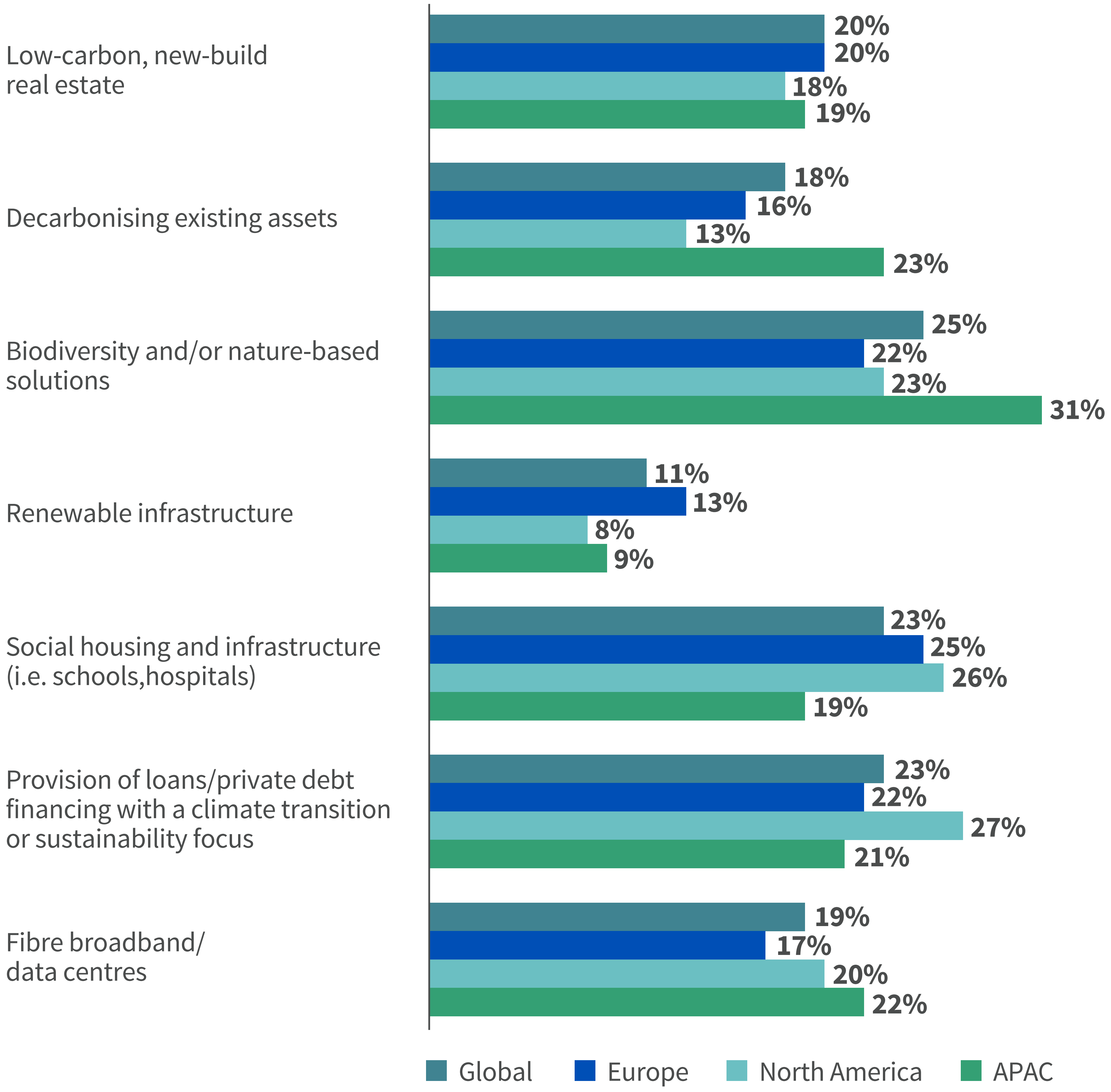
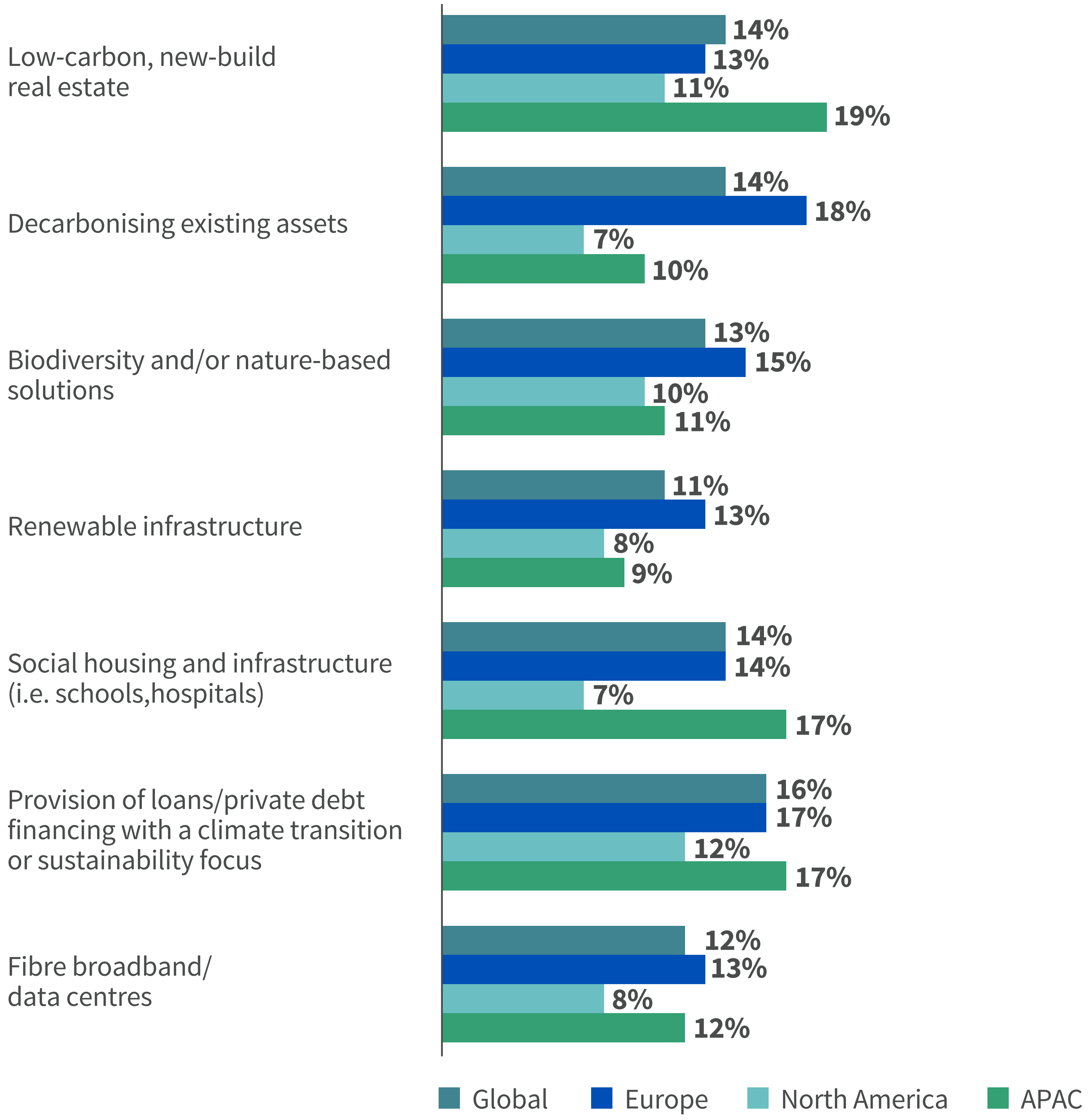


FIGURE 18C

Plan to trim exposure to sustainable real assets



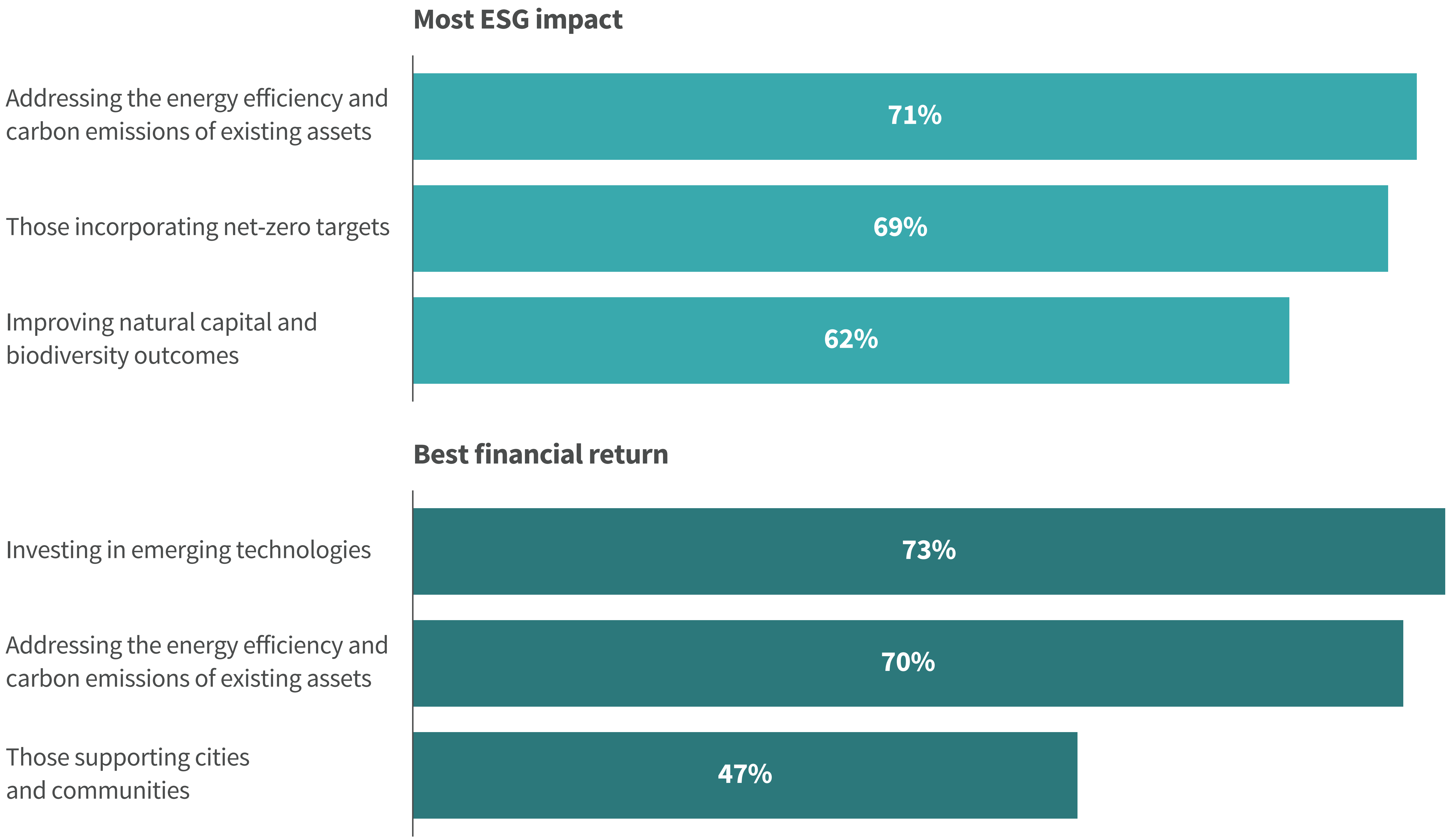
Insights into return expectations and impact

Investors have different objectives they are seeking to achieve from their real assets. For those wanting to optimise ESG impact, the most popular theme cited was decarbonisation, via assets that might help address energy efficiency and carbon emissions (flagged by 71 per cent of respondents) or meet net-zero targets (69 per cent). Improving the state of natural capital and biodiversity outcomes also gathered wide support (62 per cent) from an impact perspective.

Through a return lens, respondents expect to achieve the highest financial rewards from investing in emerging technologies, a view supported by 73 per cent of our global survey group. Return expectations are also overwhelmingly positive around energy efficiency and decarbonisation, and supported widely (by more than two thirds of respondents) across all regions. Interest in the return potential of assets supporting cities and communities was also cited, and particularly high in APAC (50 per cent).

FIGURE 19

Which themes do you see as providing the most ESG impact and the best financial returns (select the top three)?



Commitments to net zero

In spite of the positive return expectations around energy efficiency and decarbonisation set out above, more than half the respondents in our wider survey group (53 per cent) said they were "not confident at all" or "somewhat unsure" of the actions needed to meet their long-term sustainability commitments.

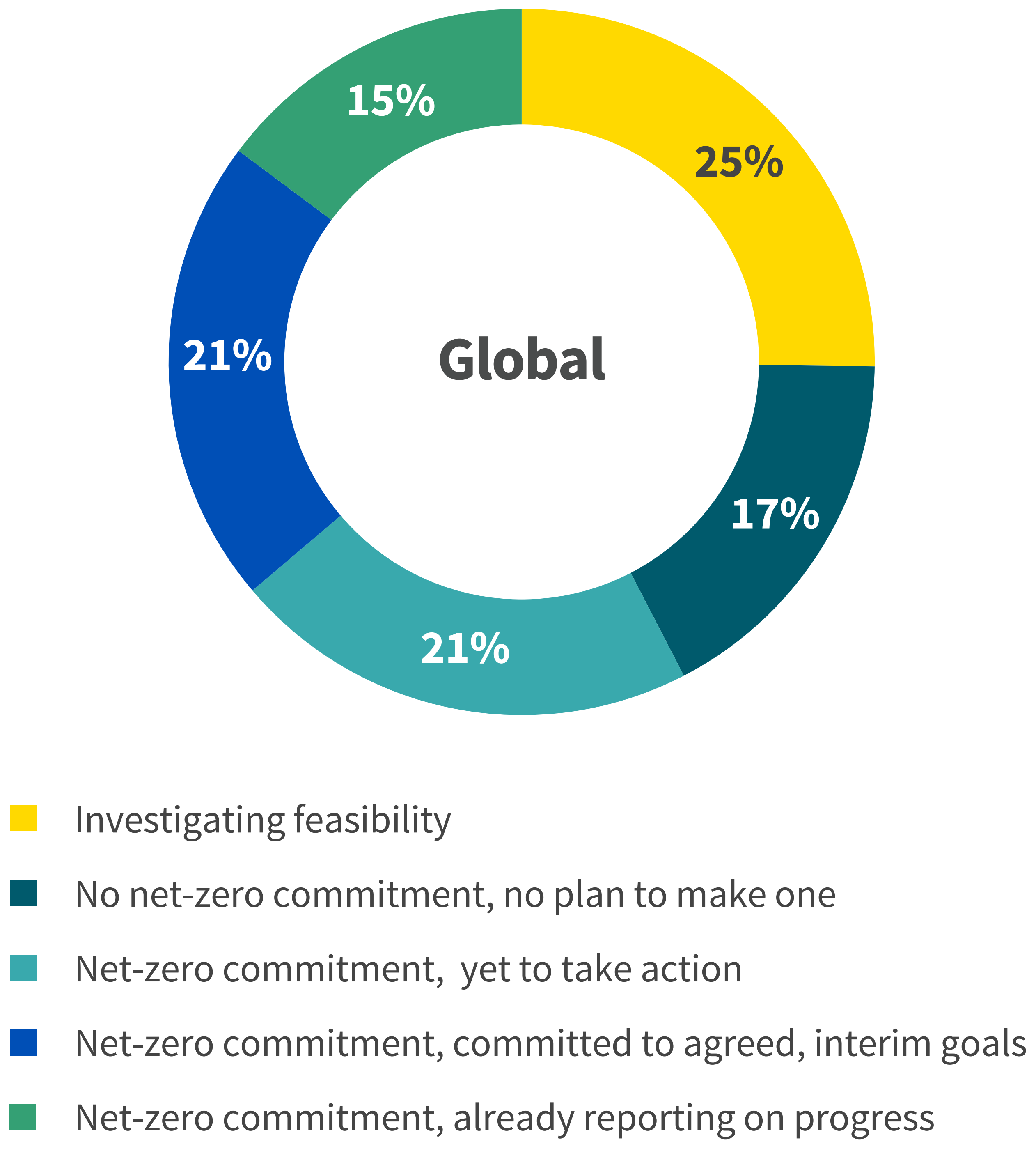
Appetite to take on the decarbonisation challenge is mixed. Among the wider group, 17 per cent say they have no plans in place for a net-zero commitment and no intention of formulating them. This group is dominated by respondents from North America (32 per cent).

Others say they are still at the scoping stage (APAC – 37 per cent, North America – 33 per cent, Europe – 16 per cent), trying to assess how feasible explicit carbon commitments are.

What is clear is that further work is needed to define net-zero policies and develop the processes linking ESG aspirations with real asset allocations and net-zero goals.

FIGURE 20

Net-zero appetite and aspiration



Most appealing asset types for impact

To gain more insight into appetite for sustainable investing, we asked our survey group to rank real assets according to their ESG impact. Climate-transition aligned investments in real estate and infrastructure topped the list (24 per cent), followed by social infrastructure projects in healthcare and education (19 per cent) and social housing (17 per cent).

Using weighted scoring to identify top preferences reinforced those themes: clear tilts emerged towards social infrastructure (57 per cent), climate-transition aligned opportunities (55 per cent) and urban regeneration infrastructure (50 per cent).

Appetite for social infrastructure (health and education) assets was evident in all regions including North America (62 per cent versus 58 per cent in APAC and 54 per cent in Europe). These results do not appear to fit with poll results suggesting creating social value is not a priority for North American respondents. This may be a question of framing: assets supporting the delivery of health and education services may primarily be viewed through a financial return rather than social impact lens. Certain assets could deliver on both counts.

FIGURE 21

Ranking most appealing real asset investments for impact

Preferences across global sample

Climate-transition aligned investments in real estate and infrastructure	**24%**
Social infrastructure (investments in health and education)	**19%**
Social housing/affordable housing schemes	**18%**
Urban regeneration infrastructure	**13%**
Nature-based solutions	**12%**
Urban regeneration real estate	**10%**
Improving broadband access in small urban centres/rural areas	**4%**

Strong interest in renewable infrastructure

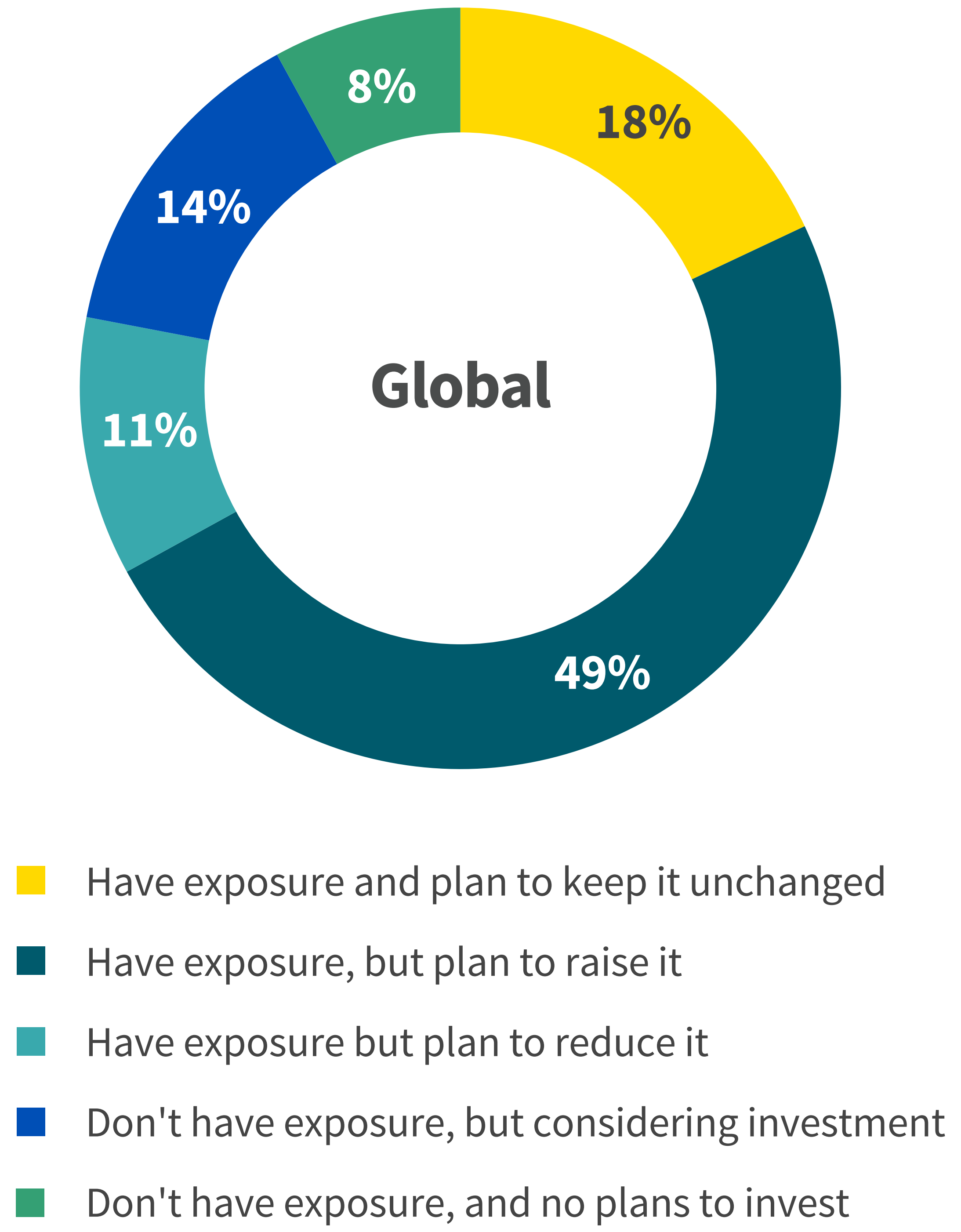
Appetite to invest in renewable infrastructure shows no signs of diminishing. Over half of European respondents have already invested in these assets and are seeking to increase exposure, along with 46 per cent of respondents in North America and 44 per cent in APAC.

The cluster of potential investors on the sidelines without exposure considering allocations is also considerable (North America – 17 per cent, Europe – 14 per cent, APAC – 13 per cent). These potential buyers far outweigh those who revealed plans to trim back their holdings (11 per cent overall).

There is a small group with no renewable infrastructure exposure and no plans to invest, making up just eight per cent of the global survey group.

FIGURE 22

Intentions to change allocations to renewable infrastructure



53%

of European respondents have already invested and are seeking to increase exposure

Prioritising nature and nature-recovery

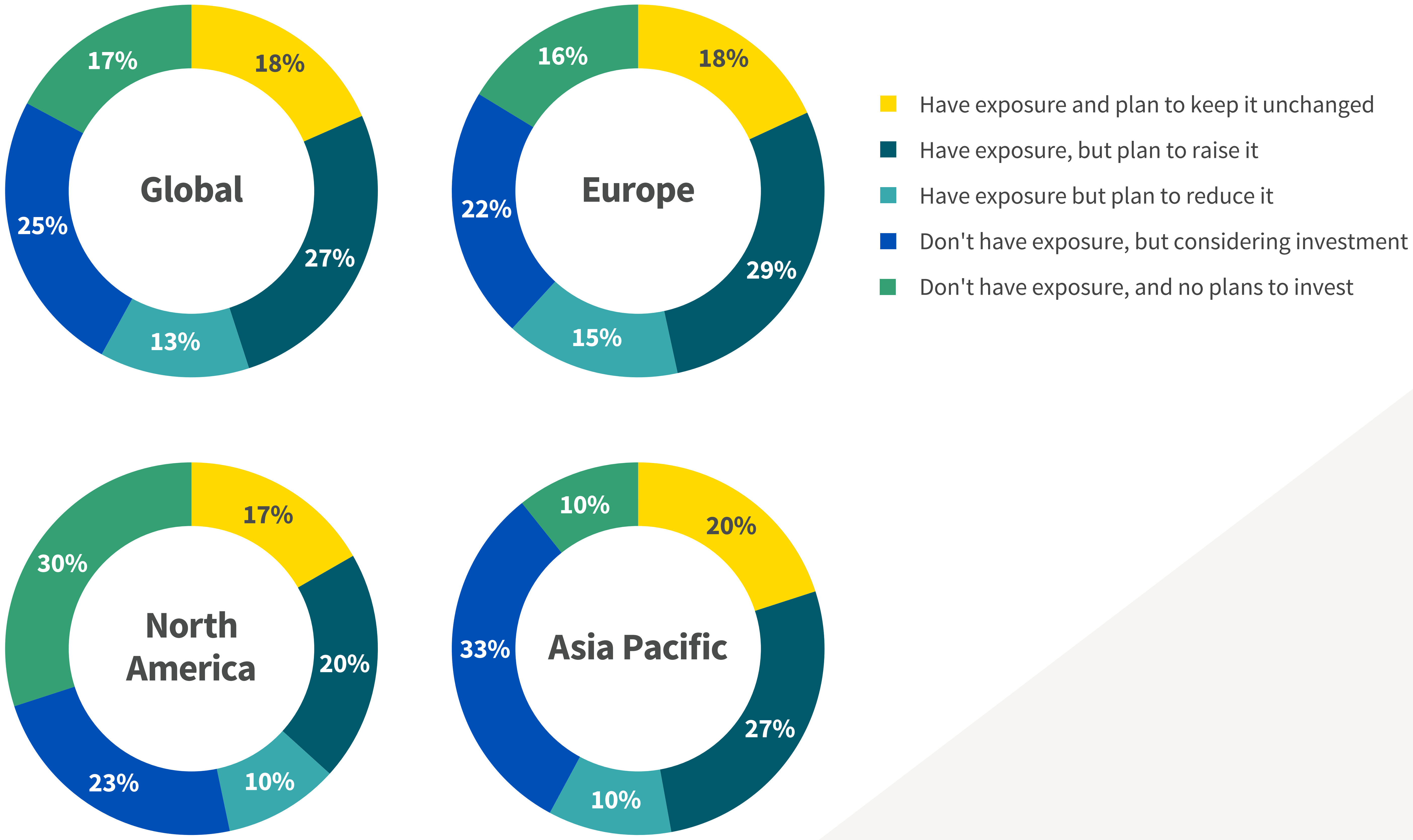
Our polling highlighted growing interest among investors in nature-based solutions such as forestry and biodiversity enhancement, albeit this interest is emerging from a low base. Today's allocations to nature-based solutions are small, but this conceals existing allocations.

Very few respondents (three per cent) listed nature-based solutions as the most appealing sustainable real assets they can access now. The lack of familiarity with this part of the market may also explain why return expectations appear particularly muted relative to other asset classes.

Nevertheless, interest is growing in all regions. More than half of respondents (58 per cent) have some exposure to nature-based solutions or biodiversity. Twenty-seven per cent of existing asset holders plan to increase their exposure, led by respondents in Europe (29 per cent) and APAC (27 per cent). Another 24 per cent do not have any exposure at present but are considering it. Thirteen per cent are contemplating reductions.

FIGURE 23

Intentions to increase exposure to nature-based solutions and/or biodiversity



Identifying material risks

The most cited risk in investing in sustainable real assets was difficulty measuring or evidencing positive impact (47 per cent overall). That concern was most strongly expressed by North American respondents (52 per cent), who also expressed discomfort about potentially misleading environmental or sustainable claims (52 per cent).

Investors in APAC (54 per cent) also flagged concerns about greenwashing. The concern from Europe was lower (46 per cent) but still notable.

Another risk factor highlighted was the scope for unsatisfactory performance of sustainable real assets. Respondents in all regions flagged this (53 per cent in the US, 46 per cent in APAC, 36 per cent in Europe), along with high valuations (43 per cent in North America, 41 per cent in Europe and APAC).

47%

of global respondents flag the difficulty measuring or evidencing positive impact

Accessing sustainable real assets and ESG process integration

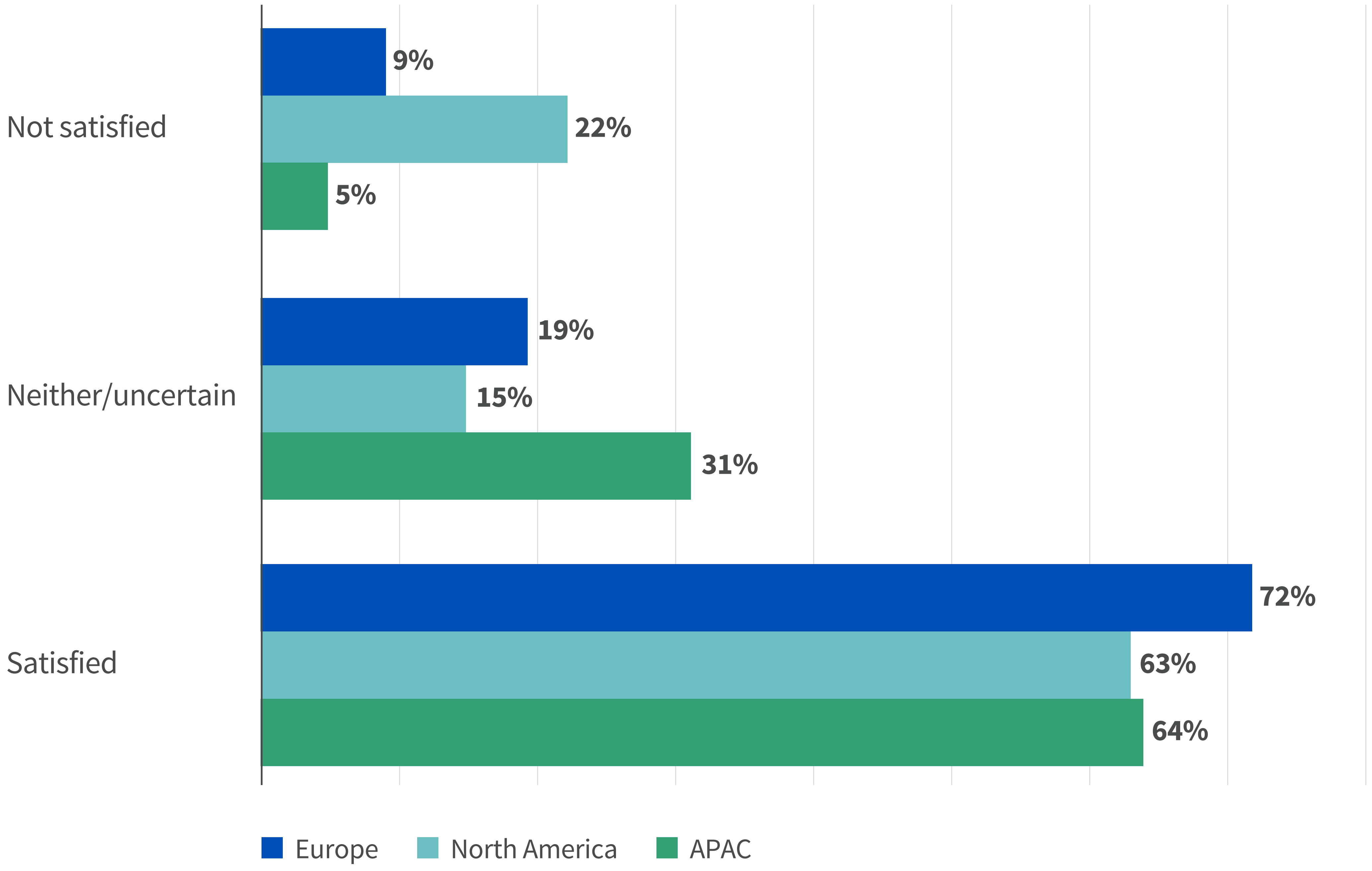
Accessing sustainable real assets is nuanced, and many of the processes and metrics associated with integrating ESG factors into the investment process are still being refined. With that in mind, we used our survey to explore how satisfied investors were with their ability to access assets of interest and how their managers were performing with ESG integration.

Our survey revealed dissatisfaction among investors in their ability to access desirable assets, with limited pathways to invest and high transaction costs.

However, satisfaction with the integration of ESG factors into the investment process was high (69 per cent of the global cohort). The dissatisfied group (nine per cent overall) was concentrated in the US and Canada (22 per cent versus nine per cent in Europe and five per cent in APAC). These findings may indicate opportunities for managers able to deliver the quantitative and qualitative credentials investors are seeking.

FIGURE 24

Satisfaction with ESG integration in the investment process



REAL ASSETS STUDY 2024

Risks and barriers

Risks and barriers

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

Perhaps unsurprisingly given the challenging market environment, investors view various macroeconomic issues as the key risks they face. Persistently high interest rates and the threat of a global recession are uppermost in investors' minds.

Globally, 60 per cent of institutional investors identified high interest rates as being among their top three concerns over the next 12 months, followed by a global recession (51 per cent) and liquidity risks (34 per cent). Political risks and increased market volatility are other factors on investors' minds.

From a regional perspective, worries over interest rates topped the list of investors' concerns in Europe, North America and the APAC region. As for the threat of a global recession, it was most prominent in North America, where 58 per cent of investors cited it as among their top three concerns, compared with 55 per cent in Asia and 47 per cent in Europe.

Among other concerns, political risks were high on the agenda for 35 per cent of investors in Europe, while 47 per cent of investors in North America were worried about liquidity risks. As for the APAC region, the third-biggest risk was market volatility, cited by 35 per cent of investors expressing concern.

58%

of North American investors cited a global recession as one of their top three concerns

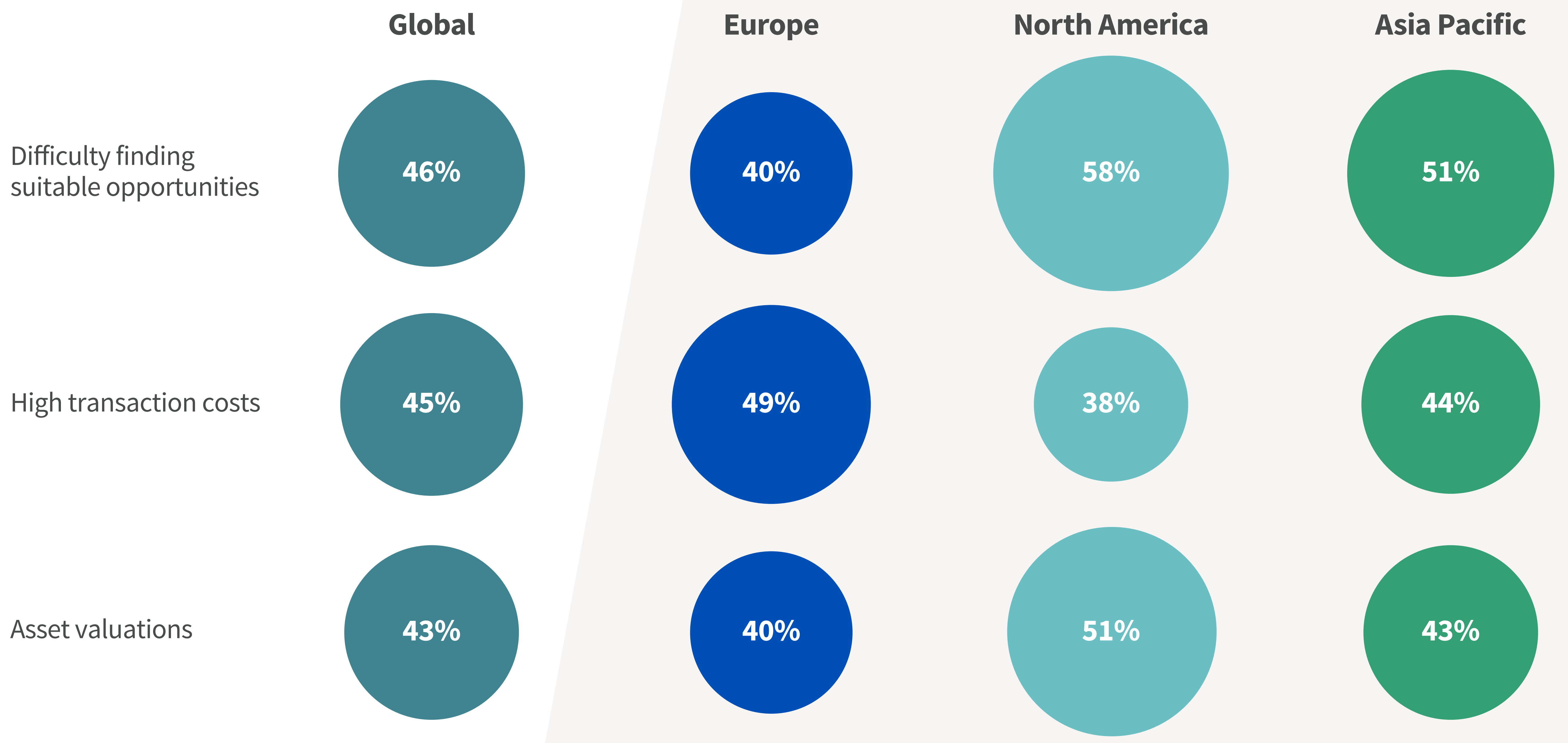
When it comes to what investors perceive to be the biggest barriers to new or additional investment in real assets, 46 per cent of investors globally cited the difficulty in finding suitable opportunities, followed by 45 per cent who are worried about high transaction costs, and 43 per cent who are concerned about valuations.

Other barriers to investment include a perception of better opportunities in public markets (33 per cent), difficulties in benchmarking performance (32 per cent) and regulation (31 per cent).

The data reveals interesting regional nuances. North American investors recorded the highest scores in terms of difficulty in finding suitable opportunities (58 per cent) and asset valuations (51 per cent), but also cited a lack of in-house experience as a significant barrier (30 per cent), a concern shared by the same proportion of Asian investors. For European investors, high transaction costs were cited as the biggest barrier (49 per cent), while they were also the most concerned of this year's cohort over regulation (38 per cent).

FIGURE 25

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



REAL ASSETS STUDY 2024

Survey methodology and organisations covered

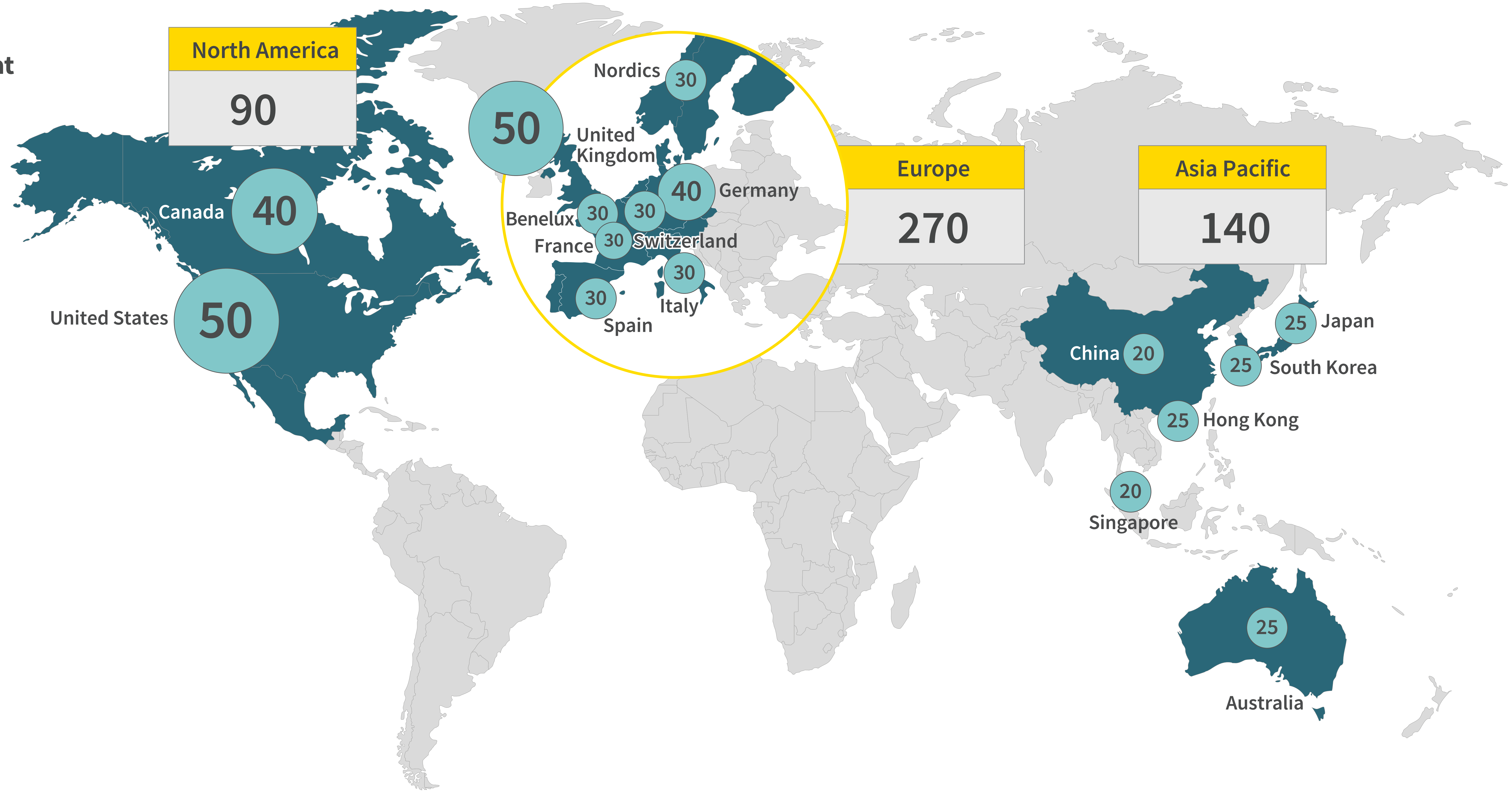
Regional breakdown

This study was conducted by CoreData Research in September and October 2023, which questioned senior decision makers at 500 institutional investors in Europe (270), North America (90) and Asia Pacific (140), with combined assets of US$3.8 trillion.

Questioning

500

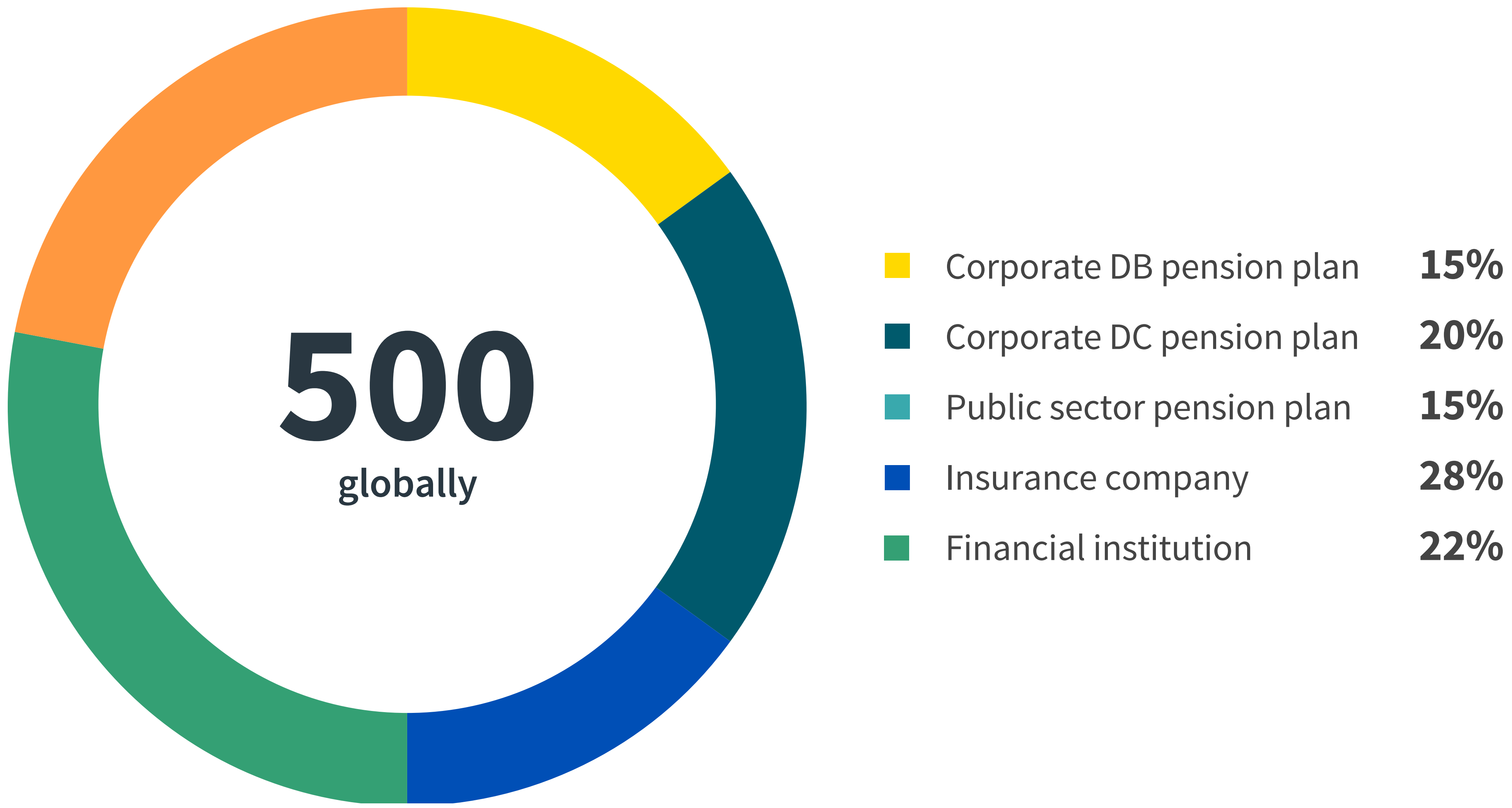
senior decision makers



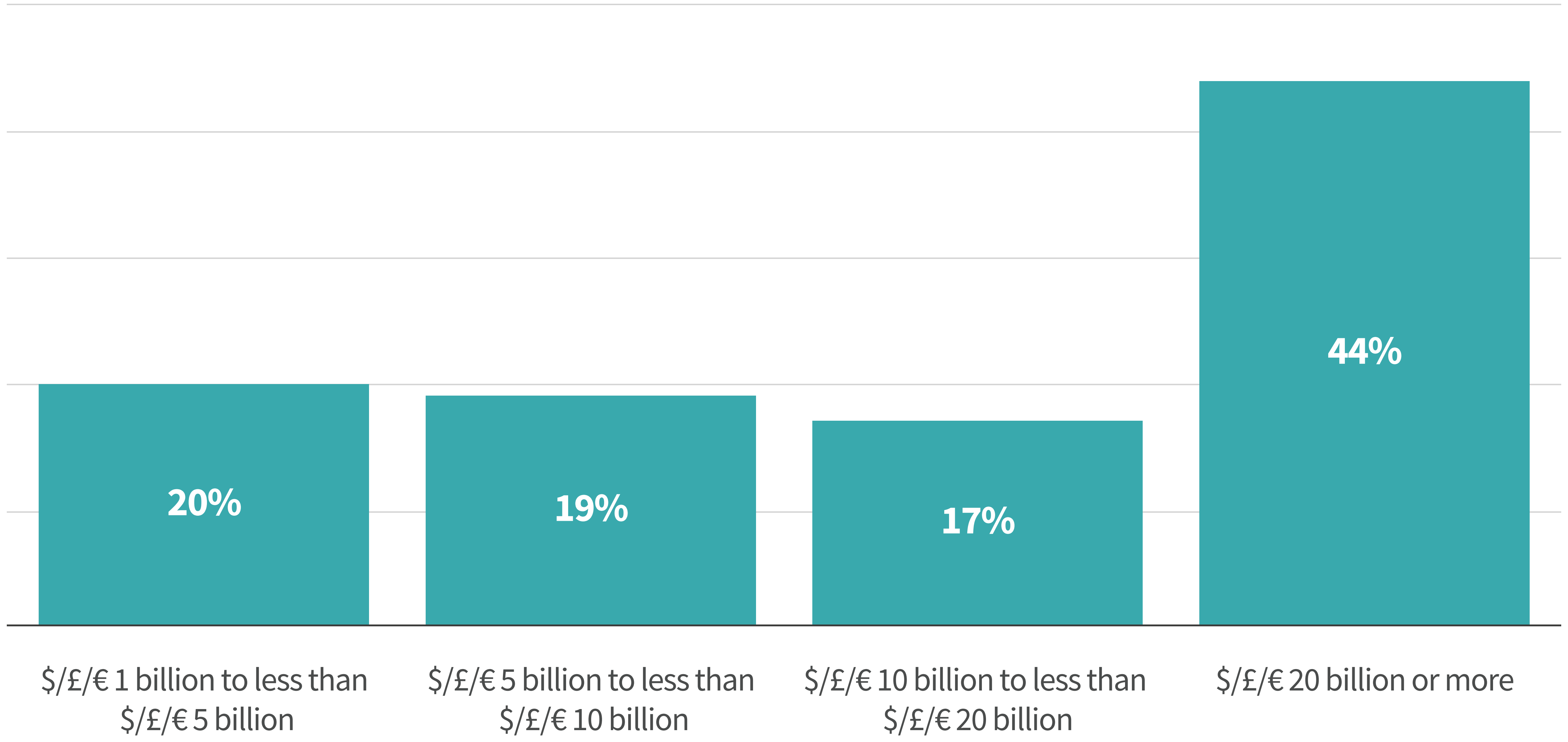
Assets Under Management (AUM)

Institutional type

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



Assets Under Management



Representing over

$3.8tn

AUM globally

Source: CoreData Research, who questioned 500 institutional investors around the world in late September and October 2023.

REAL ASSETS STUDY 2024

Our real assets capabilities

Our real assets capabilities

Real assets play a crucial role in shaping society and economies. As direct investors in real assets, we are committed to delivering an exceptional client experience and building a sustainable world. Our multi-asset mindset, scale and ability to invest with conviction underpins our ambition to be a global leader in sustainable real assets and a trusted partner for our clients.

Our approach to real asset investing

As one of Europe's largest real assets investment managers with over £40 billion in assets under management and 180 specialists across five locations, we have the scale to access the full depth and breadth of real asset markets across real estate, infrastructure, private debt and multi-asset real assets.

Our diverse capabilities enable us to offer investors sustainability-focused solutions aligned to various client outcomes, from capital growth through active equity investments, cashflow matching via debt solutions and bespoke requirements spanning multi-assets. We offer a range of pooled and bespoke solutions, as well as co-investment opportunities.

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

www.avivainvestors.com/contact/

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