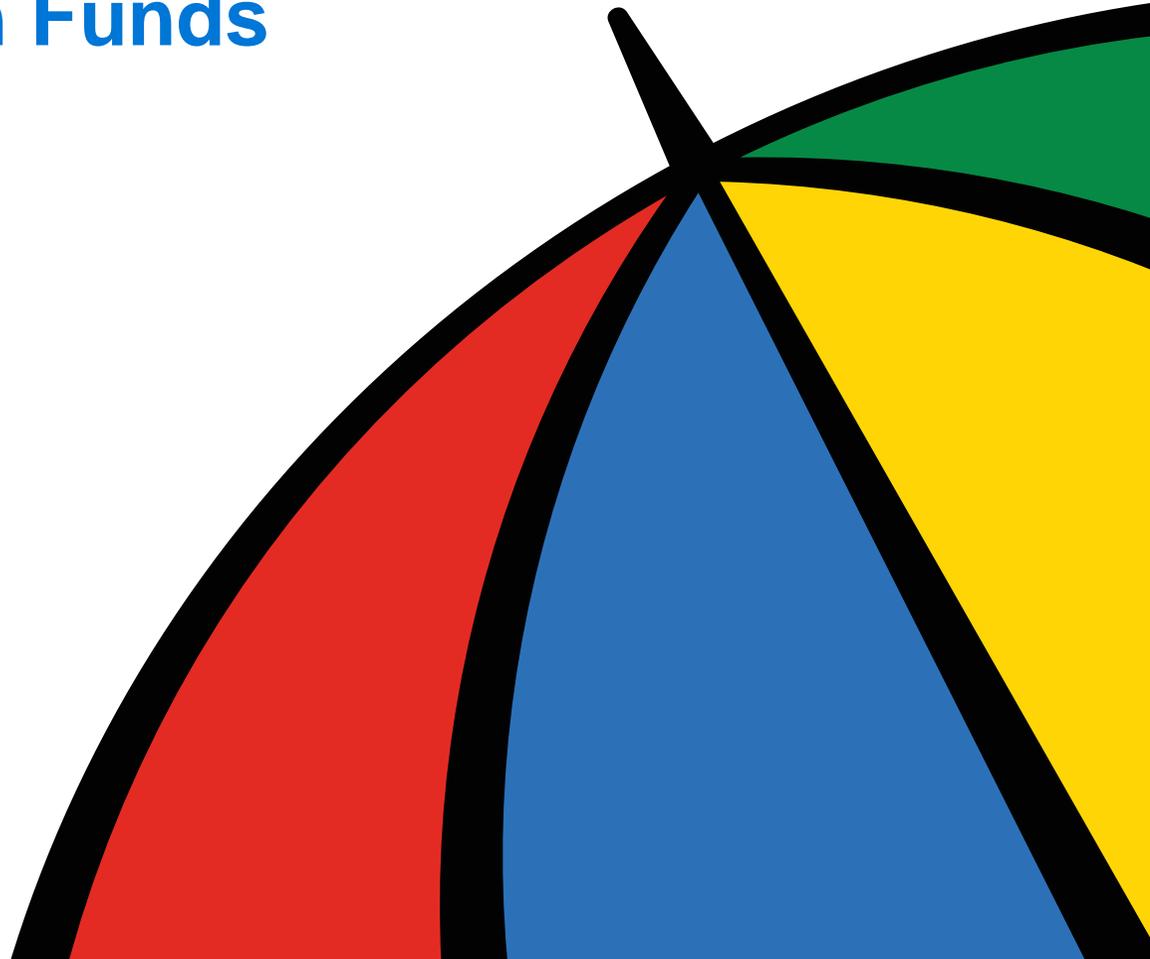


The Changing Role of Real Estate in Pension Funds

14 April 2021

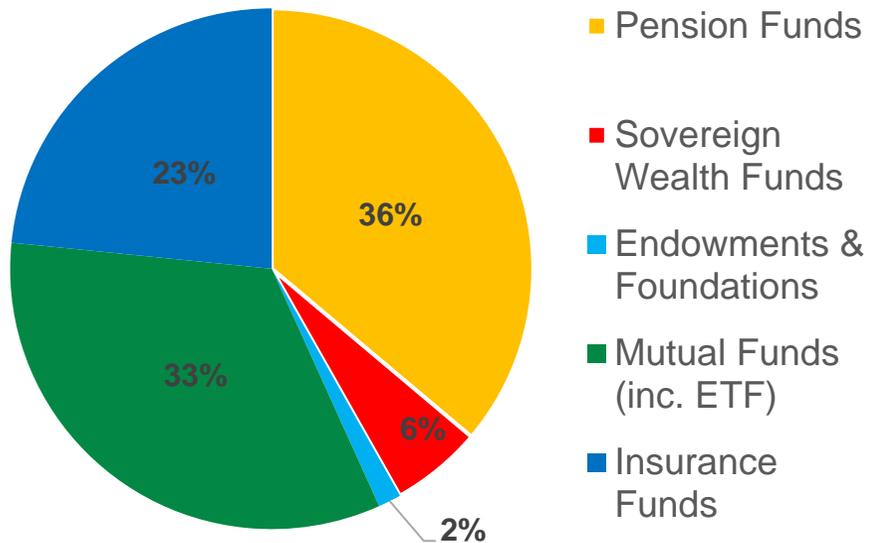
Rob Martin, CFA
Director, Strategy & ESG
LGIM Real Assets



Why do we care about pension funds?

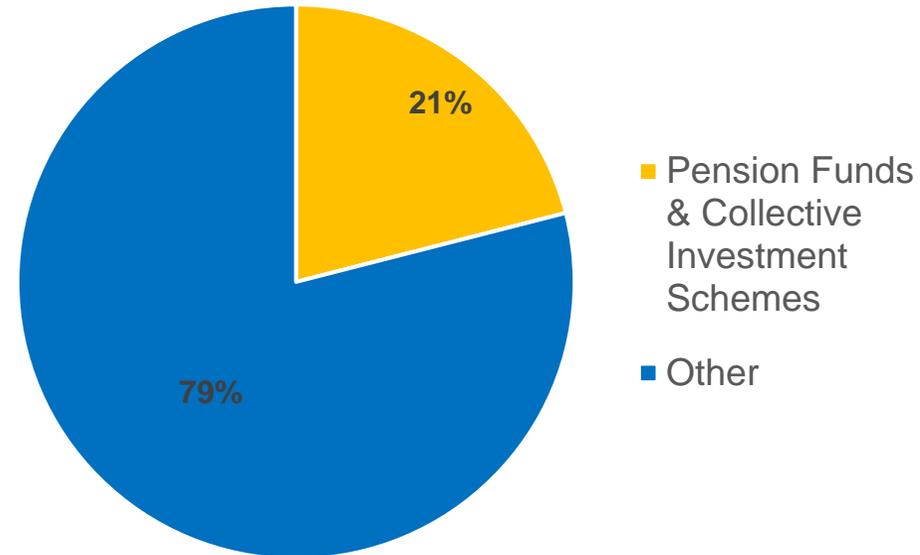
Institutional Assets

Global Institutional AUM - \$140 trillion



UK Commercial Real Estate

Universe size - £951bn



Structural shift from Defined Benefit to Defined Contribution

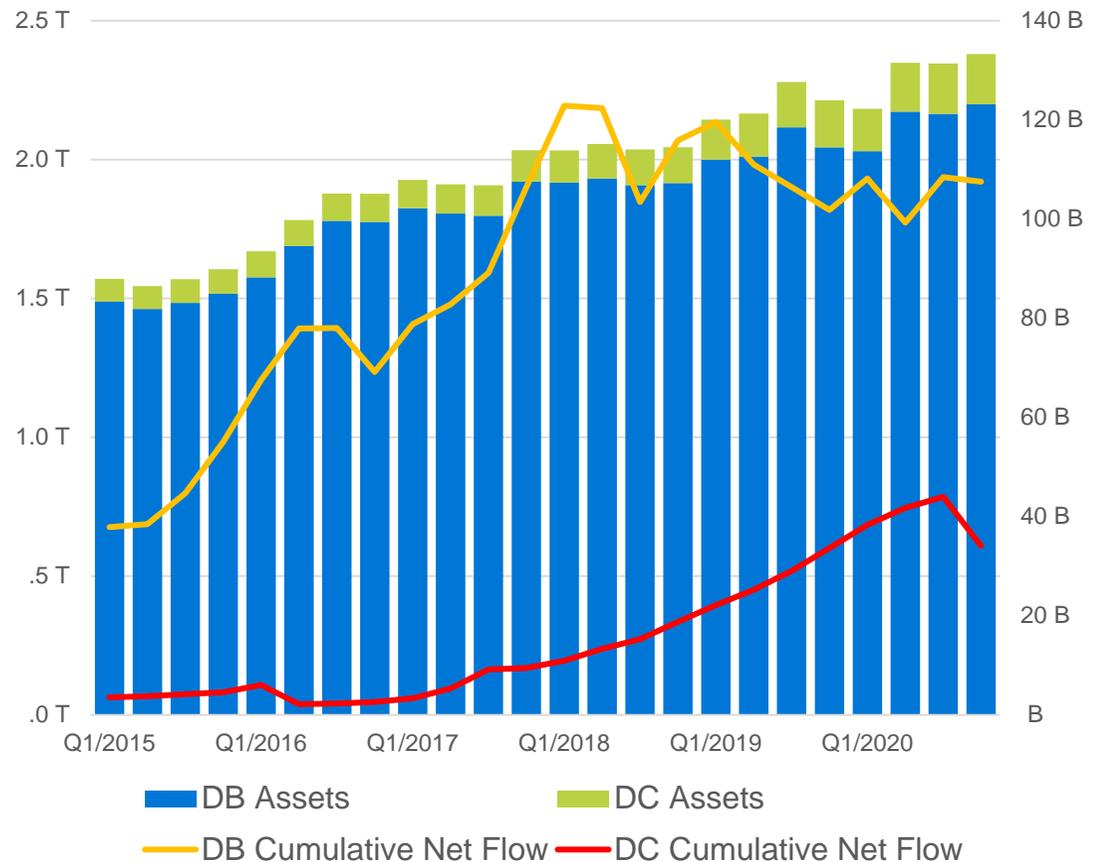
Defined benefit (aka final salary)

- Payouts are based on the number of years worked and final (or average) salary
- Investment risk sits with the employer

Defined contribution

- Savers build up a pot of money over their working lives
- Employers frequently contribute
- Investment risk sits with the individual
- Increasingly the norm...

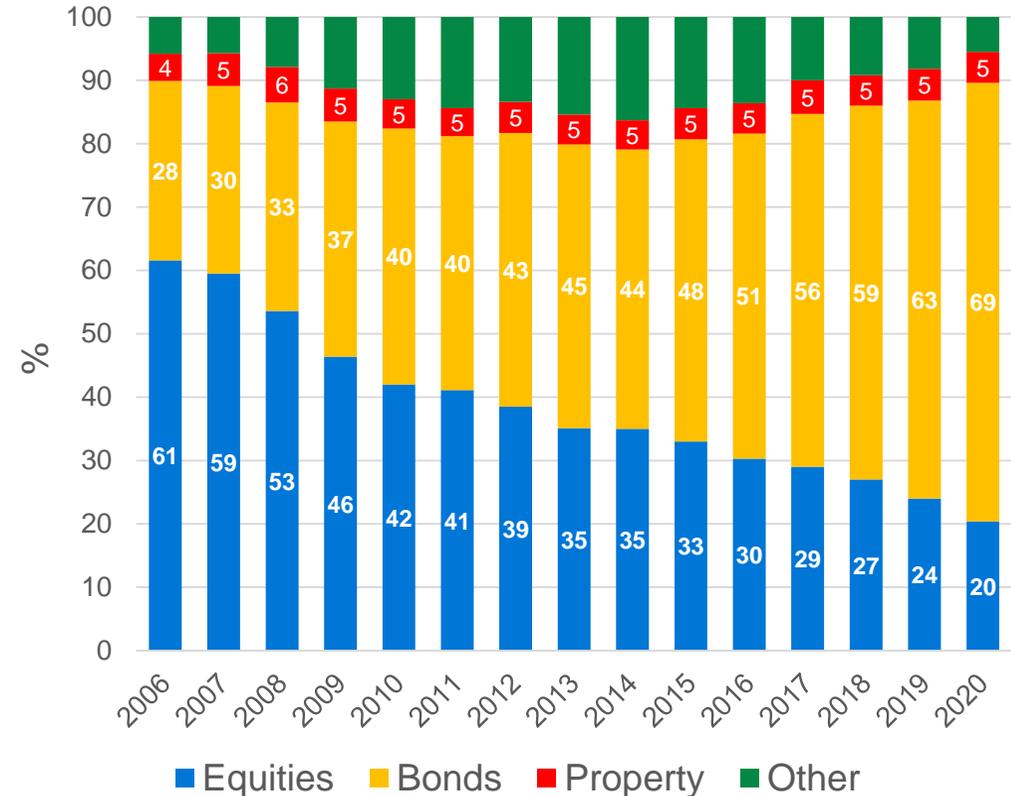
UK Total Pension Assets and Net Flows



DB schemes increasingly focus on income stability

- Most schemes closed to new entrants
- Actuaries calculate expected payouts
- These are increasingly 'certain' (subject to unexpected changes in eg. life expectancy)
- Assets are structured to provide a stream of income to fit liabilities
- Which has driven a massive shift towards bonds and similar assets to deliver highly predictable cashflows

UK DB Pension Fund asset allocation



This has driven the emergence of 'long-income' property

LGIM Limited Price Inflation (LPI) Fund

- Investment objective is to provide an income stream that rises annually in line with RPI (between 0% and 5%)
- 24 year average lease length
- 53% of income from AA or A rated tenants
- Yield on acquisition; +3% vs equivalent index-linked gilts



£1.8bn NAV



24.0 years WAULT to Expiry*



BBB Average credit quality of tenants



3.1% Income Return



94% Of Income RPI Linked



0.0% Void ERV



Source: LGIM Real Assets December 2020. The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

4 | *Minimum 20 year lease on acquisition. A maximum of 5% of Fund Gross Asset Value can be invested in sub investment grade tenants and leases shorter than 20 years WAULT figure assumes break is exercised.

** A maximum of 30% of Fund Gross Asset Value can be invested in AA/AA- public sector credit with 250-300bps > equivalent dated index linked gilt coupons.

Rising flow from DC is both challenge and opportunity...

What they want:

- Low Fees
- Liquidity
- Responsible investing
- Growing demand for ESG and 'impact'

“

With additional growth expected through increased allocations to alternatives over the next 10 years, we expect that alternative managers will see the largest revenue growth ”

Broadridge, 2019, UK DC and Retirement Income

DC assets are an “unstoppable wall of cash” and illiquids are the “hottest topic” on the investment side.

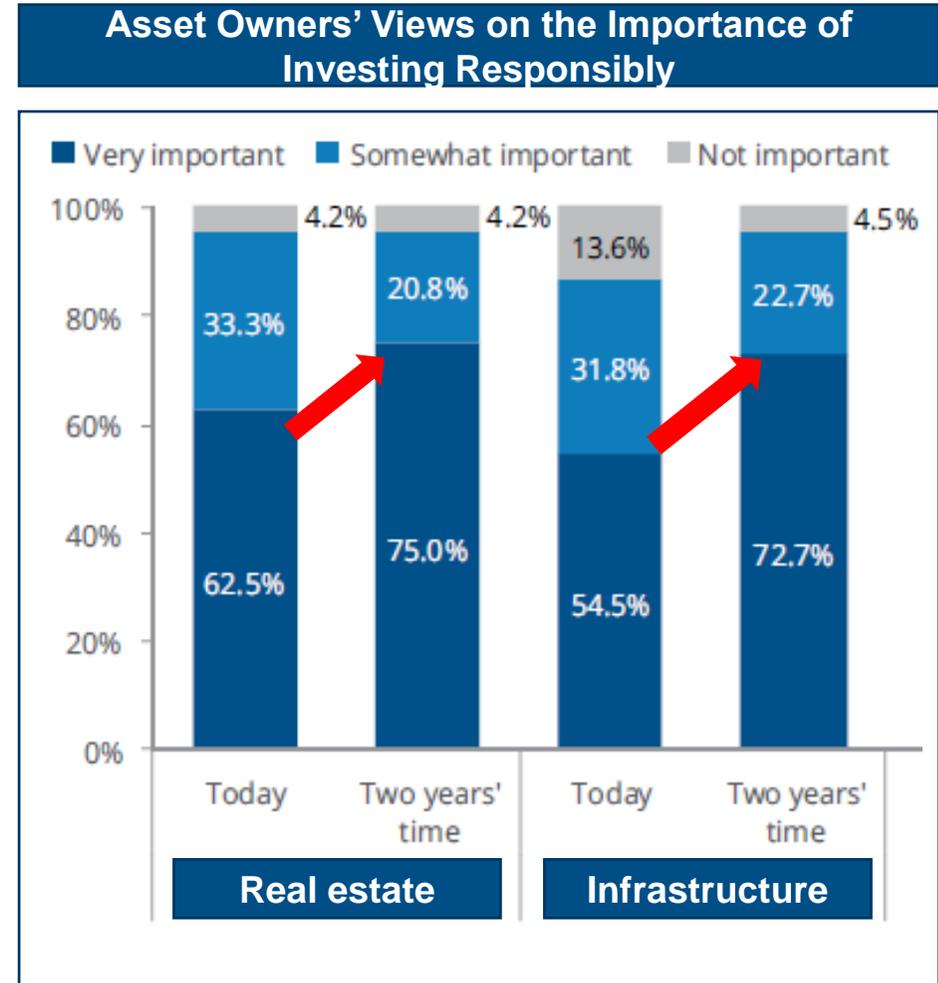
LGIM Solutions

A few implications...

- There is a big shift going on in the ultimate ownership of real estate
- Which is driving some different priorities
- Pension funds are focused on outcomes, not “Retail / Office / Industrial”
- DB is increasingly focused on stability of income rather than maximising returns
- Which has driven the emergence of new market segments
- DC investment is growing rapidly but the illiquidity of real estate is a challenge

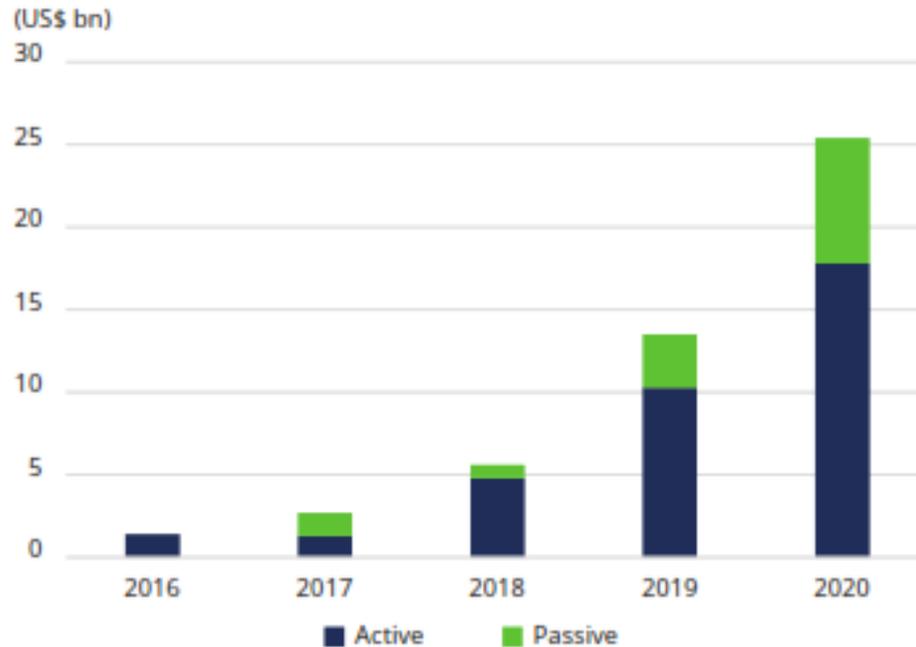
ESG has become a (?the) central topic in professional investing

- Ethics → Responsible Investment
- Management → Stewardship
- Risk → Opportunity
- Niche → Mainstream

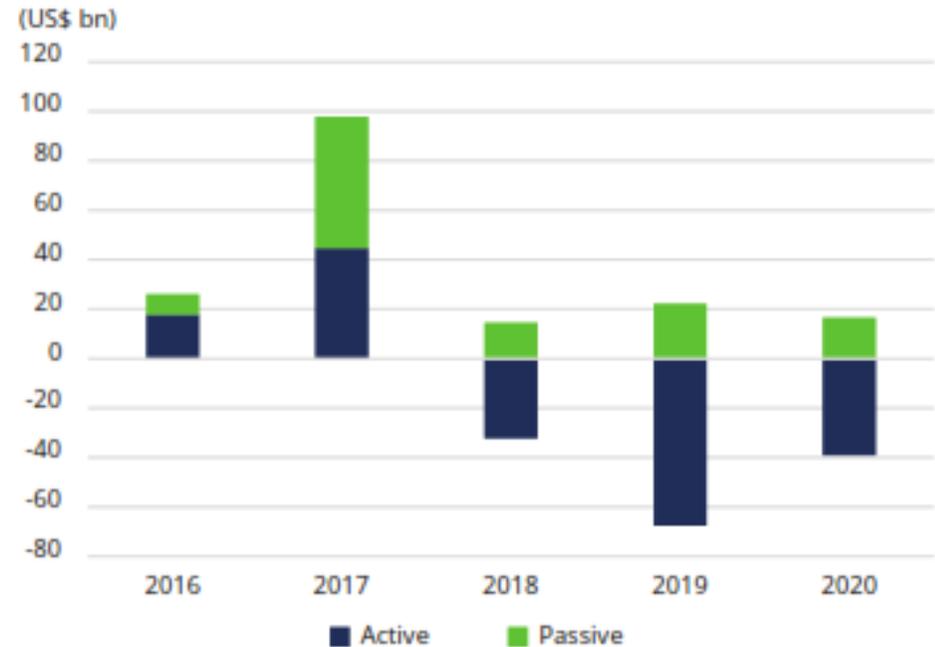


This isn't theory - ESG is driving where capital flows...

Net sales of ESG funds - UK



Net sales of non-ESG funds - UK



Source: Schroders, Broadridge. Data from January 2016 to December 2020. Region defined on the basis of the fund's domicile.

Wave of real estate commitments around Carbon/ Net Zero

Search **Bloomberg**

Markets

Carney Joins Brookfield to Lead Firm's Expansion Into ESG Funds

By Scott Deveau and Jason Kelly
26 August 2020, 13:00 BST

- Former Bank of England governor will be vice chairman of firm
- 'I think we can become a category killer in ESG': CEO Flatt



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NEWS

Macquarie Asset Management net-zero commitment

BY SUSANNA RUST | 9 DECEMBER 2020



Aviva becomes first major insurer to commit to reaching net zero emissions by 2040

Landsec aiming to become net-zero business by 2030, sets 1.5C science-based target

8 November 2019, source [edie newsroom](#)

Commercial real estate firm Landsec has launched an updated sustainability strategy for its carbon emissions, aiming to become a net-zero business by 2030 and reduce its absolute carbon emissions by 70% as part of a 1.5C

9 DECEMBER 2020

Grosvenor launches £90m programme to reduce emissions from historic portfolio

- New Pathway details how the business will become net zero carbon by 2030
- Commitment to a minimum 52% reduction in emissions from 2019 baseline
- £90m ring-fenced to future-proof Mayfair and Belgravia portfolio in addition to initial £25m invested since 2013

Derwent London sets out carbon plans

By Riya Makwana | Tue 28 July 2020

Derwent London has revealed its net-zero pathway following its commitment to become a net-zero carbon business by 2030.

Net Zero Carbon by 2040

It is wide building

M&G pledges to terminate coal-powered portfolios by 2040

Joins Powering Past Coal Alliance

It's not only about climate...

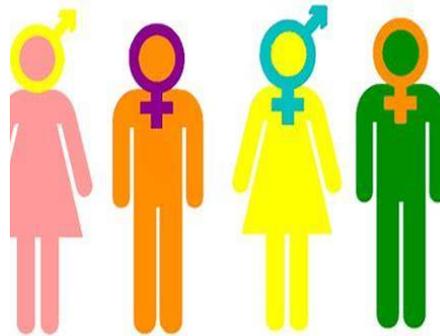
Social impact

COVID-19 has pushed "S" into the spotlight by highlighting a range of societal challenges, **increasing demand for more social impact** and supporting a Just Transition



Gender, diversity & inclusion

A number of high profile events over the last couple of years have accelerated **importance of gender, diversity and inclusion**

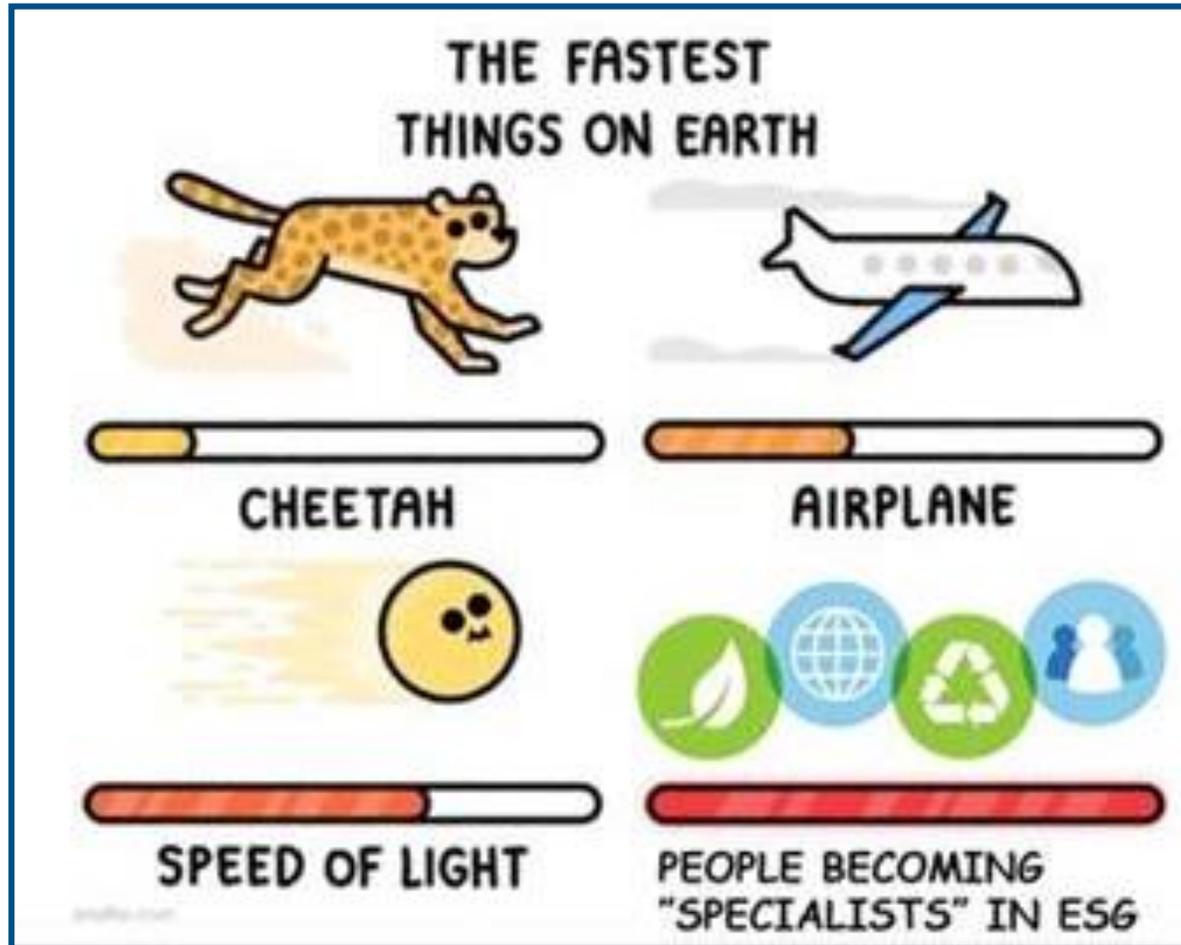


Biodiversity

Biodiversity and nature-based solutions are gaining momentum, including the launch of the Taskforce on Nature-based Financial Disclosures (TFND)



Increasing focus on combating greenwashing...



What does that mean for you?

Strategy

- Consideration of ESG factors / risk management is now assumed
- More ambitious targets emerging

Measurement & disclosure

- Clients and regulators are driving demand for facts
- Carbon has become a new currency
- But it will go wider e.g. (bio)-diversity

Knowledge building

- Concepts / terminology are still a mystery to many
- Key issue is relating to different specialist roles
- Opportunity to differentiate !

