

Preqin Research Report Infrastructure Investor Survey

August 2010



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The global financial crisis ended the sustained period of growth experienced by the unlisted infrastructure industry in the years leading up to 2008. Fundraising slowed due to increased investor caution and deal flow suffered as a result of the decline in the availability of the debt financing. In 2009, infrastructure fundraising fell to its lowest level since 2005, with only 17 funds closing raising just \$7.8bn.

The infrastructure fundraising market remains both challenging and competitive, but as the economy starts to recover there are signs that investor confidence is starting to return. By June 2010, fundraising in the sector had already eclipsed the 2009 total, with \$12.6bn being raised by 11 unlisted infrastructure funds in the first half of the year.

In June 2010, Preqin surveyed institutional infrastructure investors from around the world to find out more about investor sentiment towards the key issues facing the infrastructure asset class. Respondents completed a survey covering the following areas:

- The alignment of investor and fund manager interests
- The areas in which alignment of interests can be improved
- The long-term future of the private equity fund model in the infrastructure asset class
- Infrastructure investment plans over the next 12 months

- The key issues facing the infrastructure industry at present
- The regions infrastructure investors feel provide attractive investment opportunities

The survey consisted of multiple choice questions and respondents were invited to raise and/or comment further on issues they felt were particularly important.

In the section that follows, the survey results are analysed in-depth and, where appropriate, compared with the results of a similar survey conducted in October 2009.

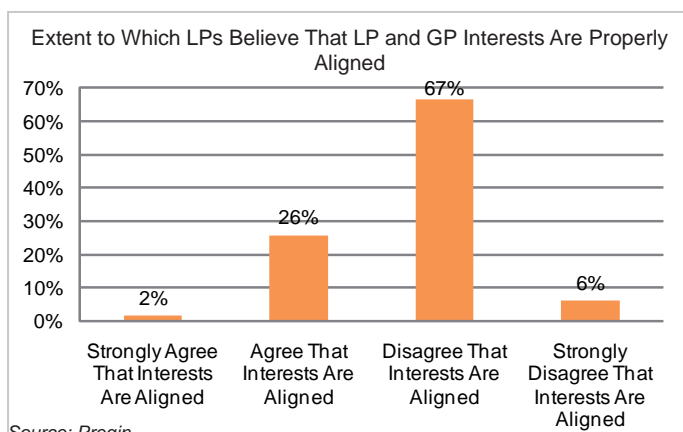
Extent to Which Investors Believe That LP and GP Interests Are Properly Aligned

Almost 75% of investors surveyed disagree or strongly disagree that the interests of investors and fund managers are properly aligned, as shown in Fig. 1. A number of the sample commented that the existing private equity fund structure is not suitable for infrastructure investment due to the inherent differences in the risk/return profiles of the asset classes. One investor stated: "There is too much reliance on the private equity fund model, essentially the 2 and 20 structure," while another claimed: "I believe [interests] are trending in the right direction, but most are still trying to apply the private equity model, which may not work for core and core-plus type infrastructure investments."

However, just over a quarter of those questioned believe interests are aligned. One respondent commented: "In Australia they are. The market mainly consists of fund managers running open-ended infrastructure funds rather than closed-ended private equity-style funds." This statement reflects the notion that other fund structures, such as open-ended vehicles or evergreen funds, may be better suited to infrastructure investment than the private equity fund model.

Although the majority of investors believe interests are not aligned, many stated that this is dependent on the policies of the fund manager. As one investor claimed, "The question cannot be answered sensibly as it depends on the individual fund."

Fig. 1:



Source: Preqin

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Areas in Which Investors Believe That Alignment of Interests Can Be Improved

Specific areas in which investors believe interests need improving are shown in Fig. 2. Respondents were able to select multiple fields. The level of management fee charged and carry structures were the most popular areas in which investors believe investor and fund manager interests need to be better aligned, with 72% of investors citing each issue as a problem. 53% of investors take issue with having to pay fees on capital that has not yet been invested, while 45% think fund managers need to address their level of commitment to their own funds. 25% of investors surveyed believe there needs to be greater interaction between investors and fund managers when making investment decisions.

Again, reliance on the private equity fund structure was cited as a reason for misalignment of interests. One respondent reflected concerns that the long-term characteristics of infrastructure investment do not match the ten-year term of a traditional private equity fund, saying: "There is tension between the long-lived nature of infrastructure assets and the shorter-term focus of private equity funds, which call for shorter holding periods, realizations and distributions of capital, profits and carry." Another commented: "The fee structure is set up for an asset class capable of returning 20%, but expected [infrastructure] returns are much lower than that."

One investor suggested that the real estate fund structure is a more appropriate model for infrastructure, stating: "Management fees should likely resemble what is seen in real estate as you move from core to opportunistic infrastructure. For core investments, the hurdle rate should be a moving target (i.e. real return or premium over LIBOR)."

Other investors suggested that fund managers should be less reliant on management fees for their income, and that total fees earned by managers should better reflect the level of returns received by investors. One respondent stated: "It is simple. Managers should earn significant money (above cost recovery) only when investors earn decent returns."

Investor Views on the Long-Term Viability of the Private Equity Fund Model for Infrastructure Investment

The use of the traditional private equity fund model in infrastructure investment is a heatedly debated topic. Consequently, respondents were asked whether the model has a long-term future in the infrastructure asset class, and the results are shown in Fig. 3. Investors that do not believe the private equity model has a long-term future in the infrastructure sector were able to choose from a number of alternative funding structures.

Fig. 2:

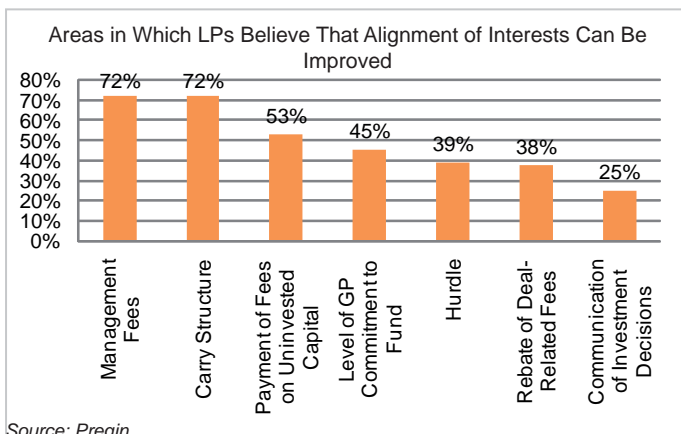
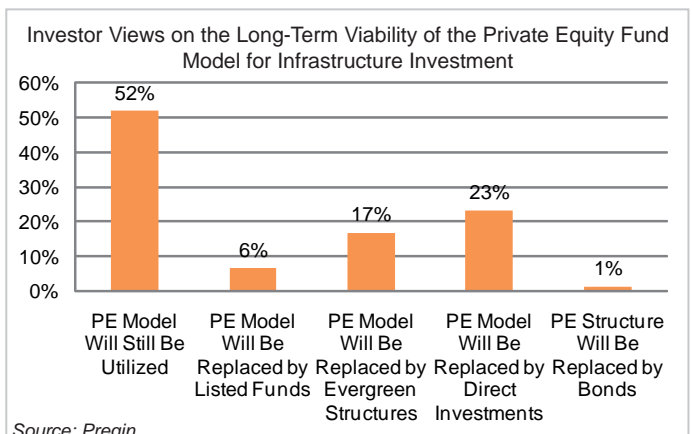


Fig. 3:



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Over 50% of investors surveyed believe that the private equity model will still be utilized going forward, although this is dependent on the resolution of other issues already raised such as fund structures and fees. Of those investors that believe the private equity fund structure will not be used in the future, almost half think that it will be replaced by direct investment, although this will limit the level of exposure smaller investors are able to gain to infrastructure assets.

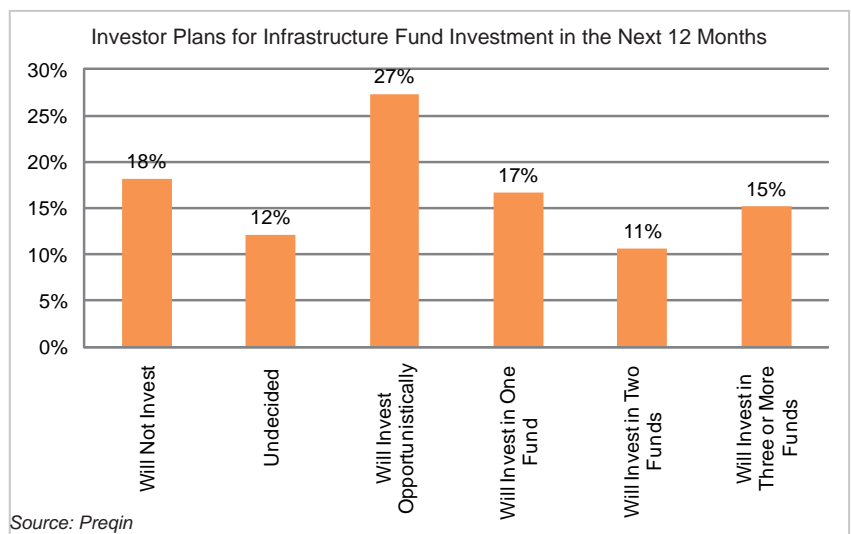
Respondents discussing the topic raised similar points. One investor believes that the fund model used will depend on the type of infrastructure fund being raised, stating: "I do [believe the private equity model has a long-term future in the asset class] but core strategies might be best accessed through open-ended funds, while opportunistic infrastructure might be best in a private equity structure. Direct investments are the best way to access the asset class, but are not a viable option for the majority of investors."

Another interviewee suggested that fund structures could be tailored to individual investors in the future, saying: "More customized structures for smaller groups of investors may be a likely avenue, including some advanced structures for public-private partnerships."

A third investor believes that a variety of fund models will be used in the infrastructure sector going forward, suggesting: "We believe a combination of closed-end structures, direct investment and cost-efficient core funds will exist in parallel."

On the whole, investors believe that the private equity model will continue to be used but must be adapted to fit the needs and demands of both fund managers and investors, taking into account the longer-term nature of infrastructure investment compared to the relatively short-term private equity model.

Fig. 4:



Investor Plans for Infrastructure Fund Investment in the Next 12 Months

As shown in Fig. 4, 70% of investors surveyed plan to invest in infrastructure funds in the coming 12 months. This is compared to just 40% of investors that stated they planned to make investments in infrastructure funds in our October 2009 survey, and shows that investor confidence is slowly returning following the financial crisis, with many investors looking to increase their exposure in the coming 12 months.

The largest proportion of investors (27%) stated that they plan to invest opportunistically in the asset class, while just over a quarter have plans to invest in two or more funds. More investors plan to make multiple commitments than those who plan to make a single investment in the coming year. 18% of investors do not plan to commit to infrastructure funds over the next 12 months, down from 29% in October 2009, while a further 12% remain undecided.

Discussing their investment plans, most respondents indicated that they will be flexible with regard to the number of funds they

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will commit to and the amount of capital they will invest. One said: "We will look at anything that seems interesting."

These figures are positive and suggest that investors are beginning to return to market following the financial downturn. However, investors are likely to be much more selective when making fund commitments in the future, meaning fund managers will need to work hard to attract capital. This also means fundraising is likely to remain tough in the coming 12 months when compared to pre-crisis figures.

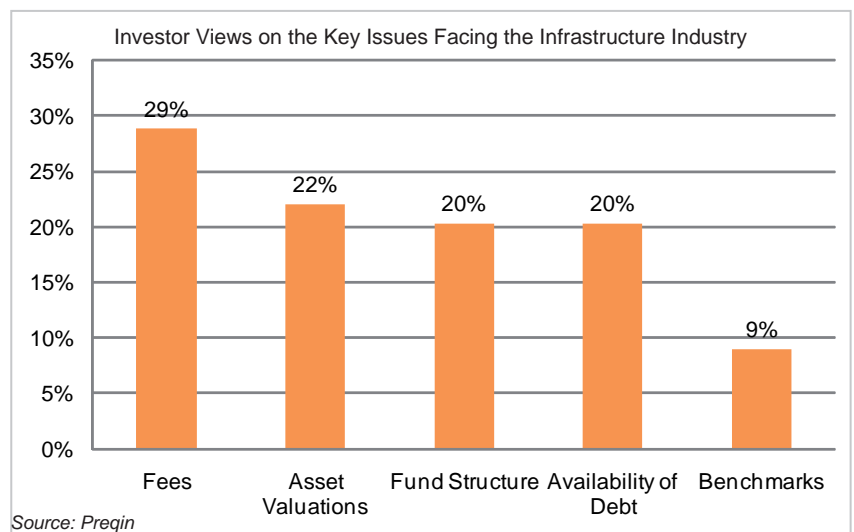
Investor Views on the Key Issues Facing the Infrastructure Industry

Investors were asked for their opinions on the biggest issue facing the infrastructure industry at present. The results were categorized and are illustrated in Fig. 5.

The highest proportion of surveyed investors (29%) are most concerned about fees, although fund structure, asset valuations and the availability of debt were each highlighted as important issues that need to be resolved. According to investors, the least pressing issue within the industry is performance benchmarks, with only 9% of respondents rating this as a key issue. This issue is relatively unavoidable due to the relative youth of the unlisted infrastructure market.

The availability of debt featured prominently in the October 2009 investor survey and continues to be an important issue facing the infrastructure industry, according to the investors surveyed. One investor commented: "Maximum debt levels should not exceed 35% of total value. It is ridiculous that so many infrastructure deals use such high levels of leverage." Another stated: "The inability to complete deals due to lack of debt is the key issue facing the market." This issue is still limiting deal flow in 2010, combined with continued investor caution impacting fundraising levels.

Fig. 5:



Many respondents commented on the impact new regulation would have on the industry, believing that this is an important issue facing the industry at the present time. One investor stated: "Political and/or regulatory risk are significant in infrastructure and understanding how these issues flow through to asset values is very important, especially with the increased regulatory risk worldwide in many asset classes."

Another respondent supported this view, claiming: "Changes in regulation and cutbacks from governments, for example feed-in tariffs are key issues facing the industry." While another stated: "Restrictions on the domicile of the fund is now becoming an issue."

Manager experience is also a concern among investors. One investor surveyed claimed: "There are too many 'wannabe' managers that are not credible in terms of their experience in infrastructure investing, their ability to manage a fund or the appropriateness of their fund structure."

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Regions That Investors Believe Will Provide the Most Attractive Investment Opportunities

Investors were asked to identify the region that they think will provide the most attractive infrastructure investment opportunities over the short- to medium-term, the results of which are shown in Fig. 6.

Unsurprisingly, the developed North American and West European markets were highlighted as important regions. North America is slowly becoming more open to private sector involvement in infrastructure projects, with many investors intending to target such opportunities in the future. Asia was also a popular choice, with 19% of respondents highlighting the importance of Asian infrastructure development. This shows the increasing significance of emerging market infrastructure as the need for development in these regions grows, which is also reflected in the significant number of Asia and Rest of World funds currently raising capital.

Scandinavia was seen as the least likely region to provide attractive investment opportunities, followed by the Middle East and Africa.

Conclusion

This survey confirms that investor confidence is beginning to return to the infrastructure market, with 70% of investors surveyed planning to make infrastructure commitments in the coming 12 months, as opposed to just 40% that stated such an intention in our October 2009 survey.

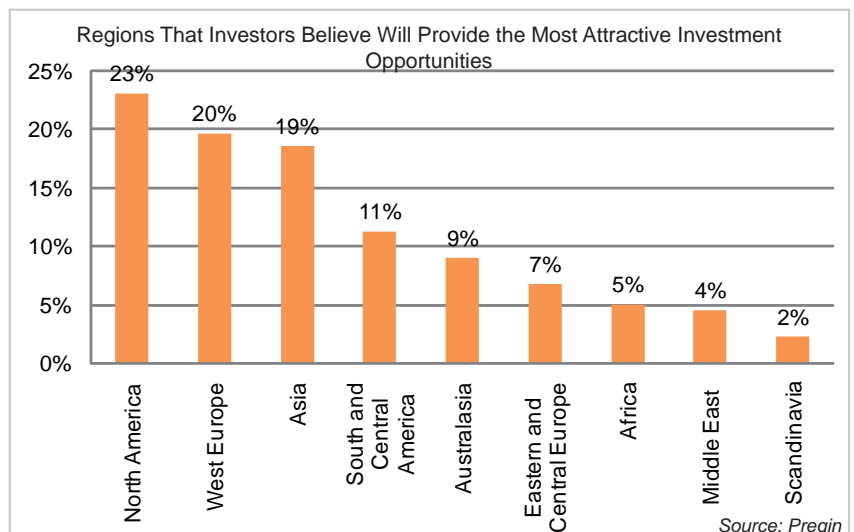
However, there are a number of key issues facing the asset class which need to be overcome to ensure continued growth within the unlisted infrastructure market. The alignment of investor and manager interests is a pressing issue within the private equity industry as a whole and the infrastructure sector is no exception. Infrastructure fund managers will have to ensure that their fund terms, especially those relating to management fees and the carry structure, satisfy investors

if they are to be successful in an increasingly competitive fundraising market.

Other issues, such as how infrastructure funds will be structured in the future and both the availability and level of debt financing needed for infrastructure development, will determine the direction the asset class takes in the future. The resolution of these issues will directly affect investor confidence and impact future fundraising and deal flow.

The infrastructure industry has entered a period of transition and although investor confidence is growing and fundraising is improving it is unlikely we will see a quick return to pre-crisis levels. However, investors are keen to increase their exposure to infrastructure over the long term and both investors and fund managers are beginning to discuss the issues facing the asset class in search of resolutions, suggesting a positive outlook for the infrastructure industry.

Fig. 6:



The 2010 Preqin Infrastructure Review

The market for unlisted infrastructure funds has grown dramatically in recent years, as an abundance of new opportunities in both developed and emerging markets has paved the way for increasing numbers of vehicles to successfully raise capital. Despite the impact of the financial crisis, there are currently more funds on the road than ever before, as governments around the world establish new initiatives for private sector involvement in infrastructure projects, enabling the industry to continue its expansion into new areas and geographies.

Key features of this publication include:

- Detailed analysis sections showing the latest trends in all areas of the industry: deals, fundraising, investors, terms and conditions, history and development and more...
- Profiles for 270 infrastructure firms and 450 funds, including 79 with performance data. Profiles include strategy and deals data, direct contact information for key contacts and more...
- Profiles for over 170 investors in the sector, including investment plans, strategic preferences and key contact details plus results of our investor survey.
- Detailed listings for all funds ever closed, plus funds currently raising capital.
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2010 Preqin Infrastructure Review - Chapters

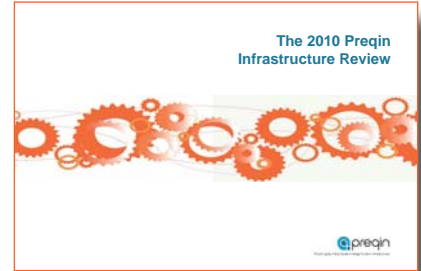
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2010 Preqin Infrastructure Review: Order Form

The market for unlisted infrastructure funds has grown dramatically in recent years, as an abundance of new opportunities in both developed and emerging markets has paved the way for increasing numbers of vehicles to successfully raise capital. Despite the impact of the financial crisis, there are currently more funds on the road than ever before, as governments around the world establish new initiatives for private sector involvement in infrastructure projects, enabling the industry to continue its expansion into new areas and geographies.

Now in its third year, the 2010 Preqin Infrastructure Review is the most comprehensive examination of the unlisted infrastructure fund market ever produced. Key features of this year's publication include:

- Detailed analysis sections showing the latest trends in all areas of the industry: deals, fundraising, investors, terms and conditions, history and development and more...
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- Information gathered from numerous data sources, including via direct interaction with fund managers to ensure the information in the Review is as accurate, comprehensive and exclusive as possible.



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