Preqin Investor Outlook: Infrastructure

The Opinions of 60 Leading Infrastructure LPs on the Market and Their Plans for the Next 12 Months

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Methodology:

Preqin, the alternative assets industry's leading source of data and intelligence, welcomes you to the 2011 edition of Preqin Investor Outlook: Infrastructure, a unique look at investors in infrastructure, their current opinions of the market and the outlook for fundraising in the year ahead.

Preqin Investor Outlook draws on the results of a survey of over 60 institutional infrastructure investors from around the world during June 2011. The sample was selected from Preqin's Infrastructure Online database, the most comprehensive and accurate source of information on infrastructre investors and fund managers available today.

Speaking directly to institutions located across the globe has enabled us not only to provide in-depth analysis of their current views and opinions, but to accompany this with comments from key investment professionals in their own words, providing readers with a unique insight into the attitudes of the leading investors in infrastructure.

We hope that you find the information included within this report useful and interesting and, as always, we welcome any feedback and suggestions you may have for future editions.

Contents:

Infrastructure Fundraising: The Recent Environment and Investor Activity

As unlisted infrastructure fundraising has suffered a turbulent time in recent years, it is more important than ever that fund managers understand the opinions of institutional investors in the asset class and the state of the fundraising market. In Q2 2011, Preqin conducted interviews with over 60 leading institutional investors in infrastructure to assess current sentiment towards the asset class. Here we briefly outline the recent history of the fundraising market and report what investors told us about their activity in the past 12 months.

The Recent Fundraising Environment

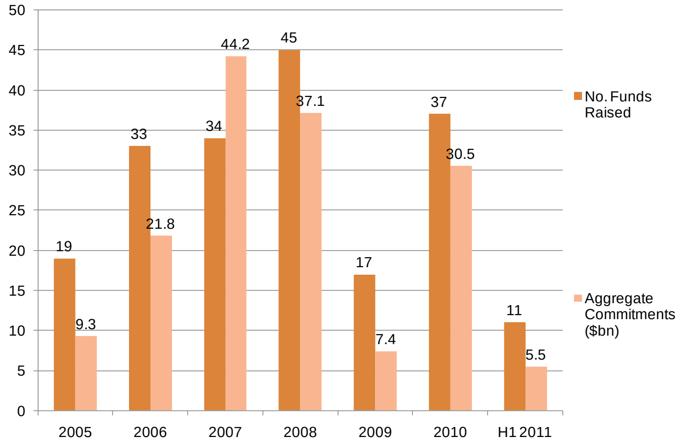
The effects of the global economic downturn and the resulting drop in institutional investors' willingness to commit to unlisted funds brought an end to the sustained period of growth in unlisted infrastructure fundraising. As Fig. 1 shows, the 34 infrastructure funds that closed in 2007 raised an aggregate $44.2bn, and 45 funds closed in 2008 having raised $37.1bn. In 2009, however, 17 funds closed having raised just $7.4bn in total.

In 2010 fundraising made a significant recovery, with 37 funds closing during the year on aggregate commitments of $30.5bn. However, much of this capital was committed prior to the onset of the economic downturn. In the first half of 2011, 11 funds reached a final close having raised a combined $5.5 billion in commitments. While it appears that the rate of fundraising has slowed from 2010, the majority of the capital committed to funds that closed in H1 2011 was committed in 2010 or 2011, indicating that investors are becoming more willing to commit to unlisted infrastructure funds again. This is backed up by encouraging interim close figures for the first half of 2011 – 18 infrastructure funds reached an interim close in the first six months of the year, closing on $9.1bn in aggregate commitments.

Recent Investor Activity

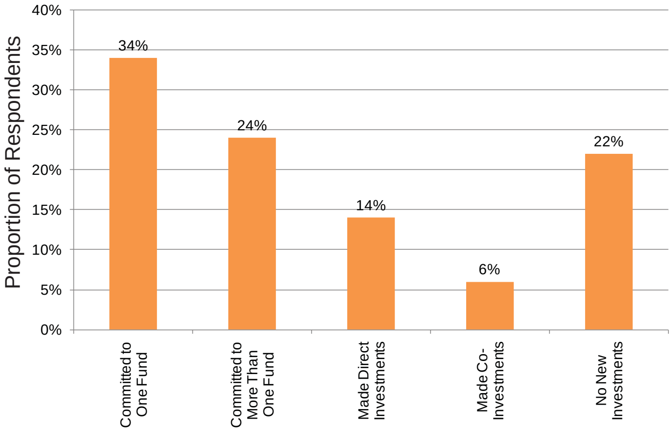
The results of our interviews with institutional investors also indicate that fundraising is recovering: nearly 60% of respondents told us that they had invested in at least one infrastructure fund in the past 12 months, as Fig. 2 shows. Nearly a quarter of those interviewed had invested in more than one fund over the last year. This figure is particularly encouraging when compared to the results of a survey conducted in October 2009, in which only 19% of respondents indicated that they had made a commitment in the preceding 12 months. A number of investors also mentioned that they had made direct investments and co-investments in the past year. Just over one-fifth of those interviewed said that they had not invested in infrastructure at all in the last 12 months.

Fig. 1: Annual Unlisted Infrastructure Fundraising, 2005 - H1 2011



Source: Preqin

Fig. 2: Investor Activity over the Past 12 Months



Source: Preqin

Alignment of Interests between Investors and Fund Managers

In an improving but challenging fundraising environment, it is important for fund managers to understand the wishes of investors when it comes to fund terms and the alignment of interests between GPs and LPs. We asked institutional investors how well they think that GP and LP interests are now aligned, and the areas where they feel that further improvement is necessary.

Are Interests Aligned?

In the context of a depressed fundraising market following the financial crisis, there was talk of LPs putting pressure on GPs to provide more favourable fund terms. The ILPA Principles were also released with the aim of establishing a set of best practices for terms and conditions. But, given these developments, how well do investors now feel that interests between themselves and GPs are aligned?

We asked investors about the extent to which they agreed that interests are aligned, with the results shown in Fig. 3. There is a fairly even split between those agreeing and those disagreeing, with some respondents stating that they strongly disagreed that interests are aligned. Despite this mixed result, it would appear that some fund managers have been adapting to changing investor demands over the past year: just 28% of respondents to the 2010 survey felt that interests were properly aligned. One investor stated: "While there have been many cases of misalignment, mostly leading to poor performance, most successful raisings now consider the ILPA Principles and can create an acceptable level of alignment; however more work remains to be done in this area."

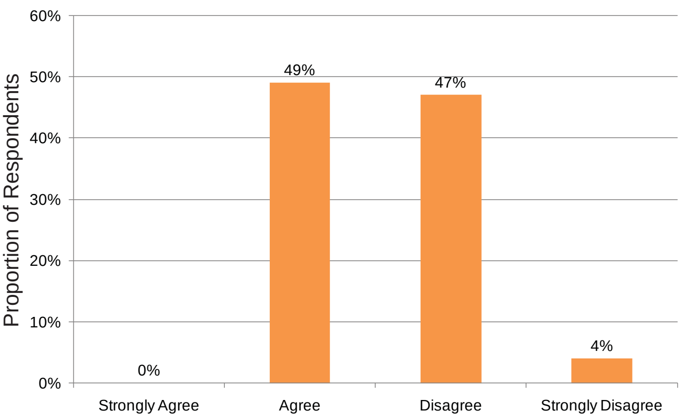
Areas for Improvement

We also asked investors what aspects of fund terms and the LP-GP relationship could be improved in order to enhance the alignment of interests, and those interviewed were able to select more than one area. Management fees were the most commonly cited issue, although the proportion of respondents selecting this area fell from 72% last year to 62% this year. The majority of investors interviewed cited the payment of fees on uninvested capital and carry structure as issues, but significant improvement in the latter is suggested by the fact that the proportion of respondents citing this as an area where alignment of interests could be improved fell from 72% last year.

Respondents were keen to discuss the issues surrounding alignment of interests. One commented: "Manager fees are far too high in most cases, and there are a number of conflicts of interest that can arise. Performance fees are often structured poorly, based on capital appreciation rather than performance above a hurdle for example." Another stated: "Hurdles should be appropriate to the risk targeted by the fund."

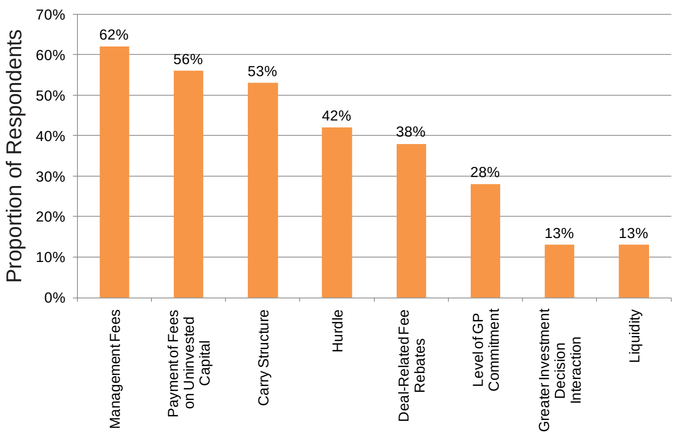
One-quarter of investors felt that there needed to be greater interaction between themselves and fund managers in 2010, but just 13% were of this opinion this year, suggesting that the channels of communication have opened up between the investor and fund manager in the past year. The results of the survey also imply that investors are a lot more satisfied with commitments GPs are making to their own funds; the proportion that stated this was an area of concern fell from 45% in 2010 to 28% this year.

Fig. 3: Extent to Which Investors Agree That Interests Are Aligned



Source: Preqin

Fig. 4: Areas in Which Investors Believe Alignment of Interests Can Be Improved



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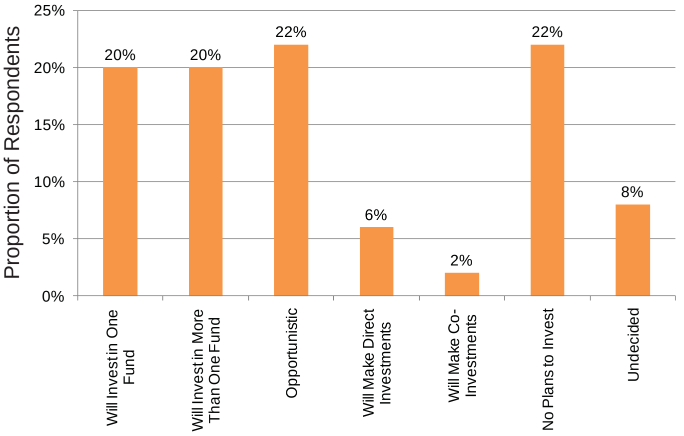
Infrastructure Investment: Investors' Plans in the Near Future

Given the recent fundraising figures and how investors feel about the alignment of interest between themselves and GPs, how does this translate into what might be in store in the immediate future for unlisted infrastructure fundraising and those GPs currently on the road seeking capital? As part of our interviews with investors in infrastructure funds, we asked them about their investment plans for the next 12 months.

Fig. 5 shows that 40% of the investors in infrastructure funds that Preqin interviewed stated that they would be investing in one or more unlisted infrastructure funds in the next 12 months. Additionally, a further 22% will be keeping an eye on the market and investing opportunistically should an opportunity arise that is a good fit for their portfolios. A total of 8% of respondents told us that they would specifically be looking for co-investments or direct investments. One participant stated: "True co-investment opportunities are very attractive to the more experienced infrastructure investor."

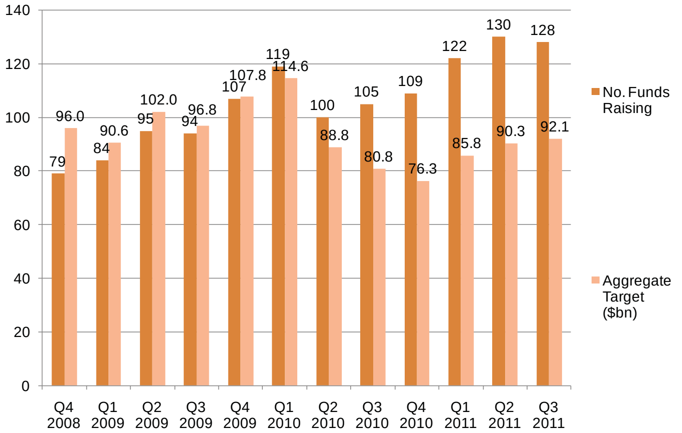
Another 8% of those interviewed said that they were as yet undecided on their infrastructure investment plans for the next year, leaving just 22% that definitively have no plans to invest in the next 12 months. While these results are encouraging and indicate that investor appetite for infrastructure funds remains strong, the near-record number of funds on the road means that some fund managers will inevitably miss out on investor commitments. Fig. 6 shows that as of Q3 2011 there are 128 unlisted infrastructure funds seeking an aggregate $92.1bn in commitments from investors. This is more than three years' worth of fundraising at the levels seen in 2010, and with supply continuing to outstrip demand it is certain that not all firms currently seeking capital will be successful in reaching their targeted goals. The fact that there are 128 funds currently seeking capital – just two below the record set in Q2 2011 – means that investors have plenty of choice when it comes to selecting which managers to invest with, and that managers need to stand out from the crowd in terms of the attractiveness of the opportunity they are offering in order to successfully meet their fundraising targets in a timely manner.

Fig. 5: Investor Plans for the Next 12 Months



Source: Preqin

Fig. 6: Infrastructure Funds in Market by Quarter



Source: Preqin

Infrastructure Investment: Investors' Long-Term Plans and Outlook for the Asset Class

Having discovered that the proportion of investors that are planning to invest in infrastructure funds over the next year has increased since our last Investor Outlook report, we also asked investors how they felt about infrastructure in the longer term and the asset class's position in their portfolios in the future.

Investors' Long-Term Plans

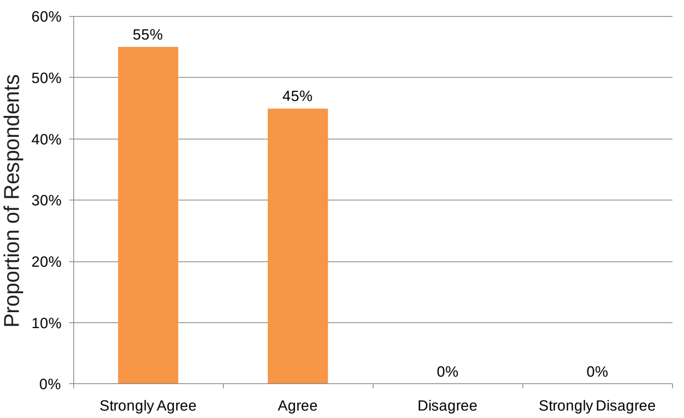
All of the investors in infrastructure that we interviewed agreed that infrastructure investments will continue to have a part to play in their investment portfolios in the future, with 55% agreeing strongly and 45% agreeing, as Fig. 7 shows. Moving on from this more general point, we asked investors to be more specific about how they planned to invest in the asset class in the future, with multiple responses allowed. Fig. 8 shows that 62% of those interviewed plan to continue to invest in unlisted funds in the long term, and that 36% plan to increase their allocation to the asset class going forward. This figure is particularly encouraging given that it represents a notable increase from the 13% of respondents participating in the 2009 survey that had long-term plans to invest more in infrastructure. Over 20% of investors told us that they plan to continue investing directly and 18% intend to co-invest when suitable opportunities arise.

Outlook for the Infrastructure Asset Class

The study suggests that the outlook for infrastructure is generally positive. All those taking part believe such investments have a valuable place in institutional portfolios, and a significant proportion have concrete plans to make investments in the coming year and beyond. Just over one-third expect to increase their allocation to the asset class in the long term.

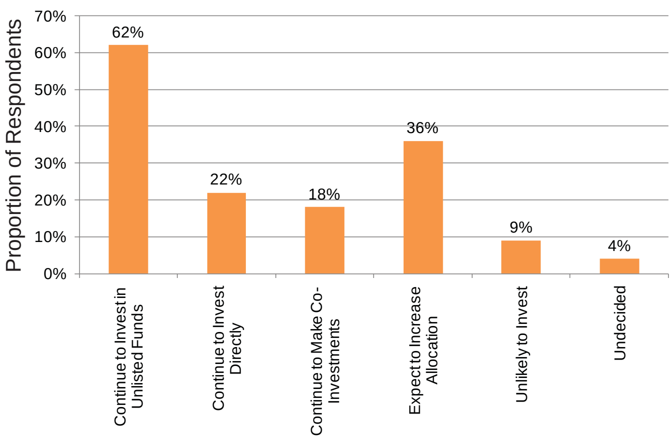
While there is much to be positive about in these findings, the fact remains that the investor community is still recovering from the global economic downturn, and remains cautious when it comes to increasing exposure. While sentiment is improving, a return to the record fundraising environment seen in 2007 and 2008 is still some way off, and those managers returning to market for the first time since the onset of the global economic crisis will find that investors with capital to commit have changed significantly in their approach to making investments.

Fig. 7: Extent to Which Investors Agree That Infrastructure Assets Have a Future in Their Investment Portfolios



Source: Preqin

Fig. 8: Investors' Long-Term Infrastructure Investment Plans



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2011 Preqin Infrastructure Review

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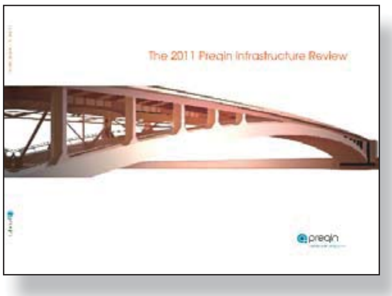

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