Preqin Investor Outlook: Infrastructure, H2 2013

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Foreword

Investor appetite for infrastructure continues to increase and the asset class looks likely to experience significant growth in the coming years. In the 12 months to June 2013, $34bn was raised by infrastructure funds holding final closes, a notable increase on the $19.5bn which was raised by funds holding final closes between Q3 2011 and Q2 2012. With 63% of investors planning to commit more capital in the coming year than they did in the last 12 months, a further increase in the rate of fundraising seems likely. In the longer term the outlook is also very encouraging, with just 58% of investors expecting to increase their infrastructure allocations in the future, and just 2% expecting allocations to decrease.

There are many investors expecting to make a sizeable capital outlay to the asset class in the coming year. Of investors planning new commitments, 48% expect to make at least three fund investments and 47% anticipate allocating at least $100mn. Unlisted funds remain the primary route to market for investors seeking infrastructure exposure, with 91% of all institutions investing the coming year targeting unlisted funds. Among the larger investors there is increased interest in investing directly, but the majority will still make a combination of fund commitments and direct investments.

A key area of the infrastructure industry which remains a concern for investors is fund terms and conditions. Many investors are unhappy with private equity-like fee structures in an asset class with very different return expectations, and 49% of respondents stated that they did not believe investor and fund manager interests are properly aligned.

Many fund managers have been adjusting their terms in light of investor concerns, with 69% of respondents saying they saw a change in infrastructure fund terms over the past 12 months in favour of the investor, but it is clear there is still work for fund managers to do to satisfy the investor community.

Despite these concerns, it is clear that many institutions believe infrastructure can play an important role in their portfolios. The congested fundraising market means raising capital for unlisted infrastructure funds is likely to remain challenging in the coming months, but encouragingly for firms on the road, the investor appetite for the infrastructure asset class is certainly there.

Key Facts

63% of investors surveyed expect to commit more capital to infrastructure funds in the next 12 months than in the previous year.

47% of investors expect to invest at least $100mn over the next year, with 12% planning to invest in excess of $500mn.

93% of investors feel their infrastructure portfolios have either met or exceeded expectations over the past 12 months.

94% of investors highlighted manager experience and background as a key factor when selecting infrastructure fund managers.

47% of investors agree that fund manager and investor interests are properly aligned in the current market, and 4% strongly agree.

67% of investors are unsure whether recent regulatory changes are positive or negative for the infrastructure industry.

Contents

Investor Activity in the Coming Year and the Longer Term

Unlisted infrastructure fundraising was strong in H1 2013, with 19 vehicles reaching a final close, securing $15.4bn in aggregate institutional investor capital. This represented an 88% increase on the $8.2bn raised by infrastructure fund managers in H1 2012, showing that investor appetite for infrastructure exposure continues to grow.

The infrastructure investor universe is still relatively small when compared to other alternative asset classes and many investors are inexperienced in the space. Fund manager competition for investor commitments is therefore higher than ever, with a large number of infrastructure funds on the road sourcing capital from a small investor base. As such, infrastructure fund managers must continue to pay close attention to investor attitudes and key demands in order to execute a successful fundraise in the current market.

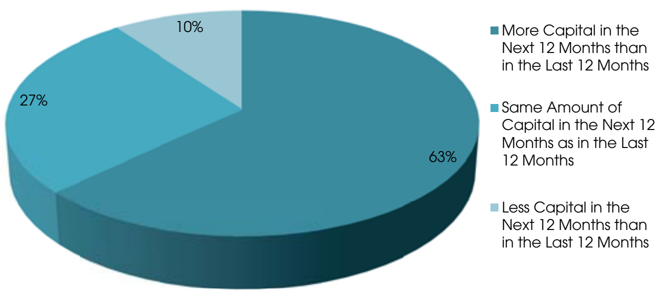
Investors' Infrastructure Commitments in 2013/14

As shown in Fig. 5.1, the majority (63%) of institutional investors surveyed expect to commit more capital to private infrastructure funds in the coming 12 months than in the previous year. This is slightly higher than the 58% of surveyed investors that expected to invest more capital in the 12 months from August 2012 and is extremely positive for fund managers looking to source new investor commitments in the year ahead. Just over a quarter (27%) of investors surveyed plan to invest the same level of capital in the coming 12 months than in the past year, while just 10% expect to invest less capital in 2013/14.

Investors' Infrastructure Allocations over the Long Term

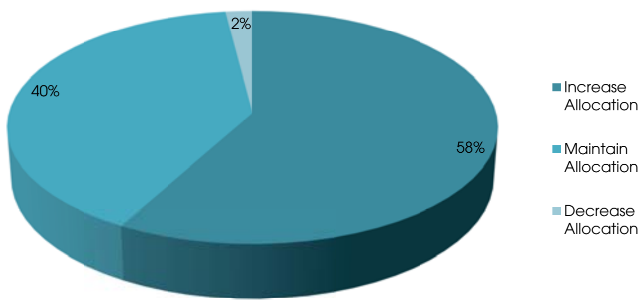
A significant 58% of surveyed investors plan to increase their allocations to infrastructure over the long term, slightly less than the 62% which expected this in August 2012. Infrastructure is still a new asset class for many investors, with 81% of investors with an active infrastructure allocation having a target allocation of less than 7.5% of total assets. As these institutions become more comfortable with the risk/return potential of infrastructure funds, allocations to the space are likely to rise. As illustrated in Fig. 5.2, a further 40% of survey respondents expect to maintain the same level of exposure to infrastructure over the long term, while just 2% plan to decrease their infrastructure allocations.

Fig. 5.1: Investors' Expected Capital Commitments to Infrastructure Funds in the Next 12 Months Compared to the Last 12 Months



Source: Preqin Investor Survey, August 2013

Fig. 5.2: Investors' Intentions for Their Infrastructure Allocations over the Long Term



Source: Preqin Investor Survey, August 2013

This is an excerpt from Preqin Investor Outlook: Alternative Assets, H2 2013.
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Future Searches and Capital Outlay

Preqin employs a dedicated team of multi-lingual analysts that is in direct contact with industry professionals at over 2,000 institutions investing in infrastructure worldwide. Through this constant communication, we are able to build a clear picture of investors' investment strategies and their plans for future investment in the asset class.

Capital Available to Invest

Fig. 5.3 provides a breakdown of the amount of capital investors plan to invest in infrastructure opportunities over the coming 12 months. Thirty-eight percent of investors planning to make new investments in the infrastructure asset class in 2013/14 have reserved up to $50mn for such opportunities. In contrast, 47% of institutional investors expect to invest at least $100mn over the course of the next year, with 12% planning to invest $500mn or more. This shows that a sizeable proportion of investors are looking to invest a significant level of capital in the infrastructure asset class, which is very encouraging for the industry.

Interestingly, 71% of those investors looking to invest $500mn or more in the coming year have a preference for direct investment strategies, showing how larger investors are becoming more interested in direct exposure to the asset class. However, 57% of those investors with a preference for direct investments will also consider investing in unlisted infrastructure vehicles, highlighting the continued importance of infrastructure fund managers to the industry.

Number of Expected Investments

A significant 52% of institutional investors that expect to be active in the coming year plan to make one or two new infrastructure investments, and a further 38% plan to make between three and four new investments (Fig. 5.4). Ten percent of investors aim to make at least five new infrastructure investments in the coming year.

Preferred Routes to Market

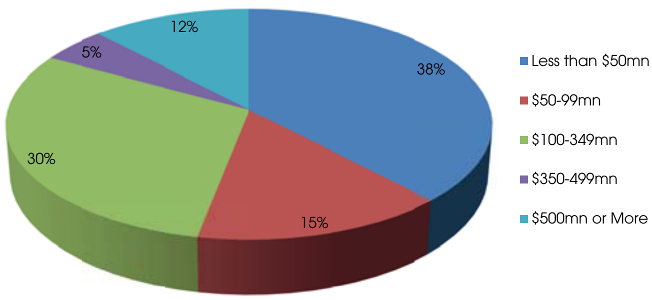
As shown in Fig. 5.5, 91% of investors looking to make new investments in the next 12 months expect to do so through commitments to unlisted infrastructure funds. Despite the growing preference among investors for direct exposure and co-investments alongside portfolio managers, the unlisted fund route remains the predominant route to market for most institutional investors. Thirty-five percent of investors will look to make direct investments in the coming year, while 11% will seek to invest in listed funds.

Data Source:

Preqin's Infrastructure Online features detailed information on the future plans of 610 infrastructure investors with active fund searches and open mandates.

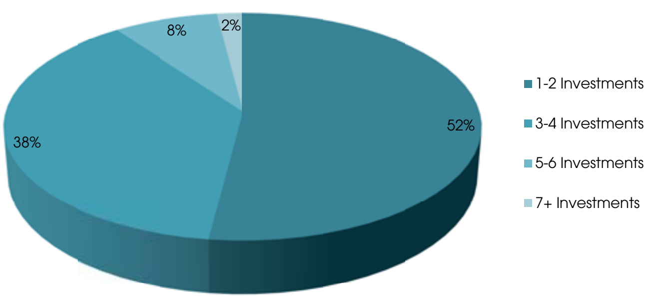
www.preqin.com/infrastructure

Fig. 5.3: Amount of Fresh Capital Institutional Investors Plan to Invest in Infrastructure over the Next 12 Months



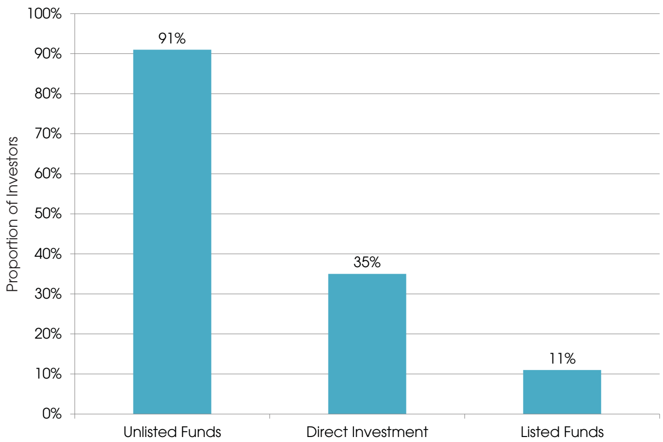
Source: Preqin Infrastructure Online

Fig. 5.4: Number of Infrastructure Investments Institutional Investors Plan to Make over the Next 12 Months



Source: Preqin Infrastructure Online

Fig. 5.5: Preferred Route to Market of Investors Searching for New Infrastructure Investments in the Next 12 Months



Source: Preqin Infrastructure Online

Satisfaction with Returns

We asked investors if the returns generated by their infrastructure investments had lived up to expectations and how their confidence in infrastructure to achieve their portfolio objectives has changed.

A significant 93% of investors surveyed feel their infrastructure portfolios have either met or exceeded expectations over the past 12 months. This demonstrates that infrastructure investments have largely performed positively despite uncertain economic conditions, and have contributed well to overall portfolio performance.

Sixty-four percent of surveyed investors stated that their infrastructure investments had met expectations and a further 29% felt their returns exceeded expectations, as displayed in Fig. 5.6. In total, this is a healthy improvement on the 81% of investors surveyed that felt their infrastructure portfolios had met or exceeded expectations in August 2012. However, it is important to recognize that 7% of investors feel their infrastructure portfolios did not meet expectations.

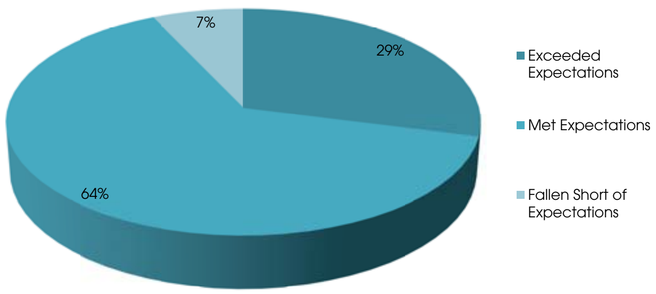
Investor Confidence in Infrastructure

The risk/return profile of the infrastructure asset class is quite diverse depending on the type of fund and chosen strategy. Some investors commit to infrastructure funds as an extension of their return-seeking private equity portfolio, while others are looking for lower longer-term yields. We asked investors whether their confidence in infrastructure to achieve portfolio objectives had changed over the past 12 months; a significant 74% of investors surveyed reported no change and remained largely positive towards the infrastructure space, as shown in Fig. 5.7. Thirteen percent of investors felt their confidence had increased.

A further 13% reported a decrease in confidence. One Belgium-based investment company that reported a decrease in confidence stated that: “the regulator is much more unstable and untrustworthy”, and considered infrastructure funds “too expensive and managers too greedy.”

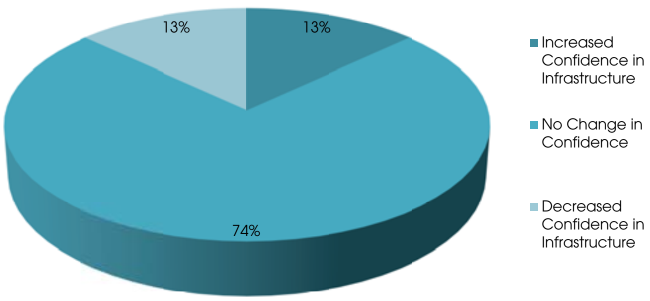
In terms of investors’ general perception of the infrastructure industry, 46% of surveyed investors are positive, while a further 46% have a neutral outlook, as Fig. 5.8 illustrates. Of those positive respondents, one Germany-based asset manager stated that their outlook was “in general positive”, but added that “fundraising is very active and a lot of money is coming into the market, so we are afraid about too much money increasing valuations and declining returns.” Another US-based public pension fund voiced similar views, stating that they had a “positive perception of infrastructure” but were “concerned about the amount of capital chasing a fairly limited number of deals, especially at the higher end of transaction size.” Despite general positivity towards infrastructure, questions still remain over issues such as expected deal flow and the impact of asset valuations on returns.

Fig. 5.6: Proportion of Investors that Feel Their Infrastructure Fund Investments Have Lived up to Expectations over the Past 12 Months



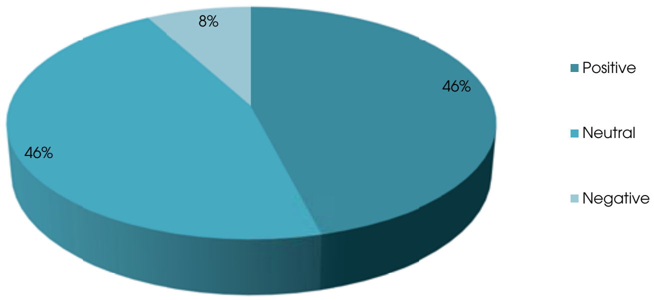
Source: Preqin Investor Survey, August 2013

Fig. 5.7: Investors’ Confidence in Infrastructure to Achieve Portfolio Objectives



Source: Preqin Investor Survey, August 2013

Fig. 5.8: Investors’ General Perception of the Infrastructure Industry at Present



Source: Preqin Investor Survey, August 2013

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Manager Selection and Key Issues Facing the Industry

Investors are now considerably more cautious when making new commitments to unlisted infrastructure funds and are generally more selective when sourcing new fund manager relationships. We asked investors about the key factors they assess when looking for infrastructure fund managers and what they think are the key issues facing the infrastructure industry in 2013/14.

Fund Manager Selection

As shown in Fig. 5.9, a significant 94% of investors surveyed highlighted manager experience and background as a key factor when selecting infrastructure fund managers. Similarly, 87% of respondents look for fund managers with an established track record in the infrastructure space. However, because the infrastructure asset class is still relatively young, few fund managers are able to illustrate a strong history and track record in the sector. As a result, investors are fairly limited in terms of the infrastructure fund managers which meet their experience criteria, with 66 of the 146 infrastructure funds currently on the road managed by less experienced first-time teams.

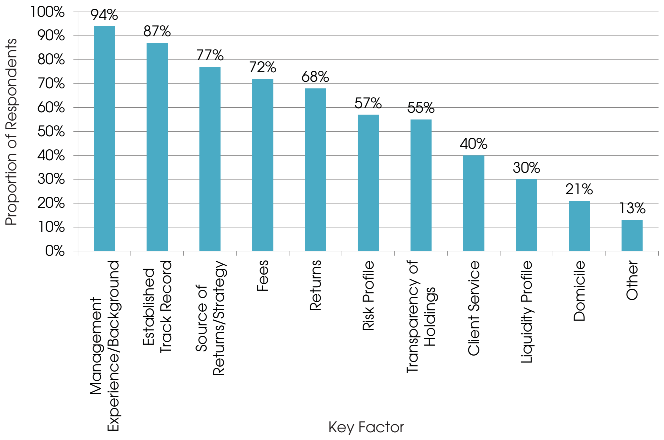
Other key issues highlighted by investors surveyed include the source of returns/strategy (77%), fees (72%) and returns (68%). Fifty-seven percent of investors surveyed consider the risk profile of the fund manager when seeking to form new relationships, while 55% look for greater transparency of fund manager holdings. Thirteen percent of respondents cited other factors, with several highlighting the need for co-investment rights when forging new fund manager relationships.

Key Issues

In terms of the key issues facing the infrastructure industry in the next 12 months, 65% of surveyed investors foresee impending regulations to be an important factor. Many investors remain uncertain about what impact new regulations such as Basel III and Solvency II will have on their portfolios, something which may become clearer in the coming year. As shown in Fig. 5.10, other important issues include fund performance (54%) and the economic environment (54%), while 50% of respondents are concerned about the fees charged by fund managers.

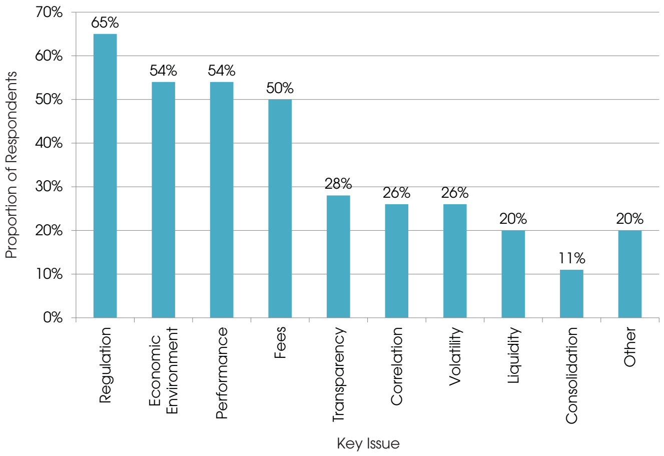
Deal flow and the amount of capital entering the asset class were named by some of the investors responding to the survey. One UK-based pension fund stated that "there may be too much capital chasing too few opportunities that are materializing." Other investors are concerned that the increasing interest in infrastructure investment is driving up asset valuations and compressing potential returns.

Fig. 5.9: Key Factors that Investors Assess when Looking for an Infrastructure Fund Manager



Source: Preqin Investor Survey, August 2013

Fig. 5.10: Investors' Views on the Key Issues Facing the Infrastructure Industry in 2013/14



Source: Preqin Investor Survey, August 2013

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Fees and Alignment of Interests

The fees charged by unlisted infrastructure fund managers remain a point of contention within the industry, but there are signs that fees are becoming more investor-friendly and a growing proportion of institutions are confident that investor and manager interests are appropriately aligned.

Alignment of Interests

Fifty-one percent of investors surveyed feel that fund managers' and investors' interests are properly aligned, demonstrating that although investors are becoming increasingly satisfied with their fund manager relationships, more needs to be done to improve relations. In such a competitive fundraising market, fund managers that look to improve their relations with investors, increase their chances of securing investor capital.

As shown in Fig. 5.11, 47% of investors surveyed agree that fund manager and investor interests are properly aligned in the current market, and 4% strongly agree. In contrast, 45% of respondents disagree that fund manager and investor interests are properly aligned, and a further 4% strongly disagree.

The proportion of investors that feel fund manager and investor interests are properly aligned has increased considerably since June 2010, when just 27% of investors surveyed believed this. However, the proportion is at a similar level to May 2011, when 49% of respondents agreed that interests were properly aligned. This illustrates that although improvements have been made, almost half of surveyed investors still feel that interests are not properly aligned and more work needs to be done to build fund manager and investor relations.

As shown in Fig. 5.12, a significant 73% of investors surveyed suggested that the level of management fee charged by fund managers is a key issue, while 70% feel that the structure of performance fees can be improved. One US-based pension fund stated that "there is room for infrastructure to adopt more of a core real estate fund type pricing model" adding that "many infrastructure managers are still trying to adopt a private equity-like 2 and 20 structure, which is not realistic given the expected returns of infrastructure."

The performance fees paid to infrastructure fund managers and the size of the fund manager commitment to their own funds are key areas viewed as in need of improvement for 43% of respondents each, while 41% believe there are issues surrounding hurdle rates that need to be addressed. One North America-based pension fund believed that "a more flexible fund life" would be a key area for improvement, as "a client should select if they want more or less liquidity."

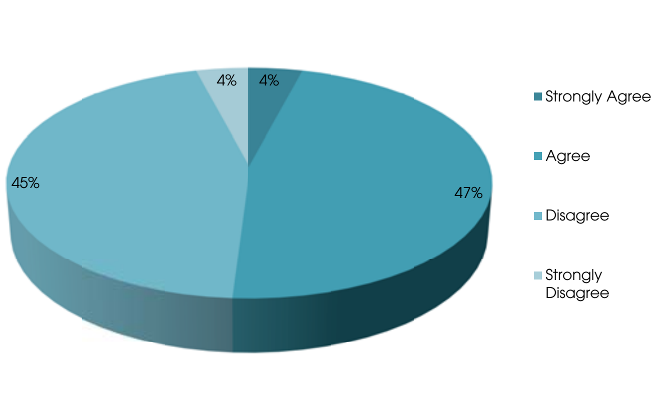
Fees

As demonstrated in Fig. 5.13, a significant 69% of investors surveyed saw a change in infrastructure fund terms over the past 12 months in favour of the investor. This coincides with an improvement in the proportion of investors that feel that fund manager and investor relations have become more aligned. Just 2% of respondents saw a change in favour of fund managers, which reflects the efforts being made by many fund managers to address the concerns of investors regarding fund terms. Twenty-nine percent of investors surveyed reported seeing no change in fund terms over the past 12 months.

Despite the majority of investors surveyed suggesting that more needs to be done with management fees to improve fund manager and investor alignment (Fig. 5.12), a significant 76% of respondents recognize that there has been a change in management fees over the past 12 months, as shown in Fig. 5.14.

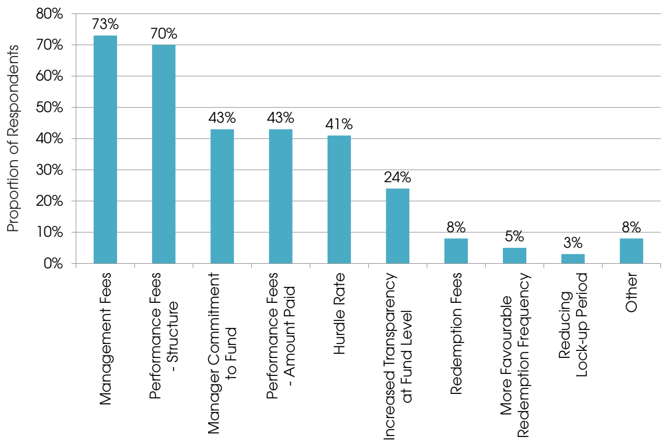
Investors are now largely unwilling to buy into the traditional 2 and 20 private equity fee structure when gaining exposure to lower risk/return profile infrastructure assets, and fund managers are clearly making concessions in this area to attract investor commitments. The private equity fee model may be suited to higher risk/return

Fig. 5.11: Proportion of Investors that Feel Manager and Investor Interests Are Properly Aligned



Source: Preqin Investor Survey, August 2013

Fig. 5.12: Investors' Views on Areas Where Alignment of Interests Can Be Improved



Source: Preqin Investor Survey, August 2013

infrastructure strategies, but most infrastructure investors are looking for fees to reflect the types of assets being invested in and the levels of return expected.

Thirty-three percent of investors surveyed have seen an improvement in the structure of performance fees charged, although again a considerable proportion of respondents still feel this is an area in need of improvement (Fig. 5.12). Other areas that have seen improvement over the past 12 months include the amount of performance fees paid to managers, hurdle rates, fund managers' commitments to their funds and fund-level transparency.

Data Source:

Subscribers to Infrastructure Online can utilize a fund terms calculator to compare the average benchmark terms for unlisted infrastructure funds by size and geographic focus, as well as individual fund terms for over 100 unlisted infrastructure funds.

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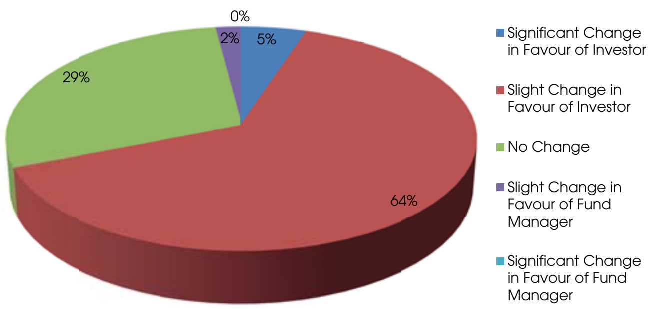
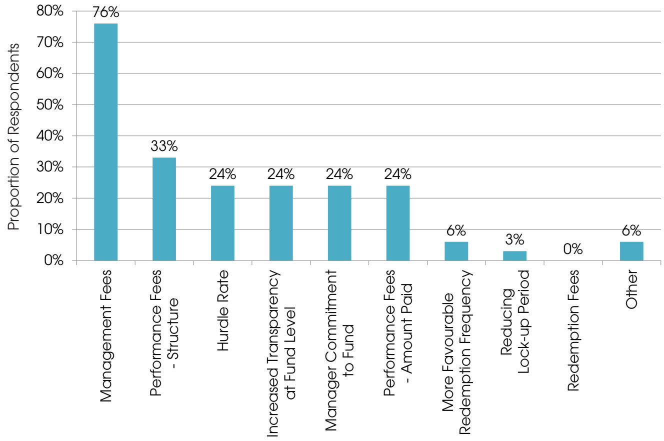
Fig. 5.13: Proportion of Investors that Have Seen a Change in Infrastructure Fund Terms Over the Last 12 Months



Source: Preqin Investor Survey, August 2013

Fig. 5.14: Areas in Which Investors Have Seen a Change in Infrastructure Fund Terms Over the Last 12 Months



Source: Preqin Investor Survey, August 2013

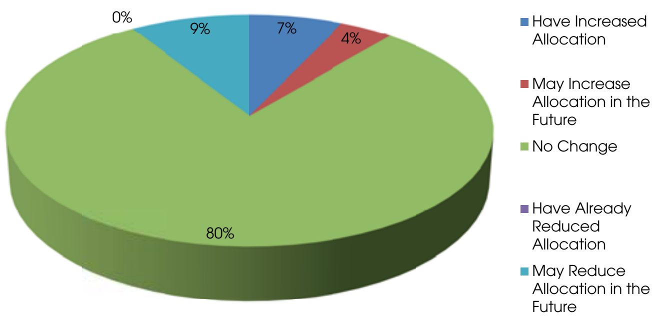
Impact of Regulation

Impending regulations such as the AIFMD, Basel III and Solvency II will have an impact on private infrastructure investment activity, although many fund managers and investors alike remain unsure as to how these regulations will affect their investment policies. We asked investors about how they expect these regulations to affect them and whether these changes will be good or bad for the infrastructure industry.

As shown in Fig. 5.15, a significant 80% of investors surveyed have not made any changes to their infrastructure investment strategy in light of impending regulatory changes. This is perhaps a reflection of the fact that many investors do not yet fully understand how these regulations will apply to them, but also because certain regulations will only apply to investors of a certain type (such as banks and insurance companies). Seven percent of respondents have already increased their infrastructure allocations as a result of these changes, while 4% may look to increase their allocations in future. None of the investors surveyed have already decreased their allocations, although 9% may look to reduce their exposure in future.

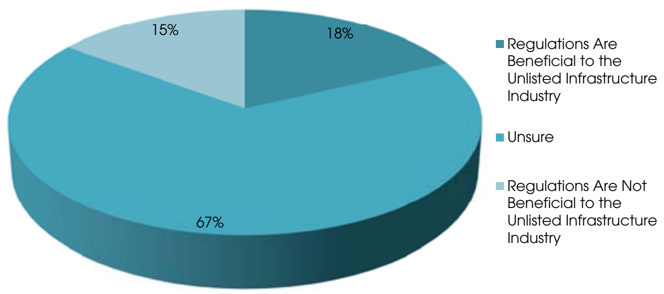
A significant 67% of investors surveyed are unsure whether these regulation changes are positive or negative for the infrastructure industry, as illustrated in Fig. 5.16. However, 18% believe the changes could be favourable, particularly for institutional investors looking at alternative ways to enter the market. One Australia-based investment company stated that “the retreat of the banking sector from infrastructure lending because of Basel III creates the opportunity for astute infrastructure investors to increase portfolio stability by adding debt into the infrastructure portfolio.” A further 15% of investors believe these regulations will have a negative impact on the infrastructure industry, particularly for banks and insurance companies active in the space.

Fig. 5.15: Ways Recent Regulatory Changes and Proposals Have Affected Investors’ Infrastructure Investments



Source: Preqin Investor Survey, August 2013

Fig. 5.16: Investors’ Views on Whether Recent Regulations Are Beneficial to the Unlisted Infrastructure Industry



Source: Preqin Investor Survey, August 2013

Data Source:

Preqin’s Infrastructure Online contains detailed profiles for over 2,000 active infrastructure investors worldwide. Preqin’s dedicated team of research analysts is in regular direct contact with all active investors, allowing us to provide detailed information on investors’ current fund searches and open mandates. Profiles also include assets under management, current and target allocations, typical investment sizes, fund type and geographic references, as well as key contact information and much more.

Infrastructure Online is the leading source of intelligence for the unlisted infrastructure fund industry, constantly updated to include details of all aspects of the asset class, including individual fund performance, fundraising information, fund manager profiles, institutional investor profiles and much more.

For more information, please visit:

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Preqin Infrastructure Online

With global coverage and detailed information on all aspects of the infrastructure asset class, Preqin's industry-leading Infrastructure Online service keeps you up to date on all the latest developments in the infrastructure universe.

Source new investors for funds and co-investments

Find the most relevant investors, with access to detailed profiles for over 2,000 institutional investors actively investing in unlisted infrastructure, including insurance companies, pension funds, family offices, foundations, wealth managers, endowments, banks and more.

Identify potential investment opportunities

View in-depth profiles for over 650 unlisted infrastructure funds encompassing all strategies including greenfield, brownfield, secondary stage, cleantech and renewable energies, debt, mezzanine and fund of funds.

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