Preqin Research Report

Survey of Institutional Investor Sentiment towards Infrastructure Funds

October 2009

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Survey of Infrastructure Investors

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In recent years the infrastructure sector has experienced dramatic growth and has evolved from a niche sector into what many now classify as a separate asset class. However, the global financial crisis has had a massive impact on the sector, not just on fund managers, but also on institutional investors, changing both their opinions of the industry and their ability to make new commitments.

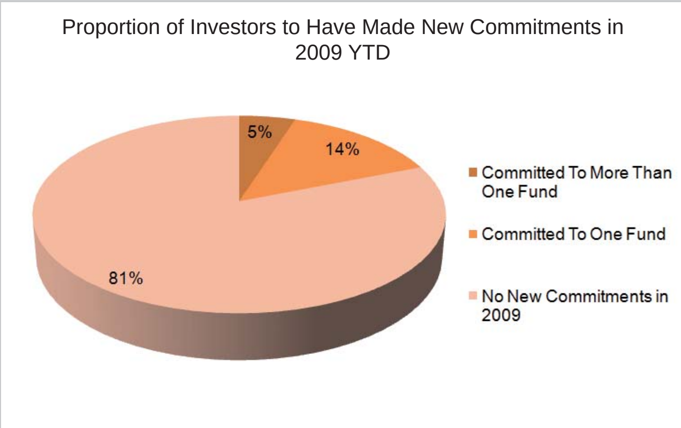
The evidence for this can clearly be seen in recent fundraising figures: in 2009 year-to-date, just nine infrastructure funds have reached a final close, raising an aggregate $6.2 billion, considerably less than the $20.3 billion raised by the 27 funds to hold a final close in the same period in 2008.

In our latest survey of institutional investors Preqin sought to investigate to what extent this drop in fundraising is as a result of shifting investor attitudes to the asset class, how permanent is the apparent decline in investor appetite for funds and when are investors likely to return to the market?

Using Infrastructure Online, Preqin's database containing profiles of over 650 infrastructure investors, we conducted a survey of 42 institutional investors over a single week in October 2009 to gain an insight into their views on the industry and their plans for infrastructure investment in the future.

For more information on Infrastructure Online, please visit: **www.preqin.com/infrastructure**

Fig. 1:



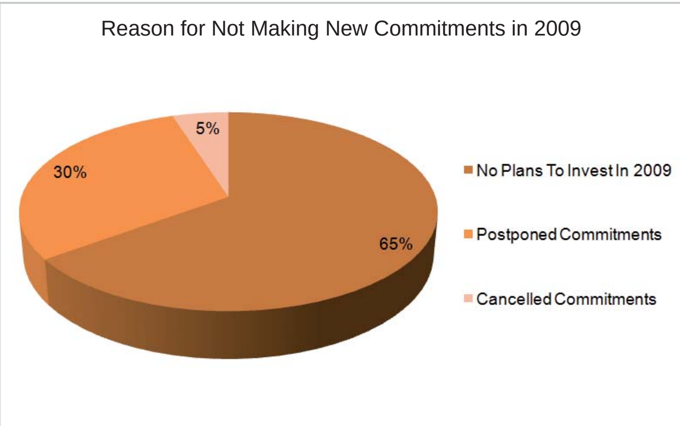
Impact of the Financial Crisis on Investor Attitudes to Infrastructure

We asked investors whether they had made any commitments to infrastructure funds in 2009 and, as shown in Fig. 1, 81% stated that they had not. The majority of investors that had invested in 2009 did so sparingly, with 14% investing in only one fund and just 5% committing to multiple funds.

The economic downturn has forced investors to take stock of their existing portfolios and re-evaluate asset allocations, which has led to a decrease in investor activity in 2009. As shown in Fig. 2, 65% of investors told us that they had no plans to invest in infrastructure funds in 2009 because they had already fulfilled their target allocations. Due to market conditions many of these investors have not had to make new investments to maintain their allocations to the asset class.

30% of investors had postponed planned infrastructure commitments, choosing to wait until market conditions improve before making their planned investments. The remaining 5% of investors had completely cancelled planned commitments, citing either market volatility or a change in investment strategy as the reason behind this decision.

Fig. 2:



Investors' Future Plans for Infrastructure Investment

Infrastructure fundraising has been steadily increasing year-on-year for nearly a decade, with new investors coming to market and carving out new allocations. Despite only 19% of investors

Fig. 3:

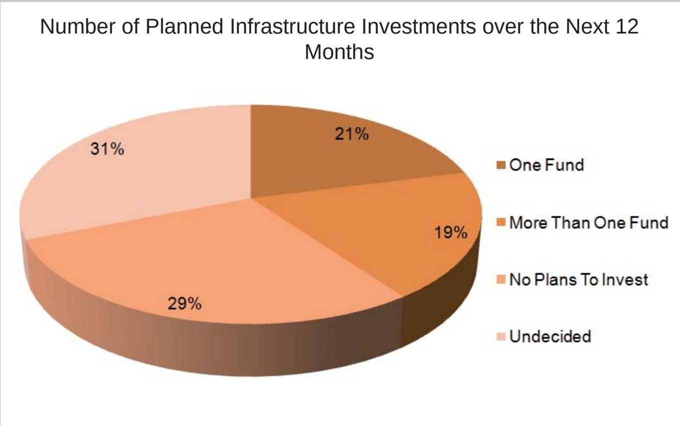
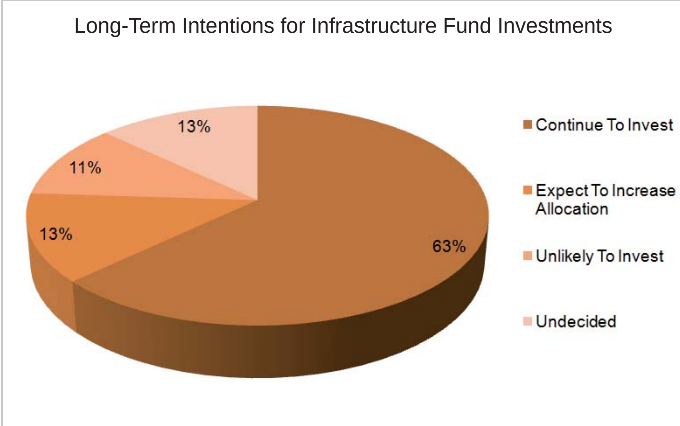


Fig. 4:



committing to infrastructure funds in 2009 year-to-date, investors continue to be optimistic towards the asset class in the medium to long term, with many investors intending to make future commitments.

As shown in Fig. 3, 40% of investors plan to make infrastructure investments over the coming 12 months, with nearly half planning to make multiple commitments.

A further 31% of investors are undecided for a number of reasons: some are monitoring the asset class and waiting for the markets to strengthen, others are concerned due to the impact of the denominator effect on their current investment portfolios, whilst several investors plan to review their investment strategies towards the end of the year. An additional 29% have no plans to invest in the coming 12 months, down from 65% in 2009. This suggests that the caution exercised in 2009 may have been a temporary measure, as investors look to return to market in 2010.

Whenever investors do return to the market however, they are likely to be much more selective when investing in infrastructure funds, and will likely invest in only the most stable funds. This will increase existing competition between fund managers as they compete for limited investor commitments. A Danish pension fund expressed this general investor sentiment well by stating: “We will be looking for the right opportunities, not simply to increase our exposure.” Another investor acknowledged that the amount of capital it planned to dedicate to infrastructure over the next 12 months “will depend on our ability to identify appropriate funds and managers.”

The long-term future of the infrastructure asset class appears to be secure, however. As shown in Fig. 4, 76% of investors intend to continue investing in infrastructure funds over the long term. 63% of investors have no immediate plans to change their allocations to infrastructure but will look to commit to funds in compliance with their current target ranges. A number of investors also suggested that they will look to make direct investments in the future as their knowledge of the asset class grows. A further 13% of investors plan to increase their allocations over the long term and 13% are undecided.

There were, however, a small proportion of investors, 11%, that stated that they were unlikely to invest in infrastructure going forward. One US pension fund told us that it had been put off by what it labelled as “false marketing” within the infrastructure sector, whereby funds that were described as “stable” were proving otherwise during the financial crisis. However, the same investor still recognised the diversification benefits and the value of infrastructure funds as an inflation hedge.

The 2/20 Management Fee Structure

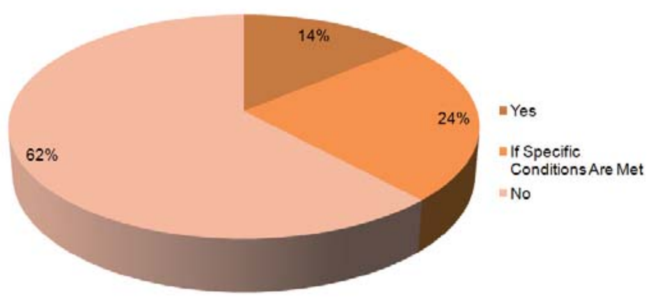
The growing number of infrastructure funds on the road has resulted in increased competition between fund managers as they struggle to achieve their targets. Going forward, infrastructure fund managers must be pro-active when marketing their funds in order to attract investor commitments, which may signal a change to the traditional private equity 2/20 management fee structure. The industry has already seen the likes of Kohlberg Kravis Roberts (KKR) and Blackstone move away from 2/20 and come up with new fee structures to secure commitments.

Fig. 5 shows that 62% of investors are no longer willing to consider investing in funds with a 2/20 structure, with many investors expecting both the management fee and carry rate to be reduced by at least half. One Dutch pension plan stated that “2/20 is history”, while many larger investors said they did not expect to pay such high fees because of their size. A Finnish insurance company provided an interesting argument, claiming that as investors usually expect around a 12% return on their infrastructure investments, fund managers should reduce their carry rate to reflect this.

Just 14% of investors are still willing to pay the 2/20 fee, suggesting that managers adopting this strategy in the future will struggle to find investors. It is also worth noting that the majority of investors that responded positively to the 2/20 structure were either smaller investors with lower negotiating power or investors with brand new infrastructure allocations, expecting fees to resemble those of traditional private equity funds.

Fig. 5:

Proportion of Investors That Agree with the 2/20 Management Fee Structure



The remaining 24% of investors believed a middle ground must be found between investors and fund managers. The majority of investors believed the fee structure should correspond with the level of risk associated with the individual fund, meaning that a higher risk greenfield fund should warrant a higher management fee and carry rate than a lower risk social PPP/PFI vehicle. One US investor stated that if a fund manager demands a high management fee and carry rate then they should take a financial stake in each deal in order to share the same risk as the investor. Other investors claimed that the 20% carry was not such an issue, but that managers must look into ways of distributing capital back to investors sooner.

Key Issues Facing the Asset Class

Despite the recent drop in investor commitments and fundraising figures, many investors continue to recognise the long-term benefits of infrastructure investment. We asked investors what they believed to be the key issues facing the asset class in the medium to long term and many of the same points were raised.

The current saturation of the infrastructure fund market was a concern for investors, as was manager experience. Due to the relative immaturity of the asset class, many of the infrastructure funds currently on the road are being raised by first-time managers. Given the current market conditions and increased investor caution, investors are likely to demand more experience when investing in a fund, which may force some inexperienced managers out of the market.

Another concern amongst investors is the lack of available leverage in the current economic climate. Infrastructure deals rely heavily on leverage and investors recognise that the current credit crunch is affecting profitability. Investors also recognised the important role that government bodies will play in the future of the asset class. Large government stimulus programs are being introduced all over the world to reduce the infrastructure deficit and it is expected that the private sector will be called upon to provide financing. Investors anticipate a boom in infrastructure opportunities as the public sector faces revenue problems in the wake of the financial crisis, which will lead to more investors coming to market, increasing allocations and making investments. Many investors also believe that areas such as renewable energy will be profitable in the future, as governments are forced to seek alternatives to fossil fuels. In the coming years the number of PPP/PFI deals up for grabs is expected to soar and governments will therefore have a huge role in the direction the asset class takes.

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This survey was conducted using information from Infrastructure Online. Infrastructure Online is the most comprehensive resource available to infrastructure professionals today. Whether you're a fund manager, investor, placement agent, lawyer, consultant or advisor this is a vital information service for you.

- **Fund Managers**: View detailed profiles on over 250 Fund Managers from around the world including background, key contacts and funds raised. Carry out advanced searches to find GPs who focus on particular fund strategies, infrastructure industry types, infrastructure project stages or locations.

- **Funds**: Detailed profiles of over 400 listed and unlisted infrastructure funds encompassing all strategies including primary, secondary, mezzanine and fund of funds; and details on the fund's investment preferences in terms of project stage, industry and geographic region.

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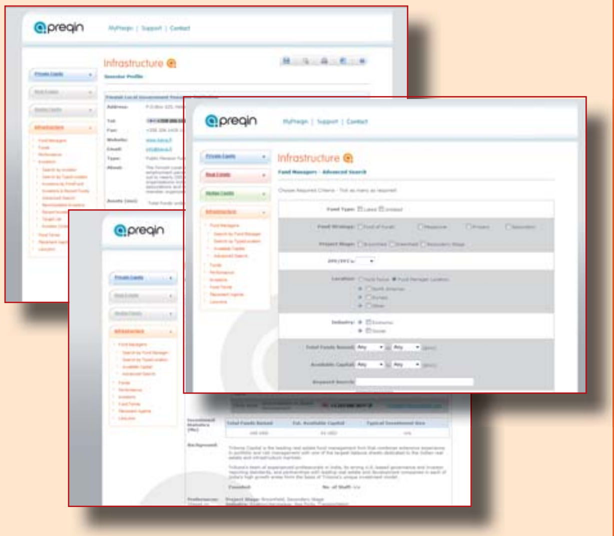

- **Performance**: View performance details of individual funds.

- **Fund Terms**: What are the typical terms that a infrastructure fund charges? What are the implications of making changes to different fees? How do these fees vary between fund type and strategy?

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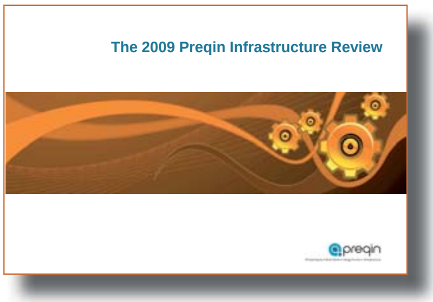
2009 Preqin Infrastructure Review: Order Form

The 2009 Preqin Infrastructure Review is the most comprehensive examination of the unlisted infrastructure fund market ever produced. With exclusive information on over 250 firms, 400 funds and over 230 investors in the sector, plus detailed analysis reviewing every aspect of the industry, the Preqin Infrastructure Review is a vital purchase for fund managers, fundraising professionals, advisors, consultants, legal firms and investors in this rapidly growing market. Features of this year's publication include:

- Detailed analysis examining the history and development of the infrastructure market; recent funds closed; current fundraising market; fund terms and conditions; investors; performance; the listed fund market; plus separate sections showing key facts and figures for the most important regions.
- Fund terms and conditions listings for 27 vehicles, plus transparent performance data for 62 infrastructure funds (all performance data is net to investors).
- Profiles for over 250 infrastructure firms and 400 funds, including detailed investment strategies and key information.
- Profiles for over 230 investors in the sector, including investment plans and key contact details.



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