

# Preqin Investor Outlook: Alternative Assets H1 2015



Private Equity | Hedge Funds | Real Estate | Infrastructure | Private Debt



alternative assets. intelligent data.

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## Data Pack for Preqin Investor Outlook: Alternative Assets, H1 2015

The data behind all of the charts featured in the report is available for free in an easily accessible data pack. It also includes ready-made charts that can be used for presentations, marketing materials and company reports.

To download the data pack from Preqin's **Research Center Premium**, please visit:

[www.preqin.com/investoroutlook](http://www.preqin.com/investoroutlook)



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# Foreword

Alternative assets continue to grow in prominence and, as they occupy ever-growing proportions of investors' portfolios, the alternatives industry has continued to increase in size. The assets under management of alternative asset classes now stands at \$6.91tn, having increased by \$648bn over the course of the past year.

This report brings together the results of a series of in-depth interviews with over 440 institutional investors, conducted by Preqin's analysts for the latest editions of the **Preqin Global Alternatives Reports**. This has enabled us to provide a comprehensive overview of institutional investor activity in 2014, their plans for the next 12 months, their changing allocations, the fund searches they are conducting and their views on the key issues impacting their alternatives portfolios.

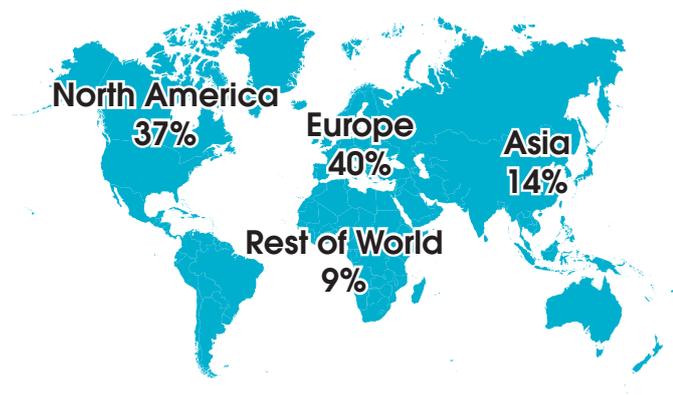
While there are naturally areas of concern among the institutional community, the majority of investors remain confident in the ability of alternative assets to help achieve portfolio objectives. Indeed, across all asset classes, a much larger proportion of investors plan to increase their exposure rather than cut back their allocations to alternatives. The alternatives landscape is becoming evermore diverse, and institutional investors are increasingly diversifying their portfolios to include a range of different asset classes. Private debt is increasingly being viewed by the institutional community as an independent asset class, and for the first time, we present the attitudes of investors in private debt alongside the views of investors in other alternative asset classes.

In addition to chapters focused on institutional investors, the **2015 Preqin Global Alternatives Reports** cover fundraising, performance, deals, fund managers, secondaries, fund terms, placement agents, consultants, service providers and more across the private equity, hedge fund, real estate, infrastructure and private debt asset classes. To get your copies of the reports, please visit: [www.preqin.com/reports](http://www.preqin.com/reports).

We hope you find this report informative and valuable, and would welcome any suggestions for future editions. To find out how Preqin's services can help your business in 2015, please do not hesitate to contact at us at [info@peqin.com](mailto:info@peqin.com) or at our New York, London, Singapore or San Francisco offices.

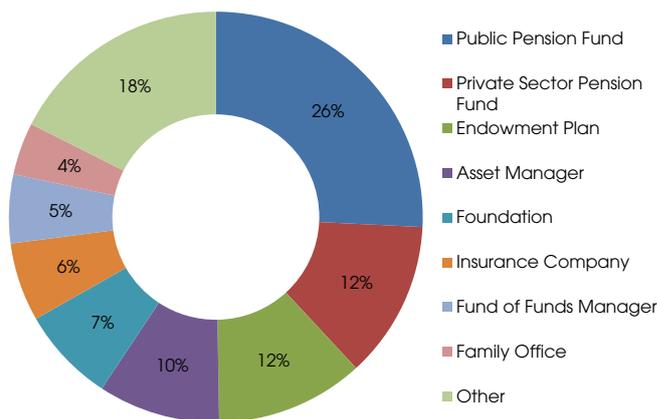
## Breakdown of Respondents

Breakdown of Respondents by Investor Location



Source: Preqin

Breakdown of Respondents by Investor Type



Source: Preqin

### 2015 Preqin Global Alternatives Reports

The **2015 Preqin Global Alternatives Reports** are the most comprehensive reviews of the alternatives investment industry ever undertaken.

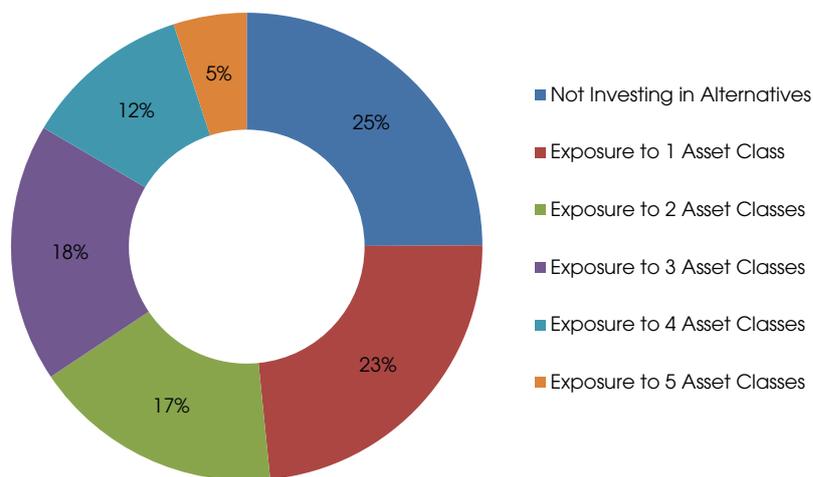
The Reports are an essential tool for anyone seeking to understand the latest developments in the private equity, hedge fund, real estate, infrastructure and private debt asset classes.

For more information, please visit: [www.preqin.com/reports](http://www.preqin.com/reports)

# Alternatives Overview

Alternative assets continue to play an important role in institutional investors' portfolios, as investors increase weightings to these asset classes, and further diversify their portfolios through new allocations to the growing range of alternative asset classes open to them. Fig. 1.1 reveals the number of these alternative asset classes that each of the over 12,500 investors profiled across Preqin's online products invest in. This demonstrates that only 35% have allocations to three or more alternative asset classes, and just 5% invest in all five asset classes. A quarter do not have any exposure to alternatives. There is, therefore, considerable scope for growth within alternative assets, as more investors will look to carve out new alternatives portfolios, and other institutions will seek to further diversify by investing across a wider range of asset classes.

**Fig. 1.1:** Breakdown of Institutional Investors by Number of Alternative Asset Classes Invested in

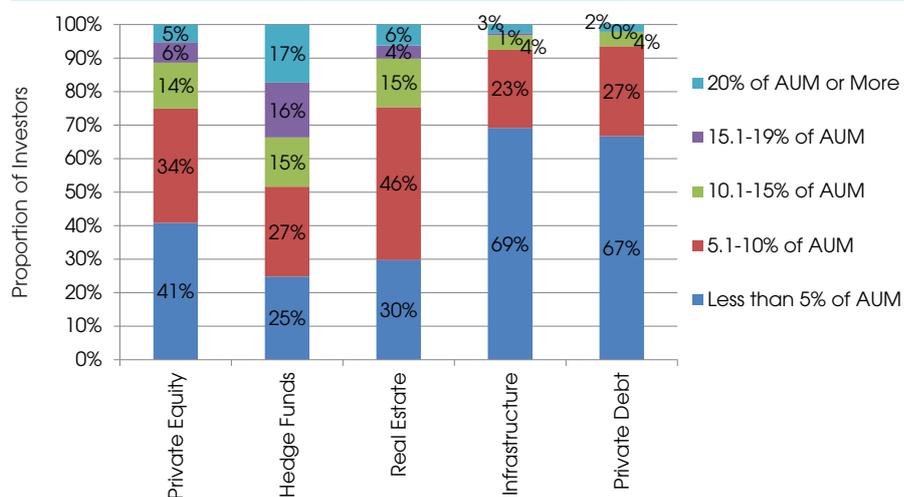


Source: Preqin Online Products

## Allocations to Alternatives

Fig. 1.2 shows a breakdown of active investors by their target allocation to each asset class, as a proportion of their assets under management (AUM). This reveals clearly that the more established alternative asset classes of private equity, hedge funds and real estate account for a greater proportion of investors' portfolios than infrastructure and private debt. Many investors aim to allocate a considerable proportion of their AUM to hedge funds in particular, with almost half (48%) of institutions targeting allocations of more than 10%, and 17% of investors in the asset class allocating 20% or more. For both private equity and real estate, the vast majority of investors target allocations of less than 10% of their AUM to each asset class, with 75% and 76% of institutions doing so respectively.

**Fig. 1.2:** Breakdown of Alternative Assets Investors' Target Allocations to Each Asset Class (Investors with an Active Allocation to the Asset Class)



Source: Preqin Online Products

With infrastructure and private debt more recently emerging as distinct asset classes, target allocations are typically lower, with 69% and 67% of investors targeting allocations of less than 5% to each asset class respectively. It is also common for investors to not have a dedicated allocation to infrastructure or private debt, but to invest from another bucket such as a general alternatives or private equity allocation.

However, allocations to both infrastructure and private debt look set to rise in the coming years, with approximately two-thirds of investors in each asset class stating that they plan to increase their allocation in the long term, as shown in Fig. 1.3. In comparison, 35% and 36% of real estate and private equity investors respectively plan to increase their allocations to each asset class, with 21% of hedge fund investors stating that they would do so. Investors in hedge funds are the most likely to reduce their

allocation to the asset class over the longer term, with 19% of investors stating that they plan to lower their allocation.

## Capital Commitments in 2015

As part of a survey of investment consultants undertaken by Preqin in November 2014, consultants were asked about the amount of capital they recommend their clients commit to each alternative asset class in the coming year. Fig. 1.4 reveals that consultants

are the most positive regarding private equity and hedge funds, with 46% and 40% respectively recommending that their clients invest more capital into these asset classes in 2015 than 2014. Thirty-five percent of consultants each recommend their clients invest more capital in infrastructure and private debt in 2015, with 32% of consultants making this recommendation for real estate.

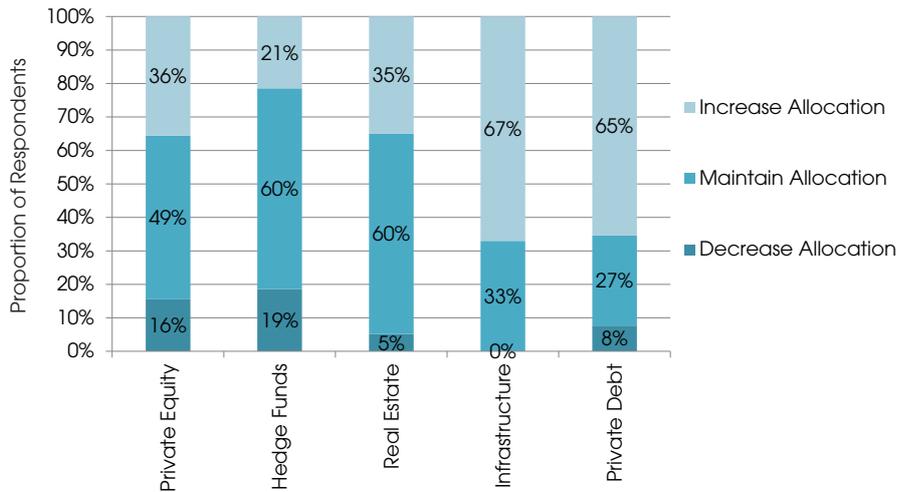
However, when investors were asked whether they would be committing more capital to each asset class in 2015, the results varied considerably, with over three-quarters of investors (79%) stating that they would be committing more to real estate in 2015 (Fig. 1.5). Investors are also particularly positive regarding private debt, with over half (55%) planning to commit more capital to the asset class in 2015 than 2014. Infrastructure fundraising is likely to remain stable in 2015, with 39% of investors planning to commit more capital in 2015 and 45% planning to invest less.

Satisfaction with Returns and Perception of the Industry

Investor satisfaction with their alternative investments varies considerably by asset class, as shown in Fig. 1.6. Investors are the most satisfied with returns from real estate, with a third stating that performance exceeded expectations over the past year, and just 7% stating that they fell short of expectations. Private equity investments have also largely lived up to expectations, with 17% stating returns exceeded expectations and three-quarters believing investments met expectations. At the other end of the spectrum, the relatively poor performance of hedge funds last year (the Preqin All-Strategies Hedge Fund benchmark generated returns of 3.78% in 2014) has led to dissatisfaction among many investors, with 35% believing hedge fund returns fell short of expectations.

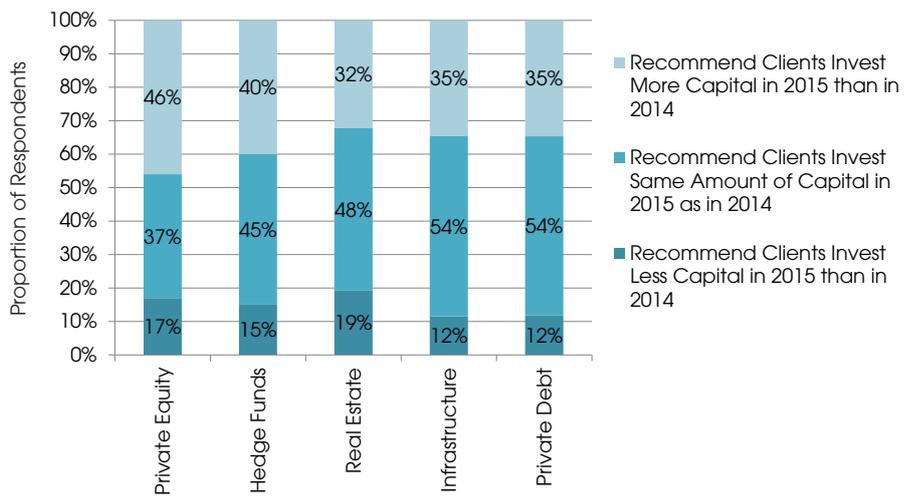
Views on the alternatives industry as a whole vary by asset class, with Fig. 1.7 showing that investors are most likely to view the private equity and infrastructure industries positively, with 59% and 57% of investors in these asset classes respectively stating that their outlook on alternatives is positive. Almost half (47%) of investors in private debt view the industry positively, whereas the largest proportion of real estate investors (63%) view the industry in a neutral light. Hedge fund investors are again more mixed, with 26% viewing the alternatives industry positively, and 20% negatively.

Fig. 1.3: Investors' Intentions for Their Alternatives Allocations over the Long Term by Asset Class



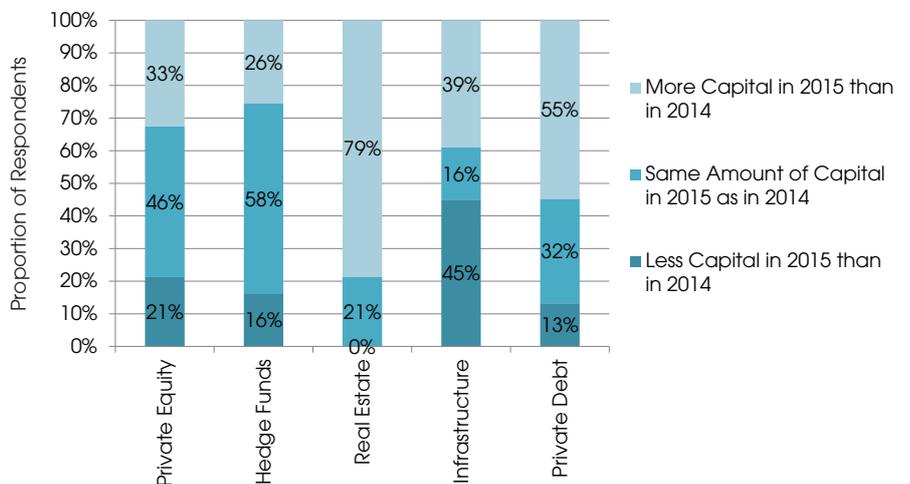
Source: Preqin Investor Interviews, December 2014 - February 2015

Fig. 1.4: Breakdown of Investment Consultants' Recommendations for 2015 Compared to 2014 by Asset Class



Source: Preqin Investment Consultant Survey, 2014

Fig. 1.5: Investors' Expected Capital Commitment to Alternative Assets Funds in 2015 Compared to 2014 by Asset Class



Source: Preqin Investor Interviews, December 2014 - February 2015

Issues in Alternatives and Alignment of Interests

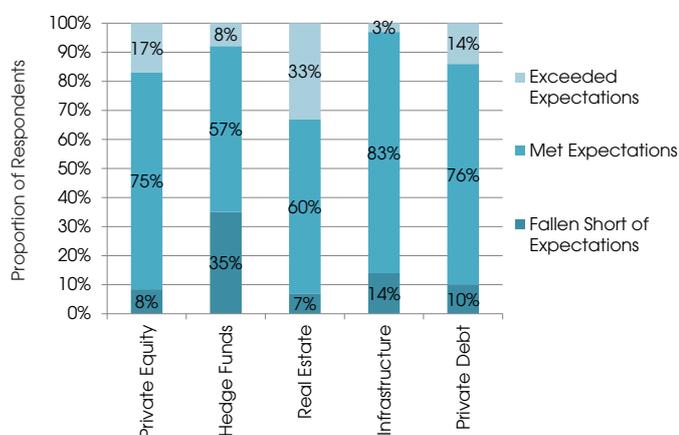
Although there are variations between asset classes regarding what investors view as the main issue in the next 12 months, key themes emerge. Fig. 1.8 reveals the top two issues for investors in each asset class, with performance the key issue for 33% of hedge fund investors and 37% of real estate investors. Fees are the top issue for 39% of private equity investors, whereas the availability of attractive investment opportunities are a key concern for 51% of private debt investors and 49% of infrastructure investors.

In a crowded market, it is vital for fund managers to ensure their interests and those of their investors are effectively aligned. Although many managers are now offering more bespoke fund terms and conditions, satisfaction among investors regarding the alignment of interests still varies. Across asset classes, investors believe adjustments in both management fees and performance fees would improve the alignment of interests. As shown in Fig. 1.9, management fees are a particularly contentious issue in infrastructure, with 91% of investors stating this as an area for improvement; while there has been movement towards more LP-friendly terms in recent years,

many investors are unhappy with infrastructure managers charging private equity-like fees in an asset class with an inherently lower risk/return profile.

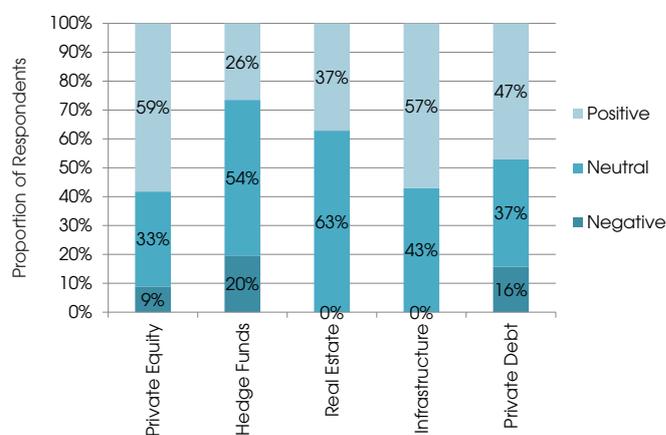
For private debt, investors view the level of fund managers' commitment to their funds as a key area where alignment can be improved, with 55% stating this. Other areas for improvement across asset classes are increased transparency at fund level and hurdle rates.

Fig. 1.6: Investors' Views on Whether Alternative Asset Class Investments Have Lived up to Expectations in the Past 12 Months



Source: Preqin Investor Interviews, December 2014 - February 2015

Fig. 1.7: Investors' General Perceptions of Each Alternative Asset Class at Present



Source: Preqin Investor Interviews, December 2014 - February 2015

Fig. 1.8: Top Two Key Issues for Investors in Alternatives by Asset Class (Proportion of Respondents in Each Asset Class Stated in Parentheses)

Private Equity	Hedge Funds	Real Estate	Infrastructure	Private Debt
Fees (39%)	Performance (33%)	Performance (37%)	Investment Opportunities (49%)	Investment Opportunities (51%)
Economic Environment (24%)	Fees (21%)	Investment Opportunities (27%)	Liquidity (33%)	Economic Environment (45%)

Source: Preqin Investor Interviews, December 2014 - February 2015

Fig. 1.9: Top Three Areas Where Investors in Alternatives Believe Alignment of Interests Can Be Improved by Asset Class (Proportion of Respondents in Each Asset Class Stated in Parentheses)

Private Equity	Hedge Funds	Real Estate	Infrastructure	Private Debt
Management Fees (60%)	Management Fees (68%)	Management Fees (58%)	Management Fees (91%)	Manager Commitment to Fund (55%)
Performance Fees - Amount (35%)	Performance Fees - Amount (38%)	Performance Fees - Amount (50%)	Performance Fees - Amount (18%)	Management Fees (53%)
Performance Fees - How They Are Charged (21%)	Performance Fees - How They Are Charged (35%)	Manager Commitment to Fund (25%) / Hurdle Rate (25%)	Performance Fees - How They Are Charged (9%) / Manager Commitment to Fund (9%) / Hurdle Rate (9%)	Hurdle Rate (49%)

Source: Preqin Investor Interviews, December 2014 - February 2015

# 2015 Preqin Global Alternatives Reports

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The 2015 reports form the most comprehensive review of the alternatives investment industry ever undertaken:

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- **Understand** the latest trends.
- **Access** analysis and statistics on fundraising, performance, deals, investors, fund managers and much more.
- **Improve** your presentations, marketing materials and company reports.
- **Answer** key questions - Who is investing? Where is the capital going? How much has been raised? What are the biggest deals?



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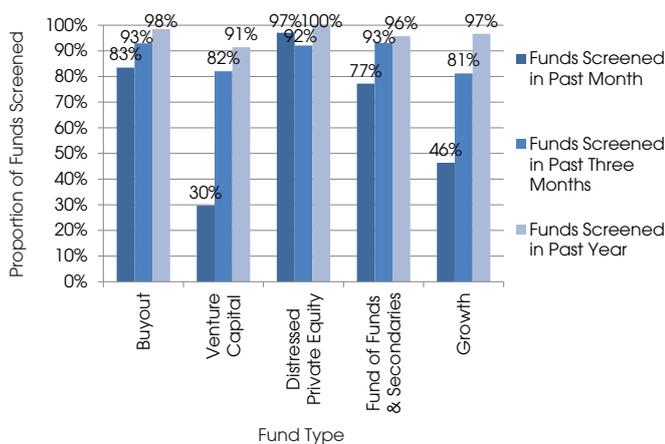


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# Investor Proactivity on Preqin Investor Network

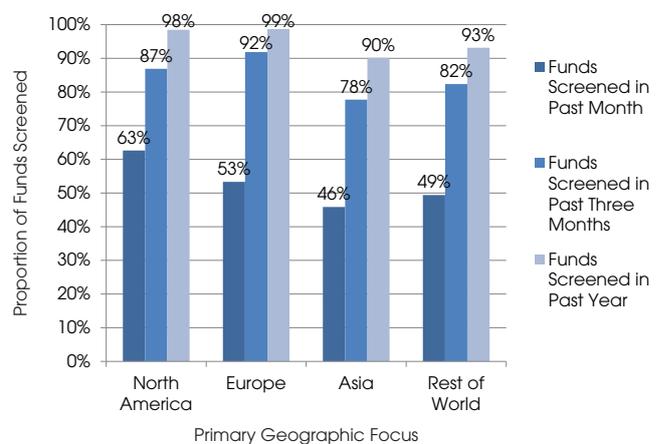
Preqin Investor Network provides accredited investors with free access to key information on all 2,200 private equity, private real estate and private infrastructure funds and 12,000 hedge funds currently open to investment. This section takes a look at the types of funds in market that investors have paid particular attention to over the past year.

**Fig. 1.1:** Proportion of Private Equity Funds Screened by Investors on Preqin Investor Network by Fund Type



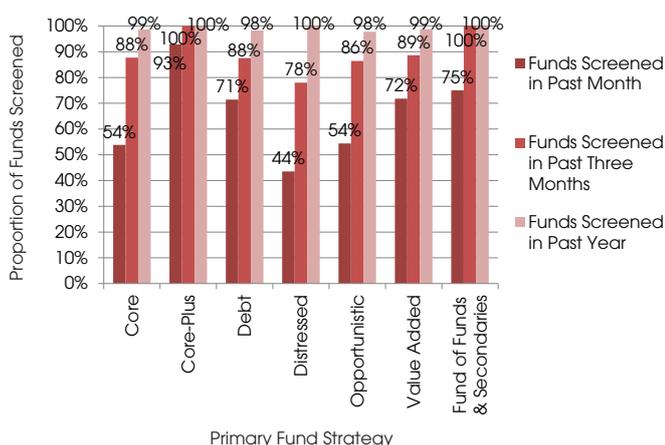
Source: Preqin Investor Network

**Fig. 1.2:** Proportion of Private Equity Funds Screened by Investors on Preqin Investor Network by Primary Geographic Focus



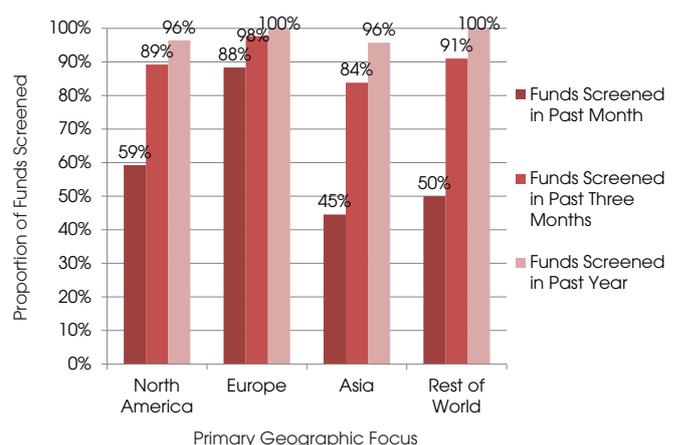
Source: Preqin Investor Network

**Fig. 1.3:** Proportion of Real Estate Funds Screened by Investors on Preqin Investor Network by Primary Fund Strategy



Source: Preqin Investor Network

**Fig. 1.4:** Proportion of Real Estate Funds Screened by Investors on Preqin Investor Network by Primary Geographic Focus



Source: Preqin Investor Network

## Preqin Investor Network

Over 6,600 investment professionals looking to make new commitments use **Preqin Investor Network** to access **free** detailed information on alternative funds open for investment. Share data with Preqin to ensure these investors have the most up-to-date information on your funds.

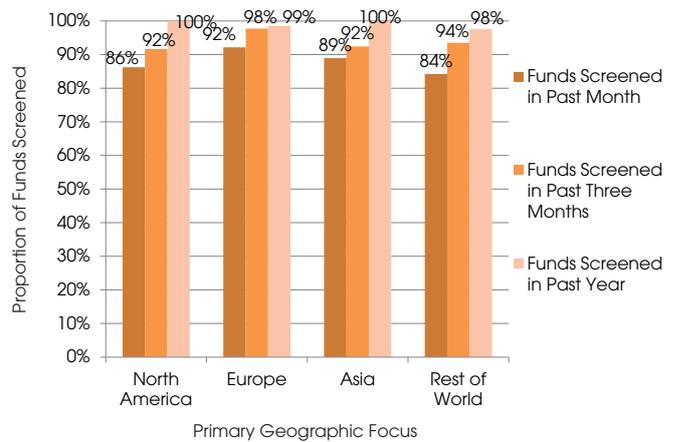
For more information, or to update your firm and fund profiles, please visit: [www.preqin.com/sharedata](http://www.preqin.com/sharedata)

**Fig. 1.5:** Proportion of Infrastructure Funds Screened by Investors on Preqin Investor Network by Target Size



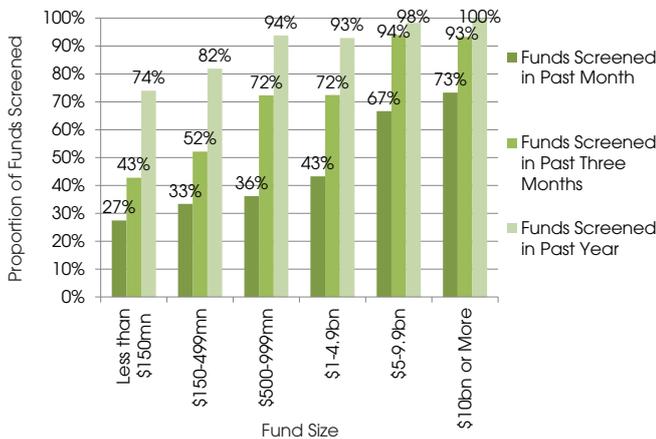
Source: Preqin Investor Network

**Fig. 1.6:** Proportion of Infrastructure Funds Screened by Investors on Preqin Investor Network by Primary Geographic Focus



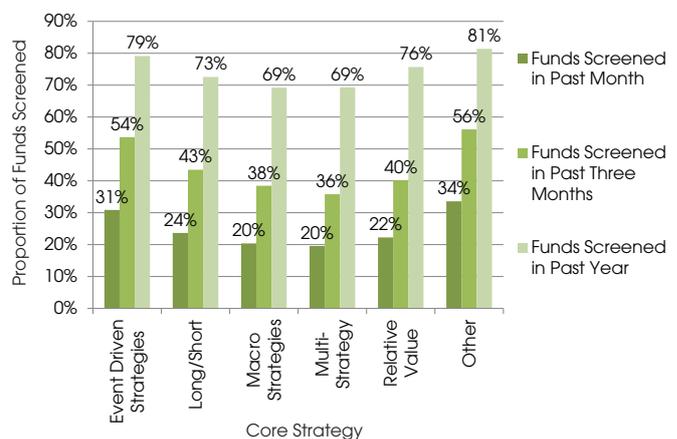
Source: Preqin Investor Network

**Fig. 1.7:** Proportion of Hedge Funds Screened by Investors on Preqin Investor Network by Fund Size



Source: Preqin Investor Network

**Fig. 1.8:** Proportion of Hedge Funds Screened by Investors on Preqin Investor Network by Core Strategy



Source: Preqin Investor Network

## Identify and evaluate alternative investment opportunities on Preqin Investor Network.

- **View** all alternative investment funds currently raising capital
- **Track** fund-level past performance for managers with a fund in market
- **Easily request** marketing materials from managers
- **Access** valuable market analysis and benchmarking tools

Signing up to Preqin Investor Network is easy – to register for **free**, please visit: [www.preqin.com/pin](http://www.preqin.com/pin)



# Private Equity

## New Challenges for a Growing Asset Class

As we move into 2015, competition remains fierce in the private equity fundraising market, with a record 2,222 funds on the road targeting an aggregate \$775bn as of the start February. Consequently, having a thorough understanding of the concerns, intentions and expectations of the investor community is vital for GPs looking to secure capital. Preqin's latest survey of over 100 institutional investors across the globe provides some valuable insight, having captured a wealth of information on investors' current attitudes towards a range of key topics within the market.

Most significantly, investors remain largely positive towards the asset class, with 92% of respondents stating that their private equity investments had either met or exceeded their expectations in the last 12 months. Given this substantial level of satisfaction, it is perhaps unsurprising that

a third of LPs surveyed indicated that they were looking to increase their allocation to private equity over the next 12 months, with 46% looking to maintain their current allocation.

However, LPs perceive there to be a variety of challenges when investing in the asset class, with 39% of respondents considering fees to be the most notable of them all. Given this statistic, GPs may be compelled to provide more LP-friendly fund terms going forward, in order to secure capital.

The recent announcement by CalPERS that will continue to reduce the number of GP relationships in its portfolio has led to speculation as to whether other institutional investors with large private equity programs will follow suit. According to Preqin's latest survey, only 14% of respondents intend to reduce the number

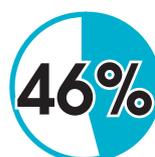
of GP relationships they maintain in their portfolio over the next two years. While this may reassure some fund managers, CalPERS' decision has ultimately added to the debate on costs of LP commitments to private equity and highlighted the concerns felt among the investor community in regard to fees charged.

As the market evolves, investors appear to be increasingly seeking alternative ways to gain exposure to private equity outside the traditional route of primary fund commitments, be it for reasons of liquidity, diversification or sheer opportunism. Preqin's results show that 56% of respondents expect to increase their level of co-investment alongside fund managers in the next 12 months, and of those that invest in separate accounts, 81% are considering making them a permanent part of their strategy going forward.

### Key Facts



Proportion of investors that feel their private equity investments have lived up to their expectations.



Proportion of investors that are below their target allocations to private equity, up from 39% in 2013 and 28% in 2012.



Proportion of LPs that feel fees are their biggest concern in operating an effective private equity portfolio.



Proportion of investors surveyed that plan to make their next private equity commitment in H1 2015.



Estimated aggregate capital invested in private equity as of June 2014.



Proportion of LPs that intend to maintain or increase the number of their GP relationships.

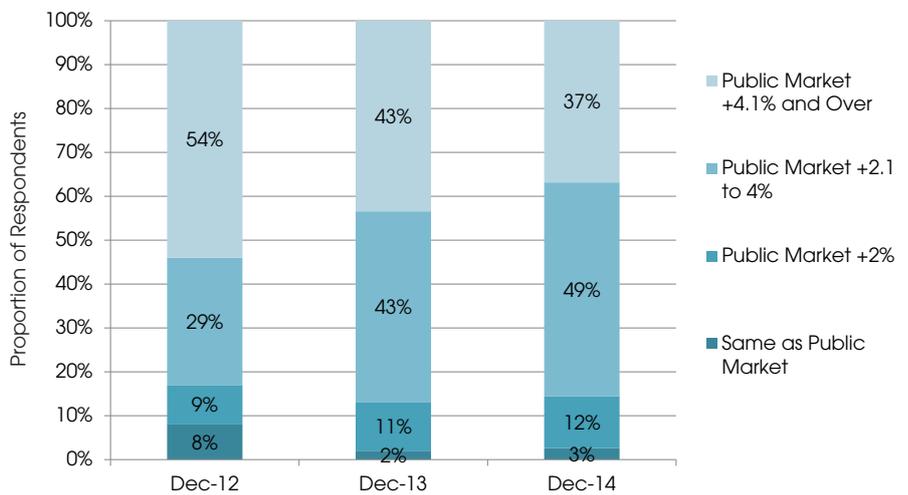
# Satisfaction with Returns

With the bullish performance of public markets continuing through 2014, Preqin's latest investor survey shows that fewer LPs expect their private equity portfolios to outperform the public market by more than 400 basis points, compared to the previous two years (Fig. 2.1). However, it remains that the vast majority of investors – 97% of respondents in December 2014 – expect their private equity returns to be superior to those of the public market. Over the past couple of years, the majority of investors have expected their private equity portfolios to outperform the public indices by 2.1-4%, rather than by a margin of 4.1% or more as in December 2012.

Despite this, over the past three years, the majority of investors have consistently had the expectations of their private equity fund investments met or exceeded, as shown in Fig. 2.2. In 2014, 75% of LPs we spoke to stated that their private equity portfolios had met expectations, and a further 17% felt their private equity investments had exceeded expectations, demonstrating continued positive sentiment towards the asset class. Further encouragement can be taken from the fact that the proportion of investors that have had their private equity investments surpass their expectations has increased each year from 2012.

In terms of investor location, North America-based and Asia-based LPs appear to have had the most success from their private equity fund investments, with

**Fig. 2.1: Investors' Returns Expectations for Their Private Equity Portfolios, 2012 - 2014**



Source: Preqin Investor Interviews, December 2012 - December 2014

all of these LPs having their expectations met or exceeded (Fig. 2.3). On the other hand, LPs based outside North America, Europe and Asia have experienced more mixed fortunes; the greatest proportion of

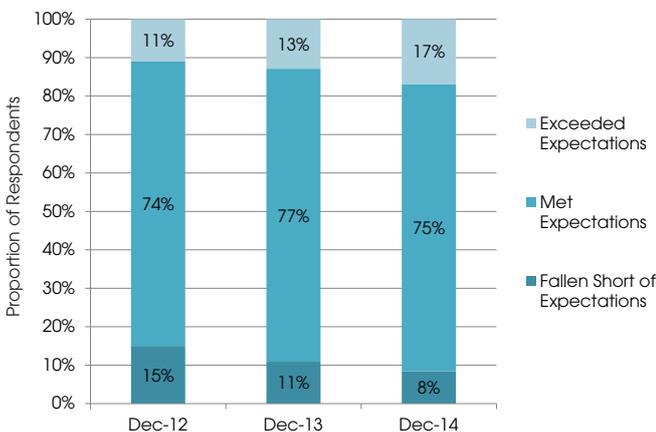
investors across all regions to have their expectations surpassed (33%), and also those with investments that have fallen short (22%), are located in Rest of World countries.

### Industry-Leading Private Equity Performance Data

Preqin's **Performance Analyst** online service is the industry's most extensive source of net-to-LP private equity fund performance, with full metrics for over 7,200 named vehicles.

For more information, please visit: [www.preqin.com/pa](http://www.preqin.com/pa)

**Fig. 2.2: Proportion of Investors that Feel Their Private Equity Fund Investments Have Lived up to Expectations, 2012 - 2014**



Source: Preqin Investor Interviews, December 2012 - December 2014

**Fig. 2.3: Proportion of Investors that Feel Their Private Equity Fund Investments Have Lived up to Expectations by Investor Location**



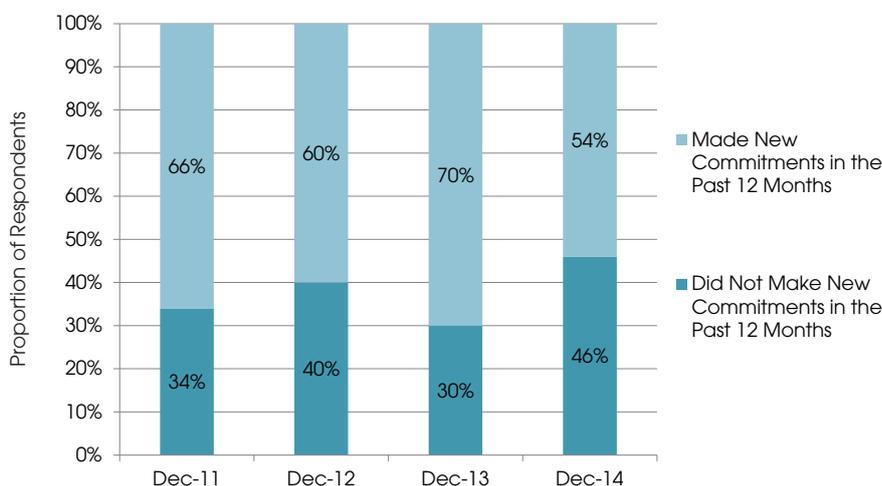
Source: Preqin Investor Interviews, December 2014

# Investor Activity in 2014

As part of the survey, Preqin asked LPs if they had made any new commitments in the past 12 months. More than half of the investors interviewed (54%) had committed to at least one new private equity fund in the last year; this represents a marked decrease from the results of recent years, as shown in Fig. 2.4. The sixteen percentage point decline from last year's results is surprising given the record amount of capital distributed to LPs in the 12-month period to December 2013 and six-month period to June 2014. Despite this drop, it is important to note that the amount of capital secured by GPs in 2014 was still a substantial \$521bn via 1,063 private equity fund closings.

The aggregate capital currently invested in private equity was estimated to be \$1.89tn as of June 2014. This figure is the amount invested in the asset class, not including committed capital that has yet to be called up by fund managers (i.e. excluding dry powder). It is calculated using the sum of the remaining NAVs of portfolios of private equity funds that have reached a final close (excluding funds of funds, secondaries funds, real estate funds and infrastructure funds). Fig. 2.5 gives Preqin's estimates of the capital invested in private equity by different types of investors, and demonstrates that public pension funds contribute the most significant amount of capital to private equity funds, accounting for 29% of aggregate capital. Sovereign wealth funds in particular have increased in prominence; these investors accounted

**Fig. 2.4:** Proportion of Investors that Made New Private Equity Fund Commitments in the Past 12 Months, 2011 - 2014



Source: Preqin Investor Interviews, December 2011 - December 2014

for 14% of total aggregate capital committed to private equity as of January 2015, compared to 8% in 2012 and 6% in 2010.

## Target Allocations

The proportion of investors that are currently below their target allocation to private equity has increased significantly from 28% in December 2012 to 46% in December 2014 (Fig. 2.6). At the same time, the proportion of investors at their target allocation has declined from 57% to 35%. This trend is likely to be the result

of the extent by which capital distributions have surpassed capital calls over the last couple of years.

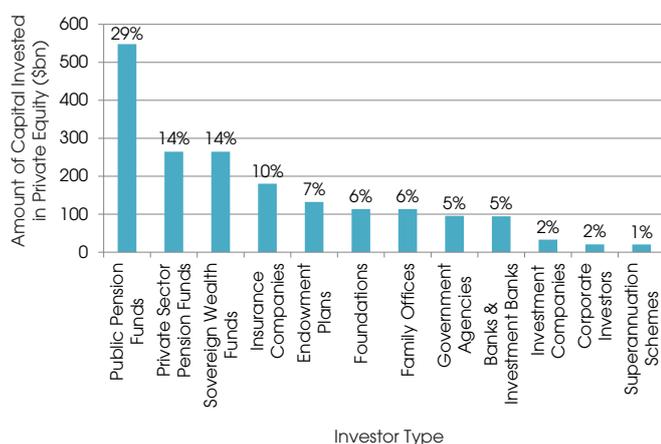
### Data Source:

Preqin's **Investor Intelligence** tracks in-depth data on over 5,400 active investors in private equity around the world.

For more information, please visit:

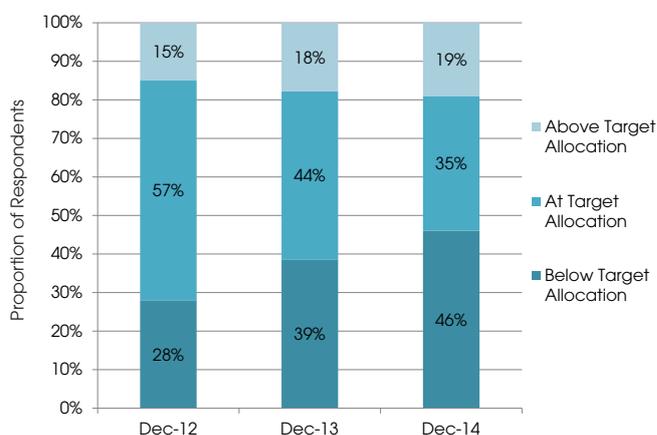
[www.preqin.com/ii](http://www.preqin.com/ii)

**Fig. 2.5:** Breakdown of Aggregate Capital Currently Invested in Private Equity by Investor Type (Excluding Funds of Funds and Asset Managers)



Source: Preqin Investor Intelligence

**Fig. 2.6:** Proportion of Investors At, Above or Below Their Target Allocations to Private Equity, 2012 - 2014



Source: Preqin Investor Interviews, December 2012 - December 2014

# Investor Activity in 2015 and the Longer Term

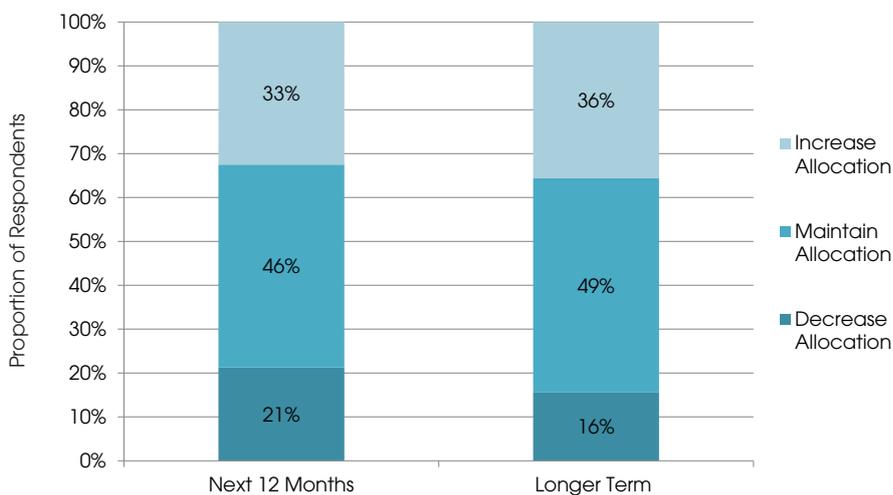
The solid performance of private equity returns in recent times, facilitated by the improving economic conditions particularly in the established markets of North America and Europe, has led to high levels of investor appetite and activity; Preqin’s survey results indicate that overall there is a strong sense of confidence in the asset class. The majority (79%) of investors will either maintain or increase their allocations over the coming year, and in the longer term, an even greater proportion (85%) of investors intend to do so (Fig. 2.7).

The proportion of investors looking to decrease their private equity allocations over the next 12 months is 21%, and 16% over the longer term. Investors continue to be drawn to the benefits that private equity investments offer their portfolio, including improvement of risk-reward characteristics, diversification, and traditionally superior returns to the public markets.

In order to meet their target allocations, LPs will have to reinvest a significant proportion of the capital that has been distributed to them of late. Fig. 2.8 shows that 53% of LPs interviewed expect to make their next private equity fund commitment in 2015, a third of investors (32%) are unsure as to when their next commitment will be, while 15% of investors do not anticipate investing until at least 2016. The fact that the majority of investors are looking to make a fund commitment in the year ahead will bode well for those fund managers currently in market or those that are looking to launch a vehicle in the next 12 months.

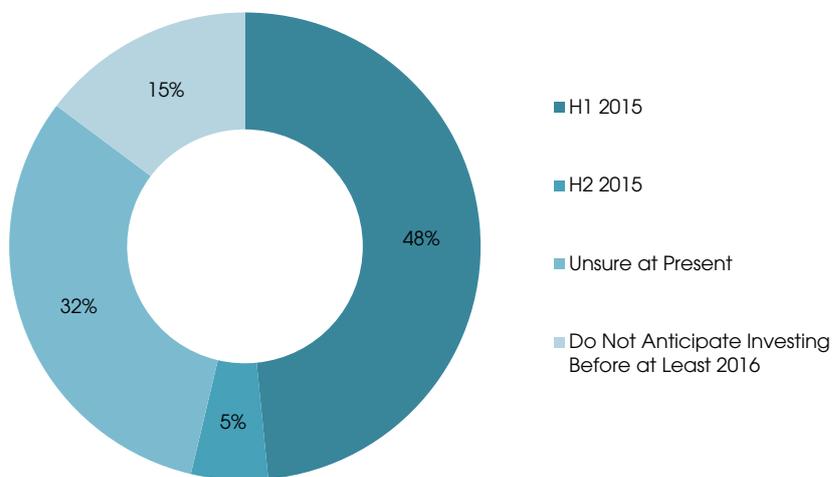
The uncertainty among almost a third of investors is substantial. This can partly be attributed to the ambiguity surrounding recent regulatory changes and proposals. With the Volcker Rule reviewed again in 2014 and the implementation date extended once more, along with the delays in the date that Europe’s Solvency II Directive is imposed, certain types of investors are restricted in their private equity investment plans.

Fig. 2.7: Investors’ Intentions for Their Private Equity Allocations



Source: Preqin Investor Interviews, December 2014

Fig. 2.8: Investors’ Timeframe for Their Next Intended Commitment to Private Equity Funds



Source: Preqin Investor Interviews, December 2014

**Data Source:**

The **Future Fund Searches and Mandates** feature on Preqin’s **Investor Intelligence** is the perfect tool to pinpoint those institutions that are seeking new private equity investments now.

Search for potential new investors by type and location, as well as their current fund type and geographic preferences.

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# Strategies and Geographies Targeted

## Fund Types

It is evident from Fig. 2.9 that small to mid-market buyout funds continue to be the most favoured fund type among investors, with 49% stating that the fund type presented the best opportunities in December 2014, and 54% seeking to invest in such funds during 2015. Venture capital funds are the second most favoured fund type for LPs; just over a quarter (26%) of investors intend to commit to venture capital vehicles in the year ahead. Though this is but a small increase from the 25% of respondents in the corresponding survey in 2013, we expect a more pronounced shift in sentiment toward venture capital vehicles given the recent turnaround in venture capital performance, whereby average returns in the year to Q2 2014 have surpassed those of any other private equity strategy over the same period.

## Preferred Geographies

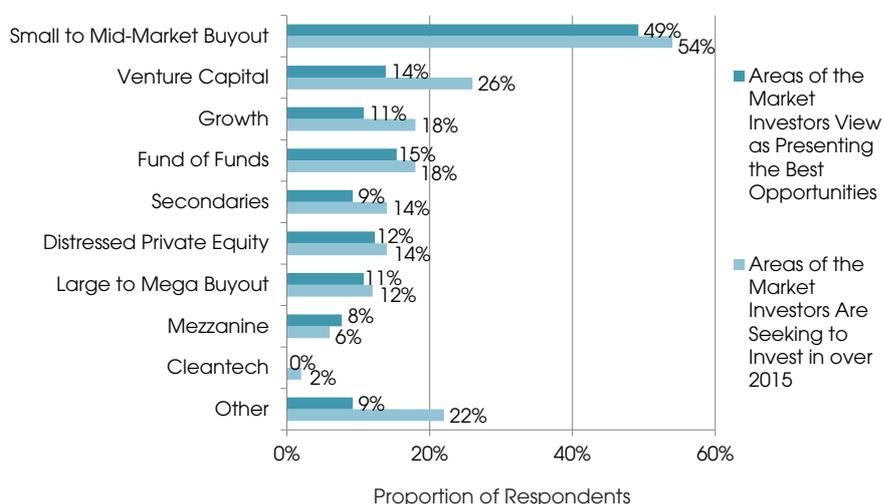
Following the global financial crisis, there was a significant decline in investor confidence in the more established markets and some LPs turned to emerging markets. However, a few years on, North America and Europe both display strong signs of recovery; emerging economies, however, are showing a slowdown in growth, with an increased proportion of investors appearing to be shying away from investment in these regions. Sixty-four percent of LPs stated that they would avoid investing in economies outside North America, Europe and Asia in the year ahead, where they would previously have invested, compared to 38% in December 2013.

Fifty-two percent of LPs indicated that Europe currently provides the best opportunities for investment. This is a drop from 59% last year, in line with 2014's emergence of unstable geopolitical situations in Central and Eastern Europe deterring investment activity.

## Opportunities in Emerging Markets

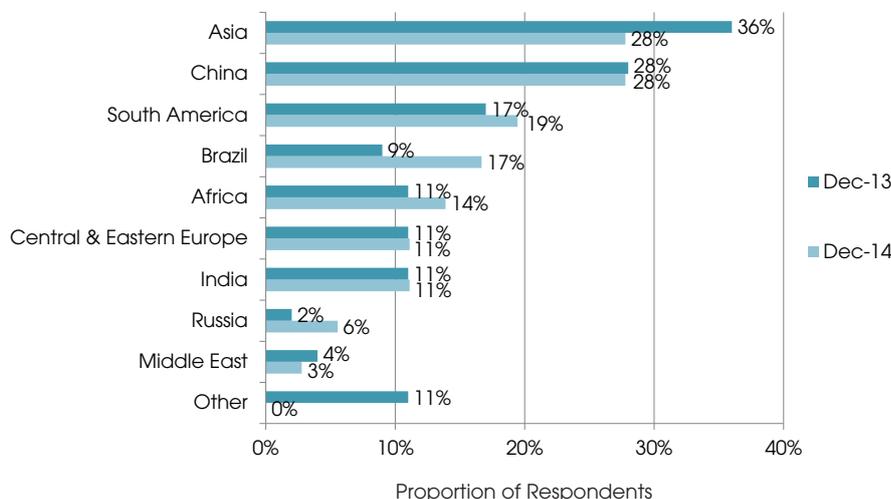
Our survey results provide clear evidence that appetite for emerging markets as a whole declined in 2014; just 5% of LPs surveyed in December 2013 were planning to decrease their allocations to emerging markets in the longer term,

Fig. 2.9: Investor Attitudes towards Different Fund Types at Present



Source: Preqin Investor Interviews, December 2014

Fig. 2.10: Countries and Regions within Emerging Markets that Investors View as Currently Presenting the Best Investment Opportunities, 2013 - 2014



Source: Preqin Investor Interviews, December 2014

compared with 25% of respondents in the December 2014 survey. However, there still exists a community of LPs that have confidence in emerging markets. A notable proportion of investors surveyed (25%) are planning to ramp up their allocations to emerging markets in the next 12 months, and a further 36% are planning to do so in the longer term.

South America continues to attract interest among LPs, with just under a

fifth (19%) of LPs believing the region presents the best opportunities within emerging markets (Fig. 2.10). The range of economic reforms introduced in the continent's economic powerhouse, Brazil, facilitates the development of the private equity asset class, feeding investor interest within this region.

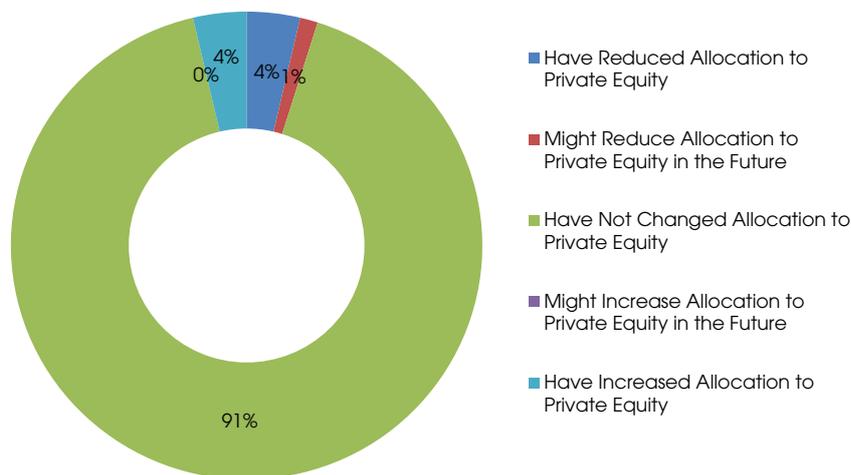
# Key Issues and Regulation

Prequin's latest survey reveals that recent regulation has caused only 8% of LPs to amend their private equity allocations (Fig. 2.11). This suggests that regulatory changes, while causing significant uncertainty among investors, have yet to have a widespread impact on LPs' allocations. One UK-based pension fund stated: "It [the AIFMD] will not affect our allocation but it does make it harder as now European fund managers cannot approach us, we have to approach them." It is also worth noting that certain legislative proposals such as the AIFMD are yet to be fully ratified within a number of European Union states.

Regulatory action in response to the financial crisis has placed the private equity industry under greater scrutiny and remains a cause for concern for investors, with 21% of respondents quoting regulation as a challenge in the year ahead.

However, the most significant proportion of LPs (39%) stated that fees are their biggest cause for concern in operating an effective private equity program in 2015 (Fig. 2.12). This represents a substantial increase compared to the same survey carried out in December 2013, when 15% of investors identified fees as the biggest challenge. Management fees, which are typically set at 2% of committed capital, have been a contentious issue, with many LPs demanding a decrease, or for fees to be aligned with the performance of GPs. One respondent from a Europe-based private sector pension plan suggested that fund managers could do more to

**Fig. 2.11: Impact of Recent Regulatory Changes and Proposals on Investors' Private Equity Allocations**



Source: Prequin Investor Interviews, December 2014

align their interests by increasing the level of GP commitment. Added to this is the fact that committed but uncalled capital is at a record high, and LPs are especially

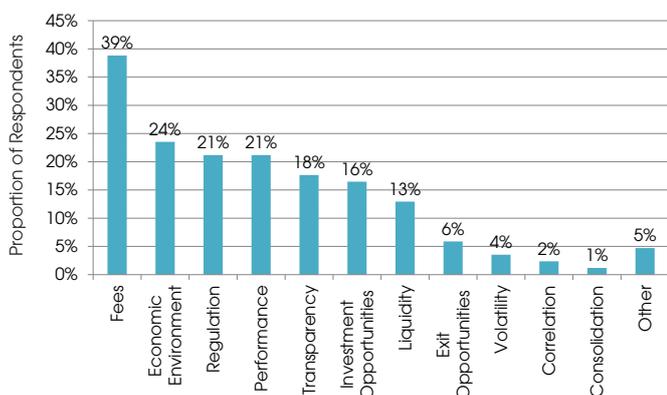
dissatisfied with paying management fees to the subset of GPs whose funds are now dormant and unlikely to invest further or raise new funds.

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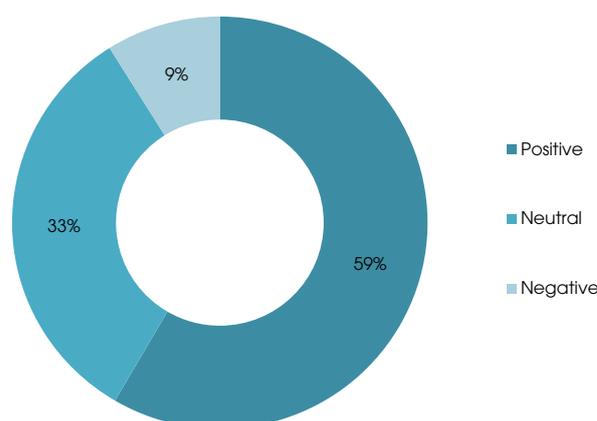
For more information, please visit: [www.prequin.com/rcp](http://www.prequin.com/rcp)

**Fig. 2.12: Biggest Challenges Facing Investors Seeking to Operate an Effective Private Equity Program in 2015**



Source: Prequin Investor Interviews, December 2014

**Fig. 2.13: Investors' General Perception of the Private Equity Industry at Present**



Source: Prequin Investor Interviews, December 2014

# Fees and Alignment of Interests

The majority (71%) of LPs we interviewed convey a belief that GP and LP interests are properly aligned (Fig. 2.14). While it is a slightly lower figure than that of the respondents in December 2013 (76%), it is still the predominant viewpoint held by investors. Twenty-nine percent of LPs now disagree that GP and LP interests are properly aligned, a five percentage point increase over last year. This marks a change from the past five years, when the proportion of investors which felt that GP and LP interests were not properly aligned was generally declining.

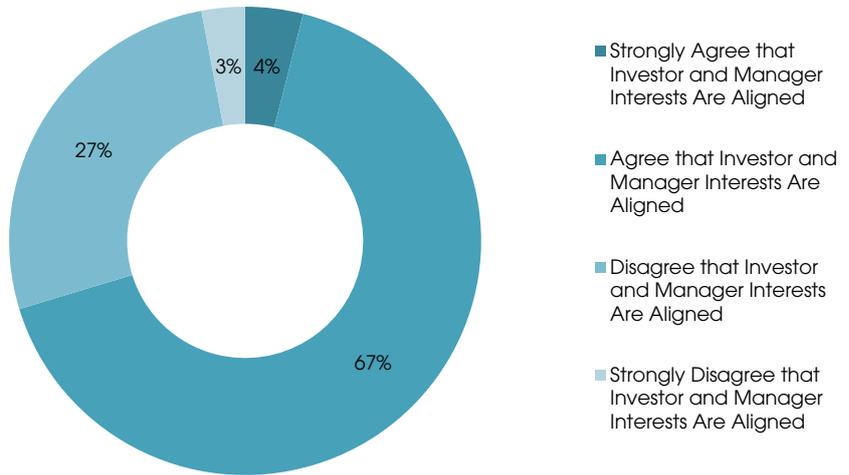
Preqin asked investors what could be done to improve the alignment of GP and LP interests. The largest proportion (60%) of respondents quoted management fees as a prominent issue, as shown in Fig. 2.15. This is an increase on the proportion of LPs that held the same opinion in December 2013 (56%), which indicates that instead of more GPs addressing and correcting the problem, more investors feel that fees are unaligned.

Another area in need of improvement is the carry structure, with investors indicating that the level of performance fees GPs charge is too high (35% of respondents) and also the method by which the fees are charged is unfavourable (21% of respondents).

### GP Relationships

Thirty-seven percent of the investors we surveyed are looking to increase the number of GP relationships they maintain in their portfolio over the next two years

**Fig. 2.14:** Proportion of LPs that Believe LP and GP Interests Are Properly Aligned



Source: Preqin Investor Interviews, December 2014

(Fig. 2.16), a decrease of 11 percentage points since 2013, indicating the desire of increasingly sophisticated LPs to streamline their operations.

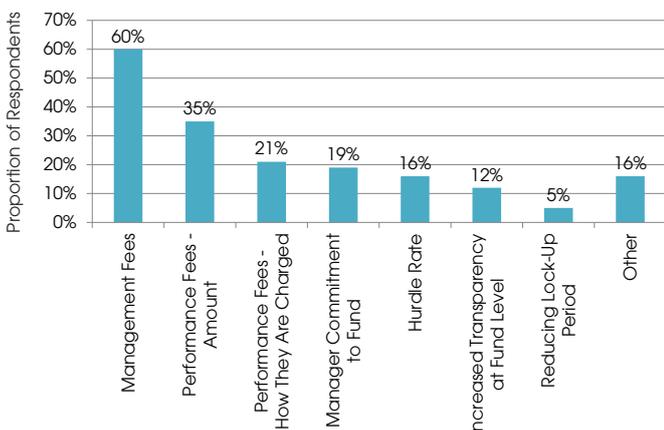
Investors' intentions with regard to forming new relationships have seen a slight decline over the past year; 85% of investors in 2013 were open to forming new GP relationships, compared to

81% in the corresponding 2014 survey. These proportions nonetheless reflect the overarching sentiment that LPs are actively looking for the best investment opportunities for their portfolios, seeking exposure to managers that offer the potential for good returns, regardless of a prior relationship.

The **2014 Preqin Private Equity Fund Terms Advisor** publication contains analysis on terms and conditions data for over 3,900 separate funds, and features anonymous listings of fund terms for more than 2,500 individual funds.

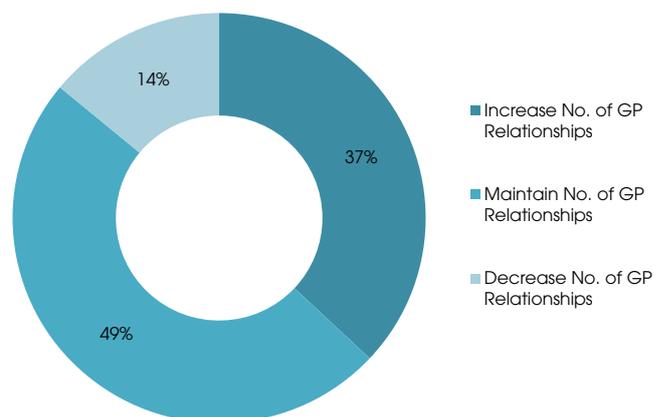
For more information, or to purchase a copy, please visit: [www.preqin.com/fta](http://www.preqin.com/fta)

**Fig. 2.15:** LPs' Views on Areas of Fund Terms and Conditions Where Alignment of Interests Can Be Improved



Source: Preqin Investor Interviews, December 2014

**Fig. 2.16:** Investors' Intentions for GP Relationships over the Next Two Years



Source: Preqin Investor Interviews, December 2014

# Alternative Methods of Accessing the Asset Class

The growing influence of sophisticated investors and a competitive fundraising environment has prompted GPs to offer bespoke investment offerings in the form of co-investments, directs and separate accounts that cater for LPs' burgeoning range of demands.

## Separate Accounts

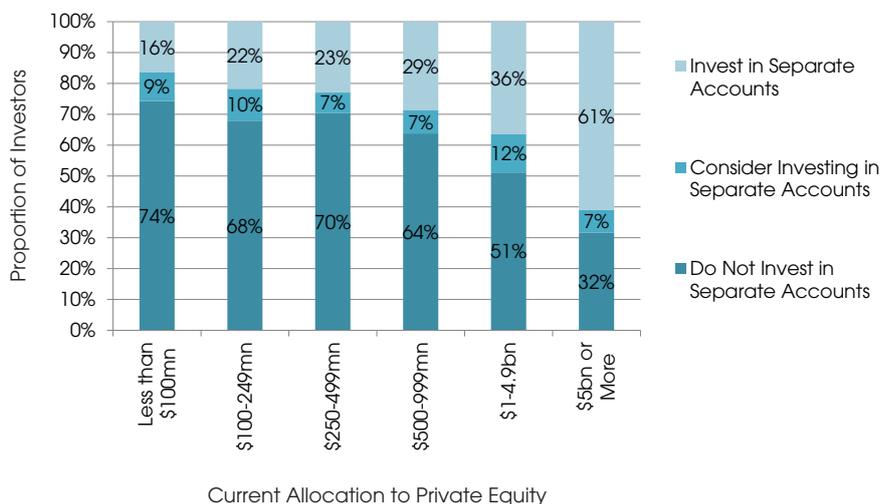
Separate accounts are increasingly being used by experienced investors desiring exposure to specific industries, regions, risk profiles and investment durations. They offer extremely attractive benefits to investors, including lower carried interest and management fees, in addition to a greater level of involvement regarding investment strategy. Separate accounts allow the LP to form a closer relationship with the respective fund manager, creating a better position from which to negotiate future terms, as well as encouraging a better level of reporting and communication from the GP.

Fig. 2.17 shows a breakdown of LPs that would consider awarding a separate account mandate by current allocation to private equity, with a clear positive correlation between the proportions of investors that will invest in such structures and the amount of capital allocated to private equity. For those LPs with \$5bn or more allocated to the asset class, 68% currently invest, or will consider investing in separate accounts, compared to 25% of LPs with less than \$100mn allocated to the asset class. The figures highlight a potential barrier preventing smaller investors from accessing these opportunities, as commitment sizes for separate account mandates do tend to be large in size.

## Direct Investments

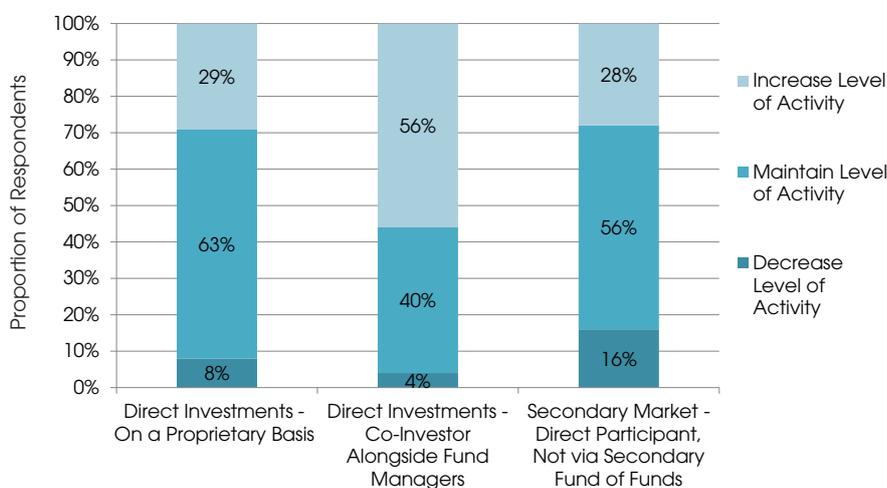
Co-investments especially look set to see growth in 2015, as illustrated in Fig. 2.18. Fifty-six percent of investors surveyed expect their level of activity in this space to increase, compared to 29% that intend to make more direct investments on a proprietary basis and 28% that will look to participate more in direct investments on the secondary market. These solutions are attracting LPs due to their lower fees, greater transparency and increased liquidity.

**Fig. 2.17: Breakdown of LPs that Would Consider Awarding a Separate Account Mandate by Current Allocation to Private Equity**



Source: Preqin Investor Intelligence

**Fig. 2.18: Investors' Expectations of Their Direct Investment and Secondary Market Activity in the Next 12 Months**



Source: Preqin Investor Interviews, December 2014

### Data Source:

Preqin's **Investor Intelligence** has detailed profiles for over 450 active investors in private equity that have awarded a separate account mandate, or are considering doing so.

Preqin's **Funds in Market** contains detailed information on 761 separate account mandates that have been issued, including size, geographic focus and more.

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# Hedge Funds

## Institutional Investors Remain Committed Despite Performance Concerns

Institutional investment in hedge funds came into the spotlight in 2014 following the exit of California Public Employees' Retirement System (CalPERS) from the asset class in the second half of the year. Despite another notable pension scheme, Netherlands-based PFZW, announcing at the start of 2015 that it redeemed its entire hedge fund portfolio at the end of Q4 2014, CalPERS' departure has not, at least as we enter 2015, opened the flood gates for many more pension schemes to exit hedge fund investments. There are more institutions than ever investing in hedge funds, investing ever-growing portions of their total portfolio in the asset class and creating increasingly sophisticated portfolios of funds.

Hedge funds struggled to generate strong performance in 2014; the Preqin All-Strategies Hedge Fund benchmark made gains of just 3.78% over the course of the year. This poor performance did not go unrecognized by investors; 35% of investors stated that their hedge fund investments failed to live up to expectations in 2014, compared to 16% that stated the same

for 2013. So why do investors continue to invest in hedge funds, even though 2014 was a disappointing year for industry performance? The industry has proven its ability to deliver consistent returns over longer timeframes, and it is this potential for solid risk-adjusted returns that appeals to investors. In fact, investors are not looking for hedge funds to match the S&P 500, but instead are turning to hedge funds to diversify their traditional equity and bond holdings with an attractive risk/return profile. With increased volatility in equity markets in 2014 and global macroeconomic events potentially leading to a difficult returns environment for traditional investments in 2015, the year could be a vital one for hedge funds to prove their true value.

Fundraising continues to be challenging for fund managers, particularly the smaller or emerging funds. However, investors remain interested in these funds in the year ahead; 52% of investors that we spoke to for the 2015 Preqin Global Hedge Fund Report said they would either invest or consider investing in an emerging fund in 2015. In

fact, as some of the largest funds reach capacity or close to new investment, we may see some smaller funds pick up new mandates as investors seek to put more capital at work in hedge funds in 2015.

Following a difficult year in terms of performance, the calls for hedge funds to cut back fees have intensified as we enter 2015. However, all fund managers – both emerging and established – will need to continue to listen and respond to all investor demands over the course of the year in order to attract capital in 2015.

Preqin conducted interviews with 134 institutional investors in November 2014 in order to gauge their outlook on industry issues such as performance, regulation and fund terms, as well as their appetite for hedge funds in 2015. Here we present a detailed analysis of the key topics affecting hedge fund investors in 2015, using results taken from our 2015 Preqin Global Hedge Fund Report.

### Key Facts



Proportion of investors that believed that hedge fund returns met or exceeded their expectations in 2014.



Proportion of investors that expect to maintain or increase their hedge fund allocations over the next 12 months.



Proportion of investors that believe that performance is the key issue for hedge funds in 2015, the most commonly cited issue.



Proportion of investors that want to see an improvement in the level of management fees charged in 2015.

# Satisfaction with Returns

In the 2014 Global Hedge Fund Report, Preqin reported that in 2013 investor satisfaction with hedge fund performance reached its highest levels recorded. However, in 2014 hedge funds posted their worst returns since 2011, and the Preqin All-Strategies Hedge Fund benchmark was in the red as many times as it was in the black. This choppy performance was noted by institutions, with investor satisfaction with hedge fund performance falling in 2014.

As shown in Fig. 3.1, 35% of investors surveyed stated that their hedge fund portfolio returns had fallen short of their expectations during 2014, a significant increase from 16% in 2013. In addition, 22% of those surveyed stated they had reduced confidence in hedge funds to perform portfolio objectives, an increase from 16% of respondents last year. Despite this, the majority (57%) of investors stated that their hedge fund investments had met expectations across the year. Just 8% of investors reported that performance had exceeded their expectations over 2014, down from 21% in 2013.

Coupled with this increase in the proportion of investors believing hedge funds had not met portfolio expectations in 2014, we also witnessed an increased proportion of investors stating that their confidence in hedge funds to meet portfolio objectives has reduced over the course of 2014. With this in mind, it

will be important for fund managers to perform well in 2015 in order to restore confidence.

Fig. 3.2 shows the specific hedge fund strategies that investors believe have exceeded and fallen short of their expectations in 2014. The investors surveyed by Preqin were divided in their opinions on long/short equity in 2014. Similar proportions of investors stated that the strategy had exceeded expectations as had fallen short of expectations: 35% and 36% respectively. Despite the overall Preqin Long/Short Equity benchmark adding just 3.49% in 2014, there were some funds that posted significant returns in the year: seven long/short equity funds featured in the top 10 performing funds in 2014. Those investors, therefore, which were invested in the better performing long/short equity funds were rewarded with high returns.

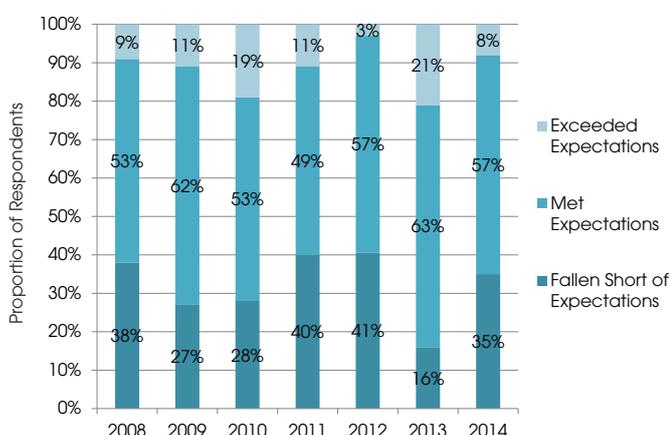
In 2013, no investors reported that their event driven funds had not met expectations; however, in 2014, 16% of investors stated that the strategy had not lived up to their performance demands. In addition, fewer investors reported that the strategy had exceeded expectations in 2014 than reported the same in 2013 (20% and 27% respectively). In the first half of 2014 the strategy struggled to post the same consistent gains it had been adding over 2012 and 2013. In the second half of 2014, the strategy faltered and went into negative territory,

particularly as a result of some high profile M&A deals falling through.

In contrast, managed futures/CTAs had a more successful 2014, adding 9.96% over the year, their best annual return since 2010, and beating the performance of the Preqin All-Strategies Hedge Fund benchmark. Nineteen percent of investors reported that the strategy had exceeded expectations, a marked increase from the 2% that stated the same for 2013. Despite a greater proportion (22%) of investors affirming that the strategy had not met expectations, this was a much smaller proportion than in 2013, when nearly half of all investors felt CTAs had not met expectations.

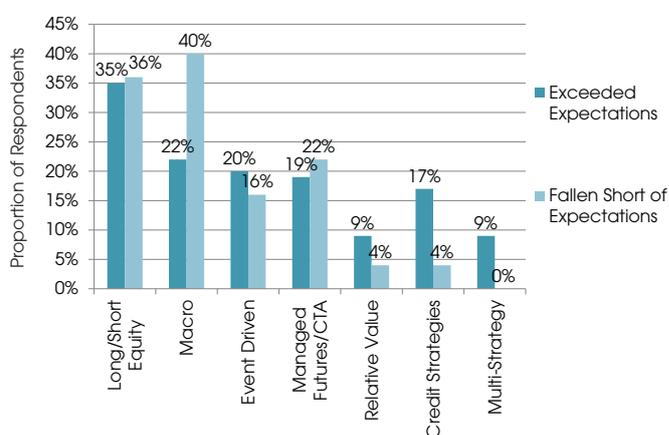
Macro funds continued to disappoint; 40% of investors surveyed believed the strategy's performance had fallen short of expectations. This, however, is a slight improvement on 2013, when 43% of investors felt they underperformed. Positively for the strategy, 22% of investors felt macro funds had exceeded their expectations, up significantly from just 2% of investors last year. This perhaps reflects the strategy's mid-year run of solid performance, particularly in a period when equity markets were proving difficult to navigate and investors looked for non-correlated assets.

**Fig. 3.1:** Hedge Fund Portfolio Performance Relative to Expectations of Institutional Investors, 2008 - 2014



Source: Preqin Investor Interviews, November 2014

**Fig. 3.2:** Hedge Fund Portfolio Performance Relative to Expectations of Institutional Investors by Strategy



Source: Preqin Investor Interviews, November 2014

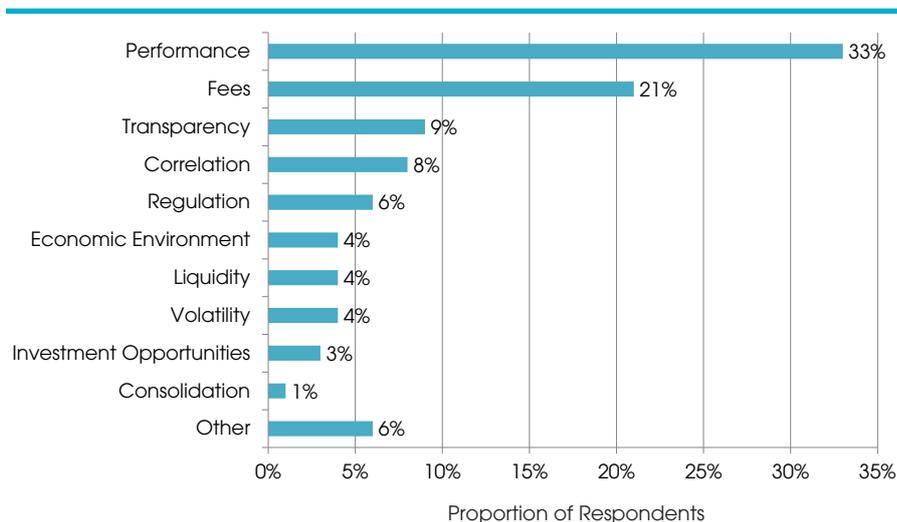
# Key Issues and Regulation

Fig. 3.3 shows the key issues investors felt the hedge fund industry would face in 2015. Performance, the most cited issue in last year's survey, remained the most common issue, cited by a third of investors. The disappointing performance of hedge funds in 2014 and an uncertain outlook for 2015 has put the ability of the asset class to deliver investors' return objectives at the forefront of investors' minds. There has also been a significant shift in the proportion of investors stating that fees will be a key issue in 2015 as compared to 2014. Twenty-one percent of investors felt fees would be the key issue moving into 2015, nearly double the proportion of investors that said the same the previous year.

Although the majority of investors surveyed were satisfied with their hedge fund investments, failure to perform in 2015 will fuel investors' continued questioning of hedge fund fees and the value they are getting from their hedge fund portfolios. The high profile exit of CalPERS from hedge funds, citing operational costs, has also helped propel the issue of hedge fund fees to the fore. In a competitive fundraising environment, some managers may find themselves needing to re-evaluate their fees, particularly in strategies that are saturated and have relatively low barriers to entry.

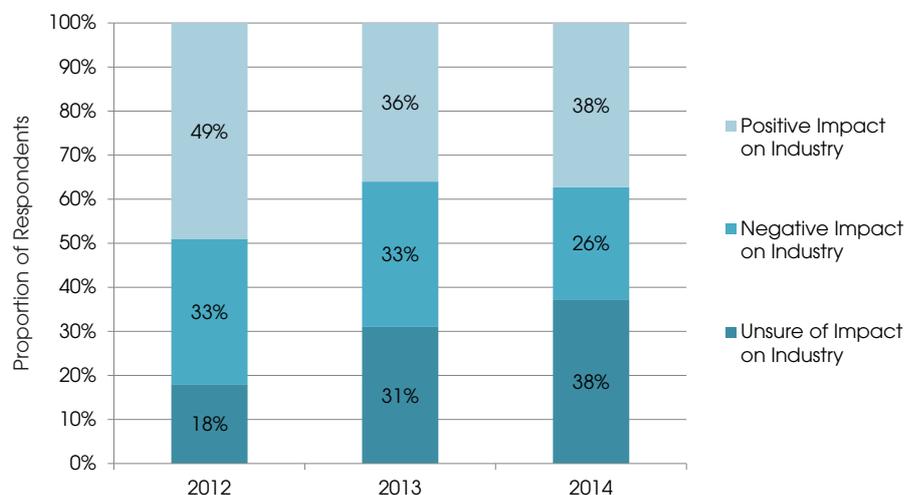
Regulation was a key theme identified by investors last year, with 24% of investors stating that it would be the key issue in 2014. However, just 6% of investors considered it the main issue moving into 2015. The industry has become increasingly regulated over recent years; much of the uncertainty surrounding the changes, from an investor's perspective, have been clarified over 2014 following the final introduction of changes to regulations such as the Alternative Investment Fund Managers Directive (AIFMD). However, Fig. 3.4 shows that more investors are still unsure about the impact that recently introduced regulation will have on the industry compared to recent years; only 26% of investors in 2014 believe that such regulation will have negative consequences for the industry. As investors become more

**Fig. 3.3:** Key Issues Facing the Hedge Fund Industry in 2015 According to Institutional Investors



Source: Preqin Investor Interviews, November 2014

**Fig. 3.4:** Investor Outlook on Hedge Fund Industry Regulations Introduced in Recent Years, 2012 - 2014



Source: Preqin Investor Interviews, November 2012 - November 2014

accustomed to investment in a regulated hedge fund industry, and the impact this will have on their fund choice, as well as the additional transparency and protection this may offer them, regulation could continue to be less of a concern for institutions.

#### Data Source:

With fees and performance emerging as key issues for investors in 2014, use Preqin's **Hedge Fund Analyst** to find out more about hedge fund terms and returns in 2014.

For more information, please visit:

[www.preqin.com/hfa](http://www.preqin.com/hfa)

# Investor Activity in 2015

Despite underwhelming performance posted by hedge funds in 2014, the majority of institutional investors appear to be committed to the asset class. At the end of 2014, there was a noticeable increase in the proportion of investors that indicated that they would reduce their allocation to hedge funds over the next 12 months compared to 2013 (16% and 8% respectively), as illustrated in Fig. 3.5. However, investor activity over the next 12 months looks encouraging for hedge fund managers, with the majority (84%) of institutional investors intending to maintain or increase their allocations to the asset class.

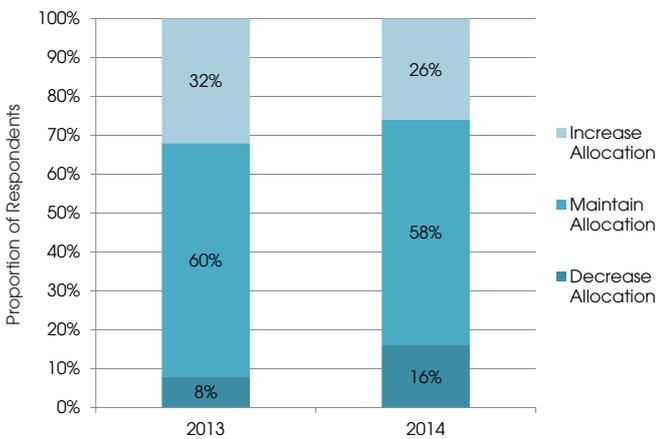
Fig. 3.6 illustrates the breakdown of the amount of capital institutional investors will be looking to commit to hedge funds over the next 12 months. The majority of investors (54%) have indicated that they each intend to invest up to \$49mn of fresh capital in hedge funds over the next 12 months. At the other end of the spectrum, a relatively small proportion of investors (8%) indicated that they would invest \$500mn or more in 2015.

Sixty-nine percent of investors plan to invest in at least three funds over the course of the year (Fig. 3.7). Therefore, it is clear that the majority of investors remain committed to investing in a

variety of funds to diversify portfolios and spread risk.

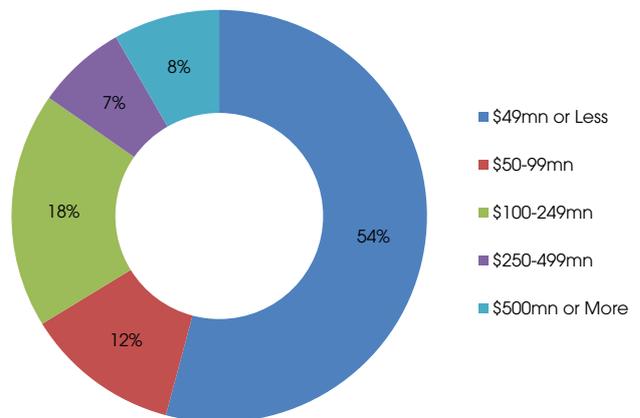
Investors were asked about their specific plans for 2015 in relation to the strategy weighting within their portfolios; across all strategies, more investors were looking to increase their exposure than decrease exposure (Fig. 3.8). As demonstrated previously in Fig. 3.5, the net movement of investor portfolios is towards investors increasing the amount of capital they plan to invest in hedge funds in 2015, with this capital likely to flow into a variety of strategies. However, long/short equity strategies look set to be the biggest winners in 2015.

**Fig. 3.5: Investors' Intentions for Their Hedge Fund Allocations in the Next 12 Months, 2013 - 2014**



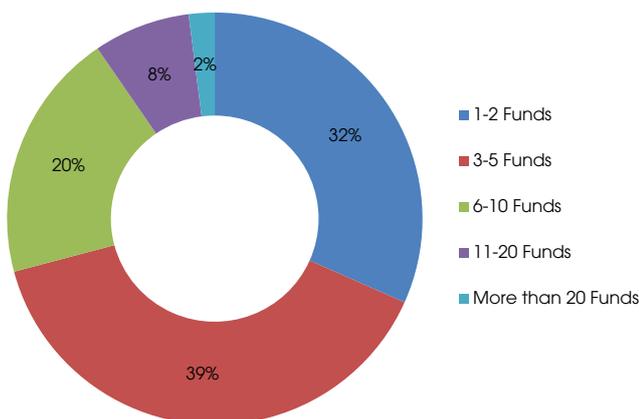
Source: Preqin Investor Interviews, November 2013 - November 2014

**Fig. 3.6: Amount of Fresh Capital Institutional Investors Expect to Invest in Hedge Funds over the Next 12 Months**



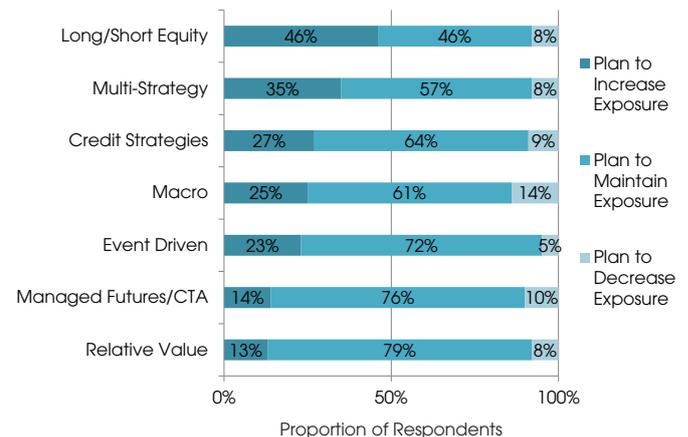
Source: Preqin Hedge Fund Investor Profiles

**Fig. 3.7: Number of Hedge Funds Institutional Investors Expect to Add to Their Portfolios over the Next 12 Months**



Source: Preqin Hedge Fund Investor Profiles

**Fig. 3.8: Breakdown of Investors' Strategy Allocation Plans for 2015**



Source: Preqin Investor Interviews, November 2014

# Attracting Investor Capital

It is fundamental that fund managers looking to attract and retain investor capital from institutional investors recognize their unique needs and requirements. Indeed, key aspects such as manager experience and high risk-adjusted returns are prominent, but what other considerations are investors looking for?

## Return Objectives

Thirty-six percent of investors cited high risk-adjusted returns as a key objective from their hedge fund portfolio (Fig. 3.9), an 11 percentage point increase from the proportion of investors surveyed at the end of 2013 (25%). This illustrates

the need for investors to see managers produce returns relative to the risk of the underlying strategy. Moreover, high absolute returns were a key return objective for a notable proportion (28%) of investors allocating to the asset class. Nineteen percent of investors required consistency or low volatility from their hedge fund holdings.

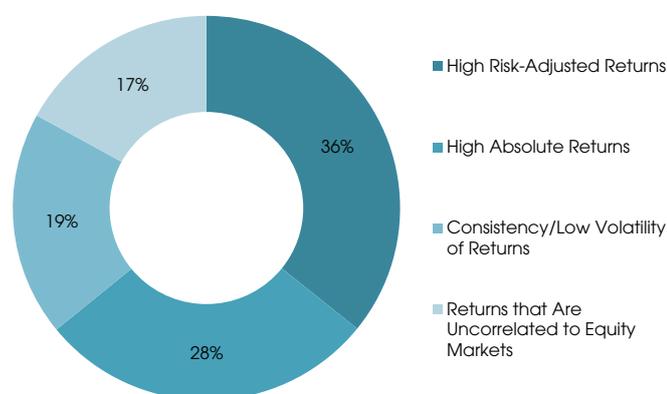
## Key Factors in Fund Manager Selection

In 2015, investors plan to place more emphasis on the experience of the management team and the strategy of the funds than they did in 2014, with fewer investors looking at returns and the

fund track record (Fig. 3.10). However, the shift is relatively small, and it is clear that all four factors are an important part of the decision-making process for institutional investors.

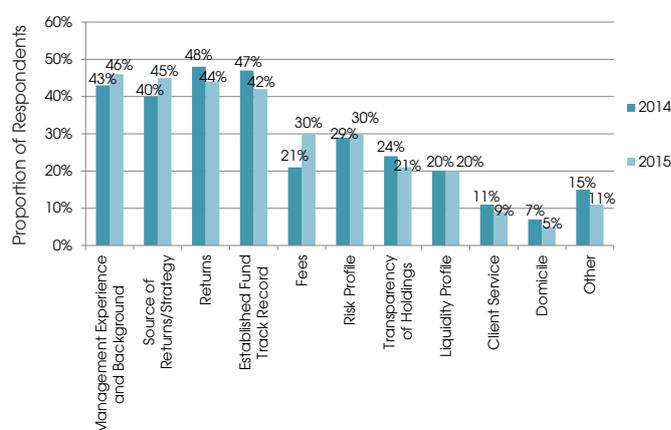
The proportion of investors that look at fees when assessing managers increased from 21% in 2013 to 30% in 2014. Given the tough year some managers have had in terms of performance, it is unsurprising that the question of fees has been awarded higher priority within investors' selection criteria. Managers may find fee structures under increased scrutiny from investors if performance continues to be volatile.

**Fig. 3.9:** Investor Returns Objectives from Hedge Fund Investments



Source: Preqin Investor Interviews, November 2014

**Fig. 3.10:** Key Factors Used by Institutional Investors to Evaluate Hedge Fund Managers, 2014 vs. 2015



Source: Preqin Investor Interviews, November 2014

## Data Source:

Preqin's **Hedge Fund Investor Profiles** is the industry's leading source of intelligence on institutional investors in hedge funds and features detailed profiles for over 4,800 investors worldwide, including information on:

- Current and target allocations to hedge funds
- Strategy and geographic preferences
- Future investment plans
- Direct contact details for key decision makers and much more.

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# Fees and Alignment of Interests

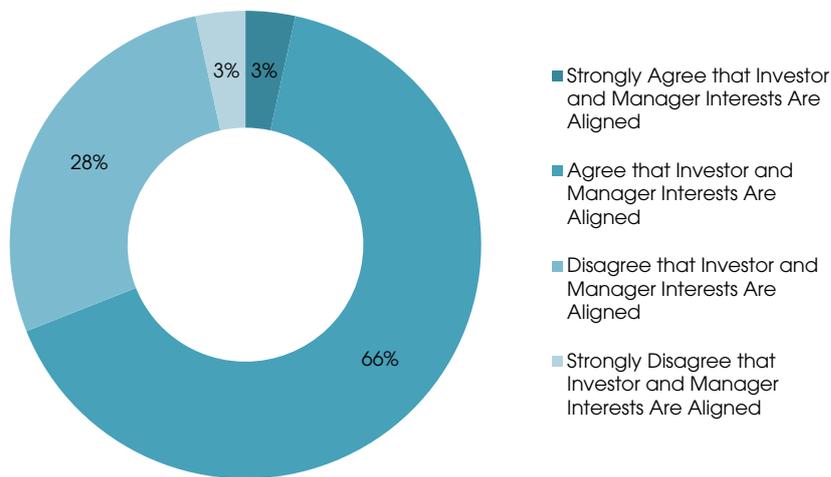
The fund terms attached to a hedge fund are an important consideration for an investor when selecting an investment opportunity. Central to these terms are the fees attached to the performance and management of hedge funds, which have evolved following several years of investor pressure to reduce fees and to better align the interests of fund managers and investors.

## Alignment of Interest

Hedge fund managers strive to achieve the optimal balance of having appropriate fees and structures to run a fund efficiently while maintaining good value in order to attract investment. Sixty-six percent of hedge fund investors believe that fund manager and investor interests are aligned, while an additional 3% strongly agree with this assertion (Fig. 3.11). However, over 30% of investors believe their interests are not aligned with fund managers.

When considering how the balance of power between investors and managers has changed over the past 12 months, the majority of investors (61%) stated there had been no change (Fig. 3.12). There was, however, a notable proportion (33%) of investors interviewed that witnessed a shift in favour of the investor regarding the alignment of interests over the past 12 months, compared to just 5% that feel there has been a change in favour of fund managers.

**Fig. 3.11: Investor Opinion on the Alignment of Interests between Investors and Managers**



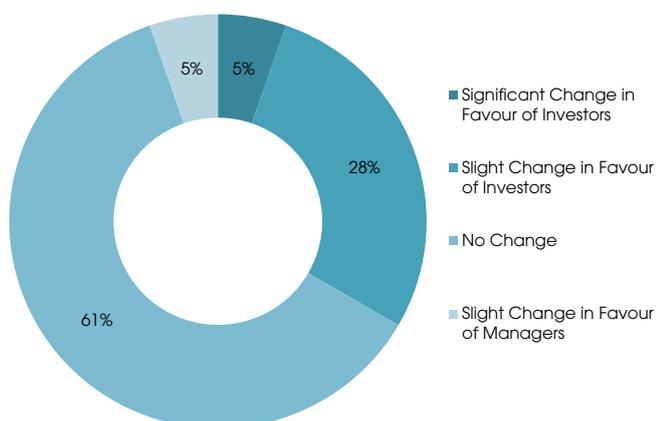
Source: Preqin Investor Interviews, November 2014

## Fees

Although a large group of investors noticed a positive shift regarding fees, a high number of investors interviewed still want fees to improve in 2015 (Fig. 3.13). Managers have reacted positively to the growing pressure on management fees as three-quarters of investors noted an improvement in this area over the past year. However, with 68% of investors still seeking improved management fees over the next 12 months, there is clearly a degree of disparity between investor

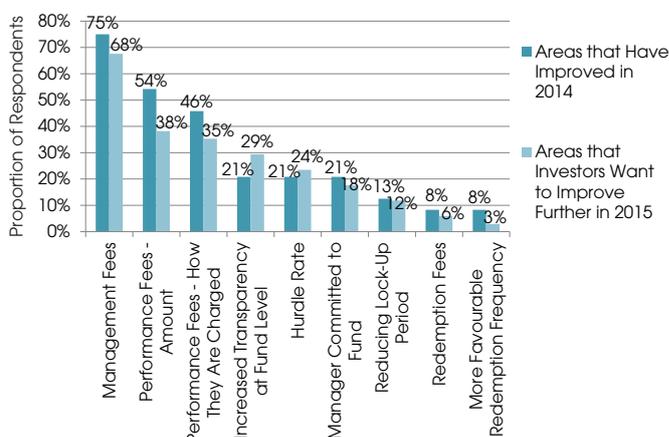
and manager interests on this subject. In fact, significantly more investors stated they wanted to see an improvement in management fees in 2015 (68%) than stated the same in our previous study for 2014 (45%). This highlights the growing concerns investors have surrounding fees, particularly in the low return environment of 2014.

**Fig. 3.12: Investor Opinion on Changes in the Alignment of Interests between Investors and Managers over the Past 12 Months**



Source: Preqin Investor Interviews, November 2014

**Fig. 3.13: Areas of Fund Terms Investors Feel Have Shown the Most Improvement over the Past 12 Months and that Need to Improve Further in 2015**



Source: Preqin Investor Interviews, November 2014

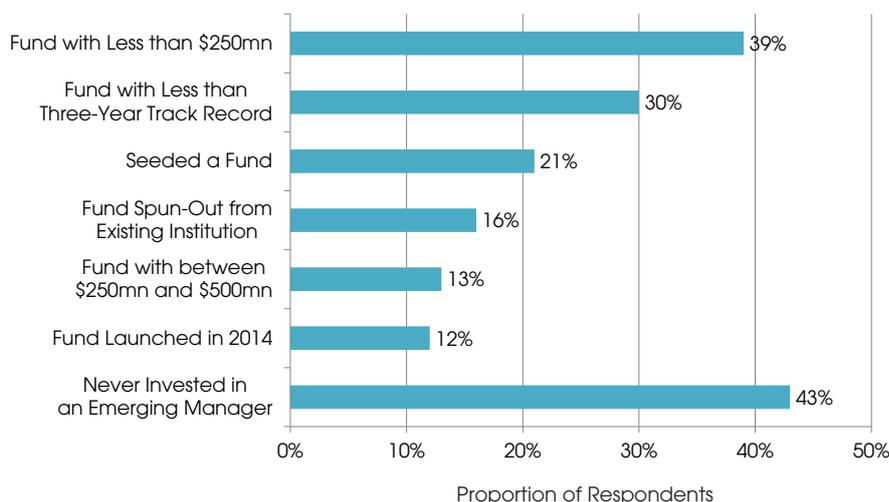
# Investor Interest in Emerging Managers

The challenge of being an emerging manager has increased in recent years, with growing competition against more established managers and higher barriers to entry as a result of regulation and the need for a robust quality infrastructure. However, some investors are keen to explore the unique offerings of small and emerging managers.

With an increased number of funds coming to market in recent years, the fundraising environment has become extremely competitive. Over the last few years, much of the inflows from institutions have gone to the larger managers. However, with over two-thirds of all hedge funds having less than \$250mn in assets under management, Preqin turned its attention to small and emerging funds to assess institutional interest in these funds. Despite investors ranking an established fund track record and fund management experience highly (Fig. 3.10), 57% of investors have invested in what they would deem an emerging manager; Fig. 6.14 outlines the types of small or emerging funds to which institutional investors have allocated capital. The largest proportion (39%) has allocated capital to a fund with less than \$250mn in assets under management.

Investors allocate capital to small or emerging hedge funds for a variety of reasons: their potential for higher returns, their ability to negotiate better fund terms with emerging managers, as well as their access to a unique strategy (Fig. 6.15). One US-based family office stated:

**Fig. 3.14:** Types of Small/Emerging Funds Invested in by Institutional Investors



Source: Preqin Investor Interviews, November 2014

“Emerging managers have a greater hunger to perform than established ones. Overall, through our emerging manager investments, we’ve been able to get the same performance at a cheaper cost.”

Investors appear to have been satisfied with their portfolios of emerging hedge funds: 91% of emerging manager

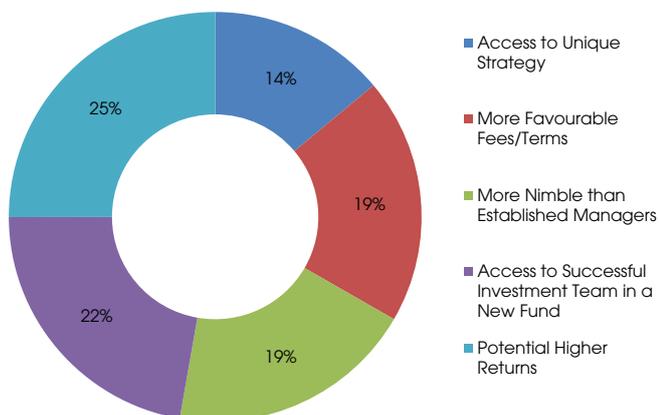
investors felt that their investments had met or exceeded expectations (Fig. 3.16). Despite track record and management experience being such a key factor in investors’ decision-making processes for 2015, emerging managers may win institutional mandates if they can show strong performance and expertise in their field.

**Data Source:**

Preqin’s **Hedge Fund Investor Profiles** features detailed profiles for approximately 1,200 investors that consider investing with emerging managers.

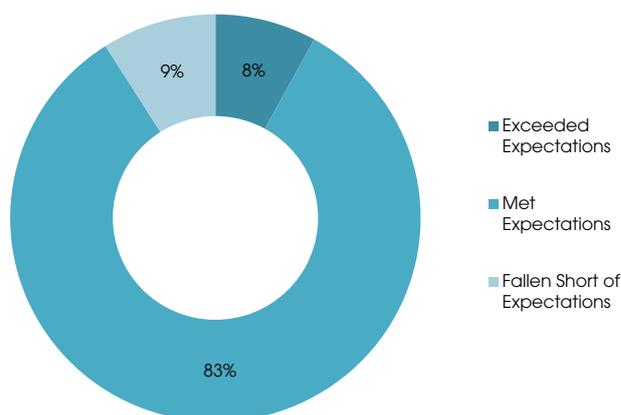
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**Fig. 3.15:** Reasons for Investors Allocating Capital to Small/Emerging Hedge Funds



Source: Preqin Investor Interviews, November 2014

**Fig. 3.16:** Small/Emerging Hedge Funds’ Performance Relative to Investors’ Expectations



Source: Preqin Investor Interviews, November 2014

# The Fundraising Challenge in 2015

As the sector grows, the hedge fund industry has become evermore competitive. With more funds in market and investors becoming more demanding, it is vital that fund managers meet investor needs and structure their products to attract investor capital in 2015. In this section, we take a closer look at how successful fund managers were at amassing assets in 2014, and what managers can do to respond to the fundraising challenge in 2015.

Fund Managers Anticipate Industry Growth in 2015	Fundraising Opportunities for 2015
 <p><b>80%</b> Proportion of managers that believe industry assets under management will grow in 2015.</p>  <p>Proportion of managers that believe the challenging fundraising environment will be a key industry issue during 2015, after regulation (53%) and ongoing volatility (41%).</p>  <p>Proportion of managers that felt there was an increased level of competition in 2014.</p>	 <p><b>26%</b> Proportion of investors looking to invest more capital in hedge funds in 2015.</p>  <p>Long/short equity funds are the most sought by investors in 2015 (as a proportion of investors searching for new funds).</p>  <p>Proportion of investors that believe North America will present the best opportunities in 2015.</p>

Source: Preqin Fund Manager Survey, June 2014 and November 2014

Source: Preqin Investor Interviews, November 2014

Meeting Investors' Needs and Demands	Leading Factors Used by Institutional Investors when Evaluating Fund Managers
 <p>Proportion of alternatives investment consultants that recommended an increase in investment in managed accounts in 2015.</p>  <p>Proportion of managers that have offered investors lower fees in return for terms more in their favour, such as longer lock-ups.</p>  <p>Proportion* of investors that want to see improvements to management fees in 2015.</p>	 <p><b>46%</b> - Management Experience and Background</p>  <p><b>45%</b> - Strategy</p>  <p><b>44%</b> - Returns</p>

Source: Preqin Investment Consultant & Fund Manager Survey, November 2014

Source: Preqin Investor Interviews, November 2014

\* Of those investors that are unhappy with the alignment of interests between investors and managers.

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# Real Estate

## Delivering Strong Performance for Investors

Institutional activity in private real estate remained stable in 2014, with a similar proportion of investors committing to funds as in 2013. Asia-based investors were more likely to have committed to private real estate funds in 2014, and institutions based in this region also stated the greatest preference for new fund commitments in 2015. In terms of strategies, core, opportunistic and value added funds remain the most favoured by institutional investors, with 51%, 47% and

56% of the investors planning to commit in the next 12 months targeting these strategies respectively.

Investor satisfaction with their real estate investments is increasing, with a third of institutions stating that their investments in 2014 exceeded expectations, a significant increase compared to the 3% which stated so in December 2012. Just 7% of investors believe their investments have fallen short of expectations.

As a result of increasing satisfaction, many investors look likely to commit more capital to the asset class in 2015, with 79% planning to do so, and no respondents planning to invest less capital. Additionally, with 35% of investors planning to increase their allocations to private real estate in the longer term, there is a large pool of potential capital likely to flow into real estate in the coming years.

### Data Source:

Access comprehensive information on all aspects of the private real estate industry on Preqin's **Real Estate Online**.

Constantly updated by our team of dedicated research analysts, the service features in-depth data on fundraising, fund managers, institutional investors, net-to-LP fund performance and much more.

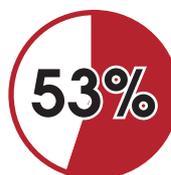
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### Key Facts



Proportion of fund managers that have seen an increase in investor appetite for real estate in the past year.



Proportion of active real estate investors that plan to commit \$50mn or more to the asset class in 2015.



Proportion of investors that believe their real estate investments have exceeded expectations in 2014.



Proportion of investors that believe fund managers' and investors' interests are properly aligned.

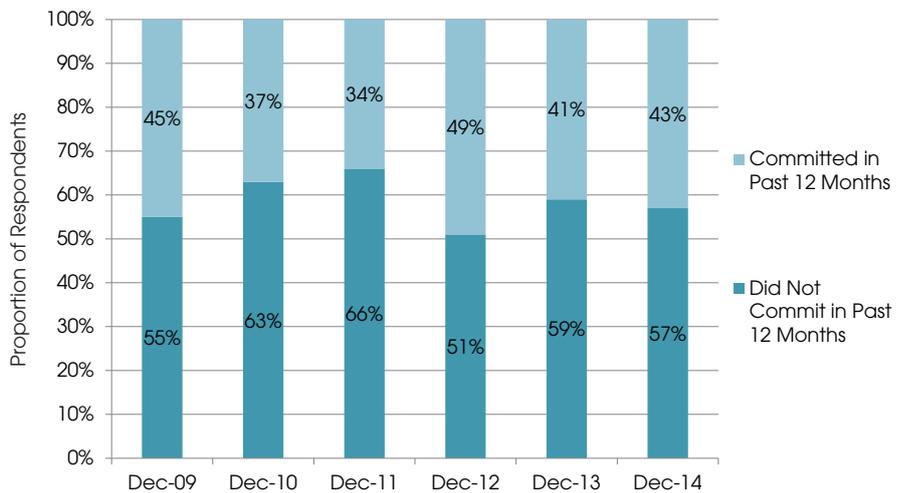
# Investor Activity in 2014

**Commitments to Private Real Estate Funds in 2014**

2014 saw a similar proportion of investors make new fund commitments as in 2013, with 43% of respondents doing so in 2014 (Fig. 4.1), compared to 41% in December 2013. When this is broken down by region (Fig. 4.2), it is possible to see that Asia-based institutions were the most active in 2014, with 71% making private real estate commitments; in comparison, 47% of North America-based investors and 40% of Europe-based investors committed to private real estate funds in 2014.

In terms of assets under management, larger investors were significantly more likely to have committed capital to private real estate funds in 2014, with 69% of institutions with \$10bn or more in assets committing to private real estate funds that year (Fig. 4.3). A larger proportion of investors with \$10bn or more in assets were active in 2014 than in 2013, when 56% of these larger institutions committed to private real estate funds. As a result, although activity among institutional investors in private real estate was relatively low in 2014, those investors that made commitments tended to be larger, and therefore more likely to make greater commitments.

**Fig. 4.1: Proportion of Investors that Committed to Private Real Estate Funds in the Past 12 Months, 2009 - 2014**



Source: Preqin Investor Interviews, December 2009 - December 2014

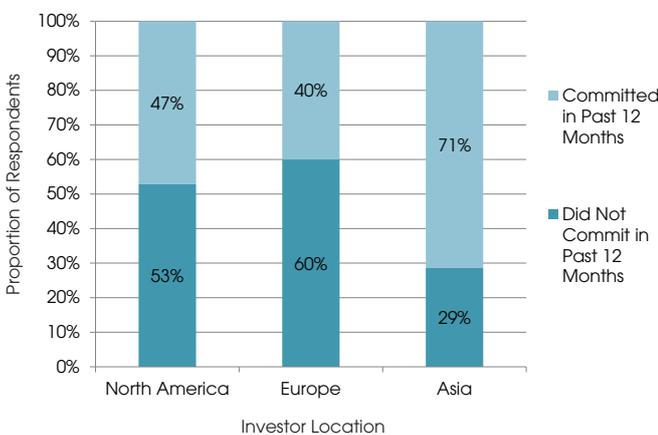
## Satisfaction with Returns

There is growing satisfaction among institutional investors with the returns they are seeing from their real estate portfolios. Fig. 4.4 shows that one-third of investors interviewed in December 2014 felt that the performance of their private real estate fund investments had exceeded expectations in the past 12 months, more than double the proportion that stated this in December 2013, and significantly higher than the

3% that stated this in 2012. As returns improve and investments increasingly provide the benefits sought by investors in real estate, more institutions are likely to return to the asset class and make new commitments.

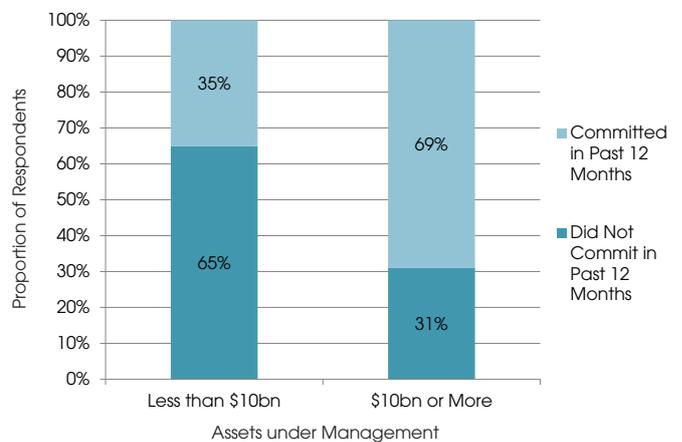
However, satisfaction in investments varies by investor location, as shown in Fig. 4.5. Sixty percent of Asia-based investors stated that their investments exceeded expectations, compared to 43% of Europe-based institutions

**Fig. 4.2: Proportion of Investors that Committed to Private Real Estate Funds in the Past 12 Months by Location**



Source: Preqin Investor Interviews, December 2014

**Fig. 4.3: Proportion of Investors that Committed to Private Real Estate Funds in the Past 12 Months by Assets under Management**



Source: Preqin Investor Interviews, December 2014

and just 19% of North America-based investors. Overall however, investments appear to be meeting expectations, with no more than 13% of investors based in any location stating that returns have fallen short of expectations.

### First-Time Funds

Institutional investors are increasingly seeking to invest with more experienced managers that have a proven track record. Fig. 4.6 demonstrates that 62% of real estate investors will not invest in first-time funds, with just 18% stating that they will do so. While there was a very small increase in appetite for new managers seen in 2014, the trend in recent years has been for fewer investors to be prepared to take on the additional risk that comes with committing capital to emerging fund managers. As a result, capital is further concentrated among a smaller selection of more experienced fund managers, a trend which is likely to continue in 2015 as institutions remain cautious of placing capital with managers lacking a demonstrable track record.

#### Data Source:

**Real Estate Online** features in-depth profiles of over 4,700 institutional investors actively investing in real estate.

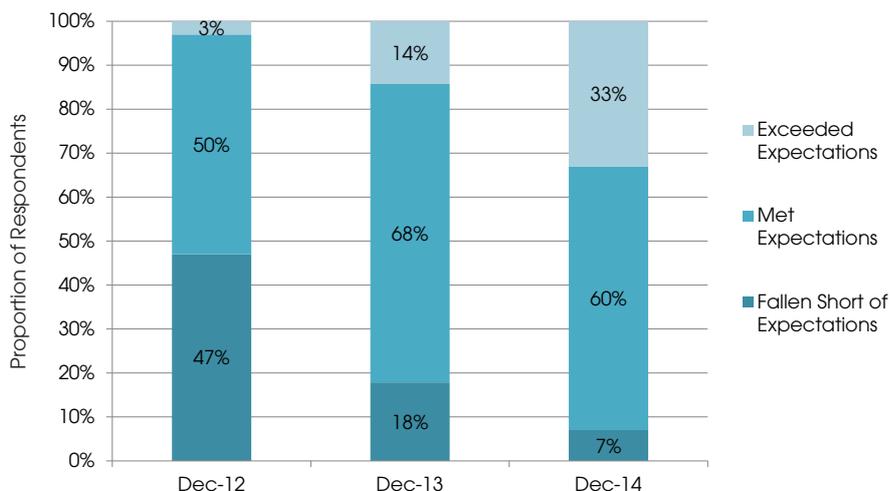
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- Assets under management
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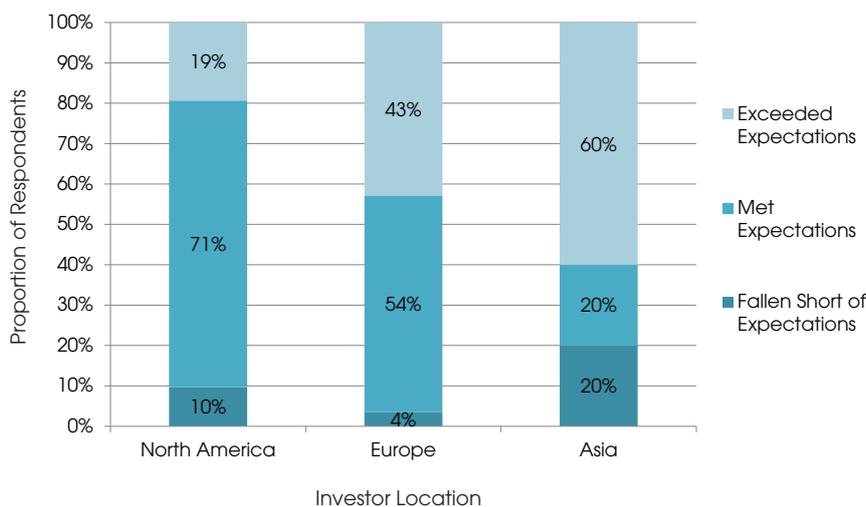
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**Fig. 4.4:** Proportion of Investors that Feel Their Private Real Estate Investments Have Lived up to Expectations over the Past 12 Months, 2012 - 2014



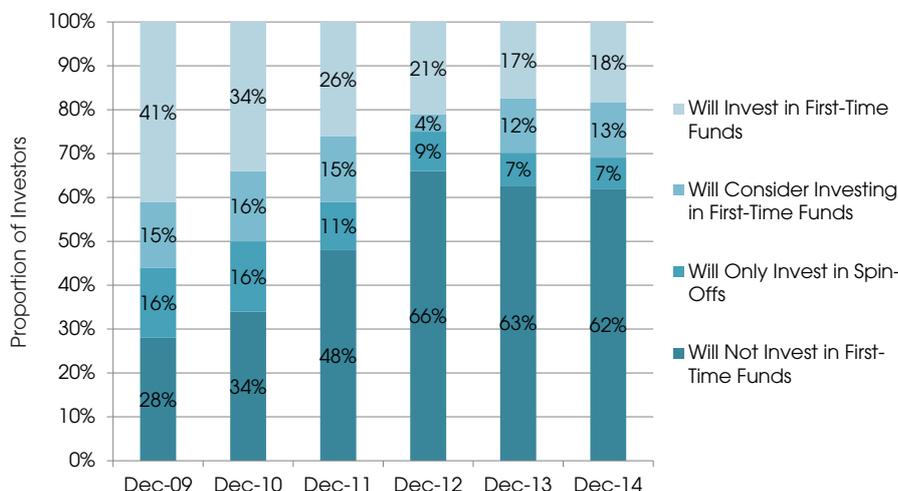
Source: Preqin Investor Interviews, December 2012 - December 2014

**Fig. 4.5:** Proportion of Investors that Feel Their Private Real Estate Investments Have Lived up to Expectations over the Past 12 Months by Location



Source: Preqin Investor Interviews, December 2014

**Fig. 4.6:** Changing Investor Attitudes towards First-Time Private Real Estate Funds, 2009 - 2014



Source: Preqin Real Estate Online

# Investor Activity in 2015

## Activity in 2015

2015 looks unlikely to see a major change in the proportion of institutions which make private real estate fund commitments, with 37% of respondents planning to invest (Fig. 4.7), a very similar proportion to the 35% that were looking to be active when surveyed on their plans for 2014. Asia-based investors are the most likely to be active, with more than three-quarters expecting to make new commitments. Asian institutions are becoming ever more important players in

the global real estate market, with many growing their allocations and targeting more globally diversified portfolios.

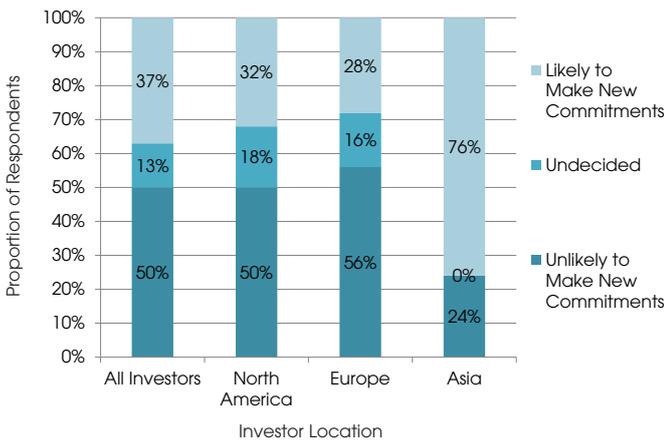
In terms of investor size, the larger institutions are more likely to be active in 2015, with 64% of respondents that have \$10bn or more in total assets expecting to make, or considering making, new fund commitments in 2015, compared to 45% of those that have less than \$10bn under management. In the longer term, further growth in real estate is expected, with 35% planning to increase their

target exposure to the asset class, while just 5% will be shrinking their allocations.

## Capital Commitments and Number of Funds Targeted

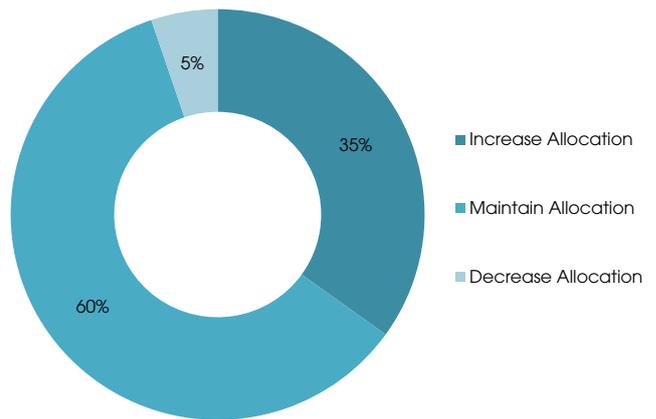
What does look set to change in 2015 is the amount of capital that active investors put to work. Fig. 4.9 shows that 79% of institutions that will be active in the coming year are planning to deploy more capital in 2015 than they did in 2014, with no respondents stating they will commit less capital. The amount

**Fig. 4.7: Investors' Intentions for Their Private Real Estate Investments in 2015 by Investor Location**



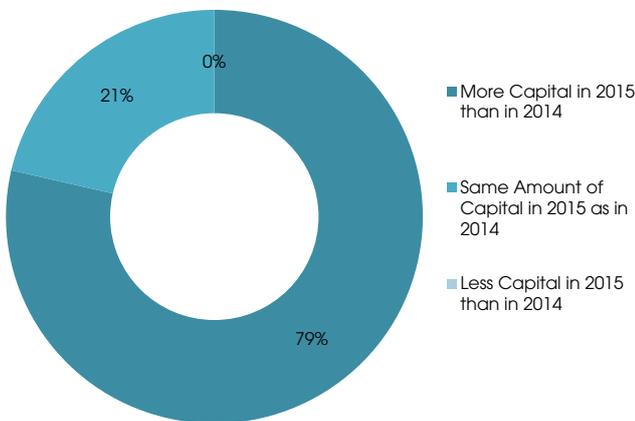
Source: Preqin Investor Interviews, December 2014

**Fig. 4.8: Investors' Intentions for Their Private Real Estate Allocations in the Longer Term**



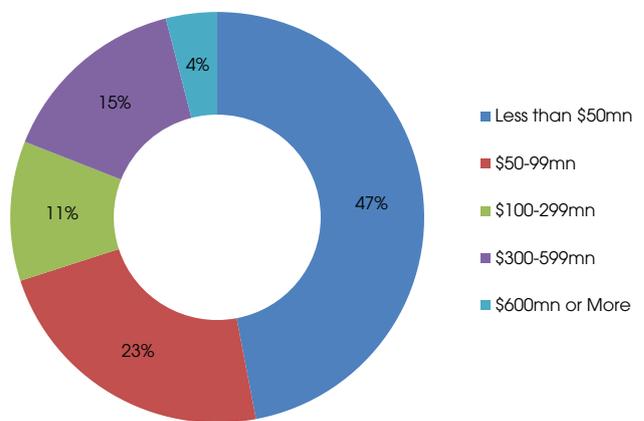
Source: Preqin Investor Interviews, December 2014

**Fig. 4.9: Investors' Expected Capital Commitment to Private Real Estate Funds in 2015 Compared to 2014**



Source: Preqin Investor Interviews, December 2014

**Fig. 4.10: Amount of Fresh Capital Investors Plan to Invest in Private Real Estate in 2015**



Source: Preqin Real Estate Online

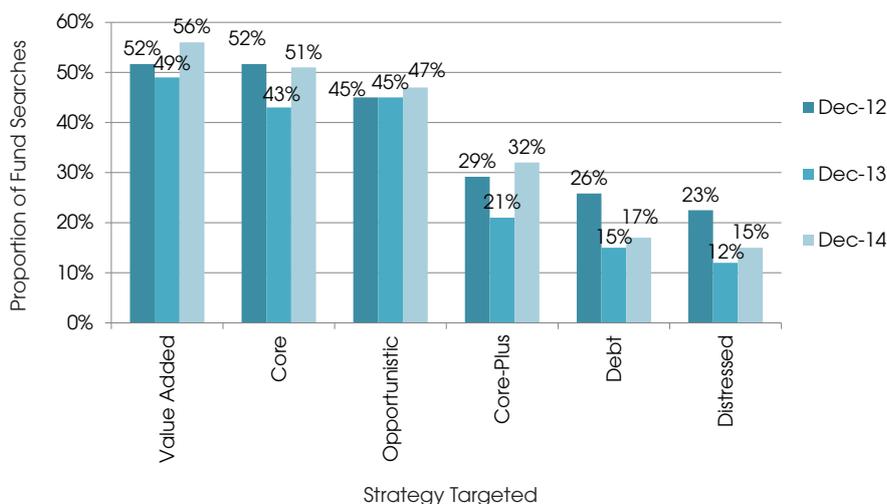
of capital investors expect to commit is shown in Fig. 4.10. The majority of active institutions will be looking to commit to two or more funds, with almost one-third expecting to make four or more commitments. Thirty-two percent of investors planning to make commitments in 2015 are looking to invest in just one fund, with a further 29% expecting to commit to two vehicles.

### Strategies and Regions Targeted

In terms of strategies, core, opportunistic and value added vehicles continue to be the most favoured by those investors planning to be active in 2015, with 51%, 47% and 56% of investors looking to commit to these strategies respectively, as shown in Fig. 4.11. Appetite for all strategies has increased since December 2013, suggesting investors are targeting a more diversified exposure and a range of strategies.

As expected, the majority of institutions looking to make commitments in 2015 have a strong domestic bias, with investors much more likely to deploy capital in markets in the region in which they are based, as demonstrated in Fig. 4.12. Asia-based investors look to have the most globally diversified outlook. These investors are the most likely to be targeting global opportunities, and are less likely to be targeting domestic

**Fig. 4.11: Strategies Targeted in the Next 12 Months by Private Real Estate Investors, December 2012 - December 2014**



Source: Preqin Real Estate Online

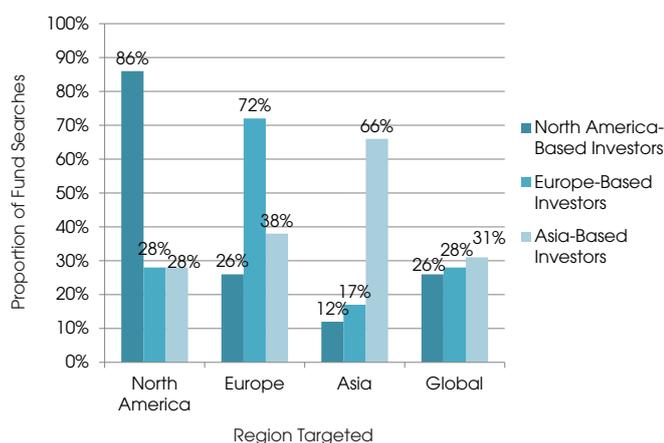
opportunities than North America- or Europe-based investors.

### Key Issues in 2015

Although returns from private real estate funds have improved in recent years, investors' views on the issues in the current market demonstrate that performance remains an ongoing concern for private real estate investors, with 37% identifying this as a key issue

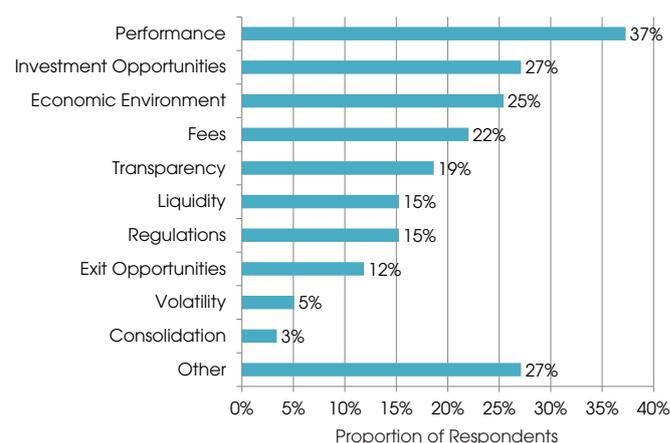
(Fig. 4.13). The availability of investment opportunities is a key concern for 27% of respondents, with highly competitive asset valuations meaning many investors have concerns about whether there are sufficient attractive opportunities for their capital to be put to work. The economic environment and its impact on real estate performance is a key concern for 25% of respondents.

**Fig. 4.12: Regions Targeted in 2015 by Private Real Estate Investors by Location**



Source: Preqin Real Estate Online

**Fig. 4.13: Investors' Views on the Key Issues for the Private Real Estate Market in 2015**



Source: Preqin Investor Interviews, December 2014

#### Data Source:

Preqin's **Real Estate Online** details investors' plans over the next 12 months, including future investment preferences, number of planned commitments and more.

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# Appetite for Separate Accounts, Joint Ventures and Co-Investments

Recent years have seen many institutional investors increasingly looking at alternative ways to gain real estate exposure other than commitments to multi-investor funds. Structures such as separate accounts, joint ventures and co-investments enable an institution to gain access to the skill and deal flow of a third-party investment manager, but may offer a greater degree of control over the direction of capital, lower fees, and an opportunity to gain a greater level of exposure to attractive assets. Fig. 4.14 illustrates how investor appetite for separate accounts has grown steadily in recent years, with 40% of investors investing through separate accounts or considering doing so.

## Appetite for Separate Accounts

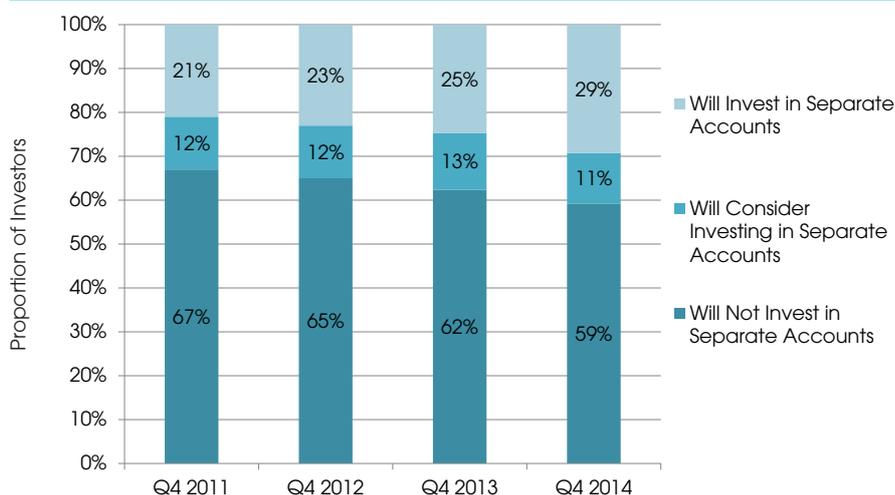
Appetite for separate account structures varies considerably by investor type. Asset managers have the strongest appetite for separate accounts, as many in this group have large investment teams and a great deal of capital at their disposal (Fig. 4.15). This is also the case with public pension funds, with 45% investing, or considering investing, in separate accounts. Many pension funds have large ticket sizes and so may find separate accounts a more effective way to put large amounts of capital to work than commitments to commingled funds. Endowment plans and foundations, groups which typically have far smaller asset bases and investment teams, are much less likely to invest through separate accounts.

## Appetite by Size and Location

Fig. 4.16 also illustrates that it is the larger investors that are likely to have the capital available to invest, along with the internal resources and knowledge required to invest through these structures, all of which require extensive due diligence, and the ability and resources to monitor and make decisions on an asset level. For investors with \$10bn or more in assets, 60%, 70% and 67% invest via co-investments, joint ventures and separate accounts respectively.

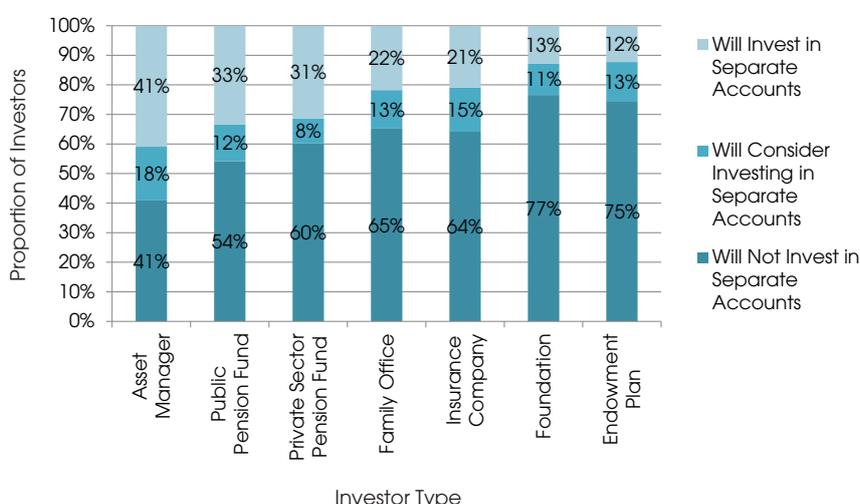
Use of these structures also varies by location. While 44% of North America-based institutions make or consider separate account investments, only 32% of Europe-based institutions would

**Fig. 4.14: Investor Appetite for Real Estate Separate Accounts, Q4 2011 - Q4 2014**



Source: Preqin Real Estate Online

**Fig. 4.15: Investor Appetite for Real Estate Separate Accounts by Investor Type**



Source: Preqin Real Estate Online

do so. A similar picture emerges with co-investments: 39% of North America-based investors are interested in co-investing alongside the managers they invest with, while 33% of Europe-based investors would do so.

## Notable Separate Accounts

Prologis US Logistics Venture is a \$1bn partnership formed between Prologis and Government Pension Fund – Global, the Norwegian sovereign wealth fund, as it continues its foray into US real estate.

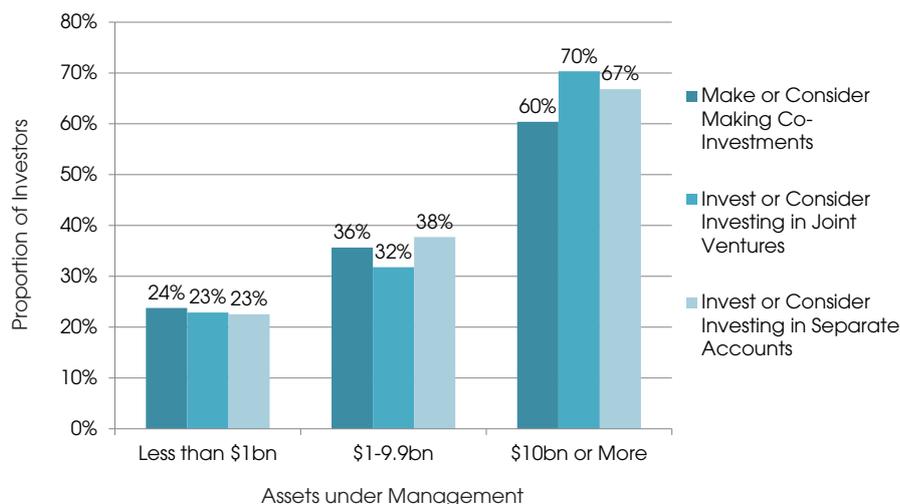
Government Pension Fund – Global committed \$450mn to the partnership, with Prologis committing \$550mn. The venture focuses on industrial and logistics assets in the US. Also targeting the industrial sector is the separate account awarded to LaSalle Investment Management by Virginia Retirement System. Through the relationship, the public pension fund gains exposure to industrial warehouse development projects in select US markets.

California Public Employees' Retirement System frequently forms separate account relationships with various real estate managers. In 2014, the public pension fund formed Pacific Multifamily Investors with Pacific Urban Residential, which focuses on the acquisition of income-producing, institutional-quality, multi-family real estate in major markets in Western US. CalPERS initially awarded \$200mn to this account and subsequently followed this with an additional \$200mn later in the year.

### Outlook

Alternative methods of investing in real estate are increasingly sought by institutional investors looking to gain a greater degree of control over their real estate exposure. Fund managers are also responding to this demand, with 57% expecting to offer more co-investment opportunities in 2015 and 54% more separate accounts. However, they are likely to remain structures mainly utilized by larger institutional investors that have the capital to allocate to these structures, and the resources to source and monitor these investments.

**Fig. 4.16: Institutional Investor Appetite for Co-Investments, Joint Ventures and Separate Accounts by Investor Assets under Management**



Source: Preqin Real Estate Online

**Fig. 4.17: Notable Private Real Estate Separate Accounts Formed in 2014**

Separate Account	Firm	Initial Equity Size (mn)	Strategy	Sector Focus	Investor
NYSCRF Frontier Mach II	Artemis Real Estate Partners	500 USD	Core-Plus	Operating Companies	New York State Common Retirement Fund
APFC - LaSalle UK Commercial Separate Account	LaSalle Investment Management	250 GBP	Core	Diversified	Alaska Permanent Fund Corporation
LaSalle VA Industrial Separate Account	LaSalle Investment Management	575 USD	Opportunistic	Industrial	Virginia Retirement System
Samsung Life - LaSalle Separate Account	LaSalle Investment Management	200 EUR	Core	Diversified	Samsung Life Insurance
Pacific Multifamily Investors	Pacific Urban Residential	200 USD	Core	Multi-Family	California Public Employees' Retirement System (CalPERS)
CPPIB-Piramal Separate Account	Piramal Fund Management	500 USD	Debt	Residential	CPP Investment Board
Prologis US Logistics Venture	Prologis	1,000 USD	Core	Industrial, Logistics	Government Pension Fund - Global
Pramerica - AP3 German Retail Separate Account	Prudential Real Estate Investors	265 EUR	Core	Retail	AP-Fonden 3

Source: Preqin Real Estate Online

#### Data Source:

View comprehensive profiles for over 4,700 private real estate investors worldwide on Preqin's **Real Estate Online**, which include detailed information on investors' preferences and intentions for co-investments, joint ventures and separate accounts, as well as current separate account relationships.

For more information, please visit:

[www.preqin.com/reo](http://www.preqin.com/reo)

# Fees and Alignment of Interests

Well-structured fund terms and conditions are important to effecting an alignment of interests between fund managers and investors. Most investors are satisfied with fund terms, with 74% agreeing that manager and investor interests are properly aligned, a five percentage point increase from December 2013 (Fig. 4.18). For those not agreeing, management fees and the level of performance fees charged were the key areas where alignment could be improved.

Given that investors are largely satisfied with fund terms and conditions, it is

perhaps unsurprising that there has been little change in the past year, with 80% not seeing any movement in terms and conditions, a smaller proportion than when investors were surveyed in December 2013 (Fig. 4.20). Where

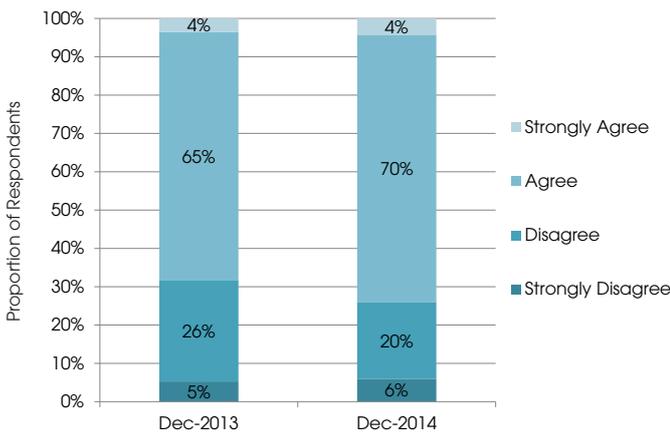
there has been a change, it has largely been in performance or management fees, with 54% and 46% of respondents respectively citing these as areas where change had occurred (Fig. 4.21).

**Looking to Compare Fund Terms to Industry Benchmarks?**

Use the Terms Calculator tool on Preqin's **Real Estate Online** to calculate fund term benchmarks for funds of different types, geographic foci, fund sizes and commitment sizes. View individual fund terms information on an anonymous basis.

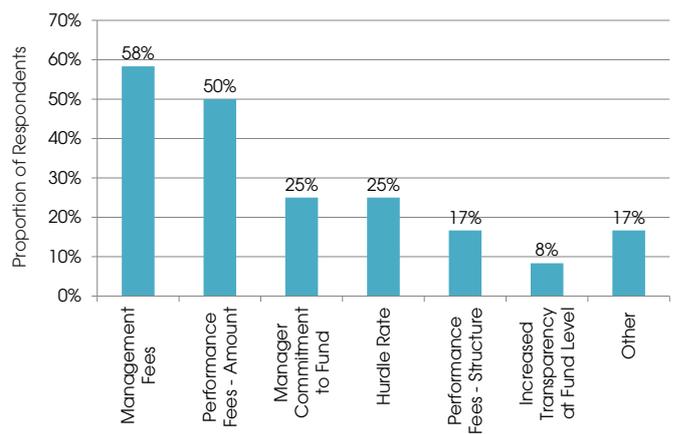
[www.preqin.com/reo](http://www.preqin.com/reo)

**Fig. 4.18:** Extent to Which Investors Believe that Fund Manager and Investor Interests Are Properly Aligned, December 2013 vs. December 2014



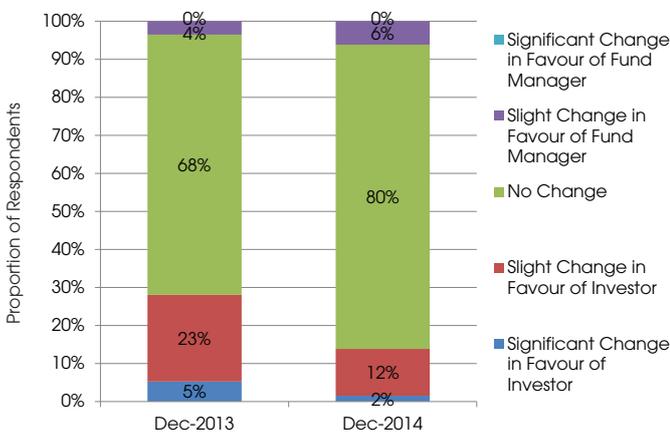
Source: Preqin Investor Interviews, December 2013 - December 2014

**Fig. 4.19:** Investors' Views on Areas of Fund Terms and Conditions Where Alignment of Interests Can Be Improved



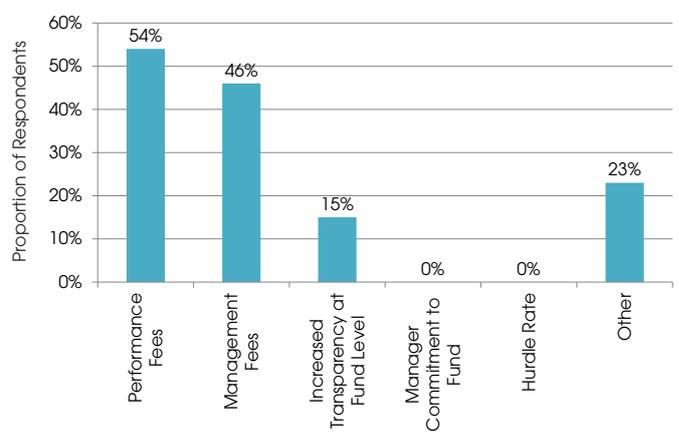
Source: Preqin Investor Interviews, December 2014

**Fig. 4.20:** Proportion of Investors that Have Seen a Change in Private Real Estate Fund Terms and Conditions over the Last 12 Months, December 2013 vs. December 2014



Source: Preqin Investor Interviews, December 2013 - December 2014

**Fig. 4.21:** Areas in Which Investors Have Seen a Change in Private Real Estate Fund Terms over the Last 12 Months



Source: Preqin Investor Interviews, December 2014

# Infrastructure

## Concerns in the Short Term, but Continued Growth in the Long Term

Infrastructure is a growing part of many institutional investors' portfolios, with target allocations to the asset class rising to an average of 5.7% in 2014, compared to 5.1% in 2013. Additionally, the majority (57%) of investors view the infrastructure industry positively, and a considerable 67% plan to increase their allocation to infrastructure over the longer term, reflecting the growing importance investors are placing on infrastructure as a part of their overall portfolios.

Investors are increasingly seeking alternative structures to pooled funds, with 45% seeking to invest in separate accounts,

and 50% targeting co-investments alongside fund managers. Additionally, investors' favoured route to market is changing, with unlisted funds now targeted by just 65% of investors planning to invest in the year ahead, compared to 91% in December 2012, and direct infrastructure investment sought by 56% of investors compared to 29% in 2012.

Concerns over pricing and the availability of attractive assets, however, have left investors divided on their plans for infrastructure in 2015, with a considerable 45% stating that they will commit less capital than they did in 2014, while 39%

stated that they will invest more capital. Encouragingly, 53% of institutions planning to make further investments in 2015 expect to invest at least \$100mn, with a sizeable 19% expecting to invest at least \$500mn. As a result, those investors that are planning to invest in the year ahead are likely to commit sizeable amounts of capital. Nonetheless, with investors increasingly drawn to fund managers with a proven track record, and appetite for emerging managers continuing to decline, infrastructure fund managers seeking institutional capital are likely to continue to find fundraising challenging in 2015.

### Data Source:

Preqin's **Infrastructure Online** contains detailed information on the entire infrastructure industry.

Constantly updated by our team of dedicated research analysts, the service features in-depth data on fundraising, fund managers, institutional investors, deals, net-to-LP fund performance and much more.

For more information, or to arrange a demonstration, please visit:

[www.preqin.com/infrastructure](http://www.preqin.com/infrastructure)

### Key Facts



Fifty-seven percent of investors view the infrastructure industry positively.



Investors' average target allocation to infrastructure, up from 5.1% in 2013.



Proportion of investors that plan to increase their allocations to infrastructure over the long term.



Fifty-six percent of active investors are targeting direct investments in the next 12 months, compared to 29% in December 2012.

# Satisfaction with Returns and Allocations to Infrastructure

## Satisfaction with Returns and Confidence in the Asset Class

The vast majority of institutional investors surveyed appear satisfied with the performance of their infrastructure investments over the last 12 months, with 86% feeling that their infrastructure investments have either met or exceeded expectations in the past year, as shown in Fig. 5.1. This suggests that infrastructure assets have continued to provide investors with positive performance in the last 12 months, despite 14% of surveyed investors stating that their infrastructure investments have fallen short of expectations.

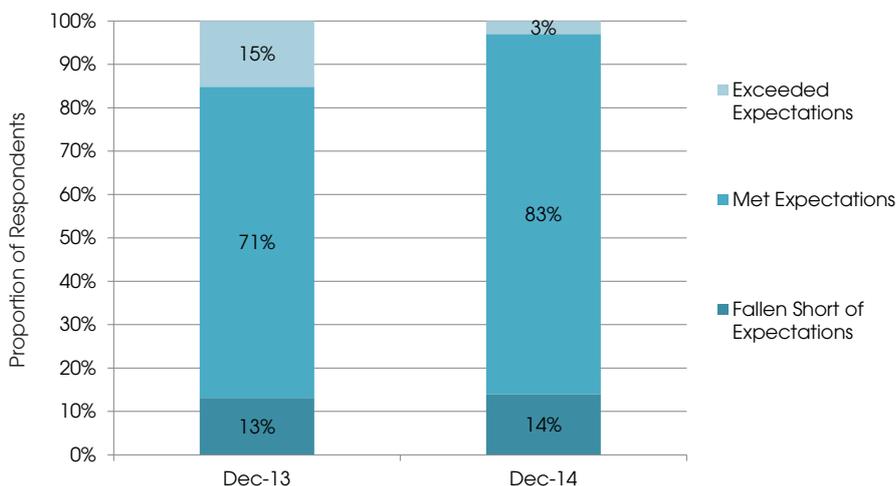
Institutional investors' general perception of the infrastructure industry is also positive. As illustrated in Fig. 5.2, a significant 57% of surveyed investors have a positive opinion of the infrastructure market, while 43% have a neutral attitude. None of the investors surveyed have a negative view of the infrastructure space, which is extremely encouraging for the asset class, suggesting that institutional investor demand for exposure to infrastructure opportunities will continue to grow in future years.

## Allocations to Infrastructure

Due to the relative youth of the asset class, institutional investors will typically allocate a relatively small proportion of their assets under management (AUM) to infrastructure, when compared with other alternative asset classes. The majority (62%) of investors are below their target allocations to infrastructure. This is encouraging for the long-term growth of the asset class, as investors will look to put more capital to work in the coming years as they move towards their long-term strategic targets.

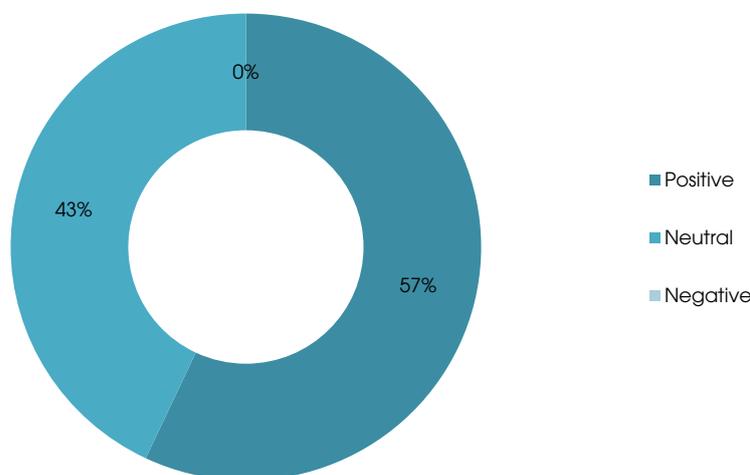
Investors' growing allocations to the asset class are revealed in Fig. 5.3; the average current allocation of investors to infrastructure has increased from 3.5% in 2011 to 4.3% in 2014, with the average target allocation increasing from 4.9% to 5.7% over this time period. Allocations to infrastructure are likely to continue to grow in the coming years, with 67% of investors planning to increase their allocation to infrastructure over the longer term.

**Fig. 5.1:** Proportion of Investors that Feel Their Infrastructure Fund Investments Have Lived up to Expectations over the Past 12 Months, 2013 - 2014



Source: Preqin Investor Interviews, December 2013 - December 2014

**Fig. 5.2:** Investors' General Perception of the Infrastructure Industry at Present



Source: Preqin Infrastructure Online

## Source of Allocation

Investors in infrastructure allocate to the asset class in a variety of ways, with Fig. 5.4 revealing that the largest proportion of investors (39%) have carved out separate infrastructure allocations. The proportion of investors with a dedicated allocation has fallen slightly in recent years; this is a reflection of newer entrants to the market being less likely to have a dedicated allocation. The absolute number of investors with an infrastructure allocation has grown in the past few

years. Accessing infrastructure through real assets allocations is becoming more common; while just under a quarter invest through a private equity allocation, although the proportion investing from a private equity bucket has fallen in recent years.

## Key Issues Facing the Infrastructure Fund Market in 2015

A number of key issues will continue to impact institutional investor appetite for infrastructure opportunities over

the coming 12 months and the general growth of the industry in the longer term. As shown in Fig. 5.5, 49% of surveyed investors suggest that the number of viable investment opportunities will be a key issue in the 2015 infrastructure market. With more investors looking to invest in the infrastructure asset class than ever before, investors are concerned about pricing and whether there are enough attractive opportunities available at present. Other key issues highlighted by investors include liquidity (33%), performance (26%) and fees (23%).

**Data Source:**

Preqin's **Infrastructure Online** contains detailed profiles for over 2,400 active infrastructure investors worldwide.

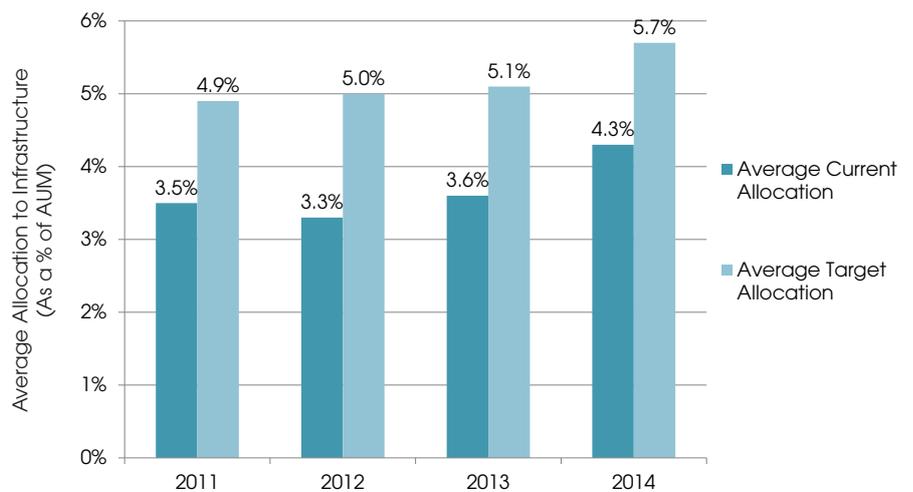
Preqin's dedicated team of research analysts is in regular direct contact with all active investors, allowing us to provide detailed information on:

- Current and target allocations
- Fund type and geographic preferences
- Future investment plans
- Direct contact information for key decision makers and much more.

For more information, or to arrange a demonstration, please visit:

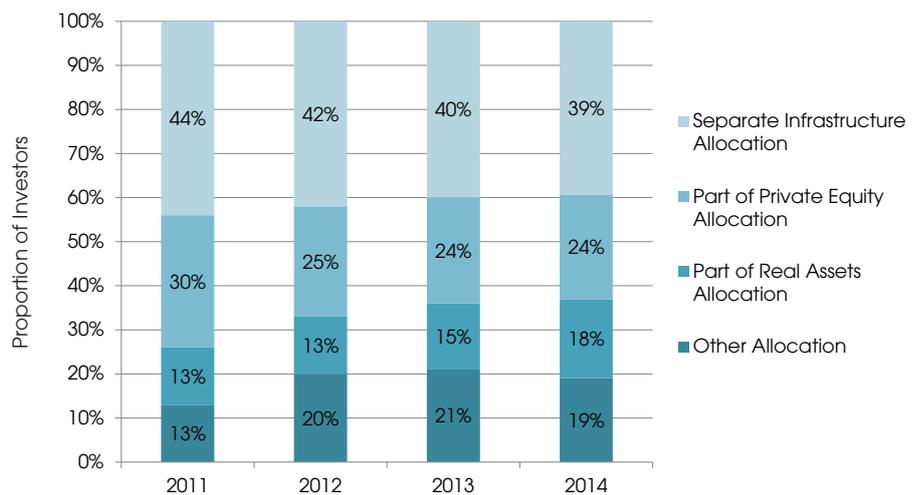
[www.preqin.com/infrastructure](http://www.preqin.com/infrastructure)

**Fig. 5.3: Average Current and Target Allocations to Infrastructure over Time, 2011 - 2014**



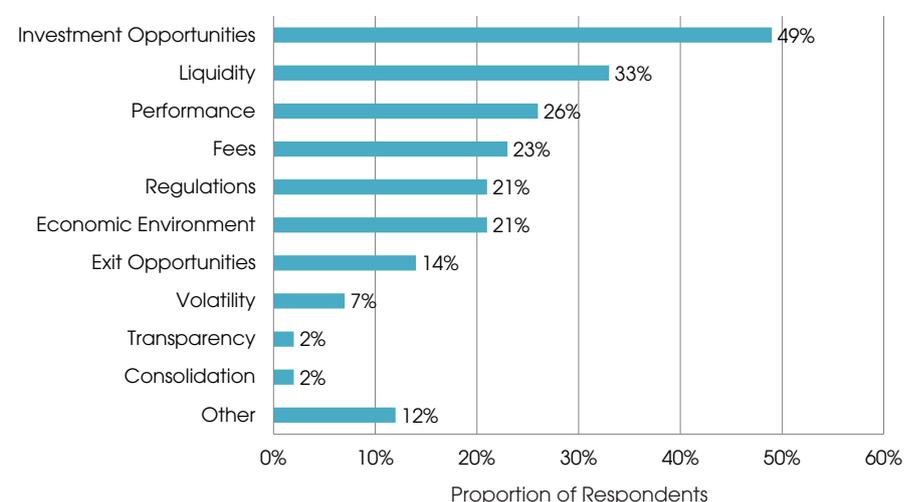
Source: Preqin Infrastructure Online

**Fig. 5.4: Breakdown of Infrastructure Investors by Source of Allocation, 2011 - 2014**



Source: Preqin Infrastructure Online

**Fig. 5.5: Investors' Views on the Key Issues for the Infrastructure Market in 2015**



Source: Preqin Investor Interviews, December 2014

# Investor Activity in 2015 and the Longer Term

Infrastructure continues to grow as an independent alternative asset class, but the market remains relatively small when compared to other alternatives. This means that many of the institutional investors currently active in the space are either new to the market or relatively inexperienced, and their preferences are continuing to evolve as they explore the best ways to gain exposure to the asset class. As a result, it is vital for infrastructure fund managers to be aware of and adjust to changing investor attitudes in order to ensure their offerings are meeting the needs of institutional investors.

## Investors' Infrastructure Commitments in 2015

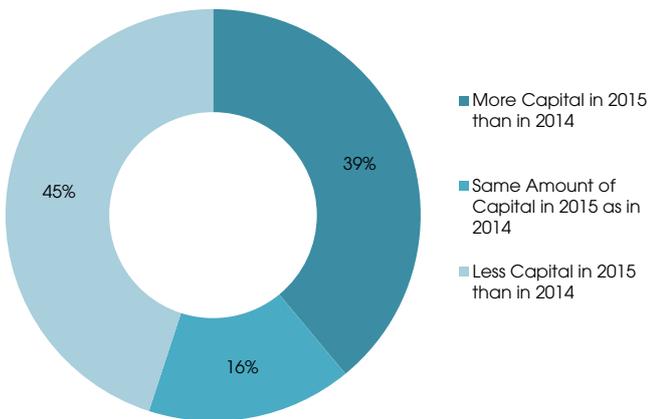
There is a mixed view from investors as to whether they will be upping or reducing their capital outlay to infrastructure in 2015. While the majority of respondents expect to commit more capital in 2015 than they did in 2014, or to maintain their level of outlay to infrastructure, a notable proportion expect to put less capital to work (Fig. 5.6). This may be a reflection of high valuations for infrastructure assets and the impact on the availability of attractive investment opportunities, with

investors electing to delay making fresh commitments in 2015 as a result.

## Investors' Infrastructure Allocations over the Long Term

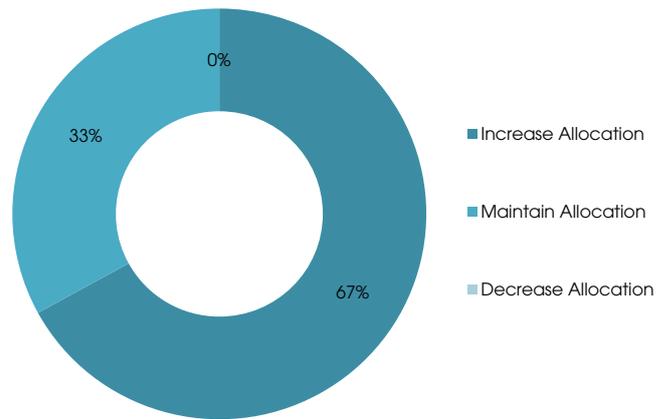
In the longer term, the prospects for the continued growth of the asset class remain very positive. The average current allocation to infrastructure across the entire infrastructure investor universe is 4.3% of total assets under management. However, as these investors become more experienced in infrastructure, build up investment teams and become more comfortable with the risks associated

**Fig. 5.6:** Investors' Expected Capital Commitments to Infrastructure Funds in the Next 12 Months Compared to the Last 12 Months



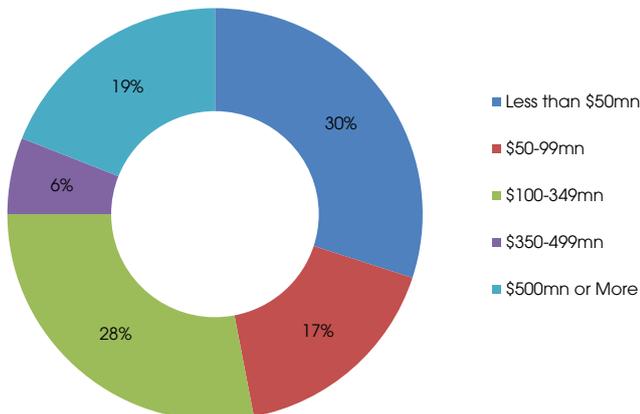
Source: Preqin Investor Interviews, December 2014

**Fig. 5.7:** Investors' Intentions for Their Infrastructure Allocations over the Longer Term



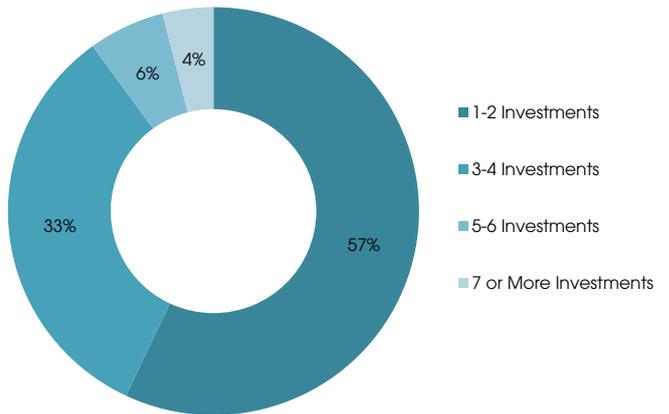
Source: Preqin Investor Interviews, December 2014

**Fig. 5.8:** Amount of Fresh Capital Investors Plan to Invest in Infrastructure over the Next 12 Months



Source: Preqin Investor Interviews, December 2014

**Fig. 5.9:** Number of Infrastructure Investments Investors Plan to Make over the Next 12 Months



Source: Preqin Investor Interviews, December 2014

with investing in the space, it is likely that allocations will increase. Two-thirds of surveyed investors intend to increase their infrastructure allocations over the long term, as shown in Fig. 5.7. An additional 33% plan to maintain their current level of exposure, while none of the investors surveyed suggested plans to reduce their allocations.

Future Searches and Capital Outlay

Preqin's Infrastructure Online service tracks the activity of over 2,400 active investors in the infrastructure asset class, through which we are able to monitor the changing investment strategies of these institutions as well as their plans for future investment. As shown in Fig. 5.8, 53% of investors with plans to make further investments in 2015 expect to invest at least \$100mn in fresh capital. This includes a considerable 19% that expect to invest at least \$500mn over the course of the year.

This shows that many institutional investors are planning to make sizeable investments in infrastructure opportunities throughout 2015. Fig. 5.9 further demonstrates this, showing that 43% of active investors expect to make at least three investments over the next 12 months. This includes 10% which plan to make at least five investments in the coming year.

In terms of investors' regional preferences for 2015, the largest proportion of investors (49%) will be targeting investments in Europe, as shown in Fig. 5.10. North American infrastructure assets will be sought by 35% of institutions, with Asia and countries outside these three core regions each targeted by just 15% of

investors. Many infrastructure investors prefer geographical diversification when investing in infrastructure, and as such a considerable 36% of investors target global infrastructure investments.

Route to Market

The route via which investors invest in infrastructure has undergone considerable change over the last three years, with a greater number of investors now seeking to invest directly in infrastructure assets, as shown in Fig. 5.11. As of December 2014, 56% of investors were targeting direct infrastructure investment in the next 12 months, compared to just 29% in December 2012. Correspondingly, the proportion of investors targeting infrastructure investment via unlisted funds has declined from 91% in 2012 to 65% in 2014, with appetite for listed funds remaining low: just 6% of active investors are targeting listed funds in 2015.

Institutional investors making direct investments were involved in 28% of transactions completed in 2014, and seem likely to be even more active in the coming year. The investors that can put capital to work directly are typically larger institutions, with an established allocation to the asset class and the resources to build sizeable investment teams. While the proportion of investors targeting pooled fund commitments has fallen in recent years, it remains the most common approach, and for many smaller investors, the best way to gain infrastructure exposure.

Outlook

The long-term outlook for the infrastructure asset class appears positive. The

demand for private investment capital in the infrastructure space will only grow in future, and the vast majority of institutional investors are planning to increase or maintain their current allocations over the longer term. While many investors are looking to commit substantial amounts of capital to infrastructure opportunities in 2015, a sizeable proportion are reducing the amount of capital they intend to put to work, and there are concerns among investors about the pricing of assets, the availability of attractive brownfield opportunities and the performance of the asset class. Fund managers looking to raise capital in 2015 will need to be able to effectively communicate how they can find value in the current market in order to successfully secure investor commitments.

Source New Investors for Your Fund with Infrastructure Online

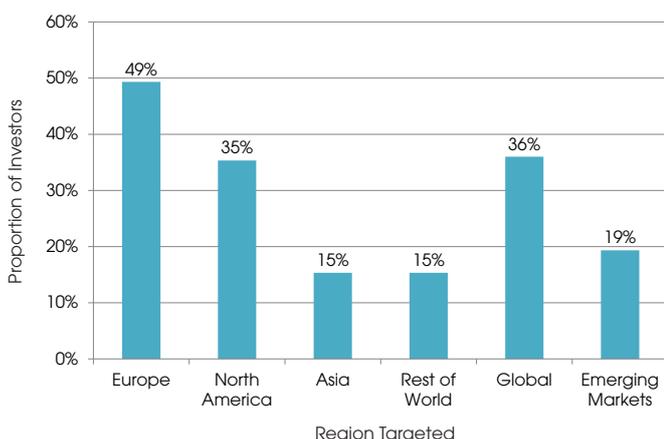
Preqin's **Infrastructure Online** contains detailed information on investors' plans over the next 12 months, including future investment preferences, number of planned commitments and more.

The **Future Fund Searches and Mandates** feature on **Infrastructure Online** is the perfect tool to pinpoint those institutions that are seeking new infrastructure funds for investment now. Search for potential investors by their preferred fund structure, fund strategy and regional preferences.

For more information, please visit:

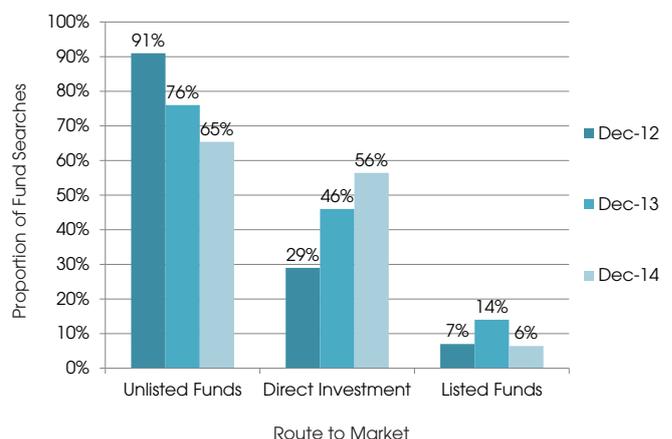
[www.preqin.com/infrastructure](http://www.preqin.com/infrastructure)

Fig. 5.10: Regions Targeted by Infrastructure Investors in the Next 12 Months



Source: Preqin Infrastructure Online

Fig. 5.11: Preferred Route to Market of Infrastructure Investors Searching for New Investments in the Next 12 Months, 2012 - 2014



Source: Preqin Infrastructure Online



**Source** new investors  
for funds or deals

**Identify** new investment  
opportunities

**Conduct** competitor  
and market analysis

**Search** for potential  
deal partners

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# Appetite for First-Time Funds, Separate Accounts and Co-Investments

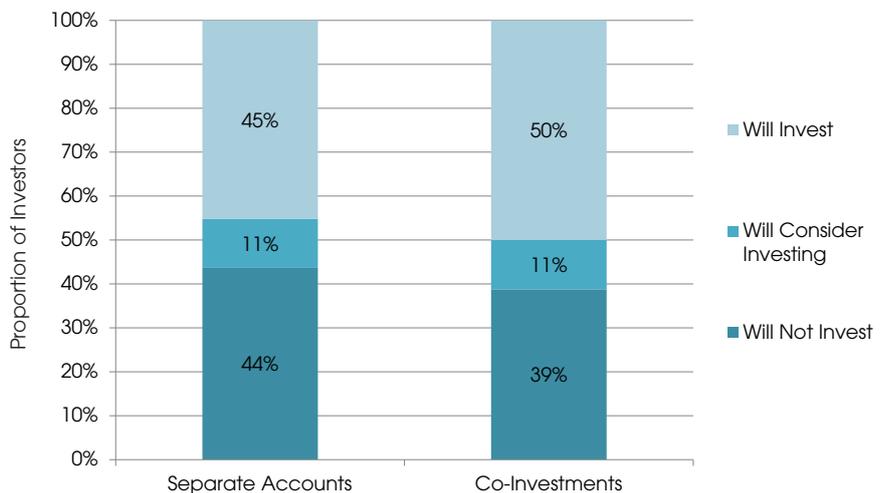
## Alternative Structures: Co-Investments and Separate Accounts

Increasingly, investors in infrastructure are seeking alternative structures to pooled infrastructure funds, which may allow them greater control over the direction of their capital, more access to attractive assets and the chance to negotiate more attractive fees. Fig. 5.12 demonstrates that 45% of investors will seek to invest in separate accounts, and 50% will target co-investments alongside fund managers. However, these alternative methods of investing in infrastructure are often only suitable for larger institutions which have a large enough ticket size, the resources to conduct the necessary due diligence for these types of investment, and the ability to monitor their portfolios on an ongoing basis. Fig. 5.13 demonstrates that investors with \$10bn or more in AUM are considerably more likely to invest in separate accounts and make co-investments, with 55% and 67% doing so respectively. In comparison, just 10% and 32% of investors with less than \$1bn in AUM will invest via these methods respectively.

### Appetite for First-Time Funds

Investor appetite for first-time funds has continued to decline over the past 12 months, as shown in Fig. 5.14, with just 43% of investors stating that they will

**Fig. 5.12:** Infrastructure Investor Appetite for Separate Accounts and Co-Investments

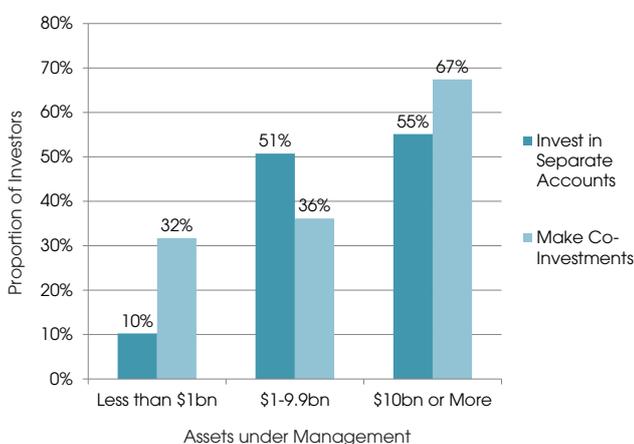


Source: Preqin Infrastructure Online

invest in first-time infrastructure funds as of December 2014, compared to 56% which stated so in December 2011. Many institutional investors are increasingly looking at investing with managers with a proven track record; as just 28% of funds in market are being raised by managers which have raised more than two infrastructure funds previously, capital is likely to become further concentrated among a smaller selection of managers in 2015.

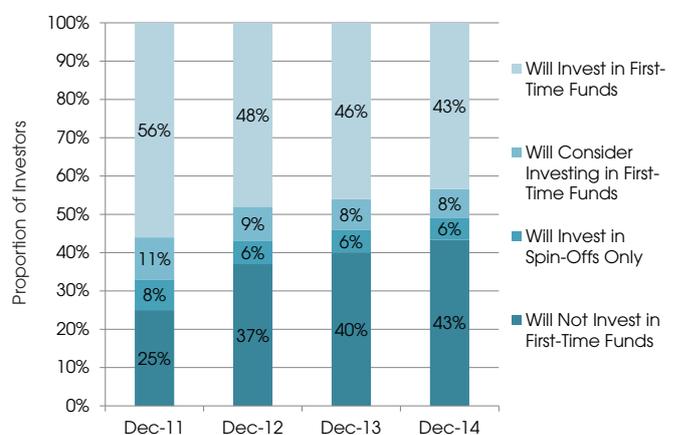
There are variations depending on investor size, with those investors with greater assets under management more likely to invest in first-time funds, as they are more likely to be able to undertake the necessary due diligence on new fund managers. Forty-eight percent of investors with \$10bn or more in AUM will invest in first-time funds, compared to just 30% of investors with less than \$1bn.

**Fig. 5.13:** Infrastructure Investor Appetite for Separate Accounts and Co-Investments by Assets under Management



Source: Preqin Infrastructure Online

**Fig. 5.14:** Infrastructure Investor Appetite for First-Time Funds, 2011 - 2014



Source: Preqin Infrastructure Online

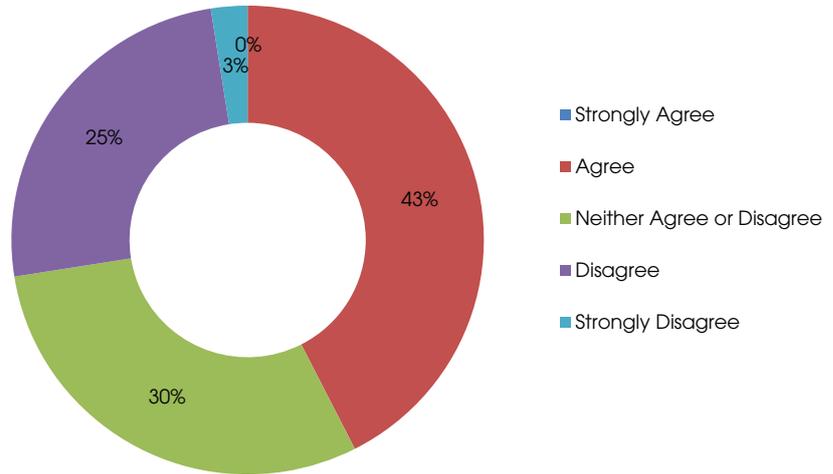
# Fees and Alignment of Interests

Fund terms and conditions have generally become more investor friendly in recent years, while the alignment of interests between infrastructure fund managers and investors continues to be a very important issue in the infrastructure fund market. Based on the results of Preqin's December 2014 investor survey, a healthy proportion of institutional investors are confident that fund manager and investor interests are properly aligned, but there are still LPs that feel more needs to be done to improve fund terms.

## Alignment of Interests

As shown in Fig. 5.15, a significant 73% of surveyed investors feel that investor and fund manager interests are properly aligned, or do not have a strong opinion either way. This compares to 65% of surveyed investors which stated the same in December 2013, and just 27% that felt this when surveyed in 2010, and points to a growing willingness from fund managers to listen to the concerns of investors. It may also reflect an acceptance among limited partners that there is a need to pay for the deal sourcing and asset management abilities of the best investment managers. Just 28% of respondents disagree that investor and fund manager interests are properly aligned, compared to 35% in December 2013. Despite the positive steps taken in recent years, some fund managers may need to make further concessions to LPs. Only those fund managers dedicated to improving the alignment of interests with

**Fig. 5.15: Investors' Views on Whether There is an Alignment of Interests with Fund Managers**



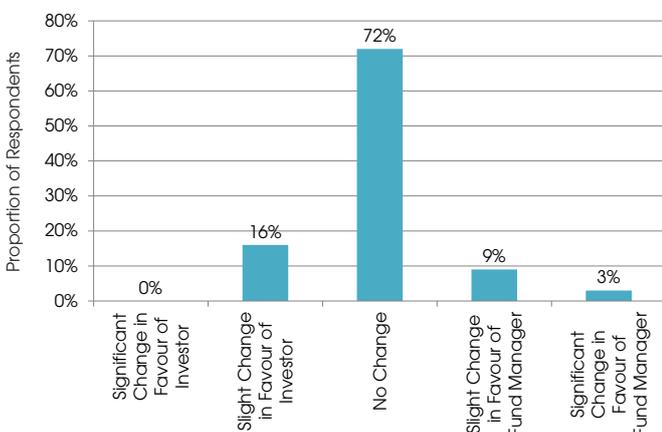
Source: Preqin Investor Interviews, December 2014

investors can hope to attract capital in a very competitive fundraising market.

There appear to have been relatively limited changes in typical fund terms in the past year, with a considerable 72% of surveyed investors having not seen a change in the structure of fund terms and conditions in the last 12 months (Fig. 5.16). While 16% had seen a move towards more LP-friendly terms, this was only slightly more than the proportion that had seen a movement in favour of the fund manager (12%).

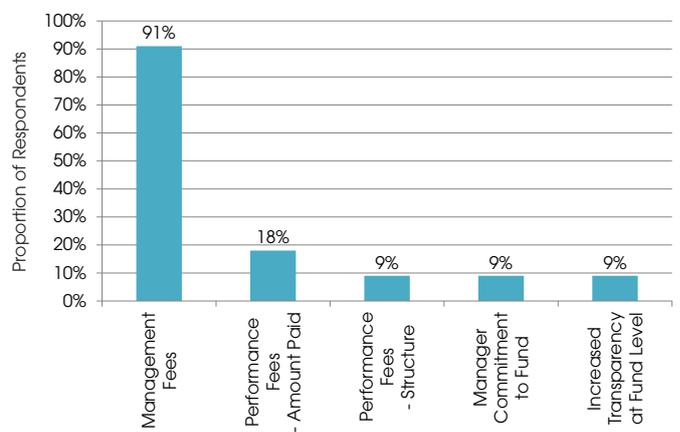
The key area where investors feel alignment could be improved is management fees, with 91% of surveyed investors stating so (Fig. 5.17). This is higher than the 61% of surveyed investors that highlighted the same issue in December 2013. Eighteen percent of investors surveyed feel that the level of performance fee charged by fund managers needs addressing, while other key issues in need of improvement include the structure of performance fees, as cited by 9% of respondents, the level of manager commitment to their own funds (9%) and the need for increased transparency at fund level (9%).

**Fig. 5.16: Proportion of Investors that Have Seen a Change in Infrastructure Fund Terms over the Last 12 Months**



Source: Preqin Investor Interviews, December 2014

**Fig. 5.17: Investors' Views on Where Alignment of Interests Can Be Improved**



Source: Preqin Investor Interviews, December 2014

# Private Debt

## Investors Are Looking to Increase Their Exposure to Private Debt

The growth of the private debt asset class has been one of the standout features of the alternative assets industry over recent years, with many investors looking to allocate capital to private debt opportunities due to the prospect of strong risk-adjusted returns in a low interest environment. Continued regulatory developments have restricted the flow of debt financing from traditional sources, creating opportunities for non-bank lenders, such as private debt fund managers, to become a greater source of capital to companies looking to secure such financing.

The private debt fundraising market is at an all-time high; as of January 2015, there

were 193 private debt funds on the road targeting aggregate capital commitments of over \$108bn. With increased competition among managers for investor capital, it is vital that fund managers understand what investors are looking for to ensure a successful fundraising.

Preqin interviewed over 50 global institutional investors that actively invest in private debt, or that are considering making their maiden allocation to the asset class, to gauge their satisfaction with their private debt investments, their plans for the coming year and their attitudes towards fund terms and conditions. The results show positive sentiment towards the private debt industry, with a significant 90%

of investors feeling that their private debt investments have either met or exceeded expectations. As well as investors being satisfied with returns, nearly half (47%) have a positive perception of the private debt industry, with a further 37% of neutral opinion.

In an increasingly crowded fundraising environment, it is also positive to see that investors are planning to increase their allocation to private debt, with 55% expecting to allocate more capital to private debt in 2015 compared to 2014. Nearly two-thirds (65%) also expect to increase exposure to the asset class in the longer term.

### Data Source:

Preqin's **Private Debt Online** contains detailed information on all aspects of the private debt industry worldwide.

Constantly updated by our team of dedicated research analysts, the service features in-depth data on fundraising, fund managers, institutional investors, net-to-LP fund performance and much more.

For more information, please visit:

[www.preqin.com/privatedebt](http://www.preqin.com/privatedebt)

### Key Facts



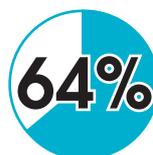
Proportion of investors that feel the returns from their private debt portfolio have met or exceeded expectations in 2014.



Proportion of investors that plan to increase their private debt allocation in the long term, with a further 27% expecting their exposure to stay the same.



Proportion of investors that stated Europe currently presents the best investment opportunities, signalling significant appetite for the region in 2015.



Proportion of investors that plan to make their next commitment by the end of 2015, with a further 25% unsure of the timing of their next allocation.

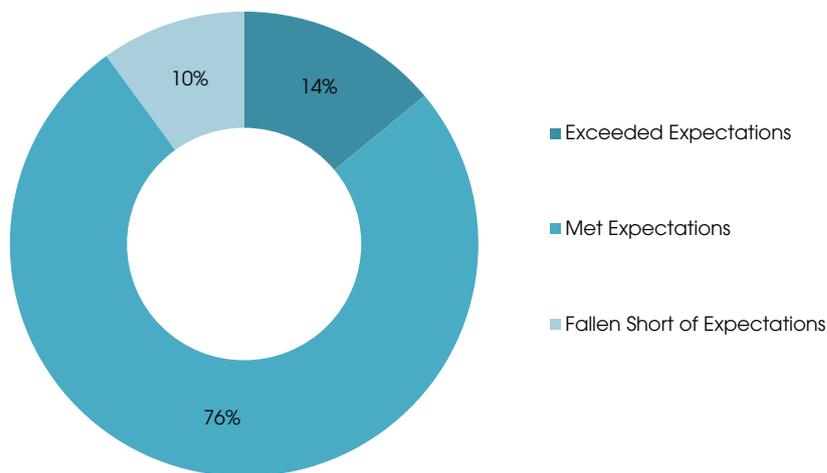
# Satisfaction with Returns and Confidence in the Asset Class

Private debt has attracted significant inflows of investor capital in recent years, with investors confident of strong risk-adjusted returns created by increased opportunities in the market as a result of bank retrenchment from the space. As private debt in many cases operates much like a fixed income product, with less scope for outperformance than many equity-based alternatives, it is encouraging to see that over three quarters (76%) of investors interviewed stated their investments had met expectations, while 14% stated their investments had exceeded expectations (Fig. 6.1).

With investors generally happy with the returns they have received from their private debt investments, it is interesting to look at investors' general perception of the private debt industry, as this likely will be in their minds when they consider allocating capital to the asset class in future. As shown in Fig. 6.2, nearly half of respondents (47%) hold positive views towards private debt, with a further 37% of neutral opinion and only 16% viewing the asset class negatively.

Despite investors holding a positive view on private debt, it is important for fund managers to understand what investors feel are the key issues in the asset class for 2015. Fig. 6.3 shows that over half of respondents (51%) feel that investment opportunities are a key issue for private debt in the current market. This can be explained by the large amounts of dry powder currently available to fund

**Fig. 6.1:** Proportion of Investors that Feel Their Private Debt Fund Investments Have Lived up to Expectations over the Past 12 Months



Source: Preqin Investor Interviews, February 2015

managers, coupled with the significant number of funds raising capital, leading to concerns that there is too much money chasing limited opportunities. Other key issues named by a large proportion of investors interviewed include the economic environment (45%), performance (43%) and fees (34%).

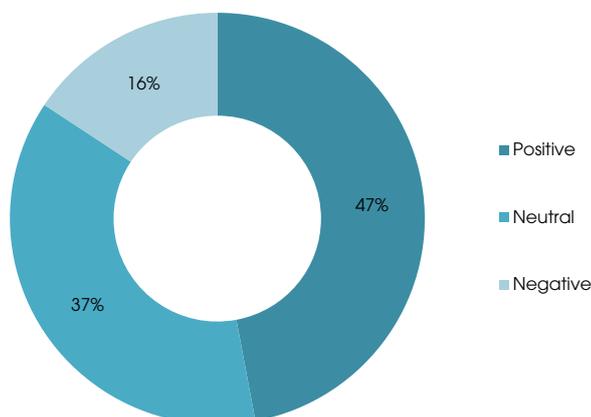
### Industry-Leading Private Debt Performance Data

Preqin's **Private Debt Online** contains net-to-LP performance data, with full metrics for over 620 named vehicles.

For more information, please visit:

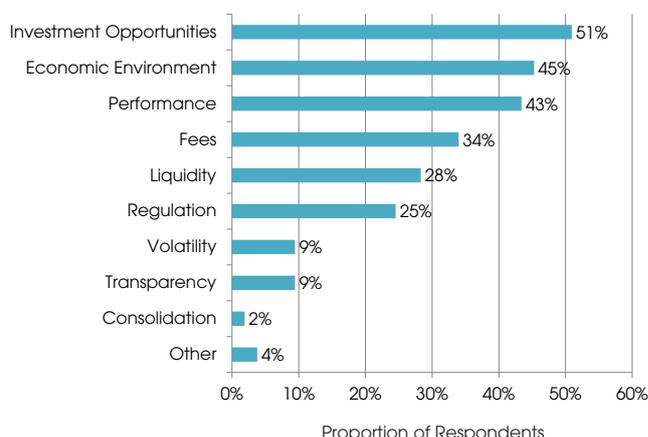
[www.preqin.com/privatedebt](http://www.preqin.com/privatedebt)

**Fig. 6.2:** Investors' General Perception of the Private Debt Industry at Present



Source: Preqin Investor Interviews, February 2015

**Fig 6.3:** Investors' Views on the Key Issues for the Private Debt Market in 2015



Source: Preqin Investor Interviews, February 2015

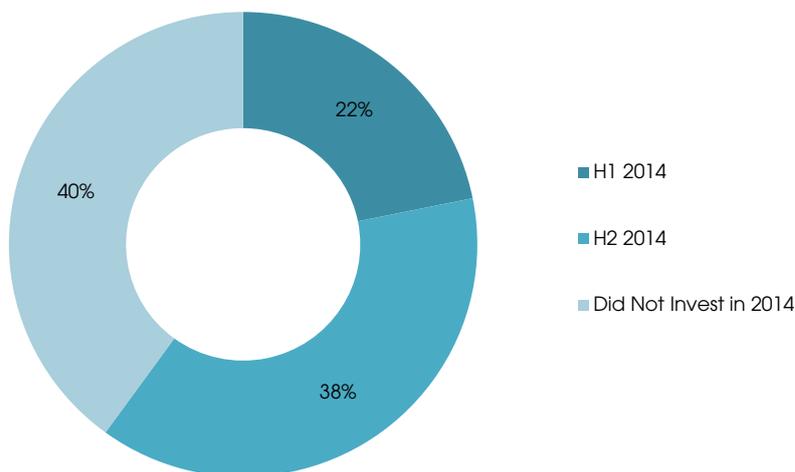
# Investor Activity in 2014

Preqin's recent survey shows that 60% of investors made a private debt fund commitment in 2014, with over a third (38%) of investors making a commitment in H2 2014 (Fig. 6.4). Despite this, 40% did not make a private debt fund commitment in 2014, showing that despite positive attitudes to the asset class and a large number of funds seeking capital, many investors decided against making new investments in 2014.

Fig. 6.5 indicates that all investors interviewed are either at or below their target allocations to private debt, with no investors interviewed currently being over-allocated; this paints a positive picture for private debt fundraisers, as investors have the capacity to make new commitments to the asset class, both to move closer towards target allocations or to maintain current levels of exposure as they receive distributions from existing investments.

In light of steady growth within private debt in recent years, Preqin asked investors how they feel the size of the market may change, whether the market has already reached its peak or if it can grow further. As shown in Fig. 6.6, the majority of investors (86%) expect the size of the private debt market to grow in the coming five years, either slightly or significantly. In contrast, only 6% of respondents expect the size of the market to decrease over the same timeframe.

**Fig. 6.4:** Proportion of Investors that Made New Private Debt Fund Commitments in 2014



Source: Preqin Investor Interviews, February 2015

**Data Source:**

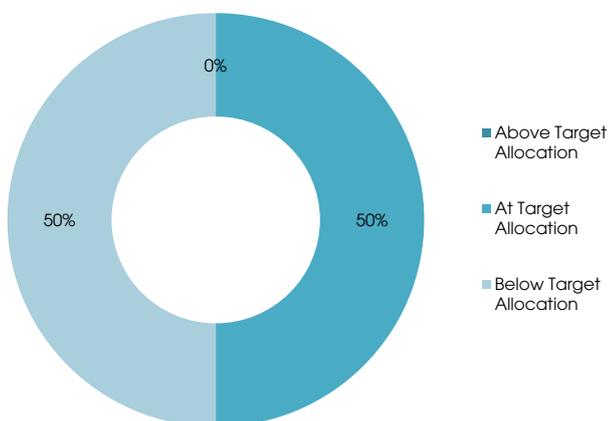
Preqin's **Private Debt Online** tracks in-depth data on over 1,400 active investors in private debt around the world.

Search for investors based on their current allocation to private debt, location, investment preferences, and much more.

For more information, please visit:

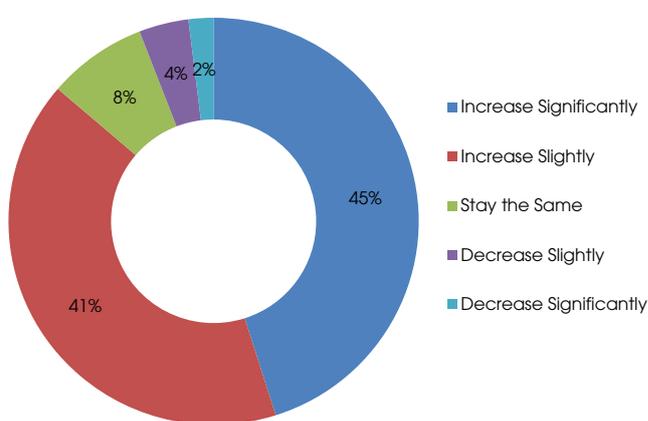
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**Fig. 6.5:** Proportion of Investors At, Above or Below Their Target Allocations to Private Debt



Source: Preqin Investor Interviews, February 2015

**Fig. 6.6:** Investors' Views on How the Size of the Private Debt Market Will Change over the Next Five Years



Source: Preqin Investor Interviews, February 2015

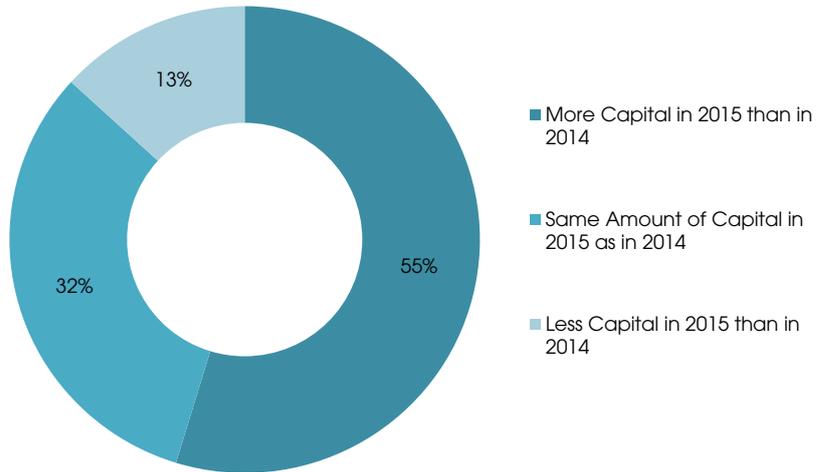
# Investor Activity in 2015 and the Longer Term

Although the private debt fundraising market is becoming increasingly crowded, Preqin's recent survey indicates that, encouragingly, investors expect to not only allocate fresh capital to the asset class in 2015, but at a greater rate than in 2014 (Fig. 6.7). Over half (55%) of respondents expect to allocate more capital to private debt in 2015 compared to 2014, with 32% expecting to allocate the same amount of capital.

Preqin's interviews with investors also revealed that the majority (57%) plan to increase their current allocation to private debt in next 12 months (Fig. 6.8), with only 6% looking to decrease their exposure. Results are also positive for the asset class in the longer term, with 92% of respondents stating that they anticipate either increasing or maintaining their current allocation to private debt in future.

With investors looking to increase their exposure to private debt, Preqin asked investors when they expect to make their next private debt fund commitment. Forty-four percent of respondents expect to make a commitment in H1 2015, with a further 20% expecting to allocate to their next private debt fund in the second half of the year (Fig. 6.9). A quarter of investors are unsure as to when they will make a new commitment, perhaps allocating to the asset class on a more opportunistic basis. Only 11% of respondents do not expect to commit to a private debt fund in 2015.

**Fig 6.7:** Investors' Expectations for the Amount of Capital They Will Commit to Private Debt in 2015 Compared to 2014



Source: Preqin Investor Interviews, February 2015

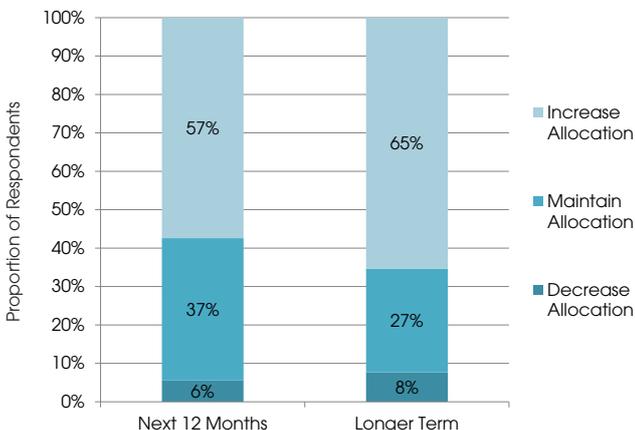
These results can be taken as a vote of confidence for the private debt industry, as investors are not only looking to continue allocating capital to the asset class but are planning to increase their activity in the space by allocating greater amounts of capital in 2015 than in 2014.

**Data Source:**

The **Future Fund Searches and Mandates** feature on Preqin's **Private Debt Online** is the perfect tool to pinpoint those institutions that are seeking new private debt investments now. Search for potential new investors by type and location, as well as their current fund type and geographic preferences.

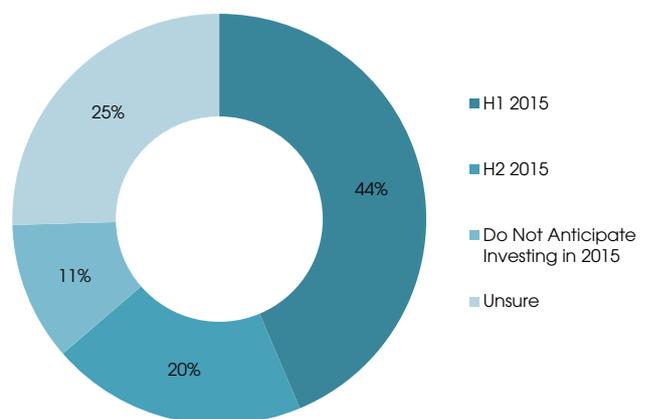
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**Fig 6.8:** Investors' Intentions for Their Private Debt Allocations



Source: Preqin Investor Interviews, February 2015

**Fig. 6.9:** Investors' Timeframe for Their Next Intended Commitment to Private Debt Funds



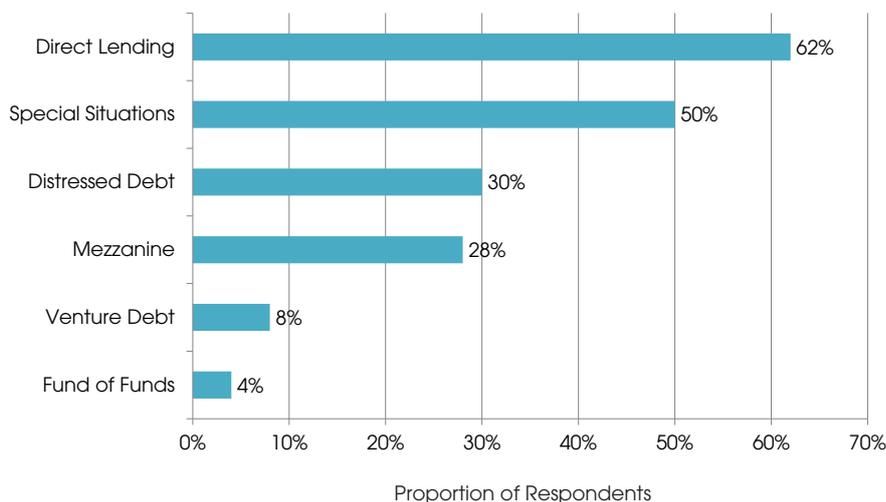
Source: Preqin Investor Interviews, February 2015

# Strategies and Geographies Targeted

## Fund Type Preferences

Direct lending is viewed as the most attractive private debt fund type to investors in the current financial climate, named by 62% of respondents (Fig. 6.10). This is in line with the current fundraising market where direct lending vehicles form the largest amount of funds seeking commitments, both in terms of number and the amount of capital targeted. Special situations are viewed as attractive by half of respondents, while distressed debt and mezzanine funds, which have historically dominated the private debt space, are viewed as attractive by less than a third of respondents, with 30% and 28% naming these fund types as presenting the best opportunities in the current market respectively.

**Fig. 6.10:** Private Debt Fund Types Investors View as Currently Presenting the Best Investment Opportunities



Source: Preqin Investor Interviews, February 2015

## Geographic Preferences

Europe is viewed favourably by 69% of investors, and was the most cited region when investors were asked which regions currently present the best investment opportunities (Fig. 6.11). This is a consequence of the relative immaturity of the European private debt market compared to North America, coupled with a significant amount of potential deal opportunities as Basel III regulations start to kick in. North America is still viewed by a significant 57% of respondents as presenting attractive opportunities, whereas only 14% of respondents thought Asia presented strong opportunities at present.

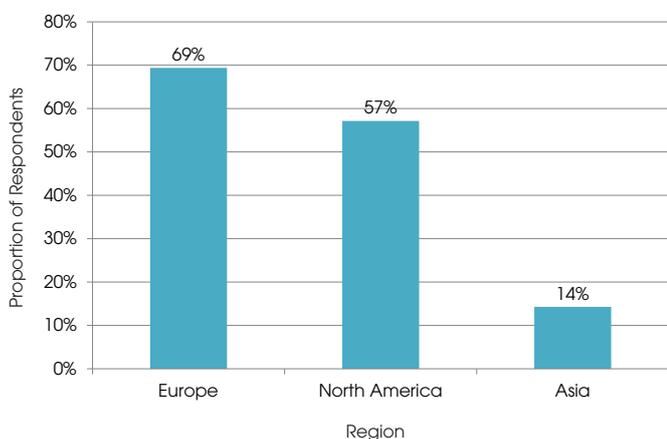
## Investors' Source of Allocation

As private debt continues to grow, it is especially interesting to see how investors define, place and understand the asset class. As shown in Fig. 6.12, nearly a quarter (24%) of investors allocate to private debt via their private equity allocation, with a further 18% accessing the asset class through their general alternatives allocation. By contrast only 11% invest through their fixed income allocation. This indicates that the asset class is very much viewed by investors as an alternative investment similar to private equity, with which it typically

shares characteristics such as illiquidity, as opposed to fixed income instruments, with which it shares features such as the underlying investments paying a coupon.

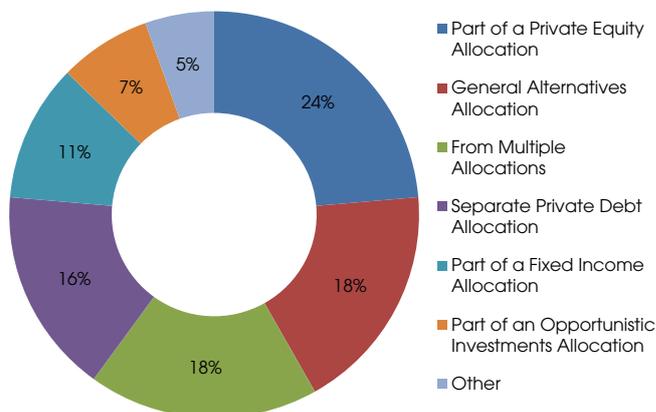
Importantly for the growth of private debt as an independent asset class, a notable 16% of investors now maintain a separate allocation to private debt; this proportion is expected to grow in the coming years as investors struggle to place private debt target returns in a private equity bucket, while at the same time struggling to place it within a fixed income allocation due to its illiquidity.

**Fig. 6.11:** Regions Investors View as Currently Presenting the Best Investment Opportunities



Source: Preqin Investor Interviews, February 2015

**Fig. 6.12:** Breakdown of Investor Allocations Used for Private Debt Investments



Source: Preqin Investor Interviews, February 2015

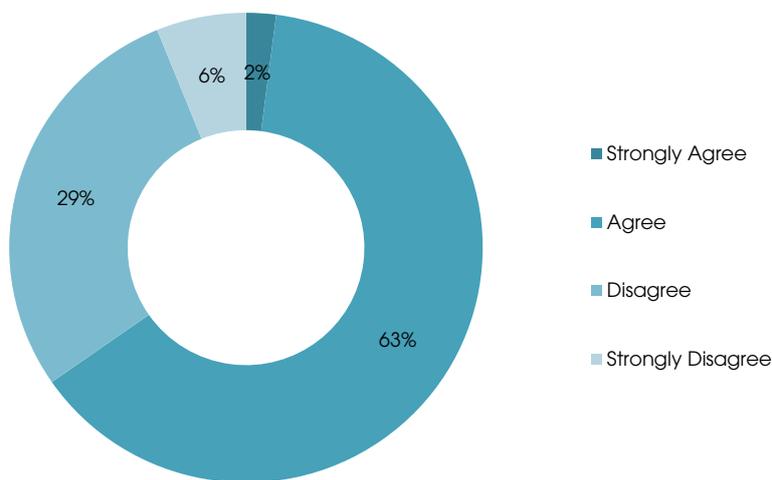
# Fees and Alignment of Interests

Preqin’s latest investor interviews reveal that the majority of investors in private debt believe that fund manager and investor interests are properly aligned, with 65% stating they either agree or strongly agree with this statement (Fig. 6.13). However, for over a third (35%) there is a lack of confidence in the alignment of interests between fund managers and investors, indicating there is still room for improvement within the industry.

Fig. 6.14 illustrates the areas in which investors believe LP and GP alignment could be improved. The amount of capital fund managers commit to their own vehicles is the most common answer (55%), indicating investors feel that a manager having a greater stake in a fund leads to a greater alignment of interests. Management fees were also named by over half (53%) of respondents as an area in need of improvement, with hurdle rates (49%) and performance fees (47%) also named by a large number of investors.

In understanding investors’ opinions on fund terms and conditions and areas for improvement, it is interesting to put this in context by looking at the factors they consider most important when selecting

**Fig. 6.13:** Proportion of Investors that Believe Fund Manager and Investor Interests Are Properly Aligned



Source: Preqin Investor Interviews, February 2015

a private debt fund manager. As shown in Fig. 6.15, 42% of investors named strategy as the most important factor they consider when selecting private debt fund managers for investment, with a further 23% naming past performance as the key factor.

Only 19% named alignment of interests as the most important factor, indicating that while a number of investors feel this is an area for improvement, it is generally not considered the most important factor when allocating capital to private debt.

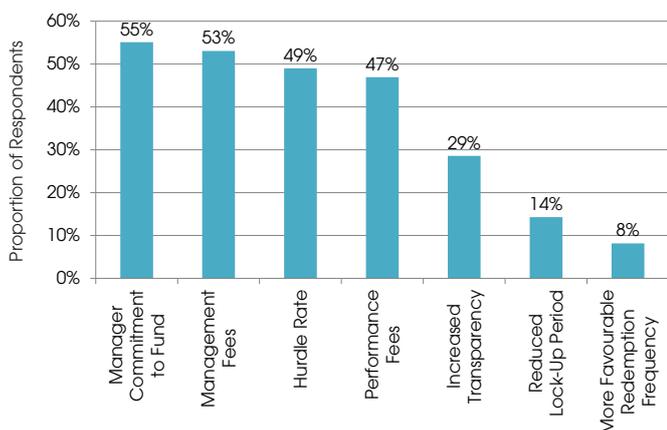
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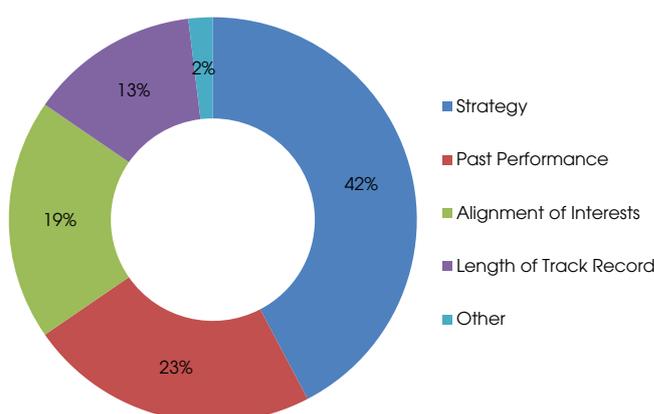


**Fig. 6.14:** Investors’ Views on Areas of Fund Terms and Conditions Where Alignment of Interests Can Be Improved



Source: Preqin Investor Interviews, February 2015

**Fig. 6.15:** Investors’ Views on the Most Important Factor They Consider when Selecting a Private Debt Fund Manager



Source: Preqin Investor Interviews, February 2015

# Preqin Investor Outlook: Alternative Assets H1 2015



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