PREQIN INVESTOR OUTLOOK: ALTERNATIVE ASSETS H1 2017

Private Equity ▪ Hedge Funds ▪ Real Estate ▪ Infrastructure
Private Debt ▪ Natural Resources

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CONTENTS

DATA PACK FOR PREQIN INVESTOR OUTLOOK: ALTERNATIVE ASSETS, H1 2017

The data behind all of the charts featured in this report is available to download for free. Ready-made charts are also included that can be used for presentations, marketing materials and company reports.

To download the data pack, please visit:

www.preqin.com/investoroutlook

FOREWORD

The alternative assets industry is bigger than ever, with more than $7.7tn in hedge fund and private capital assets managed globally, having grown by $300bn during 2016. Participation in multiple alternative asset classes is now the norm for the majority of institutional investors, with alternatives portfolios becoming more and more diverse.

Institutional investors face a number of challenges today. While the performance of most private capital funds in 2016 met or exceeded investors' expectations, there are concerns about asset pricing and whether strong performance can be maintained. Returns from hedge funds improved in 2016 but most investors still reported that hedge fund performance fell short of their expectations, with performance and fees remaining key concerns. The more turbulent geopolitical landscape we see today only creates further uncertainty.

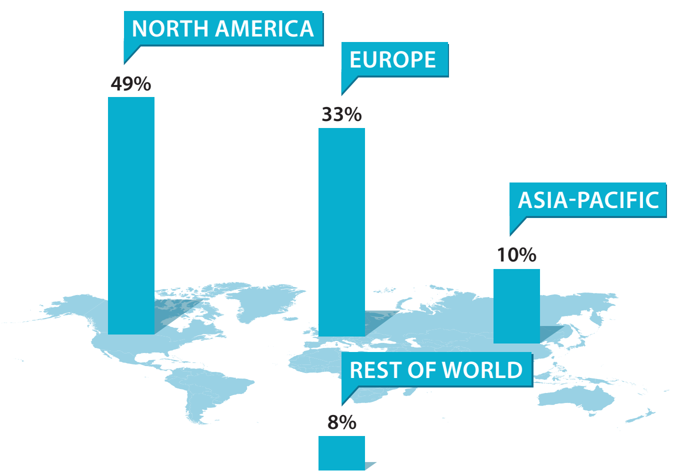
Most investors remain below their long-term target allocation to alternatives, and so have capital to put to work, but across alternative asset classes respondents stated it is harder to find attractive opportunities now than a year ago. There are almost 18,000 alternatives funds open for investment, but for investors, finding the true outperformers is a difficult prospect, particularly when the majority are finding that the marketing documents they receive are not meeting their needs.

For fund managers, standing out amid the unprecedented level of competition is a challenging prospect, and it is more important than ever to understand the changing requirements of the investor community. This report brings together the results of a series of in-depth interviews with over 500 institutional investors, conducted by Preqin's analysts for the latest editions of the **Preqin Global Alternatives Reports**. We hope it helps provide insight into institutional investors' portfolios and future plans, their confidence in different asset classes and the challenges they face.

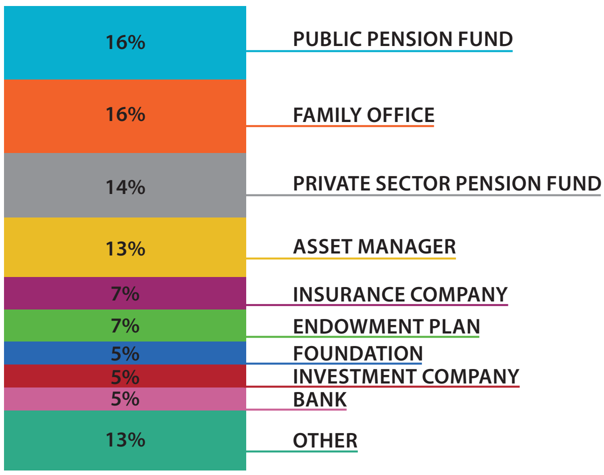
Preqin's online services are indispensable fundraising and investor relations tools for any firm managing or looking to manage institutional capital. Thousands of professionals use Preqin every day to source new investors, access exclusive information on new RFPs and fund searches, monitor the market and track competing firms.

To find out how Preqin's services can help your business in the coming months, please do not hesitate to contact at us at info@preqin.com or at our New York, London, Singapore, Hong Kong or San Francisco offices.

RESPONDENTS BY INVESTOR LOCATION



RESPONDENTS BY INVESTOR TYPE



SECTION ONE: ALTERNATIVE ASSETS

INVESTORS WANT GREATER TRANSPARENCY AND BETTER SOURCING OF REAL AND ALTERNATIVE ASSETS

- Pedro Antonio Arias, **Amundi**

Despite strong institutional investor appetite for real and alternative assets, there are concerns over transparency and the ability of managers to source these assets at a fair price, as evidenced by Preqin's most recent annual survey.

Institutional investors want fund managers to cover the basic transparency requirements, such as communicating their investment strategy clearly as well as providing detailed performance data and information about their team.

But they are also keen to have more clarity on the real cost of investing in alternative assets such as private equity, infrastructure and real estate. The survey showed that fee structure is a key investor concern.

A MORE STANDARDIZED APPROACH TO FEE STRUCTURE IS REQUIRED

It behoves managers to address concerns over fee structures and alignment of interests. In recent years, there has been a strong focus from institutional investors on fee structures of more traditional asset classes and attention will now be switched to the more opaque and more expensive fee structures of alternative asset funds.

For example, investors want to know whether they pay fees on the capital they have committed or the capital that has been invested. If investors are paying fees on capital committed and the fund struggles to source assets, investors can end up paying high fees for effectively keeping their cash on deposit.

This problem could be resolved if the general partners of private market funds were to develop a more standardized approach to fee structures. There is already a trend for fees to be paid on capital invested rather than on capital committed and we believe this should become standard practice.

This is easier for the larger global players as they have the necessary economies of scale to support a low or zero capital committed fee while they source deals. Smaller fund managers, however, could find this challenging.

Asset managers need to be wary of complacency – while there is a strong demand for real and alternative assets in the current market environment, institutional investors will not allocate capital unless the fee structures are clear and equitable.

THERE ARE CONCERNS OVER SOURCING AND VALUATION

Transparency is not the only concern institutional investors have over these assets – limited supply is creating sourcing and valuation challenges.

According to the Preqin survey, while the majority of institutional investors have a positive perception of private equity, infrastructure and real estate, a significant proportion had concerns over the pricing and valuations of these asset classes.

The report showed that while 84% of investors were positive about private equity, 70% have concerns about pricing and valuation. Similar patterns emerged for real estate: 50% were optimistic about the outlook but 68% concerned about sourcing. And 44% of investors had a positive perception of infrastructure, while 54% were concerned about pricing and valuation.

These concerns are a reflection of the fee structure currently operated by most managers. If managers can collect fees from the capital committed rather than the capital invested, there is no incentive to invest quickly.

When investors get frustrated with this process, managers respond by making one of two mistakes. Under pressure, they either pay too much for high-quality assets – because these deals are overcrowded – or they act too quickly and buy assets that look cheap but are low quality.

INVESTORS NEED A MANAGER THAT CAN TAKE A DIFFERENT APPROACH TO SOURCING REAL AND ALTERNATIVE ASSETS

To avoid the cardinal mistake of investing in an illiquid asset at the wrong price, investors will need to find those managers that are able, despite market pressures, to source fairly priced assets.

Different managers have different skills – this is especially true for illiquid real and alternative assets, where access to fairly priced assets is the key to delivering the target returns to investors.

Specialist managers have deep understanding of specific markets – such as real estate or leveraged buyouts – but lack scale. These managers struggle to meet the pressure from investors to source good-quality assets quickly. These firms struggle to provide a capital invested fee model as it leaves them lacking financial resource while searching for deals.

In contrast, global players have the financial strength and a worldwide network of partners, including banks, but often lack local knowledge.

LOCAL KNOWLEDGE AND GLOBAL CONNECTIONS ARE KEY

The ideal asset manager in the private markets world needs to combine the advantages of both a specialist manager and a global player.

Amundi could be classed as a 'glocal' company. We are a global player covering all asset classes – including traditional equities and bonds as well as alternatives – but we also have a specialist understanding of European assets and markets.

The European market remains highly fragmented where local knowledge and contacts are vital. Amundi is the largest asset manager in the region and has long-term business and banking connections which give us access to assets and deals that rivals struggle to find.

At the same time, covering a wide breadth of asset classes creates synergies between our specialized teams, enabling us to discover new investment opportunities and to source deals. For example, there are synergies between Amundi's €500bn fixed income and €9bn private debt businesses.

A good illustration of this 'glocal' ability is when asset managers benefit from deep connections with a large network of local banks throughout a region, for example, in Europe.

These local banks introduce asset managers to small and medium-sized enterprises looking for private debt and equity investors. And if a family-run business is looking for private financing to fund an Asian expansion, then our global reach helps the firm to achieve this goal.

AIMING TO OVERCOME TRANSPARENCY AND SOURCING ISSUES

Transparency and sourcing issues in private markets mean only asset managers that can take advantage of a global scale and a local footprint can align their interests more closely with those of investors. Only 'glocal' managers, rather than boutique specialist players, can ensure investors get access to good deals at fair value, and soon after the capital is committed.

Asset managers with global scale and local knowledge are perfectly positioned to work with banks to provide finance to local companies. The current low return environment is driving investor demand for these high-yield, inflation-linked returns these deals provide. And supply is growing, as companies look for a new source of finance as banks are less able to provide loans.

Asset managers have a central role to play in this trend, which we think will persist over the medium term.

AMUNDI
Publicly traded since November 2015, Amundi is the largest European Asset Manager in terms of AUM, with over €1,000bn worldwide (*). Headquartered in Paris, France, Amundi has six investment hubs located in the world's key financial centres, and offers a combination of research depth and market experience that has earned the confidence of its clients. Amundi is the trusted partner of 100 million retail clients, 1,000 institutional clients and 1,000 distributors in more than 30 countries, and designs innovative, high-performing products and services for these types of clients tailored specifically to their needs and risk profile.

End of September 2016 Amundi has created a dedicated platform for real and alternative assets. Real estate, private debt, private equity, infrastructure and alternative multi-management are now all part of a single integrated business line, bringing together some 200 experts in origination, structuring and management of these asset classes worth more than €36bn in assets under management (**). Through this new platform, Amundi offers institutional or individual investors the opportunity to directly invest in the full range of real assets through dedicated or commingled vehicles (funds, co-investment, multi-management or advisory mandates).

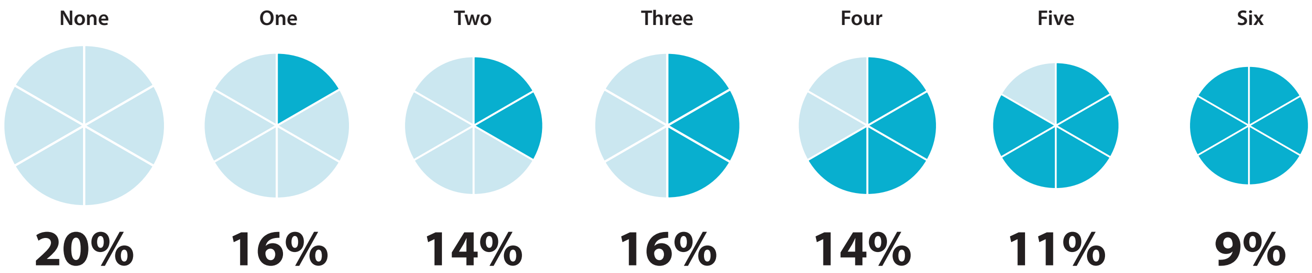
PEDRO ANTONIO ARIAS
Pedro Antonio Arias joined Amundi in July 2013 to manage the alternative assets business line: Pedro Antonio oversees the Private Equity, Real Estate, Infrastructure investments and assets, and co-manages the private debt. He was previously Deputy CEO in charge of international development and real estate at the Casino group, the French retail Group. Pedro Antonio started his career in a law firm before moving to corporate and investment banking in various leading institutions. Pedro Antonio was notably involved in mergers and acquisitions across Europe and Latin America and eventually in co-head of the restructuring practice at Rothschild & Cie for Europe. Pedro graduated from ESSEC business school and Paris-Descartes University (Law degree).

www.amundi.com

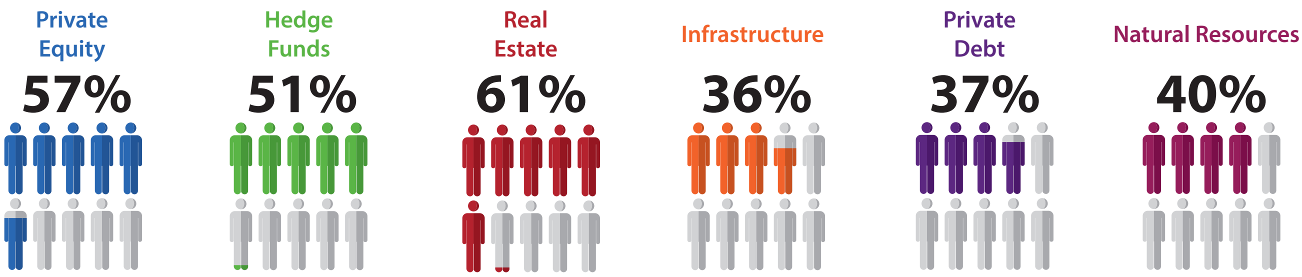
(*) Amundi figures as of 30 September 2016. No.1 European asset manager based on global assets under management (AUM) and the main headquarters being based in Continental Europe - Source IPE "Top 400 asset managers" published in June 2016 and based on AUM as at December 2015.
(**) As at 31 December 2016.

PARTICIPATION IN ALTERNATIVE ASSETS

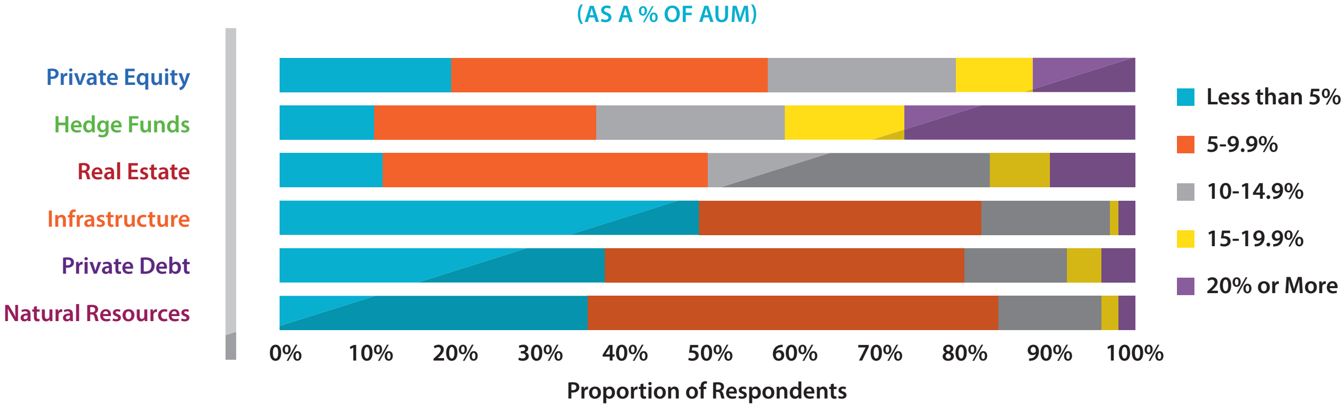
INSTITUTIONAL INVESTORS BY NUMBER OF ALTERNATIVE ASSET CLASSES INVESTED IN



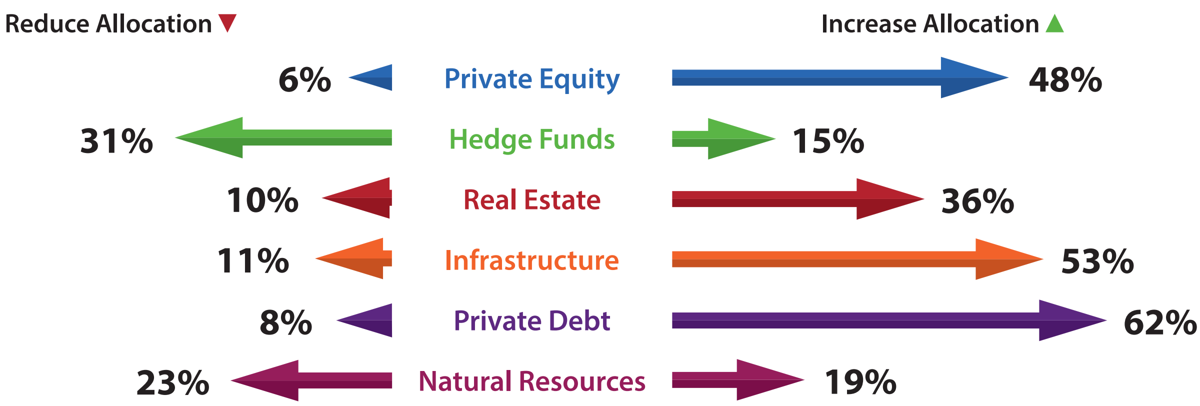
PROPORTION OF INSTITUTIONAL INVESTORS ALLOCATING TO EACH ALTERNATIVE ASSET CLASS



INSTITUTIONAL INVESTORS IN ALTERNATIVE ASSETS BY TARGET ALLOCATION TO EACH ASSET CLASS (AS A % OF AUM)

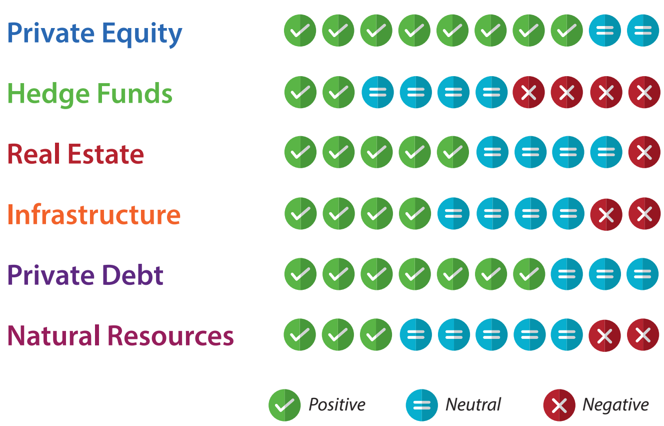


INSTITUTIONAL INVESTORS' PLANS FOR ALLOCATIONS IN THE LONGER TERM



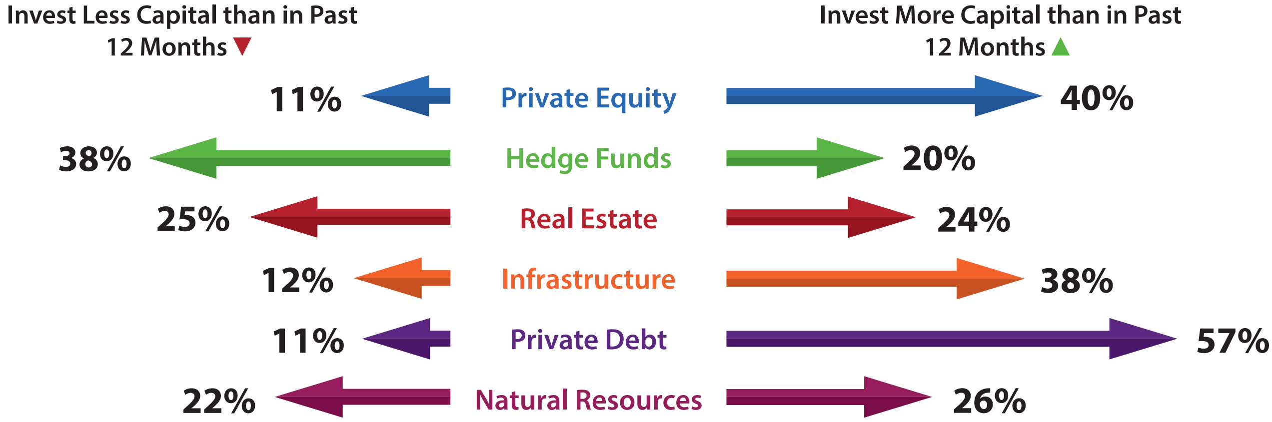
PERFORMANCE EXPECTATIONS

INSTITUTIONAL INVESTORS' GENERAL PERCEPTION OF ALTERNATIVE ASSET CLASSES



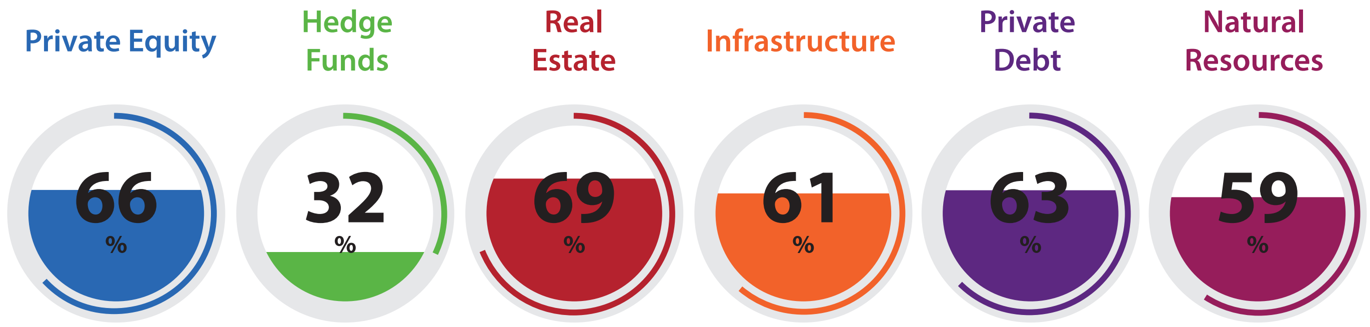
INSTITUTIONAL INVESTOR VIEWS ON ALTERNATIVE ASSETS PERFORMANCE

INSTITUTIONAL INVESTORS' PLANS FOR THE COMING YEAR

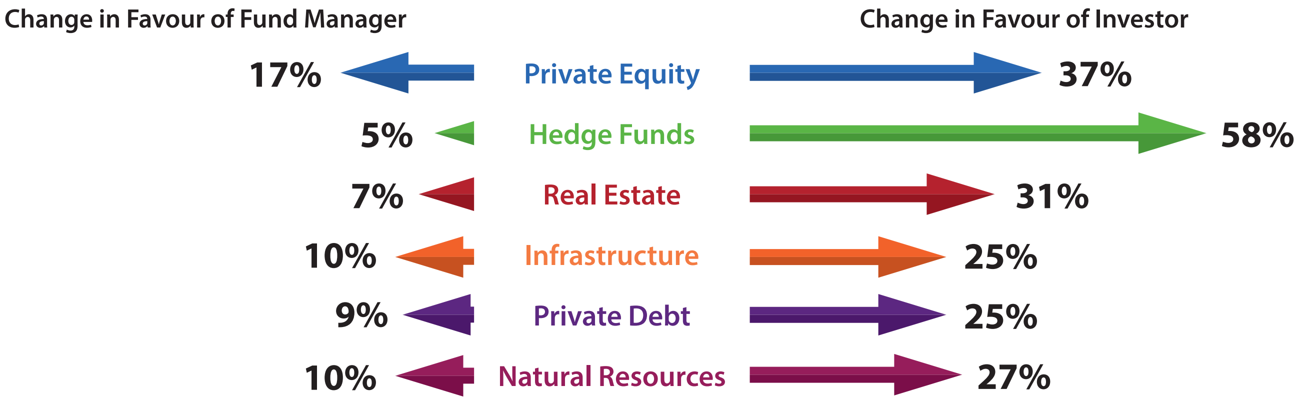


FUND TERMS AND ALIGNMENT OF INTERESTS

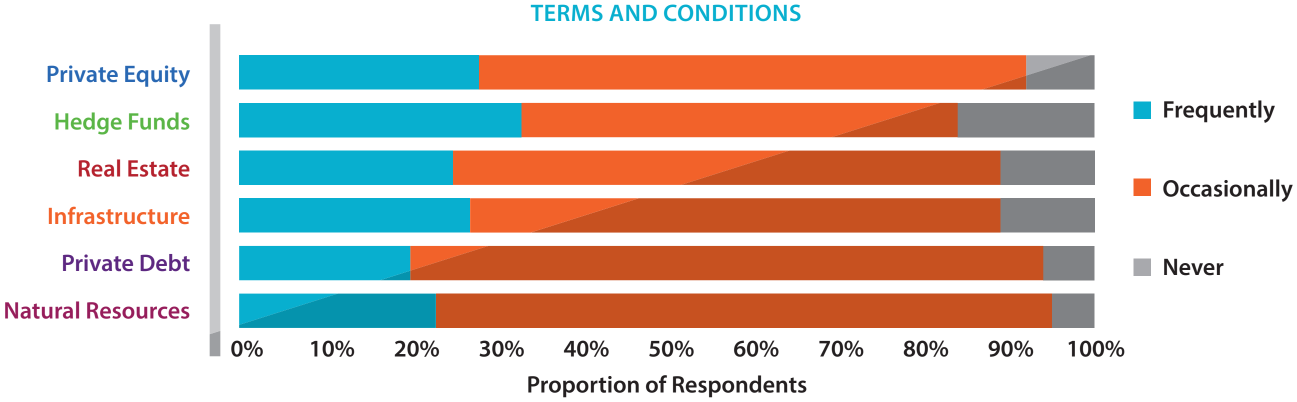
PROPORTION OF INSTITUTIONAL INVESTORS THAT FEEL FUND MANAGER AND INVESTOR INTERESTS ARE PROPERLY ALIGNED



INSTITUTIONAL INVESTOR VIEWS ON CHANGES IN PREVAILING FUND TERMS OVER THE PAST 12 MONTHS



FREQUENCY WITH WHICH INSTITUTIONAL INVESTORS HAVE DECIDED NOT TO INVEST IN A FUND DUE TO THE PROPOSED TERMS AND CONDITIONS



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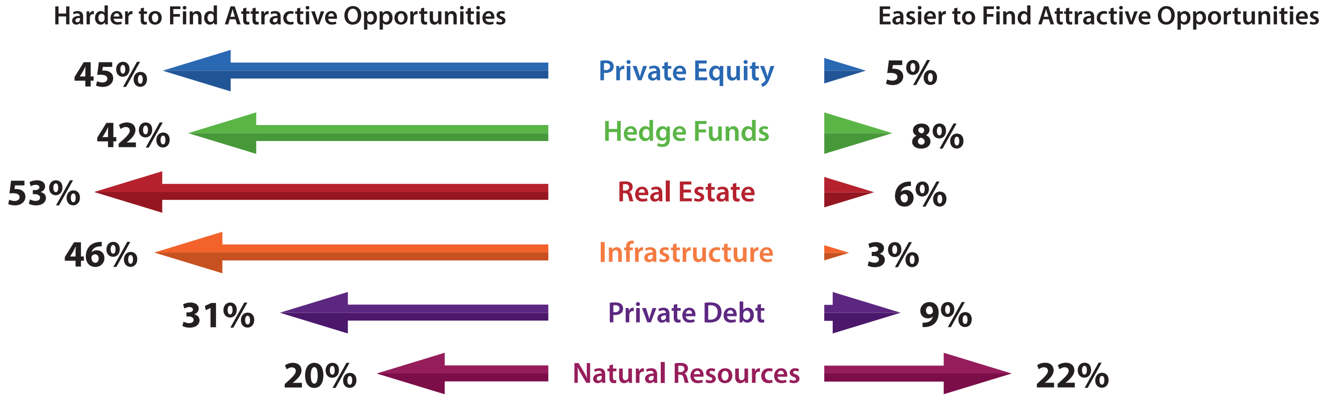
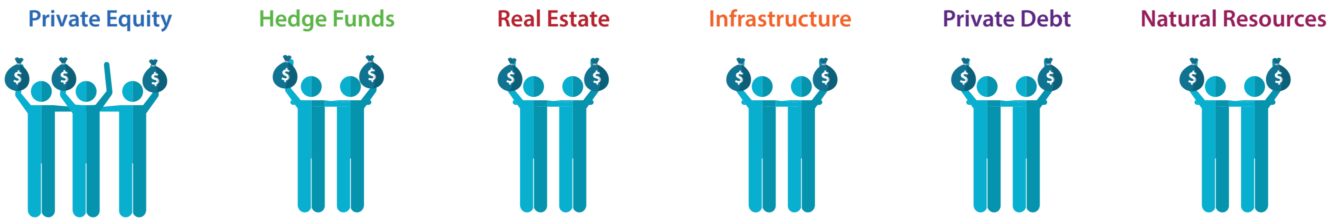
FUND SELECTION AND MARKETING

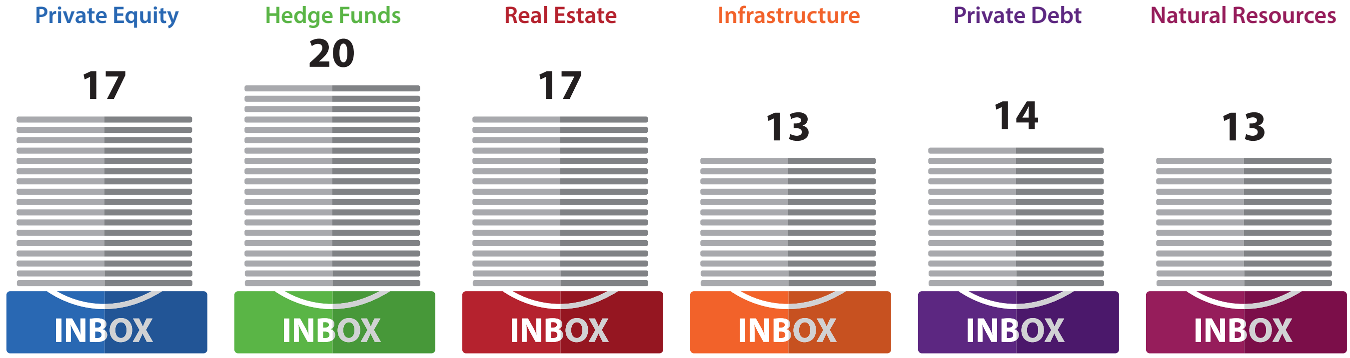
INSTITUTIONAL INVESTOR VIEWS ON THE DIFFICULTY OF SOURCING INVESTMENT OPPORTUNITIES COMPARED TO 12 MONTHS AGO



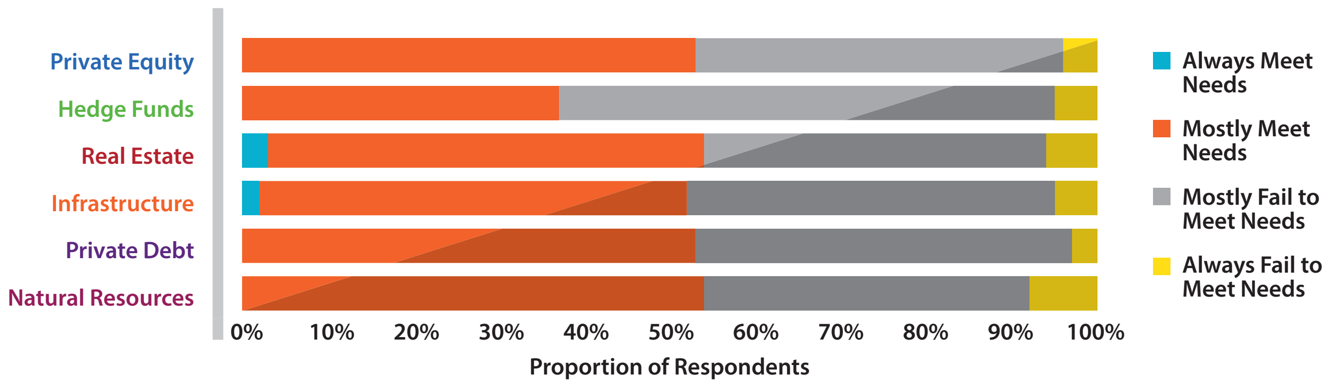
AVERAGE NUMBER OF COMMITMENTS INSTITUTIONAL INVESTORS MAKE PER YEAR



AVERAGE NUMBER OF MARKETING DOCUMENTS INSTITUTIONAL INVESTORS RECEIVE PER MONTH



INSTITUTIONAL INVESTOR VIEWS ON THE FREQUENCY WITH WHICH MARKETING DOCUMENTS MEET THEIR NEEDS



SECTION TWO: PRIVATE EQUITY

POSITIVE BEGINNINGS FOR 2017

As we move into the first half of 2017, institutional investor sentiment towards private equity is more positive than ever. Among institutional investors in private equity interviewed by Preqin in December 2016, 84% reported a positive view of the asset class, up from 59% two years ago. Recent years have seen strong performance which has, in turn, led to high distributions: $257bn was distributed from private equity funds in H1 2016 (the most recent date for which data is available) following a record $472bn in 2015. As a result, the vast majority of investors are satisfied with how their investments are performing: 95% of investors reported that their private equity portfolios had met or exceeded expectations over the past 12 months; the proportion that believe private equity has fallen short of expectations is at its lowest over the period 2011-2016.

Investors do have some concerns, however, about whether this strong performance can be maintained. In particular, they remain concerned about high valuations, as cited by 70% of respondents, and the risk that fund managers may be overpaying for assets which could be difficult to realize if prices fall at a later date. Investors also reported increasing concerns about the exit environment (51% of respondents, up from 24% this time last year) and deal flow (41%, up from 34%).

Nevertheless, despite these concerns, investors remain highly satisfied with the asset class and plan to invest greater sums of capital in private equity in order to maintain or increase their allocations. Forty percent of investors reported that they would be investing more capital in the asset class over the next 12 months than during the past 12 months, while 48% plan to increase their allocations over the longer term. As they make their investment plans for the first half of the year, these investors continue to identify small to mid-market buyout funds as the most attractive fund type at present (58% of respondents) and a greater proportion plan to increase their allocation to Europe-focused funds than to funds focused on other regions.

SATISFACTION WITH PRIVATE EQUITY

84%

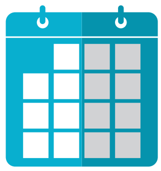
of investors have a positive perception of private equity, the greatest proportion among alternative asset classes.

KEY CHALLENGES

70%

of investors identified valuations as their leading concern going into 2017.

PLANS FOR 2017

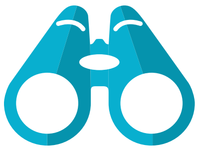


83%

of investors plan to make their next private equity fund commitment in H1 2017.

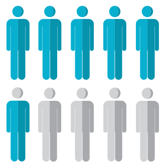
48%

of investors plan to increase their allocation to private equity over the longer term, compared with only 6% that plan to decrease it.



45%

of investors are finding it harder to source attractive investment opportunities than 12 months ago.



58%

of investors identified small to mid-market buyout funds as among those presenting the best opportunities at present.

SATISFACTION WITH PRIVATE EQUITY

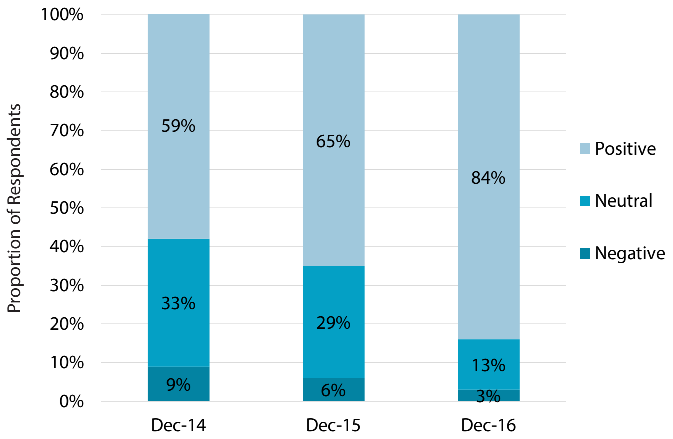
Institutional investors surveyed by Preqin in December 2016 expressed a high level of satisfaction with private equity: 84% of investors reported a positive view of the asset class at present, up from 59% two years earlier (Fig. 2.1).

Ninety-five percent of investors reported that their private equity fund investments had met or exceeded expectations in 2016, including 24% for which they had exceeded expectations (Fig. 2.2). The 5% that felt that their investments had fallen short of expectations was the smallest proportion in the past six years.

In terms of longer-term performance, investors are even more positive: 40% reported that their private equity investments had exceeded expectations over the past three years, second only to private real estate (42%). Despite this, the proportion of investors that reported that their confidence in the ability of private equity to achieve portfolio objectives had fallen over the past year increased from 9% to 14% (Fig. 2.3), possibly due to concerns about whether fund managers can continue to deliver strong returns at a time of high valuations. Nevertheless, the vast majority (86%) of fund managers reported that their confidence in the ability of private equity to achieve portfolio objectives was unchanged or had increased over the past 12 months.

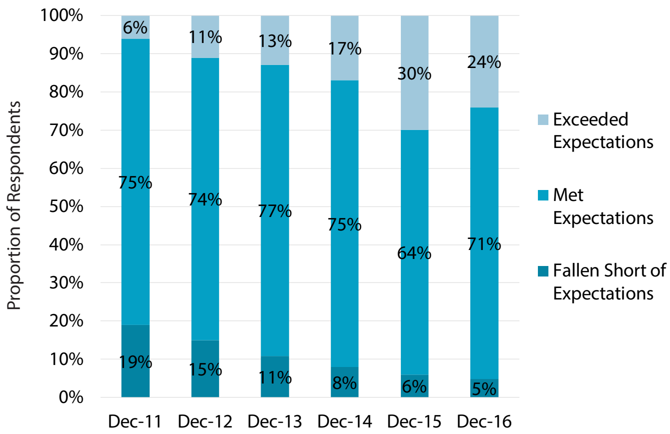
Investor satisfaction with private equity is driving larger sums of capital to the asset class as investors look to maintain and increase their allocations. Over the longer term, almost half (48%) of respondents plan to increase their allocations to private equity, while a further 46% will maintain their allocations – these are some of the highest levels seen over the past six years (Fig. 2.4).

Fig. 2.1: Investors' General Perception of the Private Equity Industry, 2014 - 2016



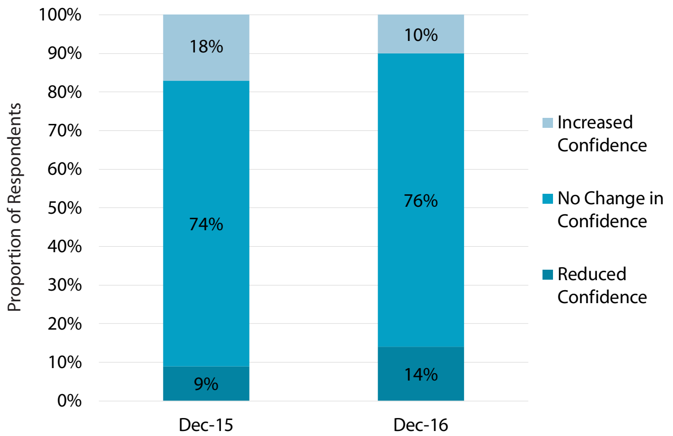
Source: Preqin Investor Interviews, December 2014 - December 2016

Fig. 2.2: Investor Views on Private Equity Portfolio Performance over the Past 12 Months Relative to Expectations, 2011 - 2016



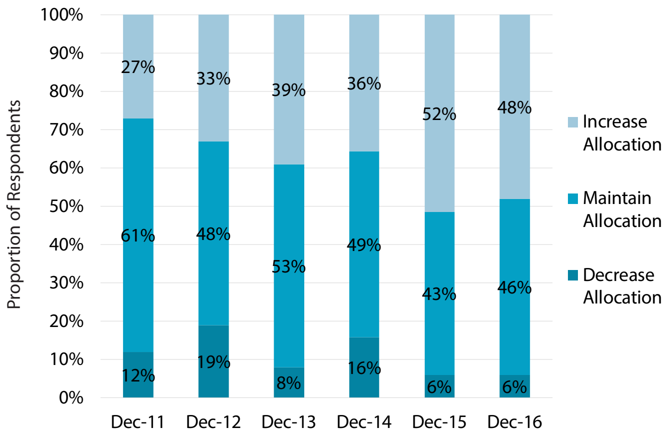
Source: Preqin Investor Interviews, December 2011 - December 2016

Fig. 2.3: Investors' Change in Confidence in the Ability of Private Equity to Achieve Portfolio Objectives over the Past 12 Months, 2015 vs. 2016



Source: Preqin Investor Interviews, December 2015 - December 2016

Fig. 2.4: Investors' Intentions for Their Private Equity Allocations over the Long Term, 2011 - 2016



Source: Preqin Investor Interviews, December 2011 - December 2016

INVESTOR ACTIVITY IN 2017

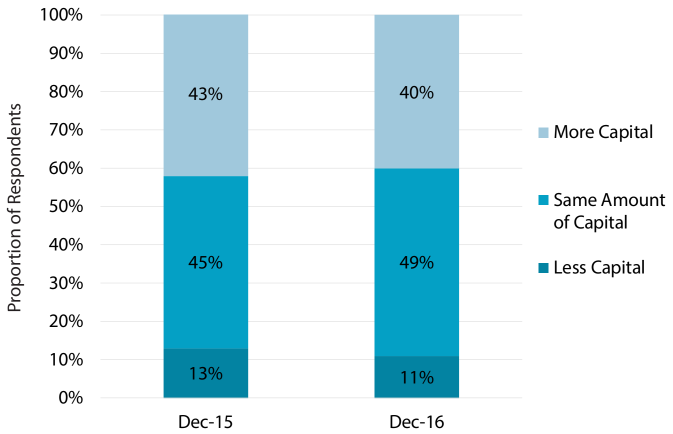
Positive investor sentiment towards private equity is set to lead to further investment in the asset class in the year ahead, as 40% of investors plan to commit more capital to private equity funds in the next 12 months than they did over the past 12 months (Fig. 2.5). Although this represents a small decrease from 43% in December 2015, the proportion that plan to invest less capital over the next 12 months has also fallen over the same period, from 13% to 11%.

With 89% of investors looking to invest the same amount or more capital in private equity in the next year, over three-quarters (76%) plan to make their next commitment in Q1 2017 and 7% intend to do so in Q2 (Fig. 2.6). A further 11% plan to invest in the second half of the year, with only 6% expecting to wait until 2018 or later for their next commitment.

Investors are increasingly spreading their investment across a number of funds, with the proportion of investors that plan to commit to five or more funds over the next 12 months increasing from 43% in the **H2 2016 Investor Outlook** to 51% at present (Fig. 2.7). Similarly, the proportion that intend to make just one or two investments has fallen from 34% to 26% over the same period.

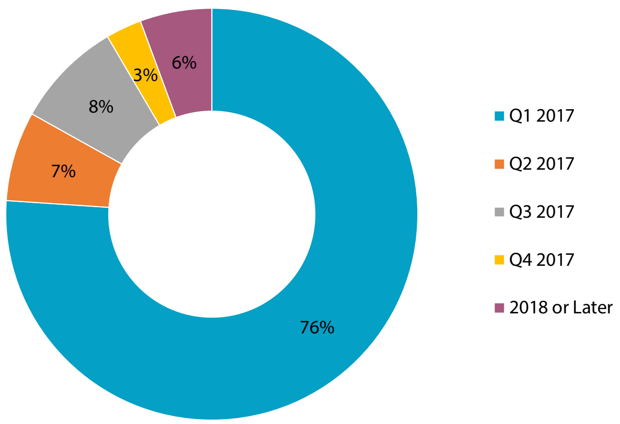
However, despite investing across a larger number of vehicles, for the majority of investors, the intended capital commitment to the asset class remains small: 52% of investors plan to invest less than $50mn in private equity over the next 12 months (Fig. 2.8). Nevertheless, a small but important group of investors will be making large commitments over the coming year: 13% of investors plan to invest $500mn or more in the asset class.

Fig. 2.5: Investors' Expected Capital Commitment to Private Equity Funds in the Next 12 Months Compared to the Previous 12 Months, 2015 vs. 2016



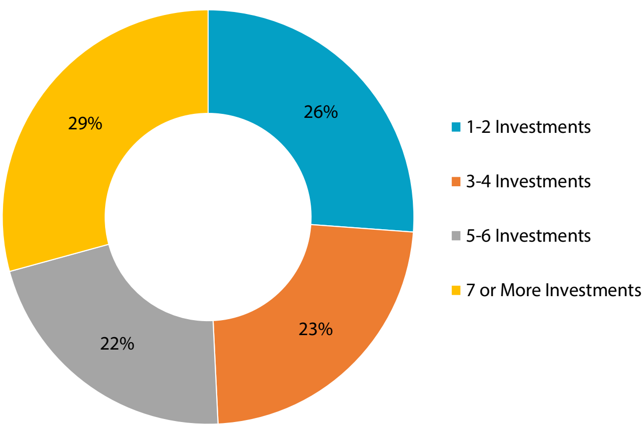
Source: Preqin Investor Interviews, December 2015 - December 2016

Fig. 2.6: Timeframe for Investors' Next Intended Commitment to a Private Equity Fund



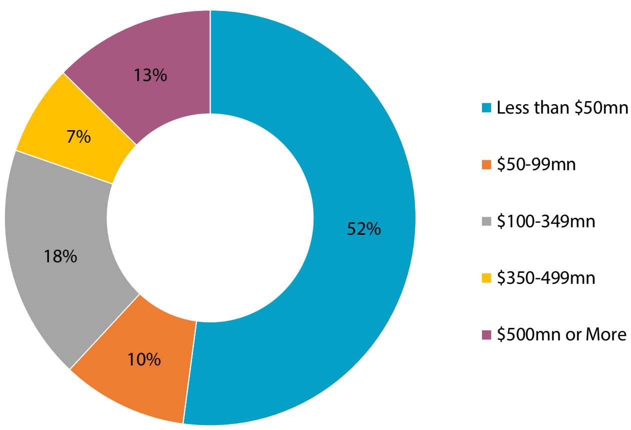
Source: Preqin Investor Interviews, December 2016

Fig. 2.7: Number of Private Equity Fund Commitments Investors Plan to Make over the Next 12 Months



Source: Preqin Private Equity Online

Fig. 2.8: Amount of Fresh Capital Investors Plan to Invest in Private Equity Funds over the Next 12 Months



Source: Preqin Private Equity Online

STRATEGIES AND GEOGRAPHIES TARGETED

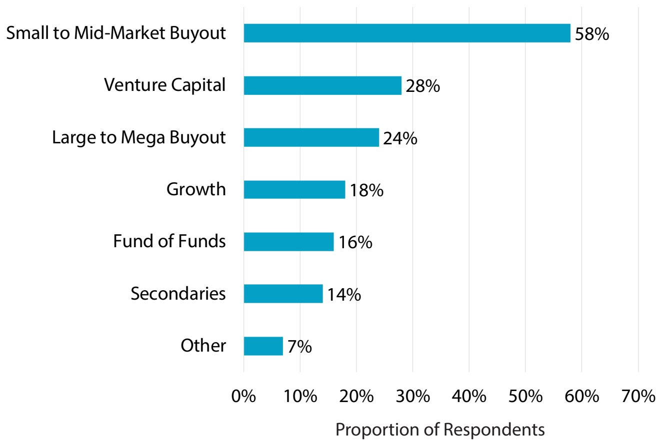
As investors seek to commit greater sums of capital to private equity over the coming year, they continue to identify small to mid-market buyout funds as the most attractive fund type, with 58% of investors believing they present the best opportunities (Fig. 2.9). This is up from 50% in the **H2 2016 Investor Outlook**, but remains below the figure for H1 2016 (61%). Venture capital followed, cited by 28% of respondents, although this has fallen from 36% in June 2016, possibly due to investor concerns about overinflated prices for venture capital companies and their potential impact on future returns.

North America is considered the most promising region for private equity investment: 61% of investors believe it presents the best opportunities at present, followed by Europe (44%, Fig. 2.10). In terms of allocations, however, a greater proportion of LPs plan to increase their allocation to Europe (31%) than North America (25%) over the coming year, with 4% and 7% planning to reduce their allocations to these regions respectively (Fig. 2.11).

Outside the established private equity markets of North America and Europe, 21% of investors saw Asia as among the most favourable regions for private equity investment. Eighteen percent of investors plan to increase their allocation to the region over the coming year, compared with only 5% that plan to decrease it.

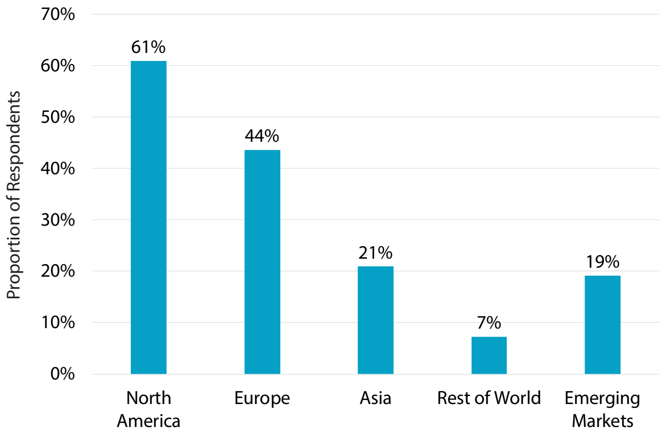
Emerging markets and the Rest of World region were seen as offering the best opportunities by 19% and 7% of investors respectively. According to investors currently active in emerging markets, the most promising countries/regions are Emerging Asia (41%), China (39%) and India (20%, Fig. 2.12).

Fig. 2.9: Fund Types* that Investors View as Presenting the Best Opportunities



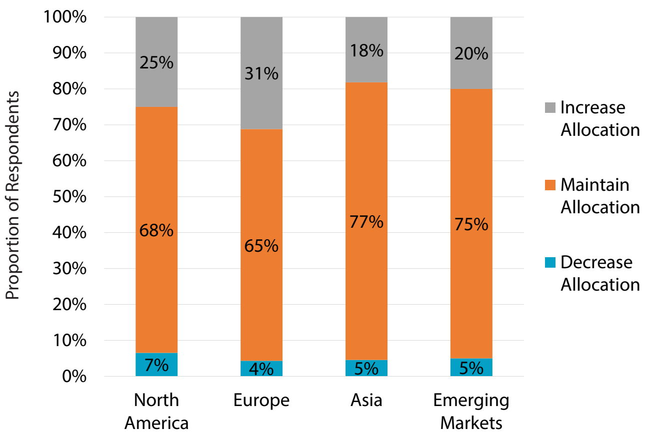
Source: Preqin Investor Interviews, December 2016

Fig. 2.10: Regions* Investors View as Presenting the Best Opportunities



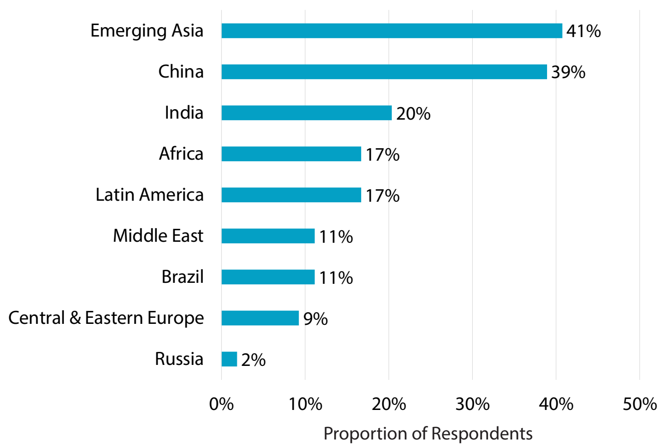
Source: Preqin Investor Interviews, December 2016

Fig. 2.11: Investors' Plans for their Private Equity Allocations over the Next 12 Months by Region



Source: Preqin Investor Interviews, December 2016

Fig. 2.12: Countries and Regions* within Emerging Markets that Investors View as Presenting the Best Opportunities



Source: Preqin Investor Interviews, December 2016

**Respondents were not prompted to give their opinions on each fund type/region individually but to name those they felt best fit these categories; therefore, the results display the fund types/regions at the forefront of investors' minds at the time of the survey.*

KEY ISSUES IN 2017

While investor sentiment towards private equity is positive, there remain a number of challenges facing investors in the asset class. High valuations for portfolio companies remain the number one concern, cited by 70% of respondents (Fig. 2.13). Combined with record levels of dry powder and stiff competition for assets, investors are increasingly concerned about the impact high pricing will have on returns in future.

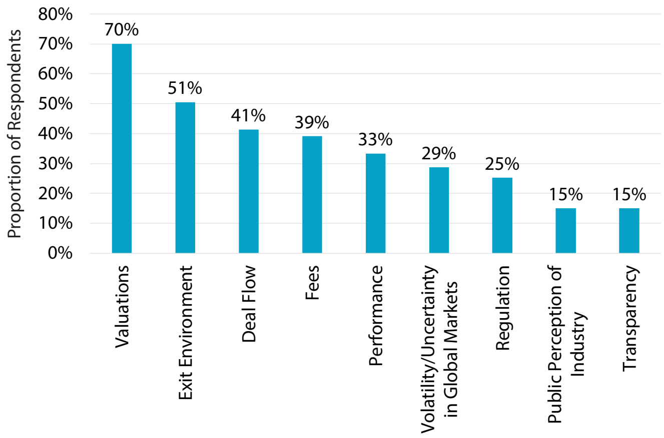
With valuations high, the exit environment has also become a key issue for the industry, with investors concerned that it may become more difficult for fund managers to realize their investments at current valuations. The proportion of investors citing the exit environment as a concern increased to 51% from 24% the previous year.

Deal flow was also cited by 41% of investors, up from 34% in December 2015. Forty-five percent of investors reported that it has become harder to find attractive investment opportunities over the past year, compared with only 5% that are finding it easier (Fig. 2.14).

In terms of broader macroeconomic developments affecting performance, the key factors that investors believe will affect their private equity portfolios in the year ahead are stock market volatility (49%), low interest rates (41%) and the geopolitical landscape (26%, Fig. 2.15).

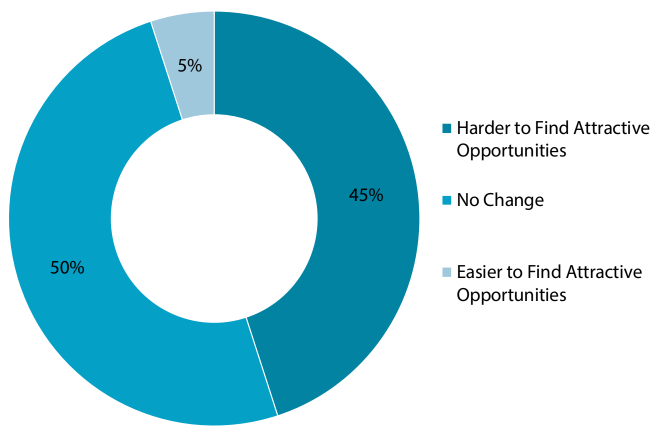
All of these issues may pose a challenge to investors as they become more ambitious in their return targets for their private equity portfolios. Just under half (49%) of investors reported that they are targeting returns of 4.1% or more above public markets for their private equity portfolios, up from 37% in December 2014 (Fig. 2.16).

Fig. 2.13: Investor Views on the Key Issues Facing Private Equity in 2017



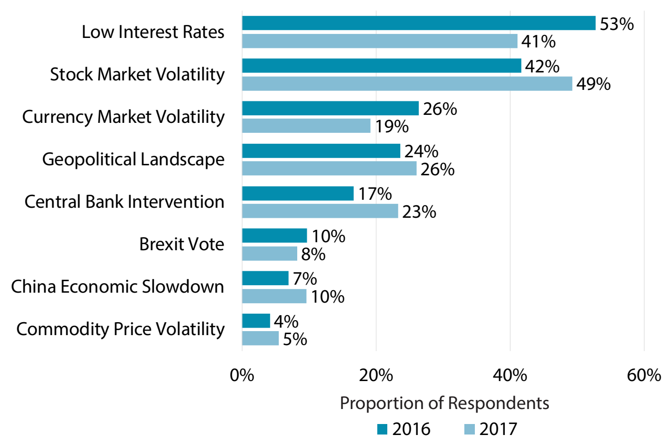
Source: Preqin Investor Interviews, December 2016

Fig. 2.14: Investor Views on the Difficulty of Identifying Attractive Investment Opportunities Compared to 12 Months Ago



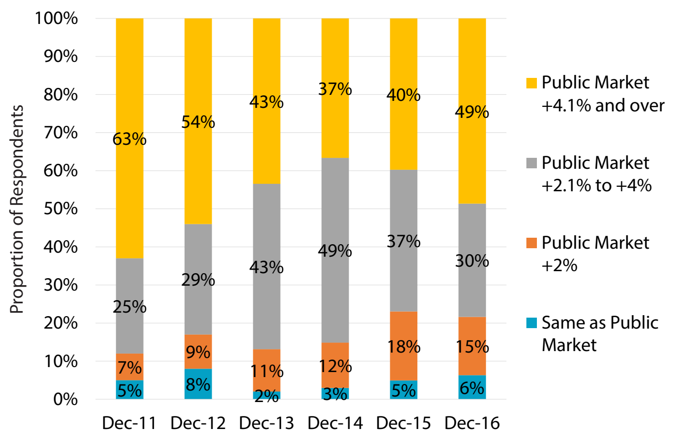
Source: Preqin Investor Interviews, December 2016

Fig. 2.15: Investor Views on the Macroeconomic Factors that Had the Biggest Impact on Their Private Equity Portfolios in 2016 vs. Predictions for 2017



Source: Preqin Investor Interviews, December 2016

Fig. 2.16: Investors' Return Expectations for Their Private Equity Portfolios, 2011 - 2016



Source: Preqin Investor Interviews, December 2011 - December 2016

FUND TERMS AND ALIGNMENT OF INTERESTS

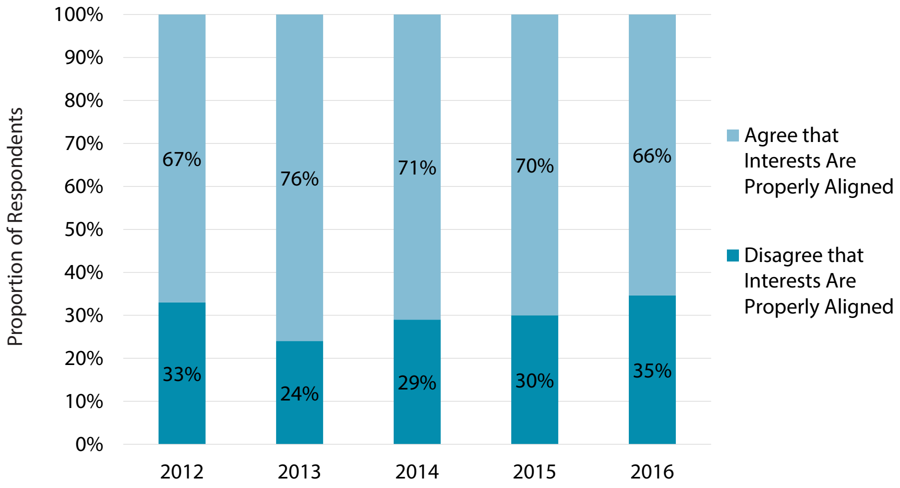
The alignment of interests between GPs and LPs is an important aspect of their relationship, and is intrinsically related to fund terms and conditions. Sixty-six percent of investors surveyed by Preqin believe that GP and LP interests are properly aligned, marking the fifth consecutive year of a majority consensus (Fig. 2.17). However, this does represent a four percentage point reduction from the previous year.

Those investors that are dissatisfied with the current alignment of interests identified a number of areas where improvements can be made (Fig. 2.18). Management fees are of greatest concern to LPs (cited by 70% of all respondents), with one respondent stating that "management fees should cover costs only with no profit. Performance should be based on properly calculated alpha generated". Transparency at fund level (63%), how performance fees are charged (60%) and the amount of performance fees (51%) were also key concerns.

Although the proportion of investors that are dissatisfied with the alignment of interests has increased slightly from the previous year, more LPs (37%) have seen changes to fund terms and conditions in their favour over the past year than in favour of the GP (17%), an indicator of the bargaining power that LPs have relative to GPs in a competitive fundraising environment and the efforts made by many GPs to address investor concerns. The largest proportion (44%) of surveyed LPs saw increased transparency at fund level, while 42% witnessed changes to management fees and 31% saw changes to the GP's commitment to the vehicle.

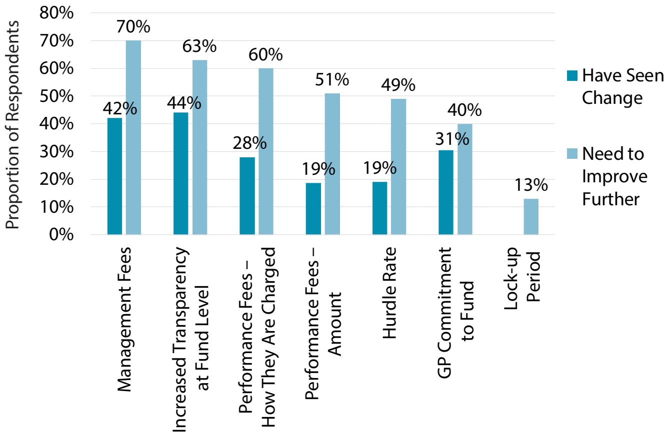
Fund terms and conditions proposed by GPs can have significant influence on whether an LP decides to invest in a fund: 28% of LPs have frequently decided not to invest in a fund as a result of the proposed terms and conditions, while a further 64% have occasionally been deterred from making an investment on this basis (Fig. 2.19). With significant competition among fund managers for investor capital, GPs will need to demonstrate their commitment to improving fund terms for investors, in such a way that they address LP concerns about alignment of interests, in order to successfully attract capital for new vehicles.

Fig. 2.17: Extent to Which Investors Believe that Fund Manager and Investor Interests Are Properly Aligned, 2012 - 2016



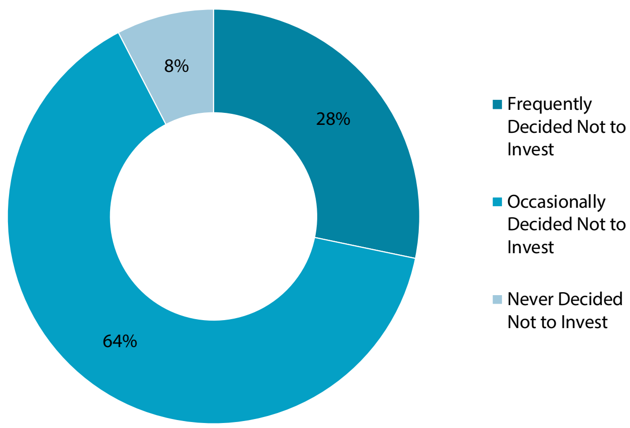
Source: Preqin Investor Interviews, December 2012 - December 2016

Fig. 2.18: Investor Views on the Areas of Fund Terms and Conditions that Have Changed over the Past 12 Months and that Need to Improve Further in 2017



Source: Preqin Investor Interviews, December 2016

Fig. 2.19: Frequency with Which Investors Have Decided Not to Invest in a Fund Due to the Proposed Terms and Conditions



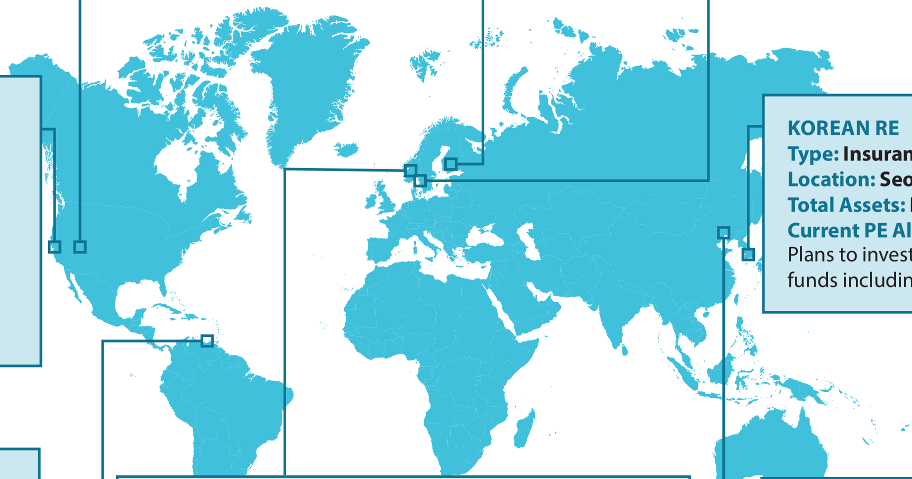
Source: Preqin Investor Interviews, December 2016

SAMPLE PRIVATE EQUITY INVESTORS TO WATCH IN 2017

NEW MEXICO STATE INVESTMENT COUNCIL (SIC)
Type: Sovereign Wealth Fund
Location: Santa Fe, US
Total Assets: $20.6bn
Current/Target PE Allocation: 7.9%/12.0%
Amount Investing in Next 12 Months: $550-650mn
Plans to invest in 5-8 funds across buyout, distressed debt, fund of funds, growth and venture capital strategies specifically, in North America, Europe and Asia.

VARMA MUTUAL PENSION INSURANCE COMPANY
Type: Insurance Company
Location: Helsinki, Finland
Total Assets: €42bn
Current/Target PE Allocation: 7.5%/7.5%
Amount Investing in Next 12 Months: €700mn
Will target buyout funds with a focus on North America, Northern Europe and Asia.

AP-FONDEN 2
Type: Public Pension Fund
Location: Gothenburg, Sweden
Total Assets: SEK 305bn
Current/Target PE Allocation: 5.0%/5.0%
Amount Investing in Next 12 Months: SEK 1.68-3.36bn
Will invest in buyout, fund of funds, growth and venture capital vehicles on a global scale (except emerging markets).



LOS ANGELES COUNTY EMPLOYEES' RETIREMENT ASSOCIATION (LACERA)
Type: Public Pension Fund
Location: Los Angeles, US
Total Assets: $47.6bn
Current/Target PE Allocation: 9.3%/10.0%
Amount Investing in Next 12 Months: $1.5bn
Will commit $1.5bn to buyout, special situations and venture capital vehicles on a global scale. Typically commits $100mn per fund.

KOREAN RE
Type: Insurance Company
Location: Seoul, South Korea
Total Assets: KRW 9.4tn
Current PE Allocation: 2.0%
Plans to invest in new South Korea-focused private equity funds including balanced, buyout and growth vehicles.

CORPORACIÓN ANDINA DE FOMENTO (CAF)
Type: Government Agency
Location: Caracas, Venezuela
Total Assets: $32.5bn
Current PE Allocation: 1.5%
Amount Investing in Next 12 Months: $30mn
Will invest in new Latin America-focused growth and venture capital funds, specifically in Colombia, Brazil and Mexico.

KLP ASSET MANAGEMENT
Type: Insurance Company
Location: Oslo, Norway
Total Assets: NOK 533.1bn
Current/Target PE Allocation: 1.0%/1.5%
Amount Investing in Next 12 Months: NOK 1.4-1.9bn
Plans to invest across 3-6 new buyout, growth and venture capital vehicles focused on Europe, including spin-offs.

CHINA INVESTMENT CORPORATION (CIC)
Type: Sovereign Wealth Fund
Location: Beijing, China
Total Assets: $813.8bn
Will invest in all types of private equity vehicles on a global scale, including first-time funds.

DATA SOURCE:

Preqin's **Private Equity Online** tracks over 6,400 institutional investors in private equity, providing detailed information on their plans for investment, allocations, full contact information for key decision makers and more.

For more information, please visit: **www.preqin.com/privateequity**

HOW INVESTORS SOURCE AND SELECT PRIVATE EQUITY FUNDS

45%
of investors are finding it harder to source attractive investment opportunities.

48%
of investors believe marketing documents fail to meet their needs.

HOW INVESTORS SOURCE FUNDS:

16%
Through internal investment team

26%
Mainly internal or consultant recommendations, some external approaches

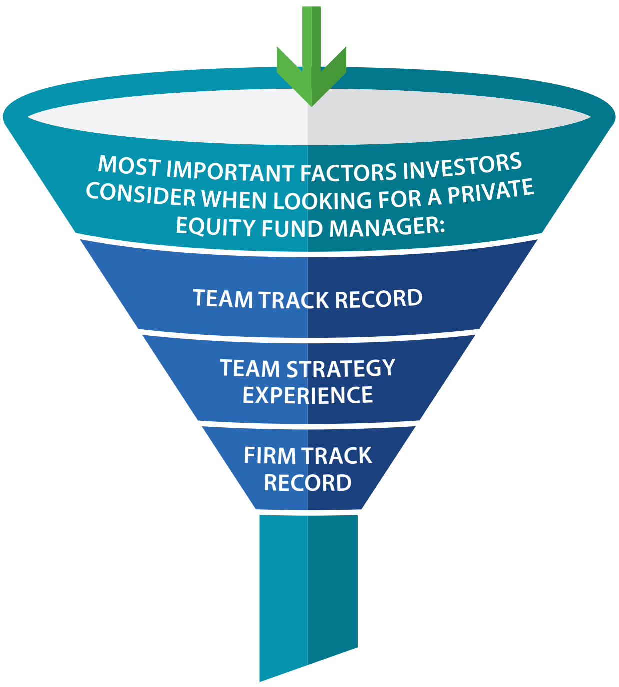
43%
Mix of internal and external recommendations

14%
Mainly approaches from GPs or marketers, some internal recommendations

1%
Solely from external approaches

HOW INVESTORS SELECT FUNDS:

The average investor receives
180
fund proposals each year



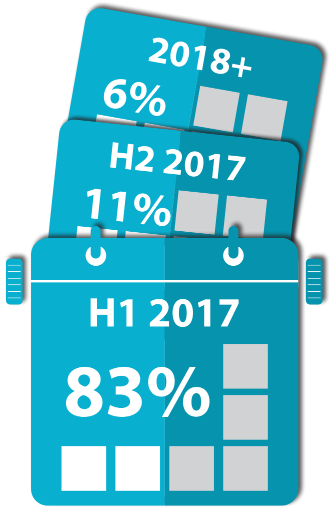
58%
of investors feel they get insufficient information on track record.

50%
of investors feel they get insufficient information on the strategy of a fund.

KEY REASONS INVESTORS REJECT A GP:

- Below-average team track record
- Fees/terms
- Length of team track record

INVESTORS' PLANS FOR THEIR NEXT FUND COMMITMENT:



8%
of proposals, on average, are sent through for a second round of screening.

The average investor makes
3
commitments to private equity funds each year.

SECTION THREE: HEDGE FUNDS

RETURNS IMPROVE IN 2016, BUT KEY CONCERNS REMAIN

2016 presented many challenges for hedge fund managers; as well as several high-profile investors announcing cuts from their hedge fund portfolios, investors more widely withdrew a net $102bn from the asset class. This not only created a challenging fundraising environment but also increased the difficulty fund managers faced in retaining capital. Amid these challenging conditions in an evolving industry, Preqin conducted interviews with over 150 institutional investors active in hedge funds to provide an overview of how investors' portfolios have performed over the course of 2016, their current views on the hedge fund industry and their plans for the year ahead.

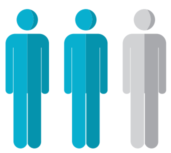
These interviews highlighted that when it comes to the hedge fund universe, two issues are at the forefront of investors' minds: performance and fees. In recent years, investors have increasingly voiced concerns about the performance of the asset class. In Preqin's June 2016 interviews with investors, 49% of respondents felt that performance was a key issue moving into the second half of the year; six months later, 73% of respondents reported the same. The Preqin All-Strategies Hedge Fund benchmark returned 7.40% in 2016, the highest level since 2013; however, two-thirds of investor respondents reported that hedge funds failed to meet expectations in 2016.

Hedge fund fees were an ever-present topic in the financial press during 2016. Some high-profile investors made significant withdrawals: New Jersey State Investment Council halved its target allocation to hedge funds in an effort to reduce the fees paid to investment managers. Furthermore, $10.9bn Connecticut-based fund manager Tudor Investment Corporation reduced fees of one of its largest funds.

The fundraising challenges of the past year show little sign of abating in 2017. Outflows accelerated over 2016, with the largest levels of investor redemptions seen in Q4. Looking forward to 2017, nearly twice the proportion of investors plan to reduce their exposure over the year than increase it, a concern for managers as both retaining capital and fundraising are likely to remain difficult tasks over 2017.

As a result, there are many challenges ahead for fund managers, but with these challenges come opportunities. Finding investors that are seeking to put fresh capital into the asset class looks set to be more difficult in 2017. However, those fund managers that can respond to investor demands for greater alignment of interests, harness some of the volatility resulting from uncertain markets and deliver better returns will be best placed to win investor mandates. In these challenging times, data and intelligence to help fund managers really understand their investors are more important than ever. The results of our investor interviews and data taken from Preqin's **Hedge Fund Online** highlight some ways for managers to succeed in 2017.

PERFORMANCE



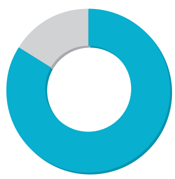
2 in 3

investors surveyed reported that their hedge fund portfolios had not lived up to expectations in 2016.

47%

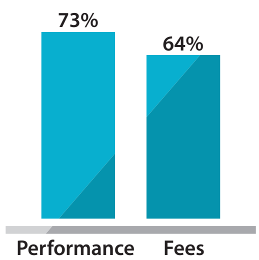
of investors surveyed issued a hedge fund redemption request in 2016, with underperformance the leading reason.

FEES



84%

of investors reported that they had not invested in a hedge fund due to the proposed fund terms and conditions.

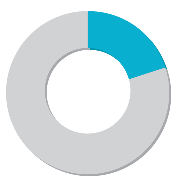


Performance and fees are seen by investors as the key issues facing the hedge fund industry in 2017.

OUTLOOK FOR 2017

76% & 57%

of investors respectively want to see improvements in the level of management fees and how performance fees are charged in 2017.



20%

of investors are intending to increase their exposure to hedge funds in 2017.

SATISFACTION WITH HEDGE FUNDS

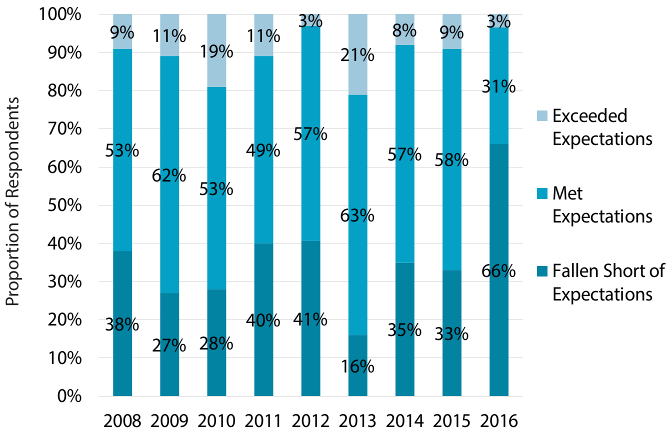
There are widespread levels of dissatisfaction with returns: two out of every three of the investors Preqin spoke to revealed that hedge funds had not lived up to their performance expectations in 2016 (Fig. 3.1) – this is twice the level reported in December 2015.

However, the term 'hedge fund' encompasses a broad array of fund types and strategies, with managers using a myriad of instruments and trading styles to generate returns for their investors. Therefore, the negative sentiment towards hedge funds as a whole is not seen across all hedge fund strategies (Fig. 3.2). Three-quarters of investors surveyed saw their emerging markets investments meet their expectations, which is unsurprising given the Preqin Emerging Markets Hedge Fund benchmark returned 9.96% in 2016 – the second best performing top-level region behind only North America (+10.20%). This represents a sharp reversal from 2015, when 91% of investors reported that their emerging markets investments fell short of expectations. The majority (69%) of investors also saw credit strategies – the second best performing top-level strategy of 2016 – meet their expectations over the course of the year.

In contrast, 58% and 73% of surveyed investors in CTAs reported that systematic and discretionary CTA holdings respectively did not meet expectations, with the Preqin All-Strategies CTA benchmark returning seven percentage points below that of the Preqin All-Strategies Hedge Fund benchmark in 2016.

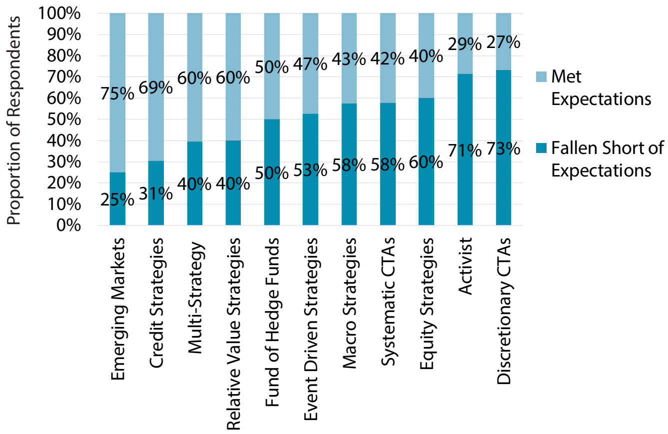
While some institutions have seen their hedge fund investments perform as expected in 2016, almost half (47%) of investors reported that their level of confidence in hedge funds' ability to achieve portfolio objectives had fallen (Fig. 3.3). Despite these concerns, more respondents believe that the asset class will perform better in 2017 (28%) than worse (19%, Fig. 3.4).

Fig. 3.1: Investor Views on Hedge Fund Portfolio Performance over the Past 12 Months Relative to Expectations, 2008 - 2016



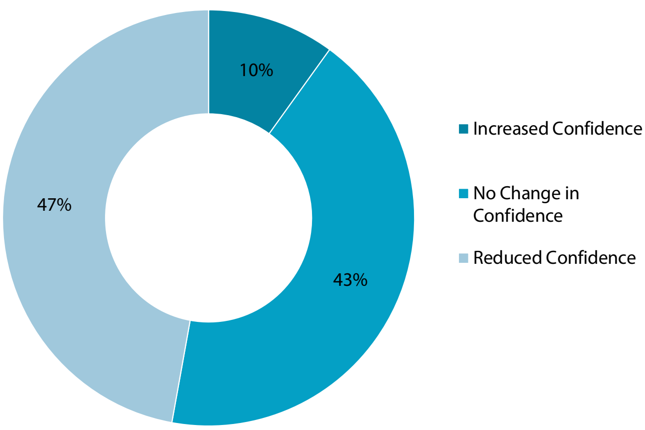
Source: Preqin Investor Interviews, December 2008 - December 2016

Fig. 3.2: Investor Views on Hedge Fund Portfolio Performance in 2016 Relative to Expectations by Strategy



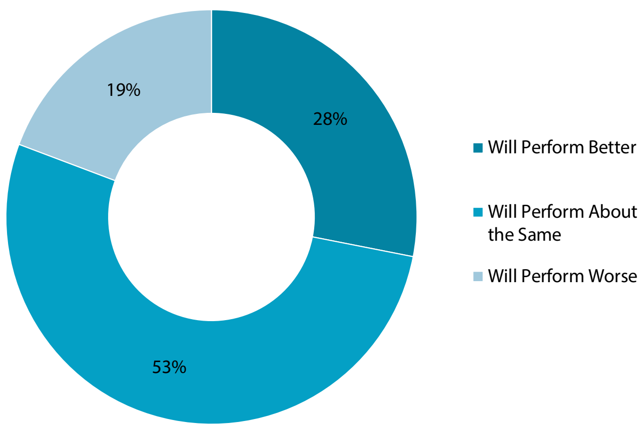
Source: Preqin Investor Interviews, December 2016

Fig. 3.3: Investors' Change in Confidence in the Ability of Hedge Funds to Achieve Portfolio Objectives over the Past 12 Months



Source: Preqin Investor Interviews, December 2016

Fig. 3.4: Investors' Performance Expectations for Hedge Funds in 2017 Compared with 2016



Source: Preqin Investor Interviews, December 2016

KEY ISSUES AND REDEMPTIONS

As seen in Fig. 3.5, there were several challenging macroeconomic factors that affected investors' hedge fund portfolios over the course of 2016; stock market volatility (54%), low interest rates (52%) and central bank intervention (50%) were cited by the greatest proportions of respondents as the factors that had the biggest impact. Investors believe these factors will remain the most influential in 2017; however, significantly more investors feel it will have an impact on their portfolios in 2017 than felt it did in 2016.

> ***Performance and fees look set to be the leading factors that hedge fund managers need to address in 2017***

The geopolitical landscape is predicted to have a greater impact on investors' hedge fund portfolios in 2017 than in 2016. 2016 saw the Brexit decision by the UK in June and Donald Trump winning the US election in November. With President Trump's inauguration in January 2017, the consequences of the change in President and his economic policy were far from clear in our December 2016 surveys. In 2017, there are set to be more major political events, notably elections in France and Germany.

Performance and fees look set to be the leading factors that hedge fund managers need to address in 2017– 73% and 64% respectively cited these as the key issues affecting hedge funds (Fig. 3.6). The perception of the industry by the public is also a key concern for investors. In 2016, various labour unions and trustees put pressure on CIOs to reduce the level of fees paid to underperforming investment managers and to re-evaluate their exposure to hedge funds. More widely than this, much of the financial media has focused on the difficulties faced by hedge funds and their underperformance relative to traditional benchmarks. This in turn has led to a somewhat negative view from the general public on the nature of the hedge fund investments that they may be exposed to through investments made by their pension funds.

REDEMPTIONS

Over the course of 2016, New York City Employees' Retirement System, AIG, New Jersey State Investment Council and Kentucky Retirement System all announced their intentions to either redeem holdings or exit the asset class entirely, often citing performance and fees as a factor in this decision. Nearly half (47%) of investors Preqin interviewed issued redemption requests in 2016, highlighting the difficulties fund managers faced in retaining assets throughout the year.

Underperformance was the leading driver behind investors' decisions to issue redemptions in 2016; the largest proportions cited the failure of funds to match benchmark returns (35%) and individual targets (27%) as the reasons behind their redemption requests (Fig. 3.7). While one-quarter of respondents

INVESTORS THAT HAVE ISSUED A HEDGE FUND REDEMPTION REQUEST IN 2016

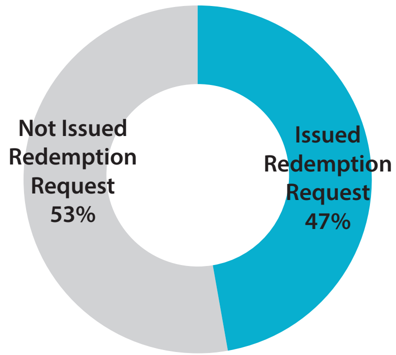
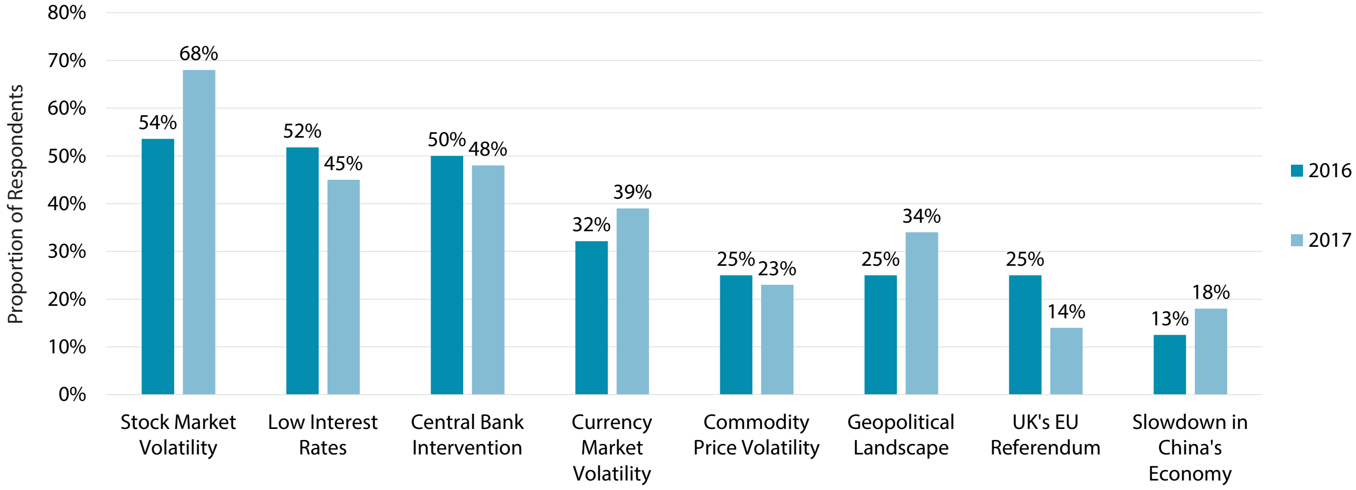


Fig. 3.5: Investor Views on the Macroeconomic Factors that Had the Biggest Impact on Their Hedge Fund Portfolios in 2016 vs. Predictions for 2017

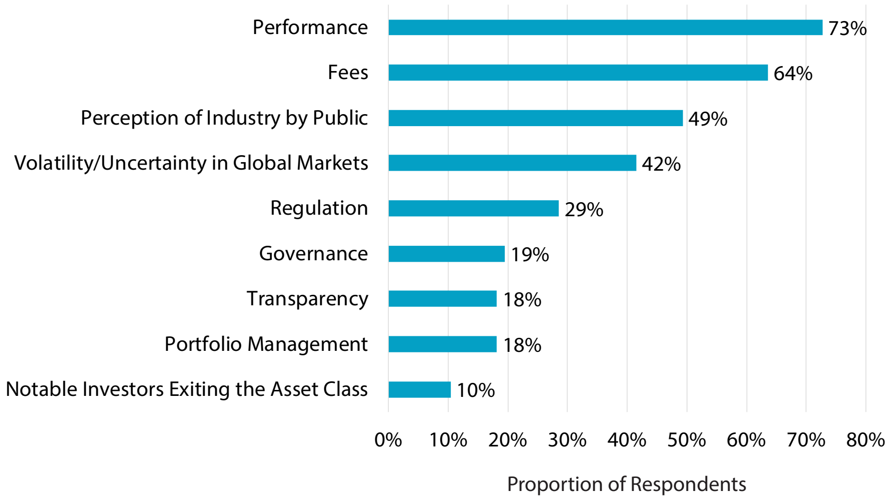


Source: Preqin Investor Interviews, December 2016 redeemed certain hedge fund holdings to allocate to other hedge funds in an attempt to rebalance their hedge fund portfolio, some respondents planned to allocate the redeemed capital elsewhere in their portfolio. Fifteen percent of investors said when they issued redemption requests that they would allocate the returned capital to other areas of their portfolio; a further 8% reported it was specifically to direct this redeemed capital to other alternative assets such as private equity.

> ***"Underperformance was the leading driver behind investors' decisions to issue redemptions in 2016***

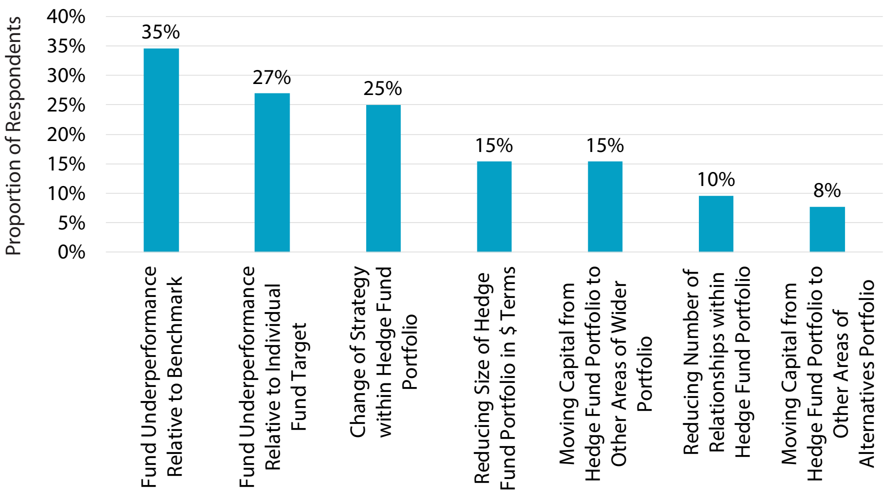
With performance disappointing two-thirds of investors in 2016, as well as being a driving factor behind redemptions, Preqin turned its attention to the length of time investors would tolerate the underperformance of a fund before issuing redemptions. The majority of respondents reported that they would only tolerate 18 months or fewer of fund underperformance before considering issuing a redemption request (54%, Fig. 3.8). As of December 2016, the cumulative return over the past 18 months of the Preqin All-Strategies Hedge Fund benchmark was 4.92%, lower than the 2016 annual return (+7.40%), highlighting the industry underperformance in 2015 which may have been a driver behind the requests in 2016. However, the largest proportion (28%) of investors reported they would stay invested in an underperforming fund for more than 18 months before redemption, and a further 16% said they would consider each fund on a case-by-case basis.

Fig. 3.6: Investor Views on the Key Issues Facing Hedge Funds in 2017



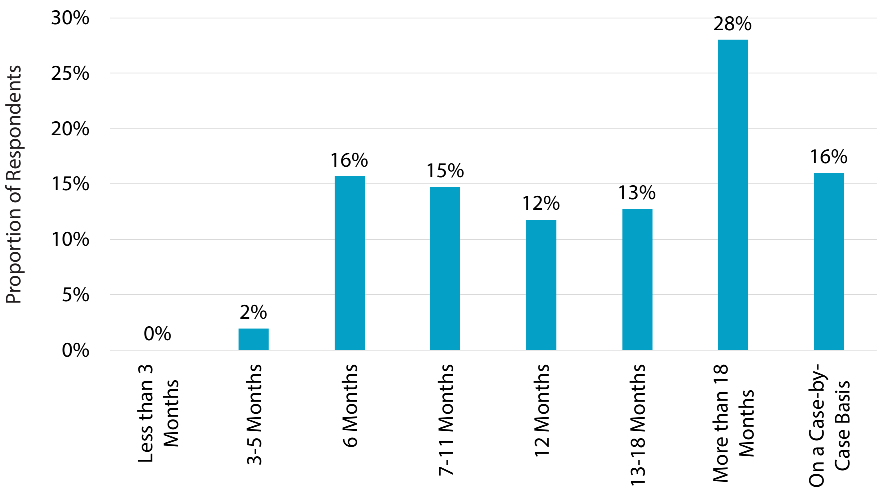
Source: Preqin Investor Interviews, December 2016

Fig. 3.7: Reasons Why Investors Have Issued Redemption Requests in 2016



Source: Preqin Investor Interviews, December 2016

Fig. 3.8: Investor Views on How Long They Will Tolerate Hedge Fund Underperformance before Redemption

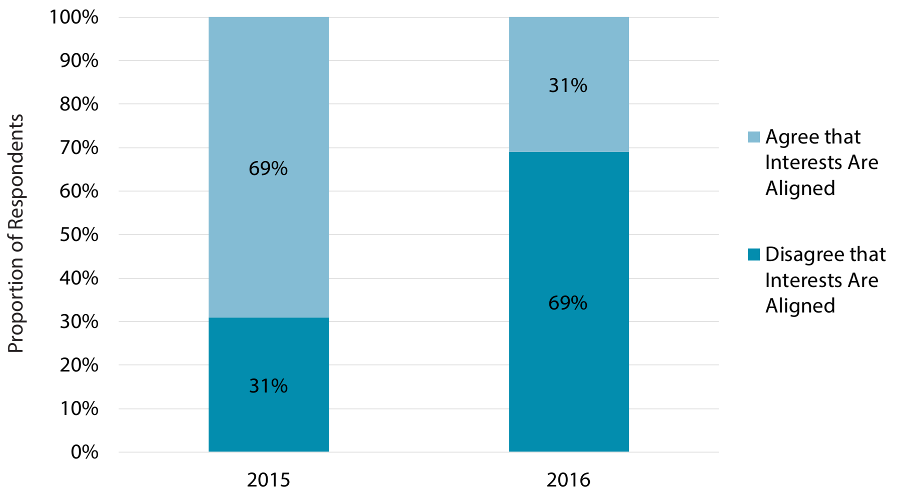


Source: Preqin Investor Interviews, December 2016

FEES AND ALIGNMENT OF INTERESTS

As seen in Fig. 3.9, over two-thirds (69%) of investors interviewed at the end of 2016 believe that their interests are not aligned with their fund managers', a reversal of sentiment from Preqin's December 2015 interviews. With two-thirds of investors surveyed reporting that their hedge fund portfolios had fallen short of expectations in 2016 (see page 23), investors are seeking greater alignment of interests between themselves and their managers, not only to better encourage managers to take on appropriate levels of risk to generate returns, but also to ensure that investors extract good value from their hedge fund investments.

Fig. 3.9: Extent to Which Investors Believe Fund Manager and Investor Interests Are Properly Aligned, 2015 vs. 2016

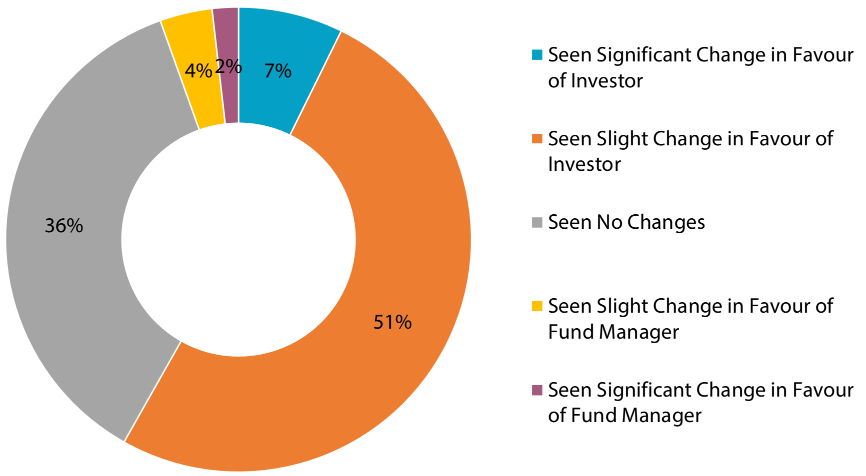


Source: Preqin Investor Interviews, December 2015 - December 2016

CHANGES IN 2016

Despite the vast majority of investors agreeing that their interests have become less aligned with those of their fund managers, 58% have seen favourable changes in fund terms over the course of 2016 (Fig. 3.10). This highlights the efforts fund managers are going to in an attempt to improve the alignment of interests with investors. However, continued efforts are needed in 2017 in order to win the approval of those investors that still believe fees are too high.

Fig. 3.10: Investor Views on Changes in Prevailing Fund Terms over 2016



Source: Preqin Investor Interviews, December 2016

MANAGEMENT FEES

Fig. 3.11 provides insight into the specific areas of fund terms and conditions that investors feel have improved throughout 2016 and which areas investors still want to see improvement in over the coming 12 months. Management fees are at the forefront of investors' minds; despite the majority (55%) of respondents witnessing an improvement in management fees in 2016, over three-quarters (76%) see room for further reductions in management fees over 2017. This is thirty percentage points higher than the proportion of investors that sought improved management fees in 2016 from our December 2015 survey.

PERFORMANCE FEES

Although nearly half (48%) of all investors interviewed in December 2016 are seeking a reduction in the level of performance fees charged, a greater proportion are looking for changes in how performance fees are charged – the first time Preqin has noted this. When performance is not meeting expectations, investors look to managers to implement more favourable terms such as hurdle rates, to better align interests and incentivize managers, or methods such as clawbacks, to return fees to investors following reversals in performance.

TRANSPARENCY AND FUND MANAGER COMMITMENTS

Although 39% of respondents have seen an improvement in the level of transparency offered by fund managers, there is still more work to be done by hedge funds to meet the demands of an increasingly sophisticated audience of investors. Fifty-seven percent of investors want managers to improve the level of transparency they offer in 2017. Although adding the necessary staff and infrastructure to provide the transparency that investors demand can be burdensome, those that are willing to incur the costs to meet these transparency demands – either internally or through outsourcing – may be rewarded with both inflows from institutions as well as capital that is invested for longer.

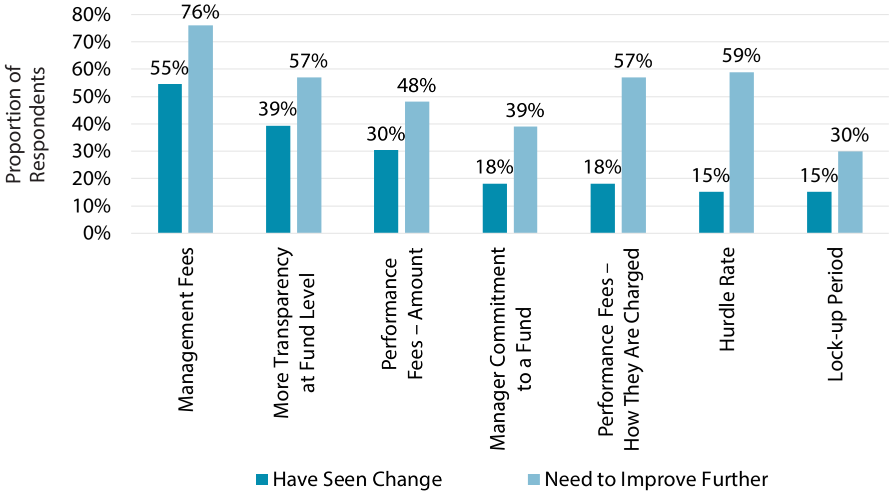
The majority (52%) of fund managers surveyed by Preqin believe that making a commitment to their own fund is the most effective way of showing alignment of interests with investors; however, just 18% of investors reported that they had seen an improvement in managers having 'skin in the game' over the course of 2016. With 39% of investors seeking improvement on this front, fund managers may need to re-evaluate how much of their own capital they have tied up in their fund and whether this is appropriate to both encourage better performance without taking excessive – or indeed too little – risk.

THE ROLE OF FEES IN THE DECISION-MAKING PROCESS

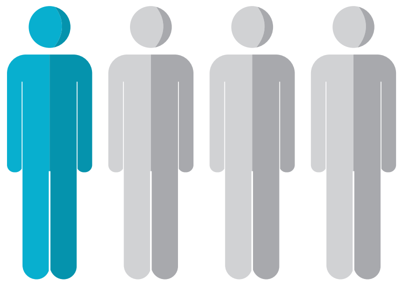
When investors begin their screening process when evaluating fund opportunities, the strategy and performance are the two leading characteristics that institutions consider. A large proportion (41%) of investors, however, reported that they also look for attractive fund terms charged by a manager as part of this process.

The importance of fees in the fundraising process is again emphasized in Fig. 3.12. The vast majority (84%) of investor respondents have frequently or occasionally decided not to invest in a fund due to the proposed terms and conditions. In addition, nearly one in four investors reported that there is insufficient information on fees contained in fund manager marketing materials. Therefore, not only is it important to evaluate fund terms and set appropriate levels of fees, it is also vital that fund managers effectively communicate to investors about the fees they will incur should they invest in the fund. Failure to do this may lead to institutional investors rejecting a fund which may otherwise meet their needs.

Fig. 3.11: Investor Views on the Areas of Fund Terms and Conditions that Have Changed over the Past 12 Months and that Need to Improve Further in 2017



Source: Preqin Investor Interviews, December 2016



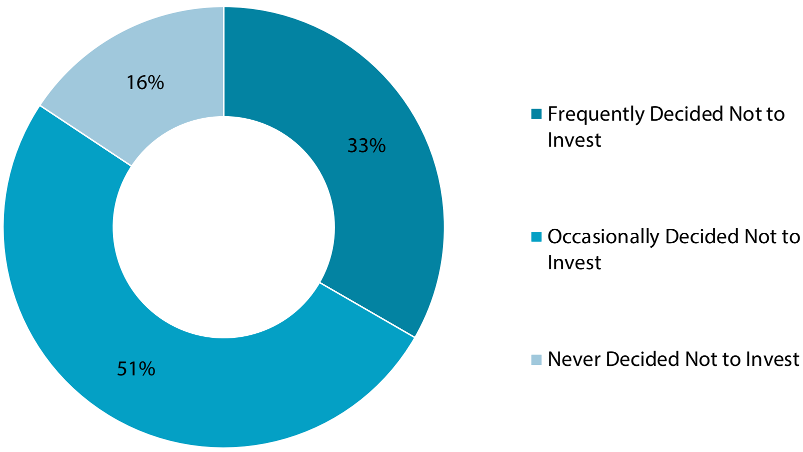
41%

of investors look for attractive fund terms when evaluating a new hedge fund opportunity.

1 in 4

investors reported that marketing materials do not provide enough information on terms and conditions.

Fig. 3.12: Frequency with Which Investors Have Decided Not to Invest in a Hedge Fund Due to the Proposed Terms and Conditions



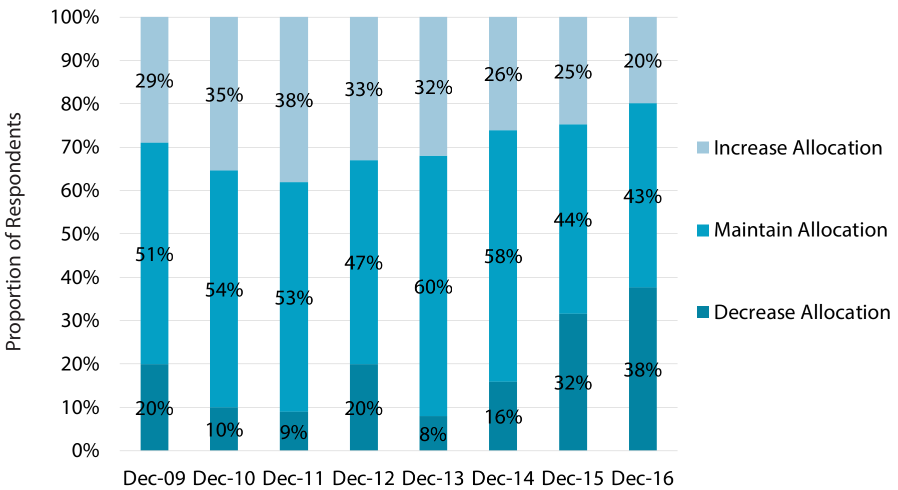
Source: Preqin Investor Interviews, December 2016

INVESTOR ACTIVITY IN 2017

In Preqin's December 2015 investor interviews, Preqin noted that for the first time since we began tracking this data in 2009, more investors planned to decrease their allocations to hedge funds than planned to increase their exposure to the asset class in the coming year (Fig. 3.13). At the time, we predicted this could be the first sign of outflows from the asset class; this prediction proved correct over the course of the year as investors withdrew a net $102bn from the industry. One year on, and Preqin's December 2016 interviews reveal that not only are a greater proportion of investors planning on decreasing their allocation to hedge funds in the next 12 months (38%, compared to 32% in December 2015) but the proportion of investors planning to increase their allocation to the asset class in 2017 has decreased (20%, compared to 25% in December 2015). With the gap widening between the number of investors decreasing their exposure and those increasing their investment in hedge funds, it looks like not only will 2017 be another year in which outflows are likely, but one in which they could even accelerate.

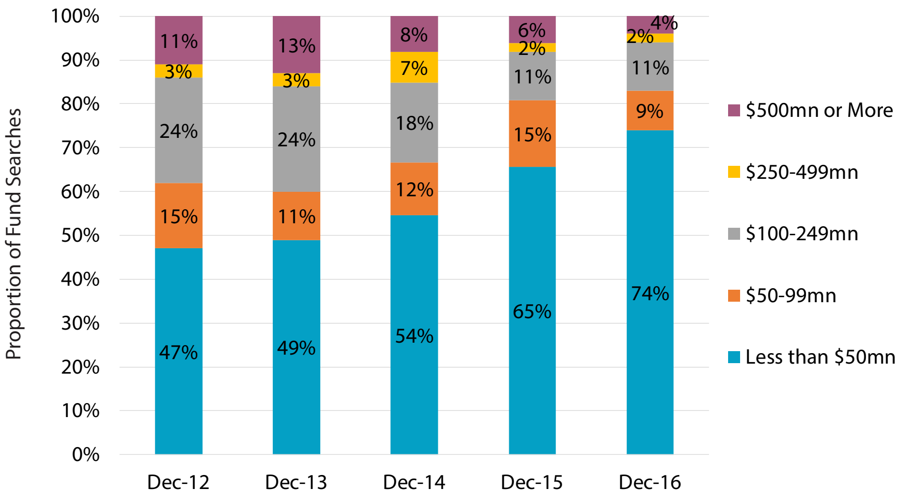
As well as the expected decrease in investor allocations in 2017, those investors that are looking for new hedge funds are planning to put smaller sums of capital to work than in any previous year. Data from Preqin's **Hedge Fund Online** shows that since 2013, an increasing proportion of mandates have been for less than $50mn, while the proportion of searches for a commitment of $500mn or more has steadily declined: three in four mandates for 2017 are for $49mn or less (Fig. 3.14). However, a potentially positive development is that there has been an increase in the proportion of mandates for three or more funds compared to the previous year (Fig. 3.15). Sixty-five percent of investors searching for new hedge funds in 2017 will be looking to commit capital to three or more funds, compared to 58% of investors that issued searches for 2016. Therefore, although there will be a smaller number of investors looking at making new allocations in the year ahead, those that are will be looking for more funds than in 2016.

Fig. 3.13: Investors' Intentions for Their Hedge Fund Allocations in the Next 12 Months Compared to the Previous 12 Months, 2009 - 2016



Source: Preqin Investor Interviews, December 2009 - December 2016

Fig. 3.14: Amount of Fresh Capital Investors Plan to Invest in Hedge Funds over the Next 12 Months, 2012 - 2016



Source: Preqin Hedge Fund Online

STRATEGIES TARGETED

Relative value strategies are attracting investors' attention in 2017: 26% of investors in these funds plan to increase their exposure to these strategies over the year, and just 6% plan to reduce the amount of capital they have invested in these funds (Fig. 3.16). Although a similarly high level of investors in macro strategies plan to increase their exposure to these funds in 2017, a fifth plan to reduce their exposure, highlighting the rather mixed outlook from institutional investors on macro strategies in 2017. Managed futures may have a more challenging year in terms of fundraising in 2017 as compared to 2016, a year in which CTAs saw inflows of $17bn. Twice the level of investors in CTAs plan to reduce their exposure to the strategy over 2017 than plan to increase their exposure. This represents a reversal of the trend we saw in our December 2015 investor interviews, and may indicate that these funds will see outflows in 2017, particularly as both systematic and discretionary CTAs have disappointed the majority of investors (see page 23).

STRUCTURES TARGETED

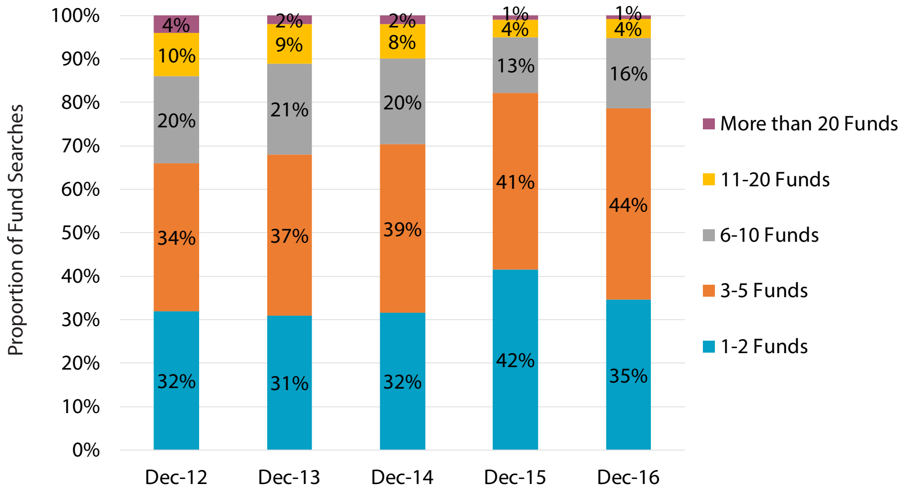
Nearly half (41%) of investors in alternative UCITS funds plan to increase their exposure to UCITS vehicles in the coming year (Fig. 3.17). One-third of respondents are planning to increase their exposure to separately managed accounts in 2017, while none indicated plans to decrease their exposure to this structure. Just under one-quarter of respondents reported plans to increase their exposure to traditional commingled funds in 2017; however, a notable 13% are planning to decrease their exposure to this structure over the coming year, perhaps as they move money towards alternative structures such as UCITS or managed accounts in order to lower fees or increase the transparency of their hedge fund holdings.

> ***2017 will not only be another year in which outflows are likely, but one in which they could even accelerate***

OUTLOOK

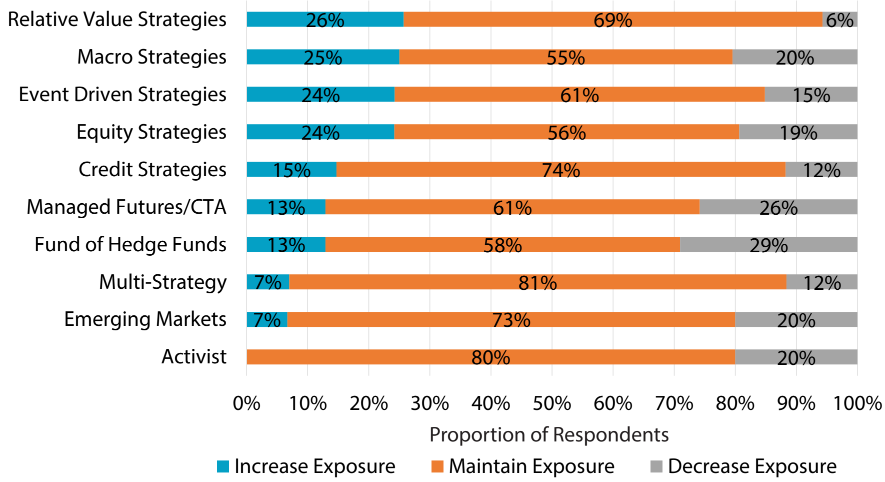
As we move into 2017, it will be the twin issues of fees and performance that the industry must address in order to win back the favour of institutional investors. However, 2016 represents the best performing year for the Preqin All-Strategies Hedge Fund benchmark since 2013, and the outlook of the majority (53%) of investors is that this will be matched in 2017, while over a quarter (28%) believe the industry will perform better in the coming year. With investors recognizing that equity market volatility could have a bigger effect on their hedge fund portfolios in 2017 than in 2016, and with continued political and market uncertainty expected over the year, the value of hedge funds to reduce risk and minimize losses may indeed be proved to these sceptical investors.

Fig. 3.15: Number of Hedge Funds Institutional Investors Expect to Add to Their Portfolios over the Next 12 Months, 2012 - 2016



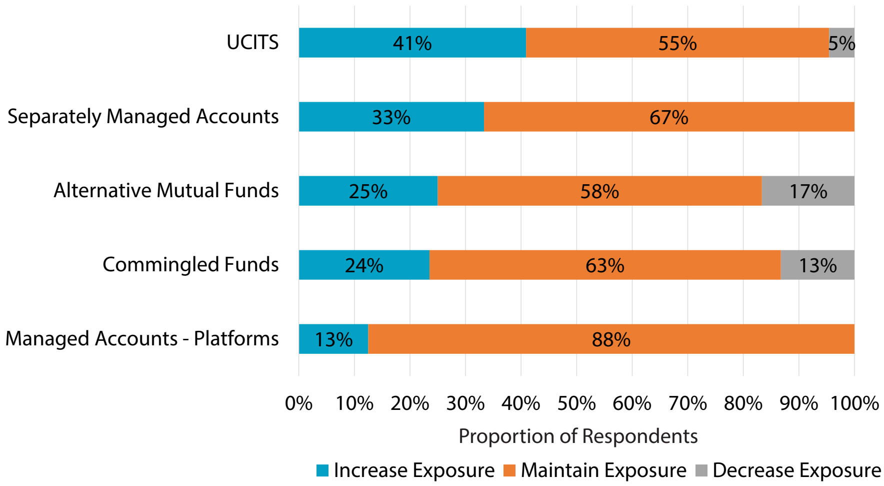
Source: Preqin Hedge Fund Online

Fig. 3.16: Investor Allocation Plans for 2017 by Strategy



Source: Preqin Investor Interviews, December 2016

Fig. 3.17: Investor Allocation Plans for 2017 by Structure



Source: Preqin Investor Interviews, December 2016

HOW INVESTORS SOURCE AND SELECT HEDGE FUNDS

42% of investors found it more difficult to source attractive investment opportunities in 2016 compared to 2015.

63% of investors believe marketing documents fail to meet their needs.

HOW INVESTORS SOURCE FUNDS:

16% Through internal investment team

31% Mainly internal or consultant recommendations, some external approaches

35% Mix of internal and external recommendations

16% Mainly approaches from managers or marketers, some internal recommendations

2% Solely from external approaches

HOW INVESTORS SELECT FUNDS:

The average investor receives **234** fund proposals each year

53% of investors feel they get insufficient information on track record.

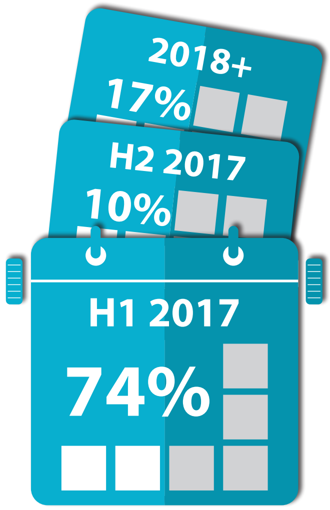
60% of investors feel they get insufficient information on the strategy of a fund.

KEY REASONS INVESTORS REJECT A FUND MANAGER:

- Below-average team track record
- Fees/terms
- Length of team track record

8% of proposals, on average, are sent through for a second round of screening.

ACTIVE INVESTORS' PLANS FOR THEIR NEXT FUND COMMITMENT:



The average investor makes **2** commitments to hedge funds each year.

SECTION FOUR:
REAL ESTATE

INVESTOR APPETITE REMAINS STRONG

Institutional investors have continued to see strong returns from their real estate portfolios, and remain committed to the asset class as a result. In the three years to June 2016, private real estate funds generated an annualized 14.9%, one of the highest returns of any private capital asset class. Given this strong performance, the vast majority of investors feel that real estate is meeting their objectives: 93% stated that real estate met or exceeded their expectations in 2016, while over a three-year period 42% felt their expectations had been exceeded, more than any other alternative asset class.

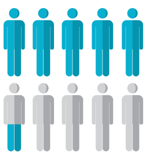
Investors have capital to put to work, but there are concerns among some institutions about the prospects for real estate, and whether there are opportunities to invest today. Asset pricing is clearly a concern for many, with 68% of investors naming it as a key issue affecting the market, and 53% stating it is harder to find attractive opportunities today than it was 12 months ago – just 6% feel it is easier. As a result, some investors are reducing their outlay to real estate in the shorter term, with 24% stating they would invest less capital in 2017 than 2016. A similar proportion (25%) stated they would invest more in 2017, with the remainder investing at the same level as 2016. This suggests we can expect 2017 fundraising to be on a par with the previous year, but significant growth seems unlikely.

There remains substantial potential for the private real estate asset class to continue to grow, with 525 private real estate funds in market, targeting $177bn in capital commitments. A sizeable 48% of investors are below their target allocation to real estate, while only 22% are over-allocated. Furthermore, with over a third (36%) of investors expecting to increase their allocation in the longer term, investors will continue to look to real estate as a key part of their portfolio for diversification, reliable income generation and attractive returns.

INVESTOR APPETITE

93%

of investors surveyed feel their real estate investments met or exceeded their expectations in 2016.



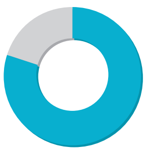
53%

of investors believe it is more difficult to find attractive investment opportunities than 12 months ago.

68%

of respondents feel that valuations were the key issue affecting private real estate in 2016.

MAKE-UP OF INVESTORS

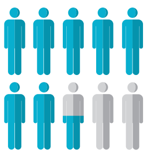


80%

of investors have less than $10bn in AUM.

$347bn

Total amount allocated to the asset class by the 10 largest real estate investors.



75%

of investors prefer to access the market via private real estate funds.

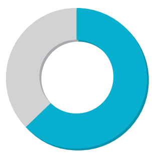
EVOLUTION OF INVESTORS

8.9%

Investors' average current allocation to real estate, below the average target allocation of 10.0%.

48%

of investors are below their target allocation to real estate – a five-year low.



63%

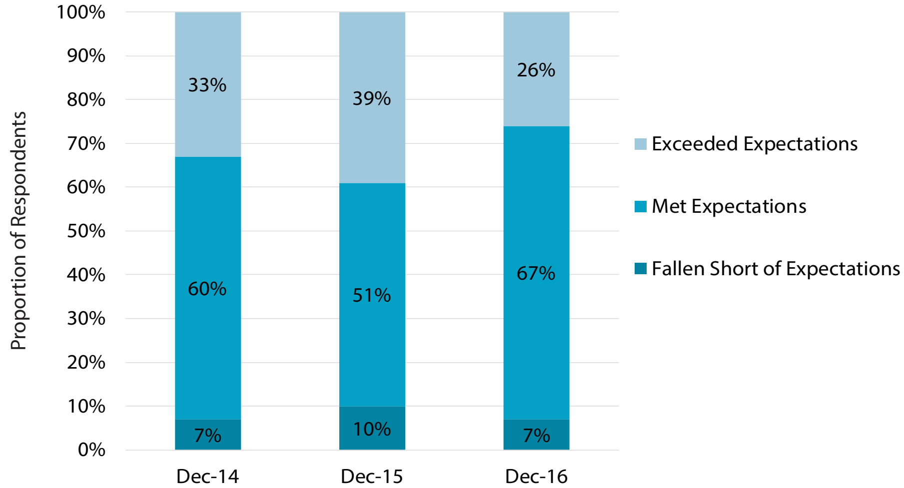
of investors will not invest in first-time funds.

SATISFACTION WITH REAL ESTATE

In December 2016, Preqin interviewed over 150 institutional investors to determine their appetite for and attitudes towards the real estate asset class, as well as their concerns and investment plans for 2017. Half of the investors surveyed have a positive perception of the asset class, with only 7% viewing it negatively.

> **"*Over the past three years, real estate performance has exceeded the expectations of over two-fifths of surveyed investors – the largest proportion among all alternatives***

Fig. 4.1: Investor Views on Real Estate Portfolio Performance over the Past 12 Months Relative to Expectations, 2014 - 2016



Source: Preqin Investor Interviews, December 2014 - December 2016

Encouragingly, almost all (93%) investors we interviewed at the end of 2016 felt that their real estate investments had met or exceeded their expectations over the past 12 months (Fig. 4.1). However, given real estate returns falling to 8.6% in the year to June 2016, down from 15.0% in the year to June 2015, it is unsurprising that only 26% of those surveyed felt the asset class had exceeded expectations, compared with 39% the previous year. By contrast, the performance of real estate over the past three years has exceeded the expectations of over two-fifths (42%) of surveyed investors, the largest proportion of any alternative asset class (Fig. 4.2).

Investors remain confident in the ability of real estate to fulfil portfolio objectives, with over three-quarters (77%) of investors interviewed reporting there has been no change in their level of confidence in the asset class (Fig. 4.3). However, compared to those interviewed at the end of 2015, the proportion of investors surveyed that have increased confidence in the asset class has fallen by six percentage points.

INVESTORS' GENERAL PERCEPTION OF THE REAL ESTATE INDUSTRY

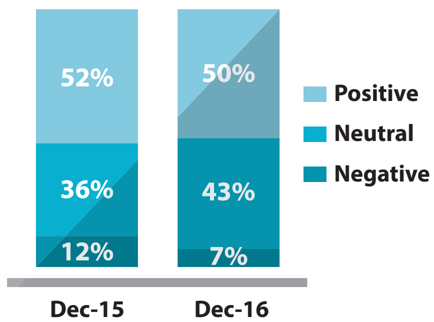
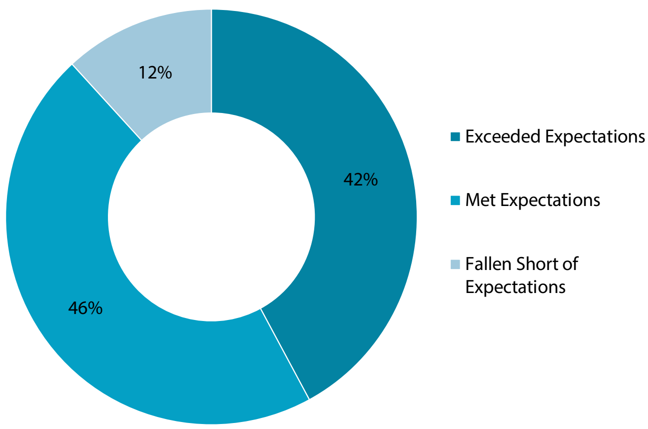
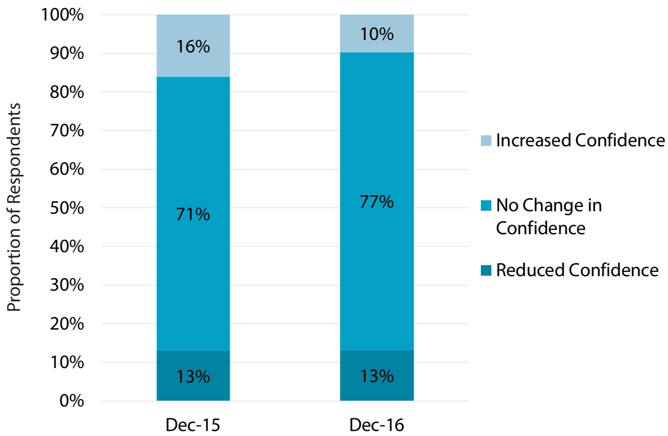


Fig. 4.2: Investor Views on Real Estate Portfolio Performance over the Past Three Years Relative to Expectations



Source: Preqin Investor Interviews, December 2016

Fig. 4.3: Investors' Change in Confidence in the Ability of Real Estate to Achieve Portfolio Objectives over the Past 12 Months, 2015 vs. 2016



Source: Preqin Investor Interviews, December 2015 - December 2016

EVOLUTION OF THE INVESTOR UNIVERSE

Institutional investors continue to recognize real estate as an important part of their investment portfolios; 63% of investors tracked by Preqin maintain an allocation to the asset class. Preqin's **Real Estate Online** features in-depth profiles for over 5,500 institutional investors worldwide that are actively investing in real estate, including their preferences, past investments, future investment plans and contact information for key decision makers.

Pension funds, private wealth firms and foundations together account for nearly two-thirds of the real estate investor universe (Fig. 4.4). Pension funds are characterized by their large AUM (a combined $16.5tn), and the larger pension funds are often able to source and manage sizeable global real estate portfolios. Private wealth has become a more important source of capital to the asset class in recent years, with family offices and wealth managers accounting for a combined 17% of all institutional investors.

ROUTE TO MARKET

While the exact composition of any investor's portfolio is dependent on its unique needs, three-quarters of all real estate investors globally utilize private real estate funds as a route to market, most likely due to the benefits fund managers can provide in terms of diversification and expertise in a range of markets. Unlisted funds are typically the investment of choice in North America, while 62% of Asia-based investors have a preference for direct investment (Fig. 4.5). In some European markets, such as Switzerland, direct investment in real estate has historically been favoured over indirect fund commitments. The $232bn insurance company Swiss Re, for example, has invested over $3bn in direct property holdings, equating to 94% of its allocation to the asset class.

INSTITUTIONAL INVESTORS' PREFERRED ROUTE TO MARKET

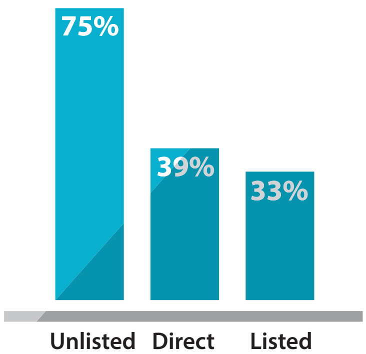
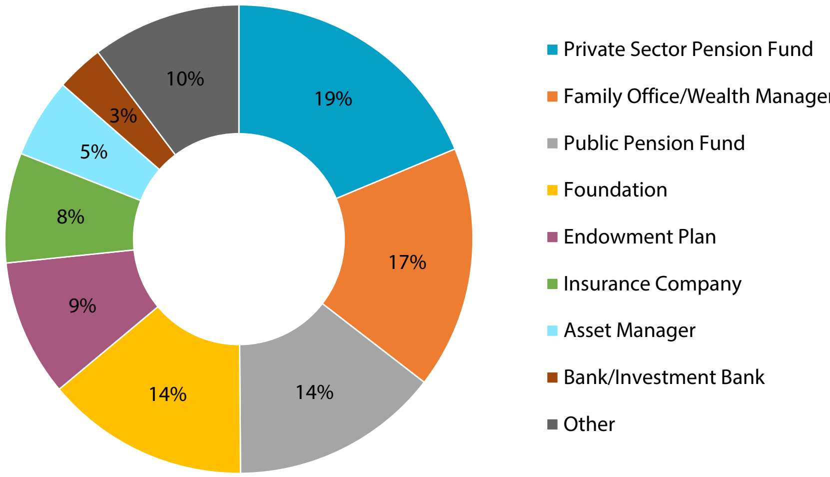
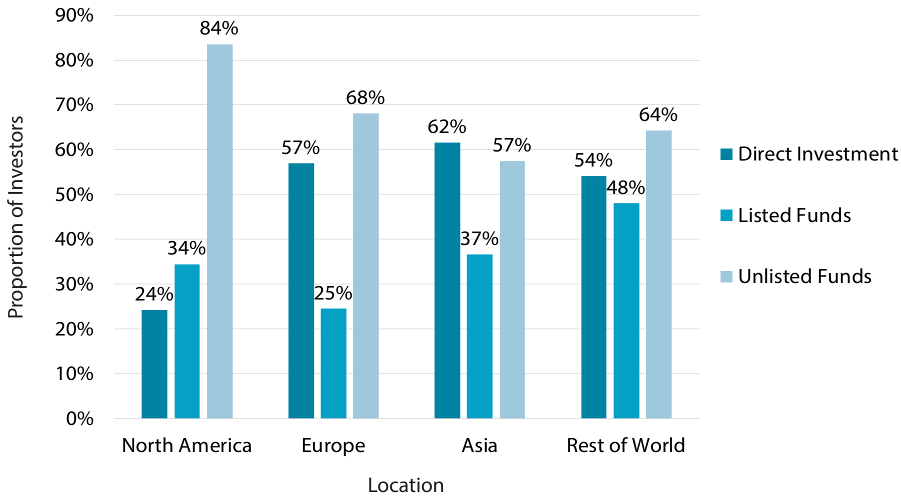


Fig. 4.4: Institutional Investors in Real Estate by Type



Source: Preqin Real Estate Online

Fig. 4.5: Institutional Investors' Preferred Route to Market by Location



Source: Preqin Real Estate Online

ALLOCATIONS

Investor allocations to real estate have grown since 2012 (Fig. 4.6), with real estate remaining an attractive alternative to traditional asset classes at a time when institutional investors are looking for ever greater diversification in their portfolios. Real estate has continued to offer competitive risk-adjusted returns, with low correlation to equity and bond returns.

Public pension funds have the least disparity between their average current and target allocations (Fig. 4.7). Of these investors, 88% utilize private real estate funds as a route to market, favoured by long-term investors due to their long lock-up periods.

Insurance companies are the furthest behind their target allocations, suggesting there is still a sizeable amount of capital that may enter the asset class in the coming years as these institutions look to move closer to their long-term strategic targets.

The proportion of institutional investors below their target allocation has gradually decreased over the past five years (Fig. 4.8). However, with almost half the institutional investors with a real estate allocation below their long-term weighting, there remains a sizeable amount of capital that is likely to continue to enter the asset class in the medium and longer term.

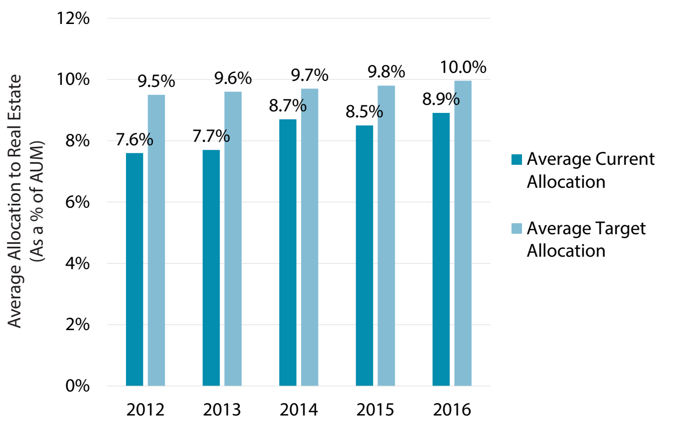
PRIVATE WEALTH FIRMS

Representing 17% of all real estate investors, private wealth firms (comprising wealth managers, single- and multi-family offices) provide a significant source of capital to the real estate market. Unsurprisingly, North America is home to the majority (55%) of private wealth firms (Fig. 4.9). While there are still relatively few of these investors based in Asia, this is an area that has been growing rapidly in recent years as the family office model becomes more widely used. Preqin's **Real Estate Online** profiles more than 100 Asia-based family offices or wealth managers that invest in real estate.

> ***“Private wealth firms investing in real estate are predominantly based in North America, although their presence in Asia is growing***

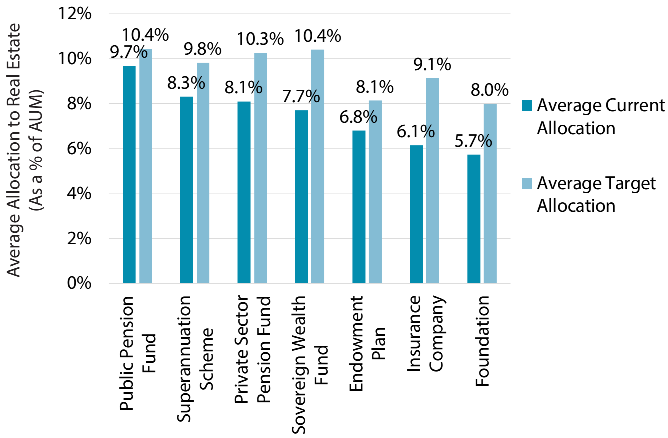
Single- and multi-family offices have similar preferences in terms of route to market, favouring direct real estate investment (79% and 63% of each group respectively) and unlisted funds (50% and 59%) over listed real estate (15% and 28%). Wealth managers on the whole have a more balanced portfolio in terms of route to market, with a stronger preference for listed real estate (40%) than family offices.

Fig. 4.6: Institutional Investors' Current and Target Allocations to Real Estate, 2012 - 2016



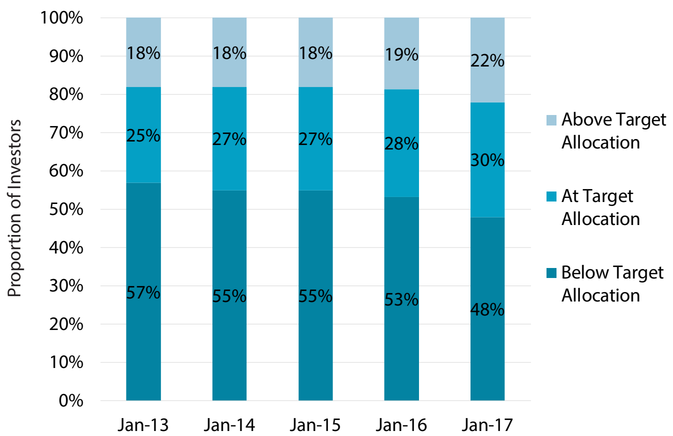
Source: Preqin Real Estate Online

Fig. 4.7: Institutional Investors' Current and Target Allocations to Real Estate by Type



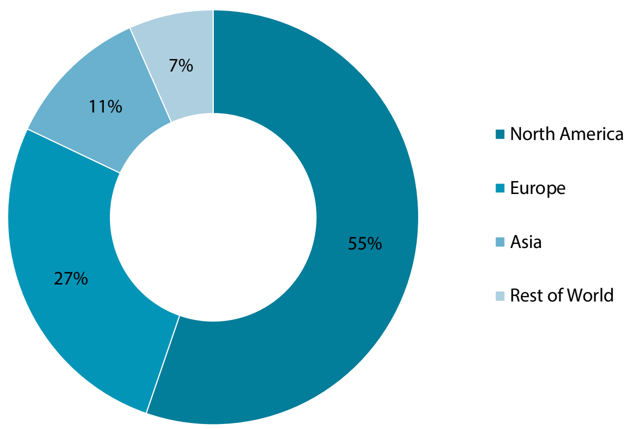
Source: Preqin Real Estate Online

Fig. 4.8: Proportion of Investors that Are At, Above or Below Their Target Allocation to Real Estate, 2013 - 2017



Source: Preqin Real Estate Online

Fig. 4.9: Private Wealth Firms Investing in Real Estate by Location



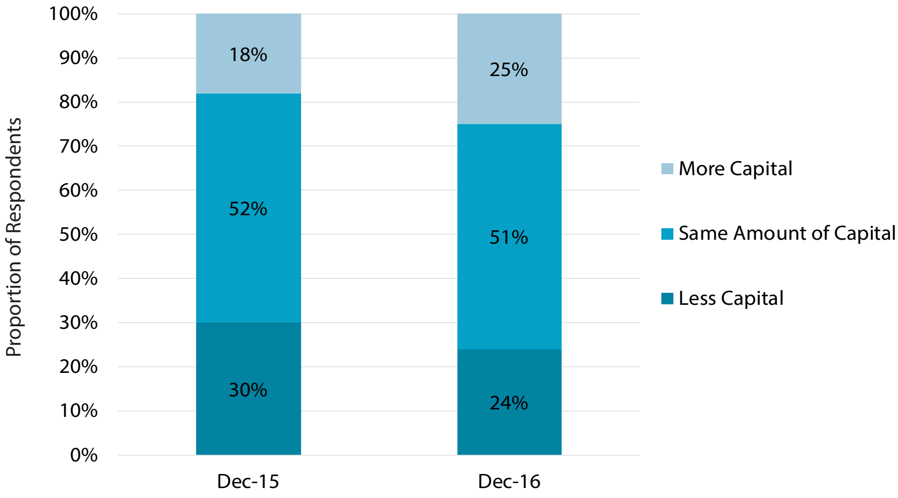
Source: Preqin Real Estate Online

INVESTOR ACTIVITY IN 2017

Nearly two-fifths (37%) of respondents believe their private real estate investments will perform worse in the next 12 months than in the last, while only 9% believe they will perform better, and this appears to be influencing short-term appetite. A significant increase in fundraising looks unlikely in 2017, as only one-quarter of investors surveyed will look to commit more capital in 2017 than in 2016; 24% will commit less capital, indicating the fundraising landscape in 2017 is set to remain competitive (Fig. 4.10). The majority (55%) of active institutions plan to commit less than $100mn in fresh capital in 2017. Some investors, however, are looking to put significant amounts of capital to work: nearly a fifth (19%) will commit $300mn or more to private real estate funds in 2017.

Over the longer term, the majority (54%) of respondents will be looking to maintain their allocation to the asset class. Further growth in capital flowing into real estate is expected: 36% of investors plan to increase their exposure to the asset class, while only 10% will be reducing their allocations.

Fig. 4.10: Investors' Expected Capital Commitment to Real Estate Funds in the Next 12 Months Compared to the Previous 12 Months, 2015 vs. 2016



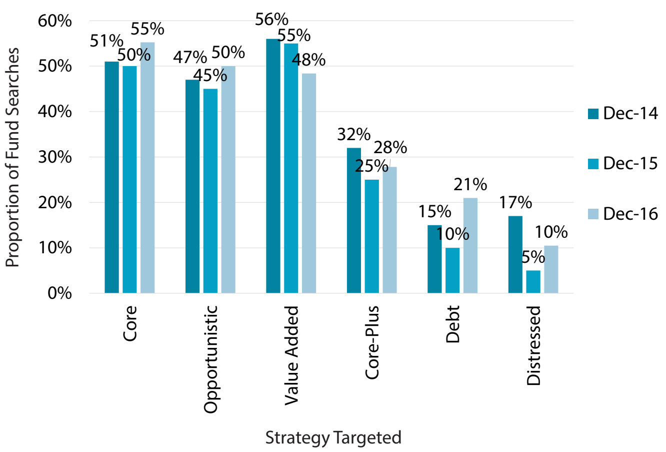
Source: Preqin Investor Interviews, December 2015 - December 2016

STRATEGIES AND REGIONS TARGETED

Fig. 4.11 shows there has been growth in investor demand for lower-risk strategies, with core funds the most favoured by those institutions that plan to be active in the asset class in 2017: 55% of investors are looking to commit to this strategy, followed by opportunistic (50%) and value added (48%). This is a notable change compared with the previous year, when the majority (55%) of investors had a preference for value added funds. While debt funds are still only targeted by a relatively small proportion of investors, the growth in demand for real estate debt opportunities may reflect investors' looking for sources of reliable income in a low-return environment.

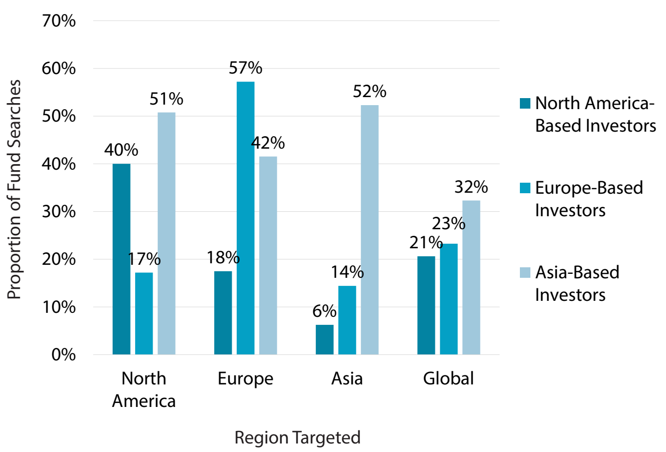
The majority of investors looking to make commitments in 2017 have a domestic bias: institutions are more likely to invest capital in the region in which they are based (Fig. 4.12). However, this bias is not as prominent as it was 12 months ago, suggesting investors are increasingly looking to diversify their portfolios. Asia-based investors in particular seem to be looking for highly diversified portfolios: 52% are targeting their home market, 51% are targeting the North American market and 42% are focusing on Europe, while nearly a third (32%) are looking at a more global spread for their investments.

Fig. 4.11: Strategies Targeted in the Next 12 Months by Private Real Estate Investors, 2014 - 2016



Source: Preqin Real Estate Online

Fig. 4.12: Regions Targeted in 2017 by Private Real Estate Investors by Investor Location



Source: Preqin Real Estate Online

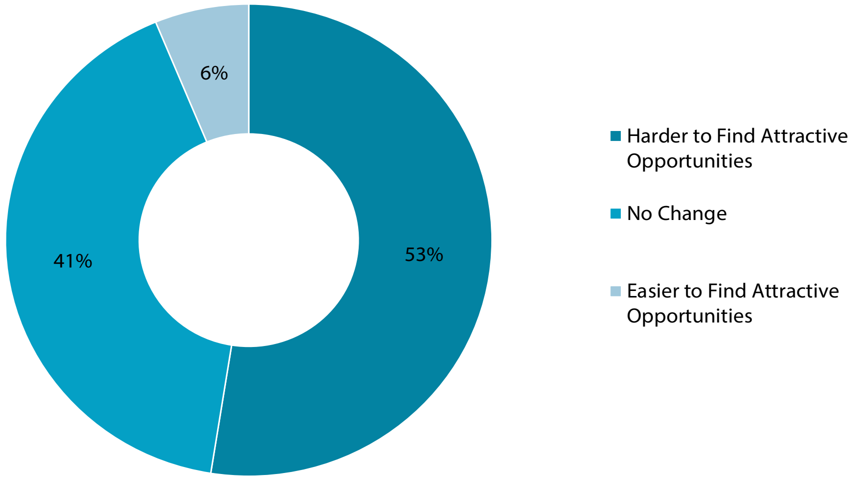
KEY ISSUES IN 2017

As can be seen in Fig. 4.13, over half (53%) of investors interviewed are finding it more difficult to find attractive investment opportunities compared with 12 months ago, with 68% of respondents reporting that asset valuations are the key issue affecting real estate (Fig. 4.14).

> ***"Asset valuations remain a key issue for investors, as does sourcing attractive investment opportunities in the current real estate market***

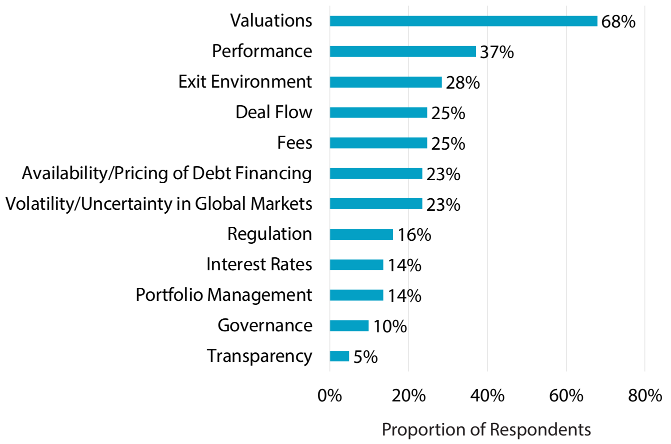
In terms of the key macroeconomic factors affecting the asset class in 2017, over two-thirds (68%) of surveyed investors believe low interest rates will have the greatest impact on their real estate portfolio in the coming year – an issue that was seen by 76% of respondents to have had the biggest impact on real estate portfolios over 2016 (Fig. 4.15). Continued low interest rates make borrowing cheap, and the spread between real estate yields and fixed income continues to make real estate attractive to many investors despite the competitive pricing. Central bank intervention (23%) and current market volatility (17%) were also named as key factors for the next 12 months.

Fig. 4.13: Investor Views on the Difficulty of Identifying Attractive Investment Opportunities Compared to 12 Months Ago



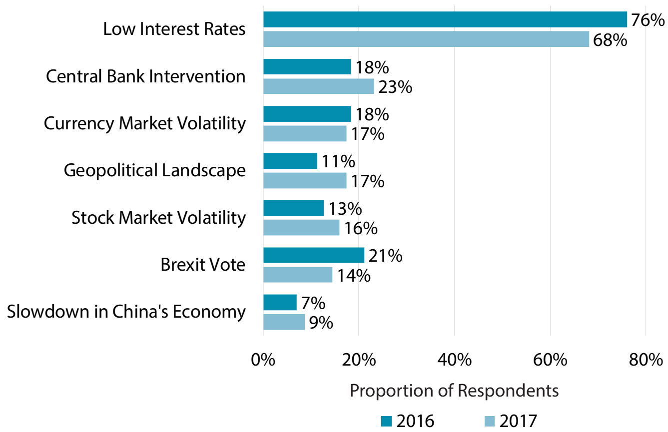
Source: Preqin Investor Interviews, December 2016

Fig. 4.14: Investor Views on the Key Issues Facing Real Estate in 2017



Source: Preqin Investor Interviews, December 2016

Fig. 4.15: Investor Views on the Macroeconomic Factors that Had the Biggest Impact on Their Real Estate Portfolios in 2016 vs. Predictions for 2017



Source: Preqin Investor Interviews, December 2016

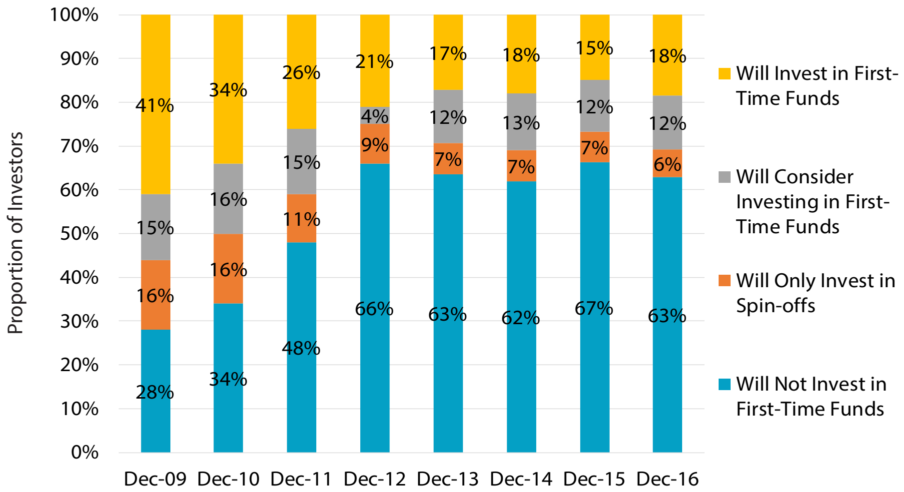
APPETITE FOR FIRST-TIME FUNDS AND ALTERNATIVE STRUCTURES

The years up to 2015 saw a steady decline in the proportion of institutional investors willing to invest in first-time funds; however, there has been a slight increase in the proportion of investors willing to invest in first-time funds in 2016 (18%) from 2015 (15%, Fig. 4.16). Institutional investor appetite also varies significantly depending on AUM: the larger the investor, the more likely they are to invest in first-time funds. These larger institutions are more likely to have the staff and resources to conduct the additional due diligence that may be required to invest with an emerging manager.

The ability of an investor to allocate capital through separate accounts, joint ventures and co-investments is also closely linked to its size, with larger institutions having the resources and the experience needed to source, review and monitor these investments. Around 60% of investors with assets of $10bn or more will invest, or consider investing, through these routes to market, while less than one-quarter of those that manage up to $1bn in AUM will consider these structures.

Fig. 4.17 and Fig. 4.18 show how the likelihood of allocating capital through co-investments and separate accounts changes with investor type. Sovereign wealth funds, which typically have large amounts of capital to put to work and sizeable internal teams (often in multiple locations), are very likely to be active through these routes. Other groups such as family offices or asset managers, which are typically more experienced in making direct real estate investments, are also more likely to make co-investments or separate account commitments. Investors such as endowment plans and foundations, which in many cases have smaller AUM and smaller investment teams, are less likely to consider these routes to real estate.

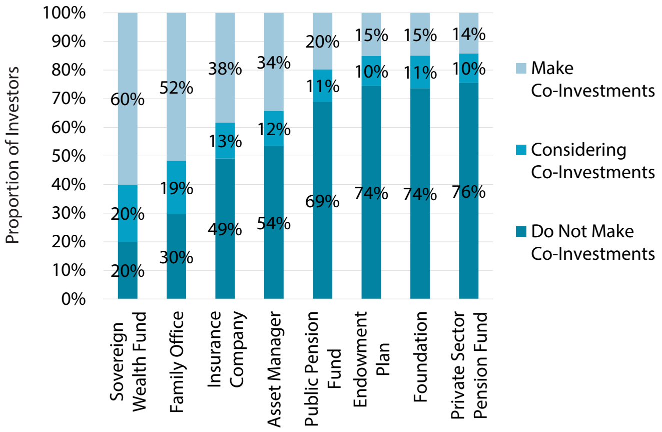
Fig. 4.16: Investor Attitudes towards First-Time Private Real Estate Funds, 2009 - 2016



Source: Preqin Real Estate Online

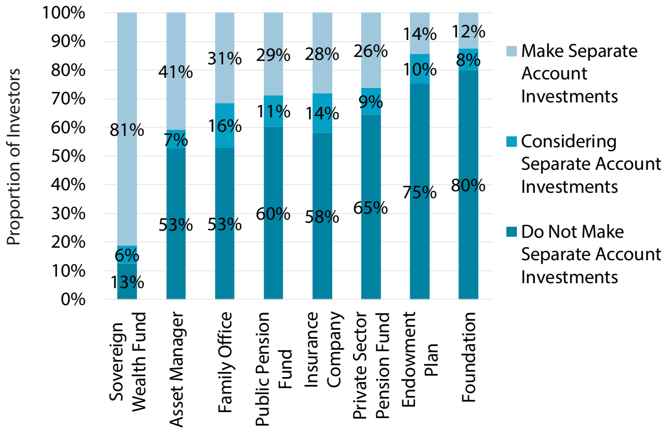
> ***Larger institutions are more likely to invest in first-time funds, separate accounts, joint ventures and co-investments***

Fig. 4.17: Investor Appetite for Real Estate Co-Investments by Type



Source: Preqin Real Estate Online

Fig. 4.18: Investor Appetite for Real Estate Separate Accounts by Type



Source: Preqin Real Estate Online

HOW INVESTORS SOURCE AND SELECT REAL ESTATE FUNDS

53%
of investors are finding it harder to source attractive investment opportunities.

47%
of investors believe marketing documents fail to meet their needs.

HOW INVESTORS SOURCE FUNDS:

22%
Through internal investment team

29%
Mainly internal or consultant recommendations, some external approaches

35%
Mix of internal and external recommendations

13%
Mainly approaches from GPs or marketers, some internal recommendations

1%
Solely from external approaches

HOW INVESTORS SELECT FUNDS:

The average investor receives
207
fund proposals each year

53%
of investors feel they get insufficient information on track record.

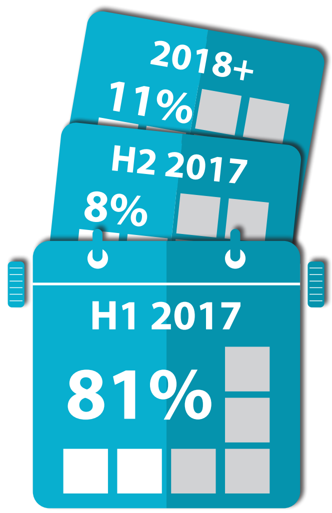
55%
of investors feel they get insufficient information on the strategy of a fund.

KEY REASONS INVESTORS REJECT A GP:

- Below-average team track record
- Fees/terms
- Length of team track record

8%
of proposals, on average, are sent through for a second round of screening.

INVESTORS' PLANS FOR THEIR NEXT FUND COMMITMENT:



The average investor makes
2
commitments to private real estate funds each year.

SECTION FIVE: INFRASTRUCTURE

INVESTOR APPETITE REMAINS STRONG DESPITE CONCERNS

In December 2016, Preqin conducted interviews with over 140 institutional investors actively committing capital to the infrastructure asset class to gauge their thoughts on the market and their appetite for investment opportunities in the coming year.

Institutional investors continue to see strong risk-adjusted returns from their infrastructure portfolios and remain committed to the asset class. Eighty-nine percent of respondents stated that the performance of infrastructure had either met or exceeded their expectations in the past 12 months.

With a record $60bn in capital distributed back to investors in 2015, nearly double the previous record of $31bn in 2014, it is unsurprising that investors are looking to ramp up their infrastructure allocations in 2017, with 88% expecting to commit either the same amount or more capital to the asset class in 2017 compared to 2016.

Despite positive sentiment and growing appetite for the asset class, investors have concerns that managers looking to successfully raise capital need to be aware of and allay. With a competitive deal environment pushing up prices for infrastructure assets, over half (54%) of investors we interviewed stated that asset pricing is a key issue for the industry in 2017, with high prices potentially eating into the eventual returns investors will see from their infrastructure portfolios. Beyond this, investors have the challenge of identifying the managers that can deliver the returns they seek at an acceptable level of risk, within an intensely competitive market.

With the majority (63%) of investors under-allocated to infrastructure in January 2017, the asset class is likely to see a continuation of strong fundraising figures and upward pressure on asset prices, particularly if interest rates remain low.

INVESTOR APPETITE

89%

of investors felt their infrastructure investments met or exceeded their expectations in 2016.

54%

of investors feel that asset pricing is a key issue for the infrastructure market in 2017.

41%

of surveyed investors will increase their allocation to infrastructure co-investments in 2017.

MAKE-UP OF INVESTORS

62%

of investors have less than $10bn in AUM.

$106bn

Total amount allocated to the asset class by the 10 largest infrastructure investors.

$23.8bn

Estimated current allocation to the asset class by Abu Dhabi Investment Authority, the largest infrastructure investor globally.

EVOLUTION OF INVESTORS

3.9%

Investors' average current allocation to infrastructure, below the average target allocation of 5.2%.

63%

of investors are below their target allocation to infrastructure.

45%

of investors will not invest in first-time funds, the largest proportion in the period 2013-2016.

SATISFACTION WITH INFRASTRUCTURE

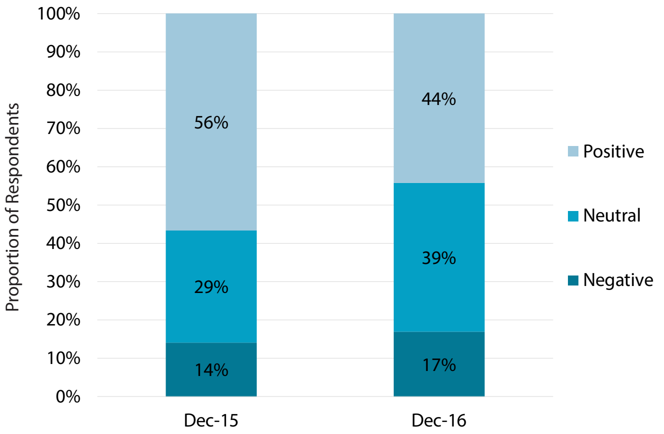
While the largest proportion (44%) of investors surveyed still have a positive attitude towards the asset class, this is a smaller proportion compared with 56% in December 2015 (Fig. 5.1). Concerns regarding asset pricing, deal flow and the ability of fund managers to put large amounts of dry powder to work may be the influencing factors in this change in sentiment. Fifty-five percent of respondents felt that the current pricing of infrastructure assets was expensive.

As shown in Fig. 5.2, 89% of institutional investors felt that their infrastructure fund investments had met or exceeded their expectations over the past 12 months, an increase from 77% in December 2015. Indicative of the level of investor satisfaction with the asset class, the proportion of respondents that felt their infrastructure investments had fallen short of expectations was substantially lower at 11% in 2016 (from 23% in 2015).

As of the end of 2016, a greater proportion (68%) of investors had experienced no change in their confidence in infrastructure to achieve their portfolio objectives over the past year than in December 2015 (64%). However, a smaller proportion (17%) have seen an increase in confidence (Fig. 5.3). Mirroring the wavering positivity among investors in the asset class, this may also reflect concerns over asset pricing and deal flow in an increasingly competitive market.

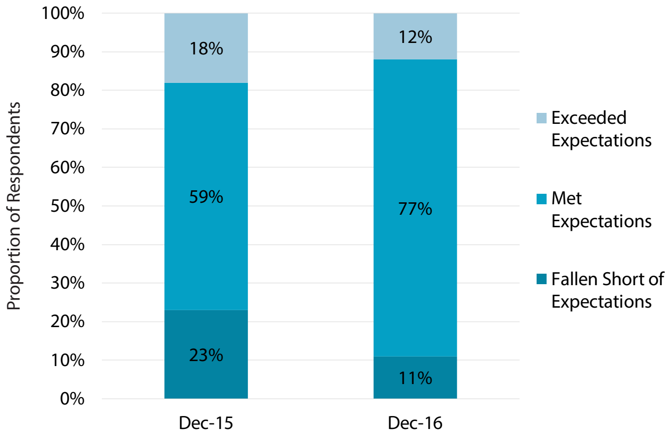
Despite investors having somewhat less confidence in infrastructure than a year ago, they continue to have a positive outlook on the asset class. Fig. 5.4 shows that 53% of investors surveyed intend to increase their allocation to the asset class over the longer term. A further 37% of investors expect to maintain their allocation to infrastructure.

Fig. 5.1: Investors' General Perception of the Infrastructure Industry, 2015 vs. 2016



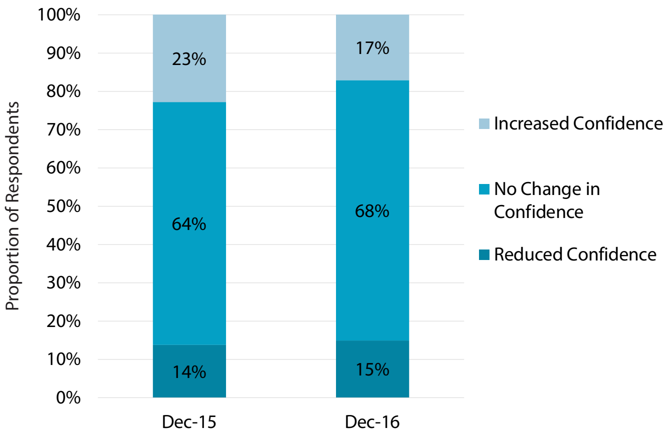
Source: Preqin Investor Interviews, December 2015 - December 2016

Fig. 5.2: Investor Views on Infrastructure Portfolio Performance over the Past 12 Months Relative to Expectations, 2015 vs. 2016



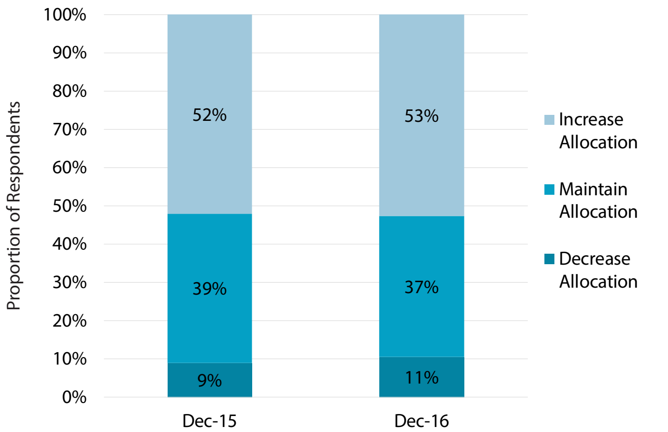
Source: Preqin Investor Interviews, December 2015 - December 2016

Fig. 5.3: Investors' Change in Confidence in the Ability of Infrastructure to Achieve Portfolio Objectives over the Past 12 Months, 2015 vs. 2016



Source: Preqin Investor Interviews, December 2015 - December 2016

Fig. 5.4: Investors' Intentions for Their Infrastructure Allocations over the Longer Term, 2015 vs. 2016



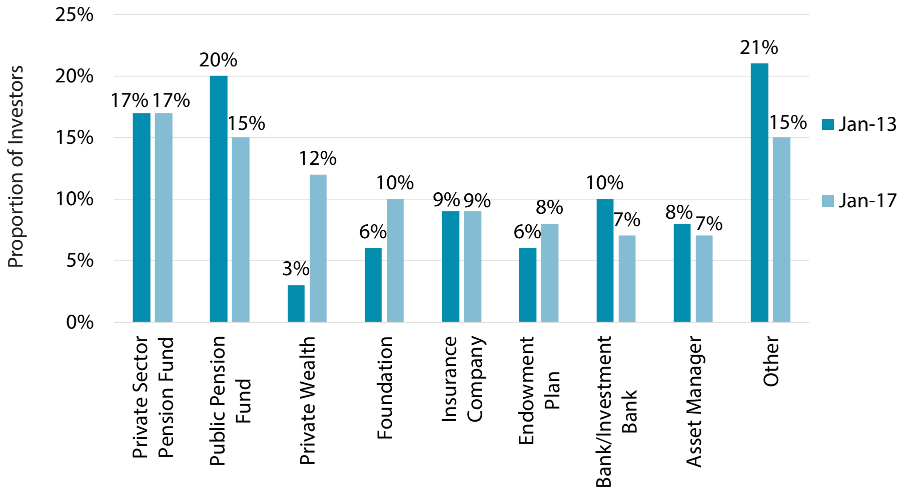
Source: Preqin Investor Interviews, December 2015 - December 2016

EVOLUTION OF THE INVESTOR UNIVERSE

Despite its relative youth as a standalone asset class compared with other alternatives, infrastructure has developed into a fully fledged independent asset class in recent years, with the size of the market and availability of opportunities increasing as many governments seek private funding for public infrastructure projects.

> ***The number of investors in the asset class has increased by more than 116% since 2013***

Fig. 5.5: Institutional Investors in Infrastructure by Type, 2013 vs. 2017



Source: Preqin Infrastructure Online

MAKE-UP OF INVESTORS

Preqin's **Infrastructure Online** service tracks over 2,900 institutional investors across the globe that are investing, or are considering investing, in the asset class, with extensive profiles of investment plans, preferences and existing portfolios. The number of institutional investors in the infrastructure asset class has increased by over 116% between 2013 and 2017, an indication of the increasing depth of the investor universe. Fig. 5.5 shows that pension funds continue to account for around a third of infrastructure investors, although public pension funds make up a smaller proportion of the overall total in 2017 compared with 2013.

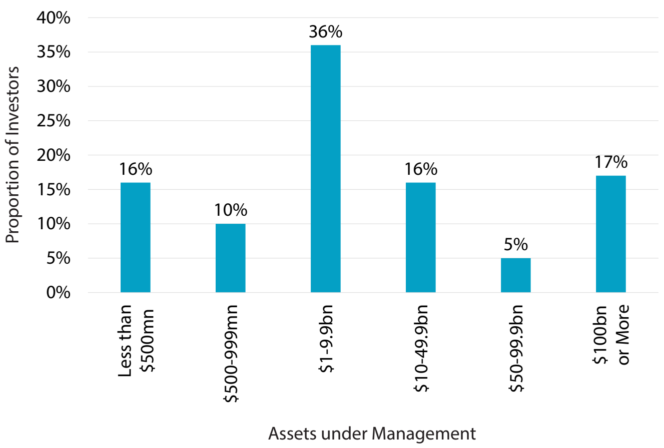
Infrastructure continues to hold substantial appeal for large institutional investors attempting to manage long-term liabilities in a low-interest rate environment, where yields remain at historically low levels. However, it is also notable that private wealth investors make up 12% of the investor universe in 2017, up from 3% in 2013.

Fig. 5.6 illustrates that large investors represent a substantial proportion of active investors in unlisted infrastructure: 17% of investors have total AUM of $100bn or more. This is a larger proportion than in previous years, indicating the increasing interest and activity in the asset class from the largest sovereign wealth funds, public pension funds and insurance companies.

ALLOCATIONS TO INFRASTRUCTURE

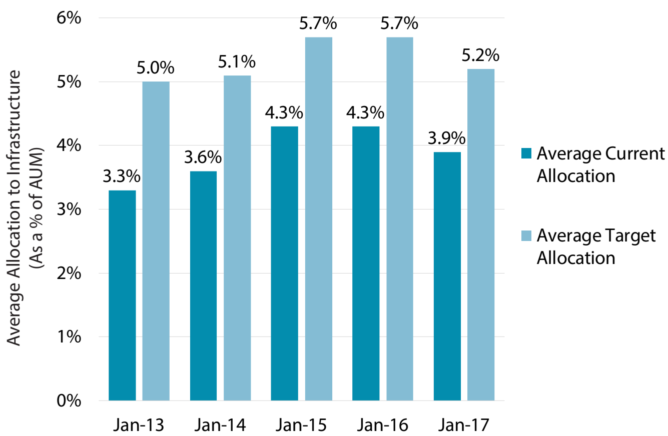
Average current and target allocations to infrastructure have decreased slightly from 2016 and stand at 3.9% and 5.2% of AUM in 2017 respectively, reversing the upward trend from 2013 to 2015 (Fig. 5.7). New investors entering the industry in large

Fig. 5.6: Institutional Investors in Infrastructure by Assets under Management



Source: Preqin Infrastructure Online

Fig. 5.7: Institutional Investors' Current and Target Allocations to Infrastructure, 2013 - 2017



Source: Preqin Infrastructure Online

numbers are likely to have contributed to this, with fresh entrants typically allocating smaller proportions of their total assets initially. Furthermore, investor concerns regarding the pricing of infrastructure assets and the availability of assets for deals may also have contributed to the reduction in average allocations to the asset class in 2016.

63%

of investors are below their target allocation to the asset class.

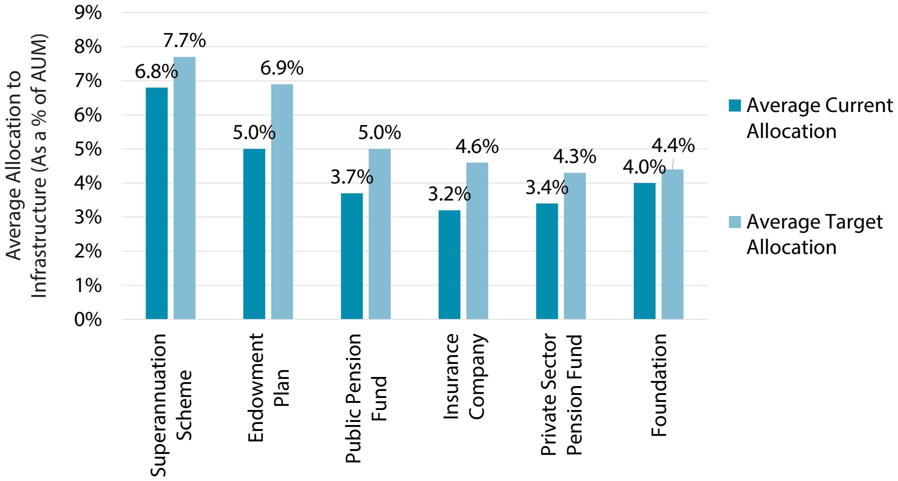
Superannuation schemes, which are typically based in the developed infrastructure market of Australia, continue to have the highest average current and target allocations at 6.8% and 7.7% respectively (Fig. 5.8), a reflection of their experience and expertise in the asset class. Significant allocations are also maintained by endowment plans and foundations, as well as other long-term investors including insurance companies and public and private sector pension funds.

The majority (63%) of infrastructure investors are below their target allocation to infrastructure, indicating the availability of capital and the continued growth prospects in the asset class (Fig. 5.9).

SOURCE OF ALLOCATION

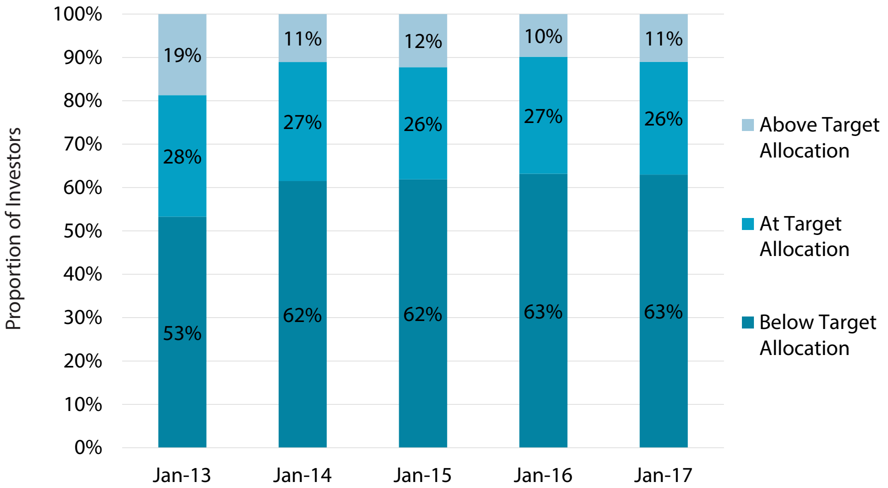
Investors continue to allocate capital to infrastructure through a number of sources, although it is notable that the proportion of investors maintaining a separate infrastructure allocation decreased to 35% in January 2017, down from 42% in January 2013 (Fig. 5.10). A possible cause of this is the increase in the number of new infrastructure investors, which are likely allocating to the asset class via a real assets (21% of all investors) or private equity (23%) allocation while building up expertise in the area.

Fig. 5.8: Institutional Investors' Current and Target Allocations to Infrastructure by Type



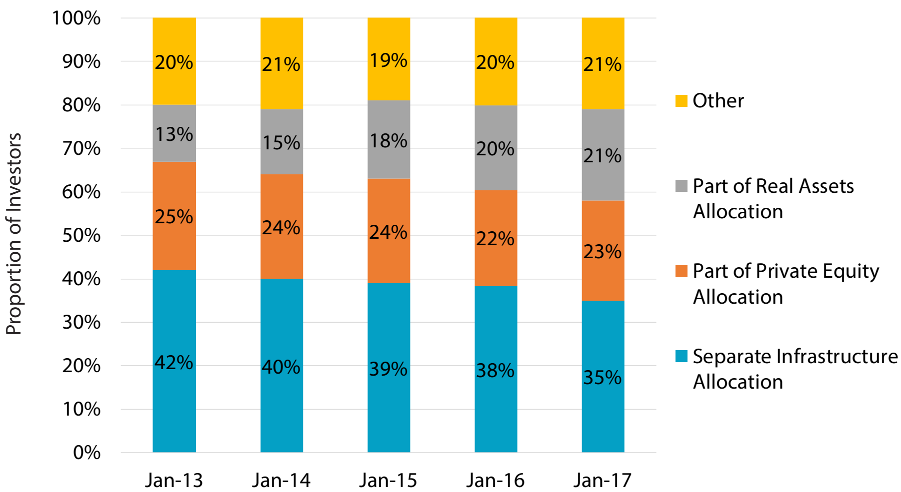
Source: Preqin Infrastructure Online

Fig. 5.9: Proportion of Investors At, Above or Below Their Target Allocation to Infrastructure, 2013 - 2017



Source: Preqin Infrastructure Online

Fig. 5.10: Infrastructure Investors by Source of Allocation, 2013 - 2017



Source: Preqin Infrastructure Online

INVESTOR ACTIVITY IN 2017

INVESTORS' COMMITMENTS IN 2017

With 88% of investors intending to commit more capital or maintain the same level of commitments over 2017, infrastructure is clearly being recognized for its potential to generate stable returns over the longer term.

The proportion of surveyed investors that expect to commit the same amount of capital in the next 12 months compared to the previous year has almost doubled from 26% in December 2015 to 50% in December 2016 (Fig. 5.11). This proportional increase coincides with a decrease in the proportion of investors that expect to commit more capital as well as those that expect to commit less in the next 12 months.

INVESTOR PREFERENCES

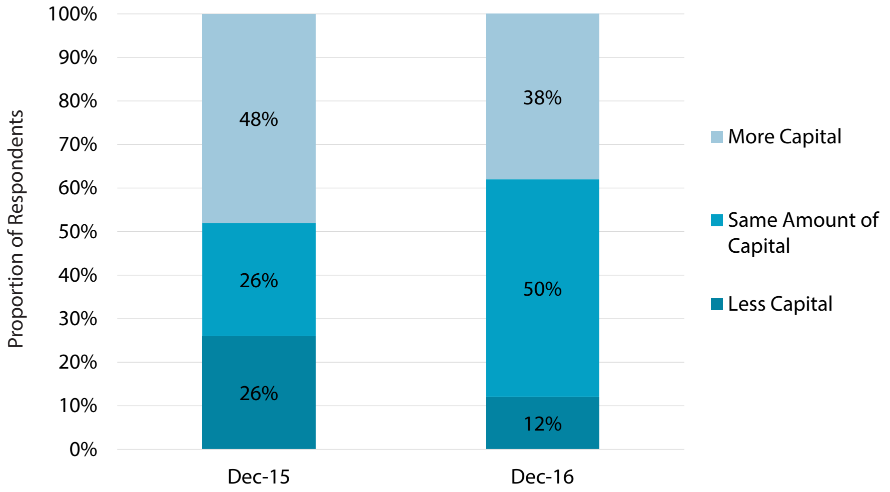
As shown in Fig. 5.12, renewable energy is favoured by the largest proportion of investors, with 64% believing that these assets present attractive opportunities. Demand for renewable energy infrastructure has been bolstered by political support for alternative sources of energy that are sustainable for the environment and cost-effective over the longer term. Private infrastructure capital therefore has sought to capitalize on these opportunities, with investors attracted to the stable, long-term risk-adjusted returns available.

> ***The largest proportion of investors believe that the renewable energy sector presents attractive investment opportunities***

A large proportion (43%) of investors believe that energy infrastructure (excluding renewable assets) presents compelling opportunities, followed by transport (34%), utilities and telecommunications (each 21%). Despite strong competition for core assets, the largest proportion (46%) of respondents believe these strategies currently present attractive opportunities, followed by opportunistic (42%) and value added (35%) strategies (Fig. 5.13).

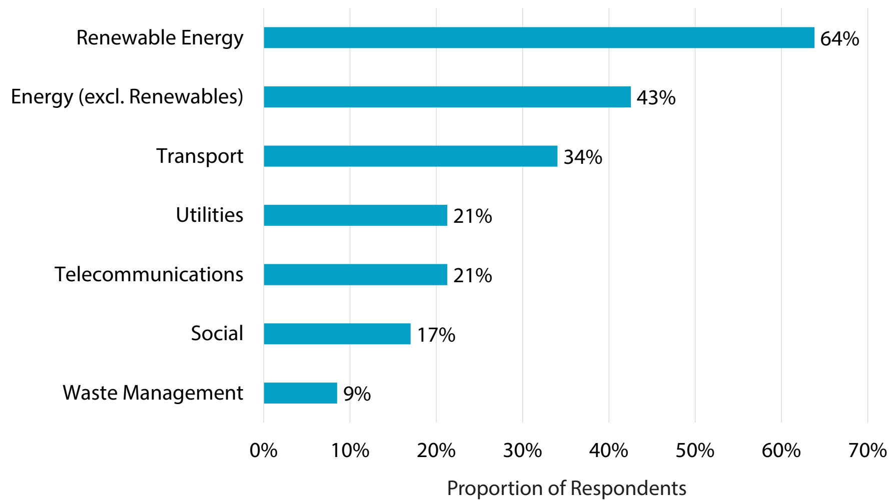
North America is the most favoured destination for infrastructure investment over the coming year, with 60% of respondents believing it presents compelling opportunities (Fig. 5.14); this coincides with the large number of North America-focused funds in market currently. Half of respondents cited Europe as presenting attractive opportunities, the market that raised the largest number of funds in 2016. Reflecting the political and economic risk associated with investing in the less evolved markets in the developing world, the smallest proportions of investors favour exposure to the Middle East (12%) and Latin America (12%). However, as competition for attractive assets in the established markets of North America and Europe pushes valuations up further, investors may seek more affordable opportunities in markets elsewhere.

Fig. 5.11: Investors' Expected Capital Commitments to Infrastructure Funds in the Next 12 Months Compared to the Previous 12 Months, 2015 vs. 2016



Source: Preqin Investor Interviews, December 2015 - December 2016

Fig. 5.12: Sectors* Investors View as Presenting the Best Opportunities



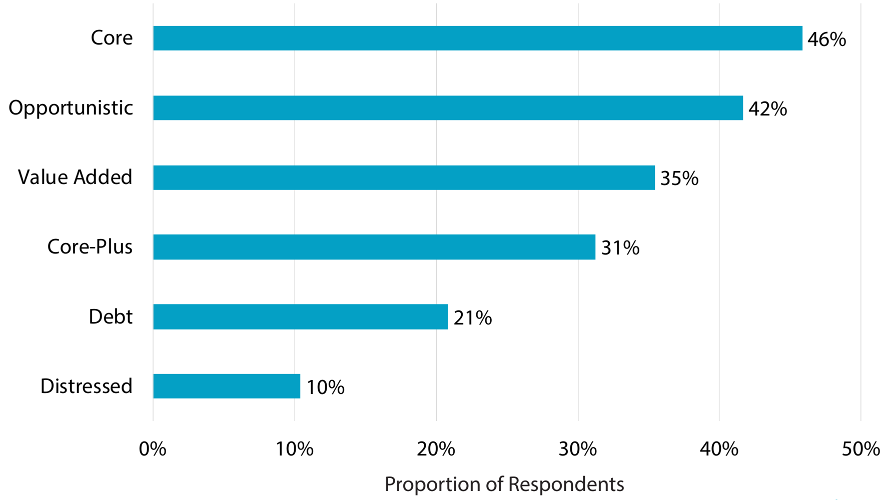
Source: Preqin Investor Interviews, December 2016

> ***The proportion of investors targeting direct investments has decreased somewhat in recent years***

ROUTE TO MARKET

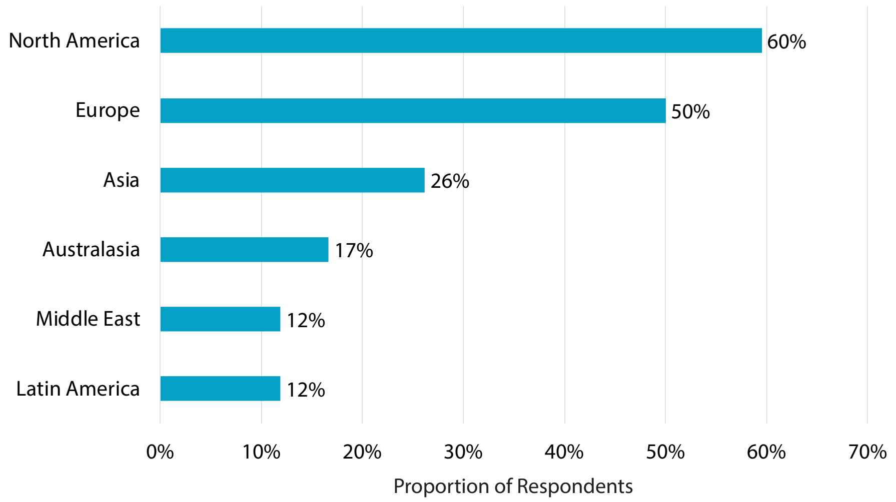
Unlisted funds remain the preferred route to market for the majority (73%) of infrastructure investors over the next 12 months, although this proportion remains significantly below the 91% recorded in January 2013 (Fig. 5.15). Increasing investor interest in the direct investment model is largely responsible for this change, with this route to market cementing itself as a major component of many investors' future investment plans. However, the proportion of investors targeting direct investments has decreased somewhat in recent years. The small reduction in average current and target allocations, the influx of new and less experienced investors entering the market in recent years and the increased appetite for unlisted funds are probable causes of this, alongside the constraints on the capabilities of investors to execute direct investment transactions internally.

Fig. 5.13: Strategies* Investors View as Presenting the Best Opportunities



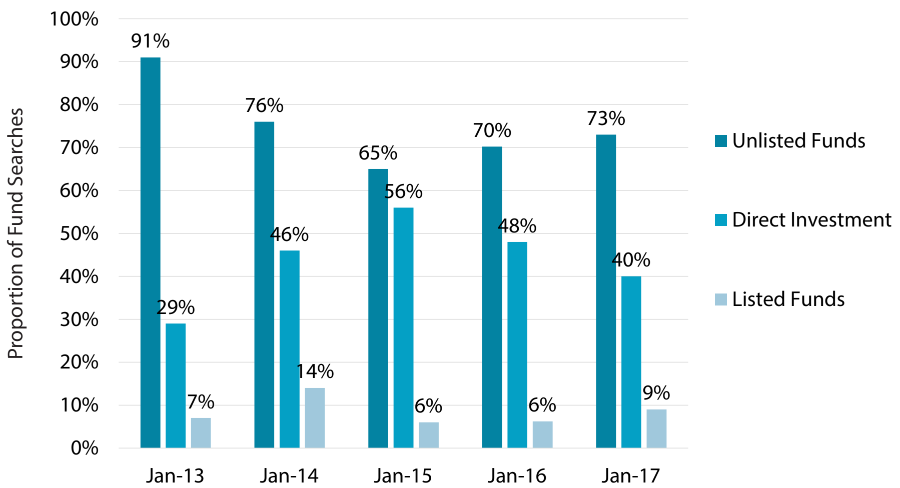
Source: Preqin Investor Interviews, December 2016

Fig. 5.14: Regions* Investors View as Presenting the Best Opportunities



Source: Preqin Investor Interviews, December 2016

Fig. 5.15: Routes to Market Targeted in the Next 12 Months by Infrastructure Investors, 2013 - 2017



Source: Preqin Infrastructure Online

**Respondents were not prompted to give their opinion on each sector/strategy/region individually but to name those they felt best fit these categories; therefore, the results display the sectors/strategies/regions at the forefront of investors' minds at the time of the survey.*

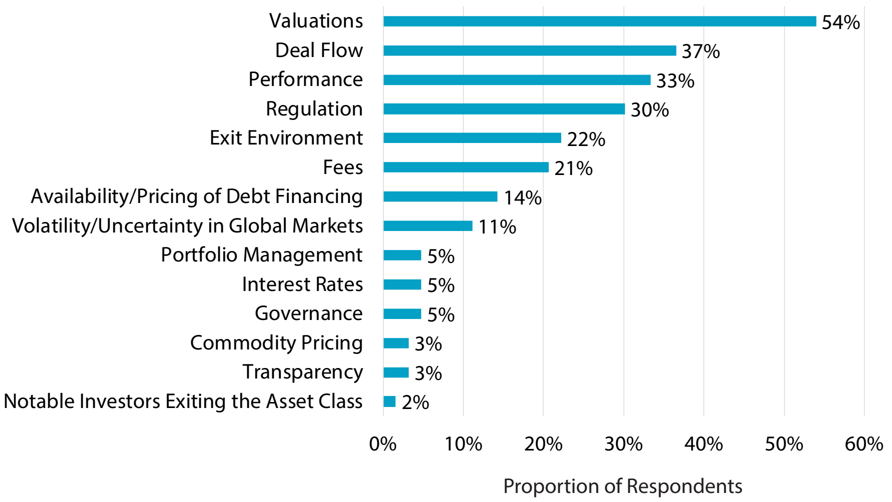
KEY ISSUES IN 2017

Increased participation from strategic and institutional investors, as well as a large number of funds on the road, has made the market more competitive. It is therefore unsurprising that pricing is the biggest concern among infrastructure investors (as cited by 54%, up substantially from 38% in 2015) as low interest rates have contributed to rising asset valuations (Fig. 5.16). The availability of attractive deals and the performance of infrastructure funds are also cited by 37% and 33% of investors respectively as key concerns in the current market, proportions that are relatively unchanged from 38% and 32% at the end of 2015. One Europe-based institutional investor noted that the infrastructure market was growing, so although prices are currently expensive, "there is hidden value, if you can find the right people and the right approach".

> ***Pricing is the biggest concern among infrastructure investors, as cited by 54%, as low interest rates have contributed to rising asset valuations***

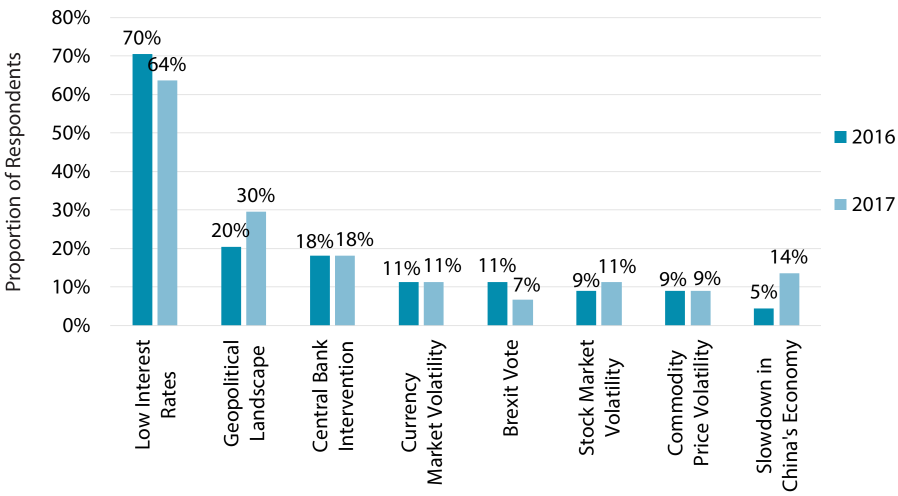
In terms of macroeconomic factors, the majority (64%) of surveyed investors anticipate that low interest rates will have the biggest impact on their portfolios in the coming year. The global geopolitical landscape was cited by 30% of investors, while only 7% expect the Brexit vote to have a significant impact on their portfolio in 2017 (Fig. 5.17).

Fig. 5.16: Investor Views on the Key Issues Facing Infrastructure in 2017



Source: Preqin Investor Interviews, December 2016

Fig. 5.17: Investor Views on the Macroeconomic Factors that Had the Biggest Impact on Their Infrastructure Portfolios in 2016 vs. Predictions for 2017



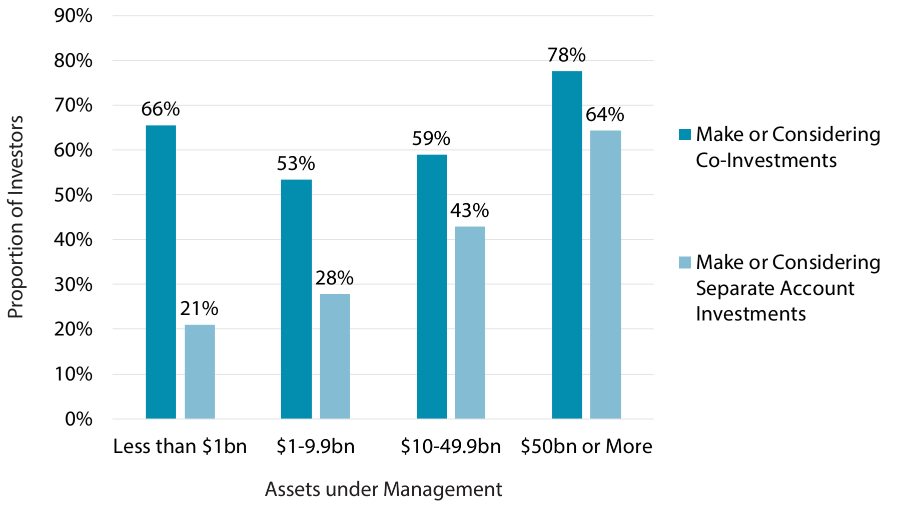
Source: Preqin Investor Interviews, December 2016

APPETITE FOR ALTERNATIVE STRUCTURES

As the asset class evolves, many investors are increasingly looking at alternatives to the primary fund commitment model to gain exposure to infrastructure. While a number of larger investors have made direct investments in assets, many others lack the expertise, human resources or financial capability to do so. Structures such as co-investments and separate accounts can offer investors the opportunity to gain more exposure to attractive assets, with more control and the potential for lower fees, while also benefitting from a third-party manager's skill and pipeline of potential deals.

Alternative structures often require larger capital commitments and substantial human resources to effectively carry out the due diligence and portfolio management required; the greater the AUM of the investor, the more likely they are to make or consider making co-investments or separate account investments. Sixty-four percent of investors with at least $50bn in AUM make or consider making separate account investments, compared with only 21% of investors with less than $1bn in AUM (Fig. 5.18). This trend is similar for co-investments; however, two-thirds of the smallest investors (those with less than $1bn in AUM) will make co-investments, as the model is less restrictive in terms of the capital outlay required than for separate accounts.

Fig. 5.18: Investor Appetite for Co-Investments and Separate Accounts by Assets under Management

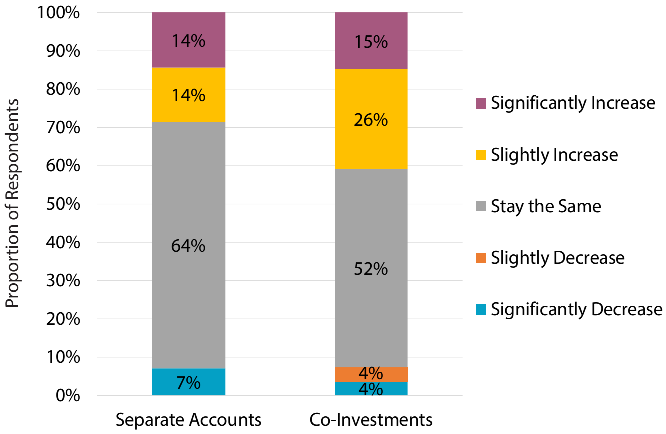


Source: Preqin Infrastructure Online

Fig. 5.19 reveals a contrast in investors' allocation plans for 2017: the majority (64%) of surveyed investors expect to maintain their existing allocation to infrastructure separate accounts, while 28% plan to either slightly or significantly increase their allocation in the coming year. A larger proportion (41%) of investors plan to increase their allocation to co-investments in 2017 compared to separate accounts, while just 8% expect to decrease their allocation.

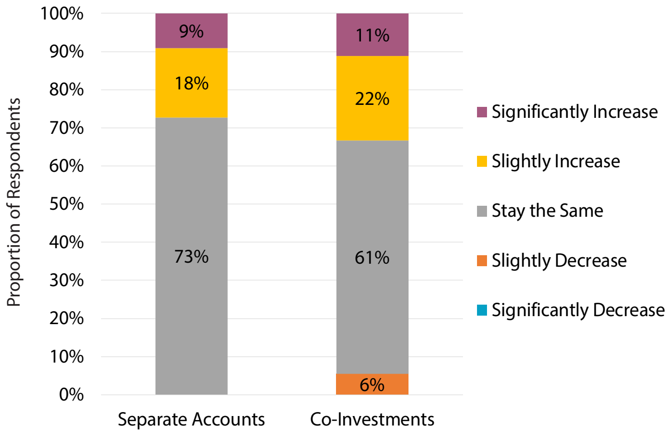
Although the majority of investors expect the proportion of co-investments in their portfolio to remain unchanged, 33% expect this to increase over the next 12 months (Fig. 5.20). In terms of separate accounts, an even larger majority (73%) do not anticipate any change, while 27% expect them to make up a greater proportion. With few, if any, investors expecting co-investments or separate accounts to decrease in prominence within their portfolios, both structures appear to have the support of the investor community in the next 12 months.

Fig. 5.19: Investor Allocation Plans for Separate Accounts and Co-Investments in 2017



Source: Preqin Investor Interviews, December 2016

Fig. 5.20: Investors' Expected Change in the Proportion of Separate Accounts and Co-Investments in Their Portfolio over the Next 12 Months



Source: Preqin Investor Interviews, December 2016

HOW INVESTORS SOURCE AND SELECT INFRASTRUCTURE FUNDS

46%
of investors are finding it harder to source attractive investment opportunities.

48%
of investors believe marketing documents fail to meet their needs.

HOW INVESTORS SOURCE FUNDS:

11%
Through internal investment team

31%
Mainly internal or consultant recommendations, some external approaches

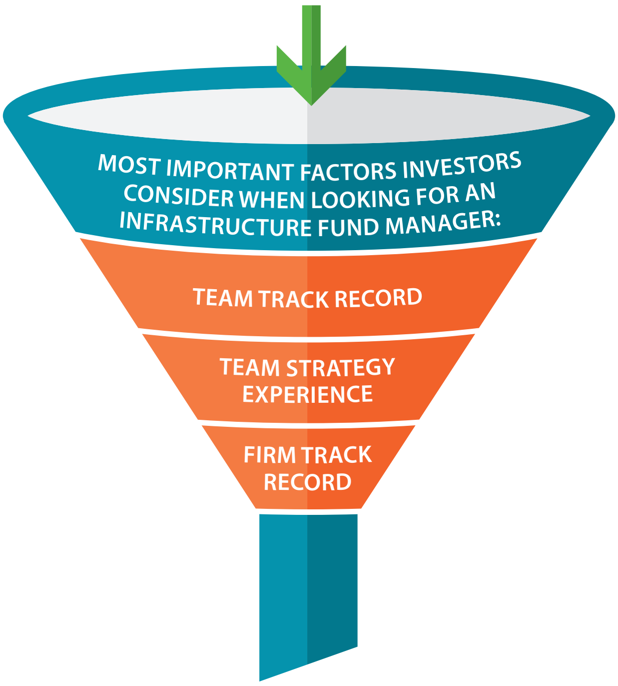
36%
Mix of internal and external recommendations

20%
Mainly approaches from GPs or marketers, some internal recommendations

2%
Solely from external approaches

HOW INVESTORS SELECT FUNDS:

The average investor receives
155
fund proposals each year



48%
of investors feel they get insufficient information on track record.

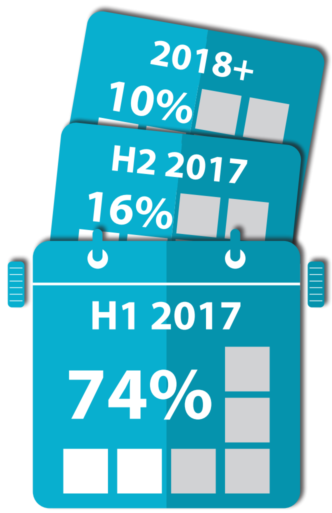
53%
of investors feel they get insufficient information on the strategy of a fund.

KEY REASONS INVESTORS REJECT A GP:

- Below-average team track record
- Fees/terms
- Length of team track record

10%
of proposals, on average, are sent through for a second round of screening.

INVESTORS' PLANS FOR THEIR NEXT FUND COMMITMENT:



The average investor makes
2
commitments to unlisted infrastructure funds each year.

SECTION SIX:
PRIVATE DEBT

INVESTORS LOOK TO INCREASE EXPOSURE IN 2017

The growth in AUM held by private debt fund managers during the past decade can be attributed in no small part to the systematic retreat of banks from the commercial lending space. Institutional investors have continuously poured capital commitments into the asset class, which now holds $594bn in AUM, and includes strategies spanning the risk/return spectrum. Preqin currently tracks more than 2,400 institutional investors that are actively investing or planning their maiden commitment to the asset class.

The positive outlook for the asset class is largely a product of the hugely positive investor sentiment: 93% of investors we interviewed communicated that their private debt investments had either met or exceeded their expectations in 2016. Strong levels of investor satisfaction are certainly welcomed by fund managers raising new funds in 2017, which will compete for commitments from the 57% of respondents that plan to commit more capital to the asset class in the coming year. At the time of Preqin's December 2016 investor interviews, just 8% of existing investors planned to decrease their private debt allocations in the long term, while nearly two-thirds intended to increase their allocations. Looking forward, investors will be keeping a close eye on interest rates and potential issues within economies around the globe, particularly the UK and US.

North America and Europe remain home to the majority of active private debt investors, with 83% of allocators headquartered in the two regions. It is likely that 2017 will see modest upticks in private debt activity outside these two areas, as investors and fund managers alike feel the effects of greater market saturation and competition. Quite a few investors perceive Africa, Asia and South America as promising areas of opportunity for private lending funds in the near future.

INVESTOR APPETITE

93%

of investors feel their private debt investments met or exceeded their expectations in 2016.

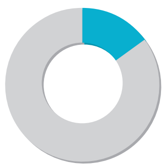
57%

of investors plan to commit more capital to private debt funds in 2017.

26%

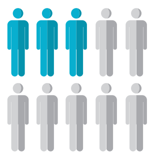
of investors typically commit to three or more private debt funds per year.

MAKE-UP OF INVESTORS



15%

of private debt investors manage private wealth.



30%

of investors in private debt are pension funds.

$5.4bn

Current allocation to private debt of KB Insurance, the largest Asia-based institutional private debt investor.

EVOLUTION OF INVESTORS

20.7%

Average target allocation (as a proportion of AUM) for family offices, the highest of any investor type.

17%

of investors in private debt are located in Asia & Rest of World, up five percentage points from one year earlier.

11%

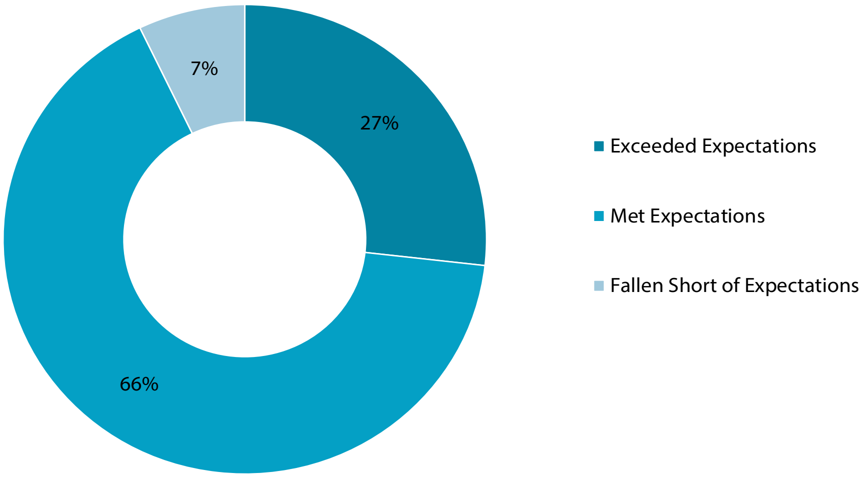
of investors invest in private debt from a dedicated allocation.

SATISFACTION WITH PRIVATE DEBT

Preqin interviewed more than 80 institutional private debt investors at the end of 2016 to ascertain how their investments have performed in the past year and where they see the industry heading in 2017. The results indicate that investor appetite for the coming year should be stronger than it was in the past 12 months. Continued interest from investors is welcome news for emerging managers as well as established fundraisers heading into 2017 with optimistic fundraising targets.

Overall, investors agree that their private debt investments lived up to their initial performance expectations. As a result, investors retain a generally positive perception of the asset class. The vast majority (93%) of respondents stated that the performance of their private debt portfolios either met or exceeded expectations in 2016 (Fig. 6.1), an increase from 86% in December 2015. More investors also have a positive view of the asset class: 68% of respondents maintain a positive perception of private debt, compared with 54% at the end of 2015 – only 4% view the asset class negatively (Fig. 6.2). Furthermore, investor confidence in the asset class remains high, with 29% reporting an increase in confidence over the past 12 months, while just 10% are less confident in the ability of private debt to meet portfolio objectives.

Fig. 6.1: Investor Views on Private Debt Portfolio Performance over the Past 12 Months Relative to Expectations

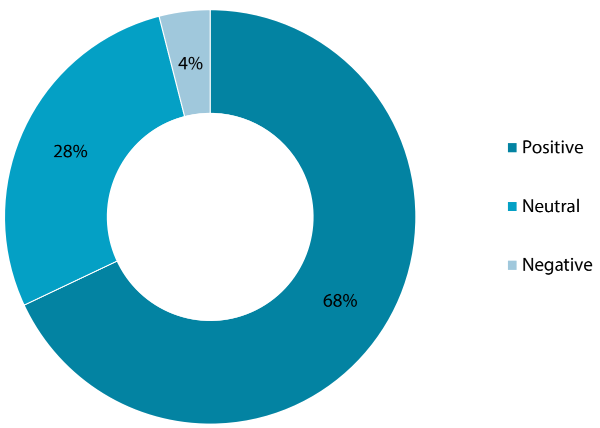


Source: Preqin Investor Interviews, December 2016

While almost all institutional investors interviewed share a positive or at least neutral view of private credit as a whole heading into 2017, sentiment on the quality of opportunities within a given strategy can vary. For example, the prominence of the direct lending segment has certainly made private debt investing more accessible being at the relatively lower-risk end of the alternatives spectrum. Strategies that sit higher on the risk/return spectrum, such as distressed and venture debt, still offer the potential for impressive returns targeted by some investors. In order for fund managers to match or surpass investor expectations, the goals of the fund and the underlying borrowers must be clearly aligned, which generally occurred over 2016 according to the satisfaction scores reported by investors.

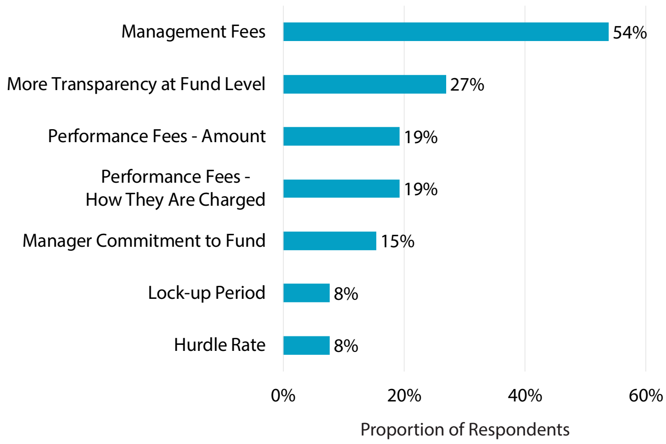
Fund terms have continued an evolution towards becoming more investor friendly, as transparency has become a uniform mandate from the alternative investor community, which continues to gain traction at the negotiating table. The majority (54%) of investors have seen changes in management fees over the past year, while 27% have experienced more transparency at fund level (Fig. 6.3).

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



Source: Preqin Investor Interviews, December 2016

Fig. 6.3: Investor Views on Areas of Fund Terms and Conditions that Have Changed over the Past 12 Months



Source: Preqin Investor Interviews, December 2016

EVOLUTION OF THE INVESTOR UNIVERSE

The private credit space has continued to evolve in the past decade as institutional investors are increasingly taking advantage of the fund opportunities that have arisen globally since 2007. Preqin's **Private Debt Online** contains detailed information on more than 2,400 institutional investors that are either actively investing in private debt opportunities or looking to make their maiden commitment. This marks an increase of more than 500 individual investors over 2016, showing heightened interest in the asset class.

LOCATION OF ACTIVE INVESTORS

While 83% of private debt investors are located in either North America or Europe, this represents a decrease of five percentage points from the previous year, indicating that investors in Asia & Rest of World are increasing their exposure to the asset class (Fig. 6.4).

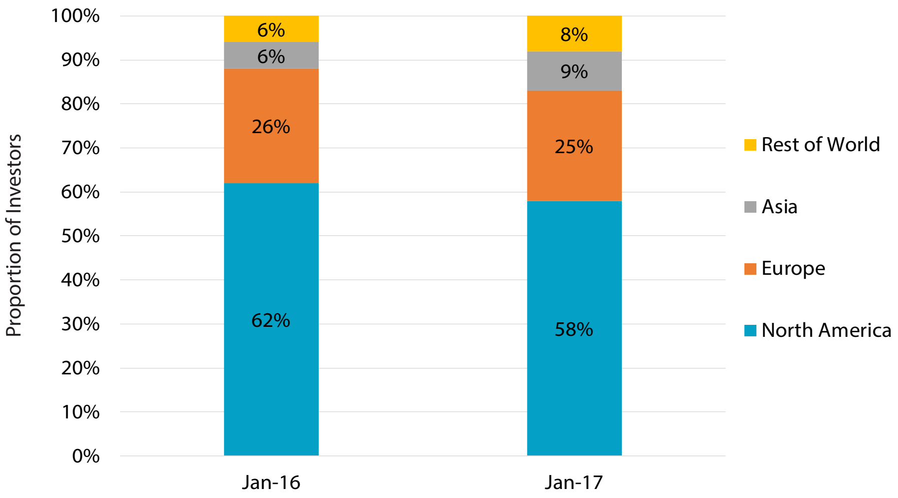
Three of the 10 largest global investors (by current allocation to private debt) are among the 17% of investors based in Asia & Rest of World: South Korea's KB Insurance allocates nearly a quarter (24%) of its $23bn in AUM to the asset class, and Ivory Coast-based African Development Bank allocates 15% of $35bn.

MAKE-UP OF ACTIVE INVESTORS

Institutional investors continue to outnumber private wealth investors in private debt: 85% of investors are institutions, while 15% manage private wealth. Public and private sector pension funds represent the largest proportions of investors in the asset class, 14% and 16% respectively, followed by foundations (13%).

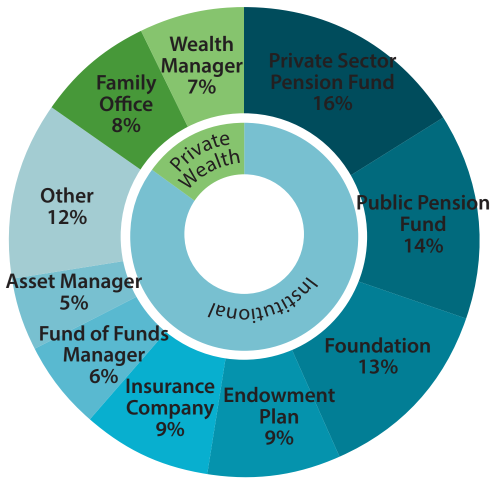
While foundations account for the third largest proportion of active private debt investors by type, they contribute the third smallest amount of aggregate capital. Comparatively, pension funds tend to account for larger proportions of invested capital as a result of typically larger AUM; public and private sector pension funds contribute the largest amounts of aggregate capital at 32% and 24% respectively (Fig. 6.6).

Fig. 6.4: Institutional Private Debt Investors by Location, 2016 vs. 2017



Source: Preqin Private Debt Online

Fig. 6.5: Institutional Private Debt Investors by Type



Source: Preqin Private Debt Online

AVERAGE ALLOCATIONS

The average current and target allocation of a private debt investor currently stand at 4.7% and 9.2% respectively. However, there is significant variation among investor types, typically associated with the amount of AUM and years of experience in the asset class. Total capital commitments to private debt will likely continue to grow, as average target allocations exceed average current allocations for all investor types.

Family offices continue to have both the highest current allocation (10.7%) and the highest target allocation (20.7%) as a proportion of AUM (Fig. 6.7). This can be attributed to fewer restrictions, increased flexibility and their appetite for higher returns compared to other asset classes. Specifically, two New York-based single-family offices are looking to make new private debt commitments in the coming year. The Laughren Group is looking to invest in opportunities in Asia, while Interventure Capital Group is targeting new distressed debt funds over the coming year.

Public and private sector pension funds, which together make up the largest proportion of investors, are both looking to increase their allocations to private debt. Public pension funds in particular have an average target allocation that is two percentage points higher than their current allocation, which would account for an additional $128bn in capital commitments.

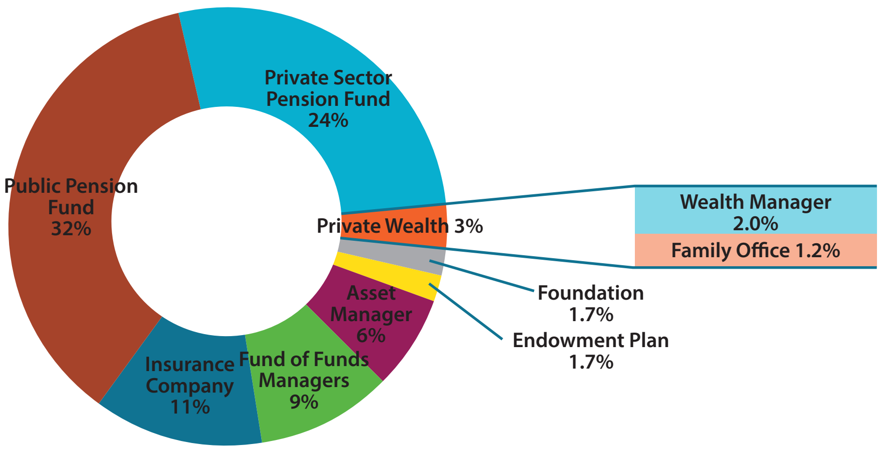
Wealth managers are looking to increase their current allocation by an average of five percentage points to meet targets, which is the second highest average increase among investor types.

PRIVATE WEALTH INVESTORS

Private wealth investors account for 15% of the private debt allocator universe by number, and constitute 3% of aggregate capital currently committed to the asset class. On average, private wealth investors are significantly under-allocated to private debt: the average current allocation to the asset class among private wealth investors is 8.3% of AUM, while the average target allocation is 15.7% (Fig. 6.9).

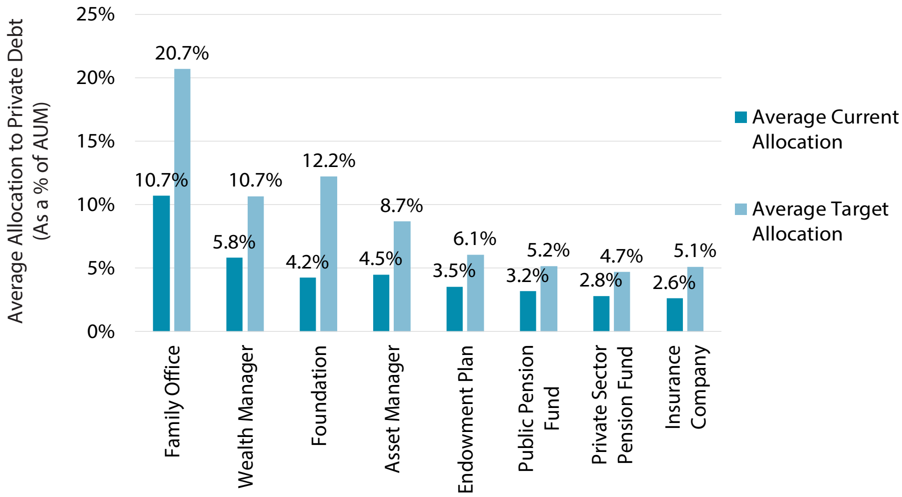
North America is home to 61% of private wealth firms active in private debt, while Europe is the headquarters for 28%. Even with the growth and expansion globally that private credit funds have seen in the

Fig. 6.6: Proportion of Aggregate Capital Currently Invested in Private Debt by Investor Type



Source: Preqin Private Debt Online

Fig. 6.7: Institutional Investors' Current and Target Allocations to Private Debt by Type



Source: Preqin Private Debt Online

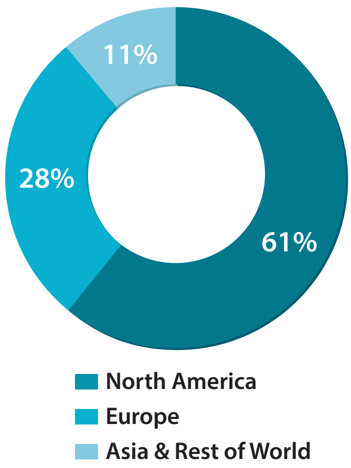
Fig. 6.8: 10 Largest Public Pension Funds by Current Allocation to Private Debt (As at January 2017)

Investor	Assets under Management ($bn)	Current Allocation to Private Debt ($bn)
New York State Teachers' Retirement System	109.5	8.8
California Public Employees' Retirement System (CalPERS)	303.4	5.0
Arizona State Retirement System	34.5	4.1
Oregon State Treasury	69.3	3.6
Texas County & District Retirement System	25.6	3.1
Washington State Investment Board	84.1	3.0
San Bernardino County Employees' Retirement Association	8.7	2.9
Florida State Board of Administration	178.5	2.7
New Mexico Educational Retirement Board	11.7	2.3
Maryland State Retirement and Pension System	46.3	2.1

Source: Preqin Private Debt Online

past few years, North America and parts of Europe remain highly concentrated regions of investor activity in the asset class. It is unclear when or if the types of opportunities offered by current private lenders will appeal to the private wealth investment base in sizeable markets such as China, but given the amount of potential capital available there will certainly be continued efforts by managers.

LOCATION OF PRIVATE WEALTH FIRMS ACTIVE IN PRIVATE DEBT

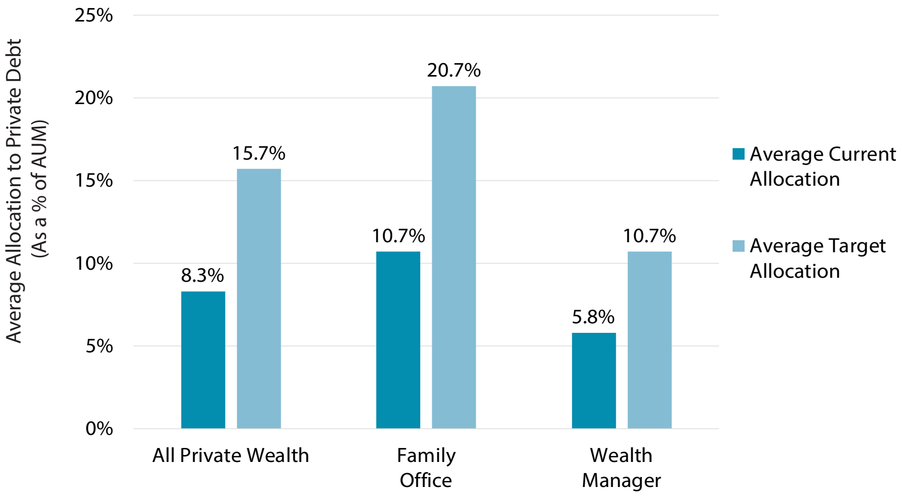


OUTLOOK

According to our December 2016 interviews with institutional investors in private debt, 89% of respondents plan to either maintain or increase the amount of capital they invest in private debt in the next 12 months compared to the previous year. A similar proportion (92%) plan to maintain or increase their allocations in the longer term. Private debt continues to expand as an asset class, as the number of investors (of all types and sizes) that are involved in private credit funds has continued to grow throughout 2016.

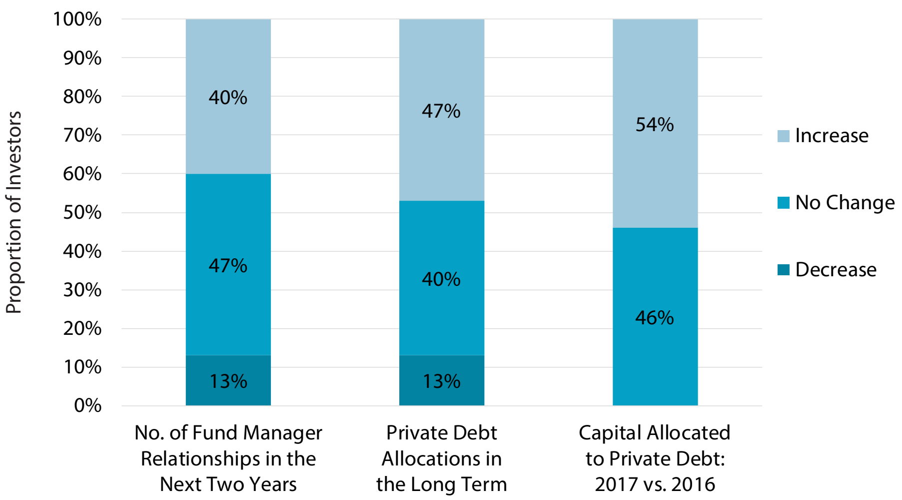
There is no reason to expect a change to the trend of increasing investor appetite for private debt through 2017. Managers based in North America and Europe should continue to see successful fundraising cycles as long as regulatory environments remain conducive to non-bank lending activity.

Fig. 6.9: Private Wealth Investors' Current and Target Allocations to Private Debt by Type



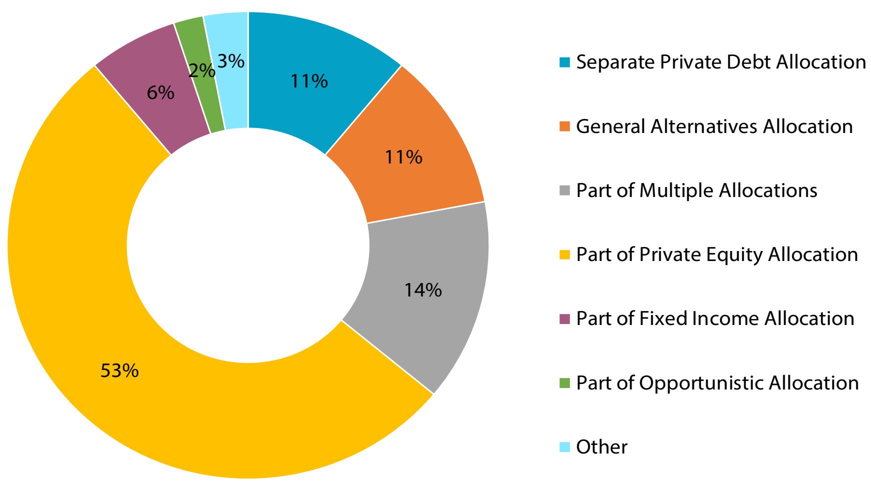
Source: Preqin Private Debt Online

Fig. 6.10: Private Wealth Investors' Outlook on Private Debt



Source: Preqin Private Debt Online

Fig. 6.11: Private Debt Investors by Source of Allocation



Source: Preqin Private Debt Online

INVESTOR ACTIVITY IN 2017

Heading into the new year, the majority of investors remain confident in their private debt investments. This is positive news for fund managers that have been steadily increasing the amount of capital deployed into private lending, as fundraising efforts should continue to yield sufficient capital.

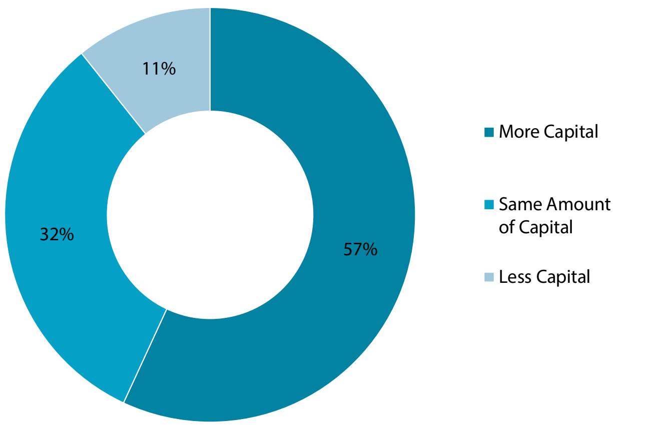
The majority (57%) of investors plan to commit more capital to the asset class in 2017 than in 2016, while a further 32% will commit the same amount of capital (Fig. 6.12). Nearly all (90%) investors currently active in private debt plan to make additional investments in the asset class in 2017, most (57%) of which expect to make their commitments in the first quarter of the year (see page 60).

While the outlook for the asset class in both the near and long term is generally positive, an increasing number of investors have noted key issues to watch within the market in the coming year. The proportion of investors that see the valuations of private debt vehicles as a key issue increased by nine percentage points from the previous year to 40% (Fig. 6.13). Other areas of concern include deal flow (36%), performance (33%) and regulation (28%).

INVESTOR ALLOCATIONS

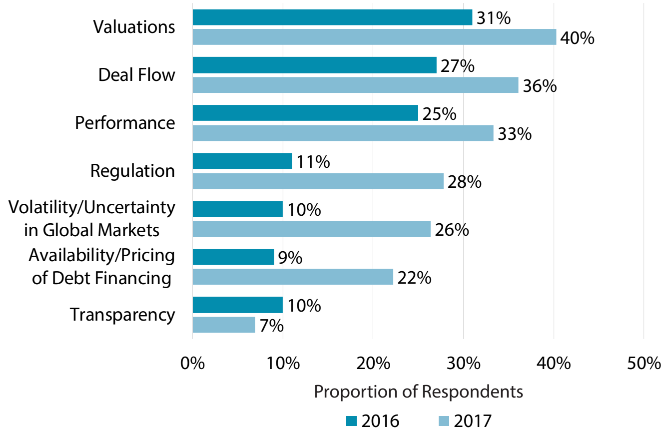
As more investors put capital into the private debt asset class over the next 12 months (Fig. 6.12), average investor allocations are also expected to increase notably: 62% of respondents plan to increase their allocations to private debt over the longer term, while just 8% plan to decrease their allocations (Fig. 6.14). Expansion of the capital pool is certainly a great sign for fund marketers, which may now see access to different investor types that have either not been able to or have chosen not to venture towards private debt funds in the past. Furthermore, the small proportion (8%) of investors

Fig. 6.12: Investors' Expected Capital Commitments to Private Debt Funds in the Next 12 Months Compared to the Previous 12 Months



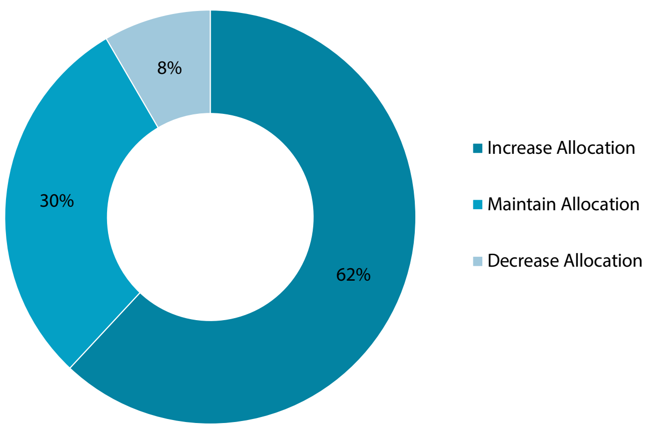
Source: Preqin Investor Interviews, December 2016

Fig. 6.13: Investor Views on the Key Issues Facing Private Debt in 2016 vs. 2017



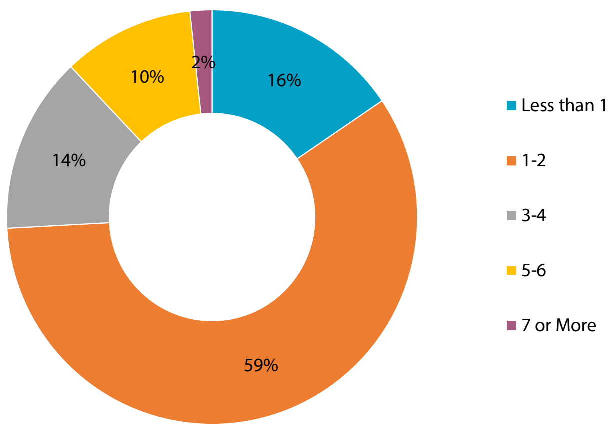
Source: Preqin Investor Interviews, December 2016

Fig. 6.14: Investors' Intentions for Their Private Debt Allocations over the Long Term



Source: Preqin Investor Interviews, December 2016

Fig. 6.15: Number of Private Debt Fund Commitments Investors Typically Make Each Year



Source: Preqin Investor Interviews, December 2016

planning to decrease their allocation is a useful gauge with which to measure the projections and confidence of institutional investors in relation to private debt fund commitments.

More than half (59%) of respondents typically make one or two private debt investments per year, and 26% commit to three or more (Fig. 6.15). The average investor commits to just over two private debt funds per year. However, almost a third (31%) of respondents now believe that it is harder to find attractive investment opportunities in private debt than it was a year ago, whereas only 9% claim that it is easier (Fig. 6.16).

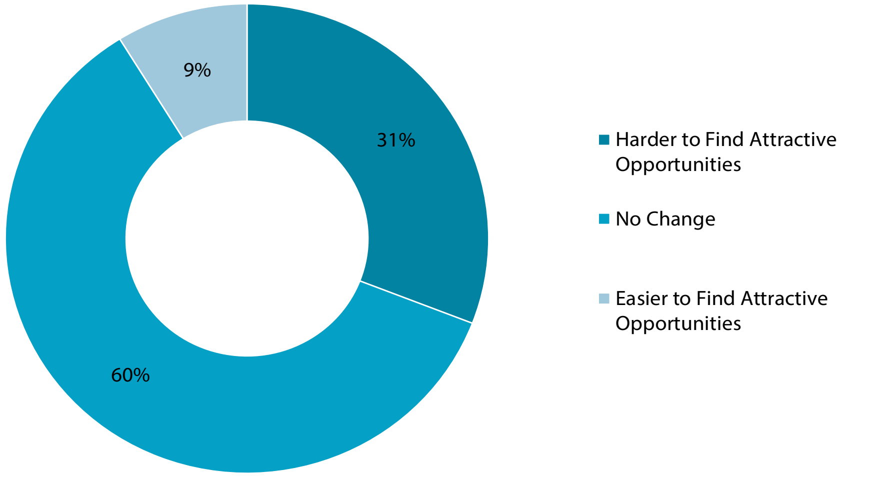
MACROECONOMIC FACTORS AFFECTING PRIVATE DEBT

The macroeconomic factors private debt investors are most concerned with for the year ahead are fairly consistent with the factors that they believe had the greatest impact on their portfolios over the past year. Unsurprisingly, the largest proportion (82%) of investors stated that low interest rates affected their portfolios the most in 2016 – 73% expect the same in 2017 (Fig. 6.17). The potential impact of central bank intervention (34%) and the US economy (32%) are also primary concerns for investors moving into the new year. Additionally, the Brexit vote remains a peripheral issue for investors, with just 8% expecting it to have a big impact on their private debt portfolios in 2017, compared with 16% that believe it impacted their portfolios in 2016.

OUTLOOK

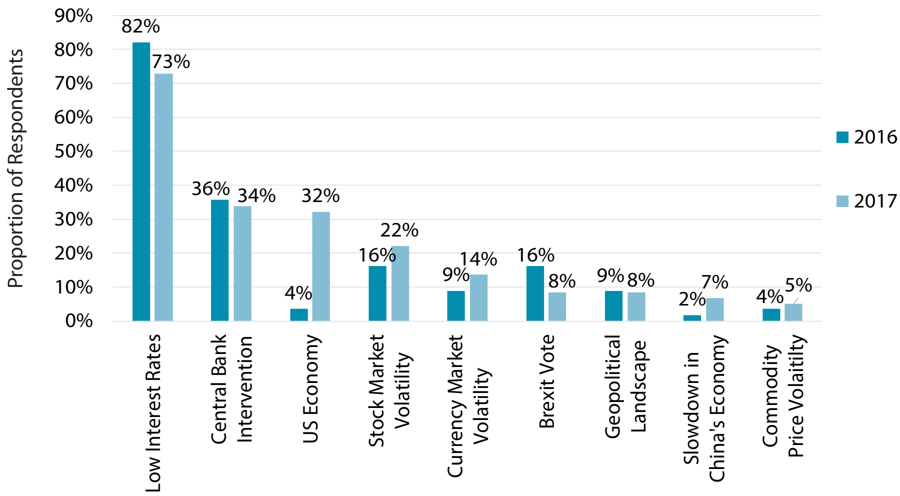
The past 12 months have displayed some encouraging results for the private debt industry. As for investor confidence, almost 3x as many surveyed investors now have more confidence in private debt (29%) than less confidence (10%). Furthermore, almost twice as many respondents believe that private debt will perform better in the coming year (19%) as those that believe it will perform worse (10%). This building confidence, along with the capital and allocation growth expected in the coming year, indicates a steadying market that still has growth potential – a promising combination for solid returns for investors and fund managers alike.

Fig. 6.16: Investor Views on the Difficulty of Identifying Attractive Investment Opportunities Compared to 12 Months Ago



Source: Preqin Investor Interviews, December 2016

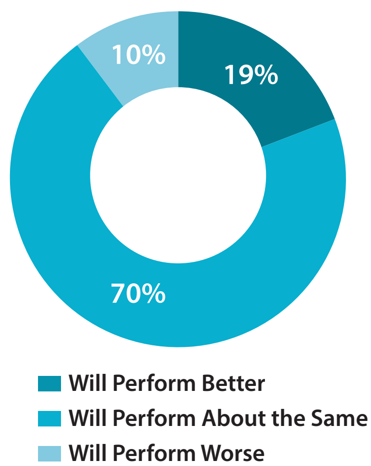
Fig. 6.17: Investor Views on the Macroeconomic Factors that Had the Biggest Impact on Their Private Debt Portfolios in 2016 vs. Predictions for 2017



Source: Preqin Investor Interviews, December 2016

INVESTORS' CHANGE IN CONFIDENCE IN PRIVATE DEBT OVER THE PAST 12 MONTHS

INVESTORS' PERFORMANCE EXPECTATIONS FOR PRIVATE DEBT IN 2017 COMPARED TO 2016



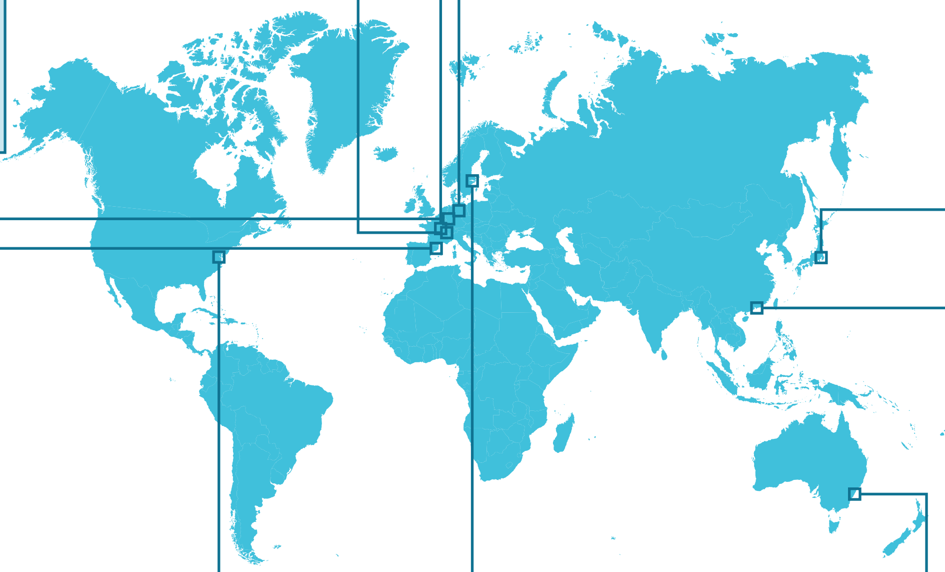
SAMPLE PRIVATE DEBT INVESTORS TO WATCH IN 2017

WOODMAN ASSET MANAGEMENT
Type: PD Fund of Funds Manager
Location: Zug, Switzerland
AUM: $2.6bn
Targeting direct lending, special situations and distressed debt vehicles, on a global scale.

CAISSE DE PENSIONS DE L'ÉTAT DE VAUD
Type: Public Pension Fund
Location: Lausanne, Switzerland
AUM: CHF 11bn ($11bn)
Will commit 10-20 CHF in the next 12 months, with a strong preference for private debt fund of funds vehicles on a global scale.

WEGA SUPPORT
Type: Family Office
Location: Munich, Germany
Considering investing in distressed, mezzanine, direct lending and special situations funds focused on Europe and North America.

HELABA INVEST
Type: Investment Company
Location: Frankfurt, Germany
AUM: €160bn ($168bn)
Seeking direct lending funds within Europe. The investment company typically commits up to €20mn per investment.



DIC CORPORATION PENSION FUND
Type: Private Sector Pension Fund
Location: Tokyo, Japan
AUM: JPY 117bn ($995mn)
Focusing on senior debt vehicles across the US and Europe.

TREA CAPITAL PARTNERS
Type: PE Fund of Funds Manager
Location: Barcelona, Spain
AUM: €41mn ($43mn)
Looking to commit €5mn to a Spain-focused direct lending fund in the next 12 months.

FTLIFE INSURANCE COMPANY
Type: Insurance Company
Location: Hong Kong
AUM: $3.0bn
Looking to make its maiden private debt commitment. Will consider opportunities globally, targeting USD-denominated funds.

WHITMAN COLLEGE ENDOWMENT
Type: Endowment Plan
Location: Walla Walla, Washington, US
AUM: $500mn
Will invest $25mn in one or two distressed debt funds in the next 12 months.

PRI PENSIONGARANTI
Type: Private Sector Pension Fund
Location: Stockholm, Sweden
AUM: SEK 3.0bn ($324mn)
Will invest SEK 25-50mn in up to two direct lending funds globally.

CHRISTIAN SUPER
Type: Superannuation Scheme
Location: Sydney, Australia
AUM: AUD 1.1bn ($832mn)
Will invest in mezzanine or distressed debt vehicles in the US market.

HOW INVESTORS SOURCE AND SELECT PRIVATE DEBT FUNDS

31% of investors are finding it harder to source attractive investment opportunities.

46% of investors believe marketing documents fail to meet their needs.

HOW INVESTORS SOURCE FUNDS:

20% Through internal investment team or consultant recommendations

31% Mainly internal or consultant recommendations, some external approaches

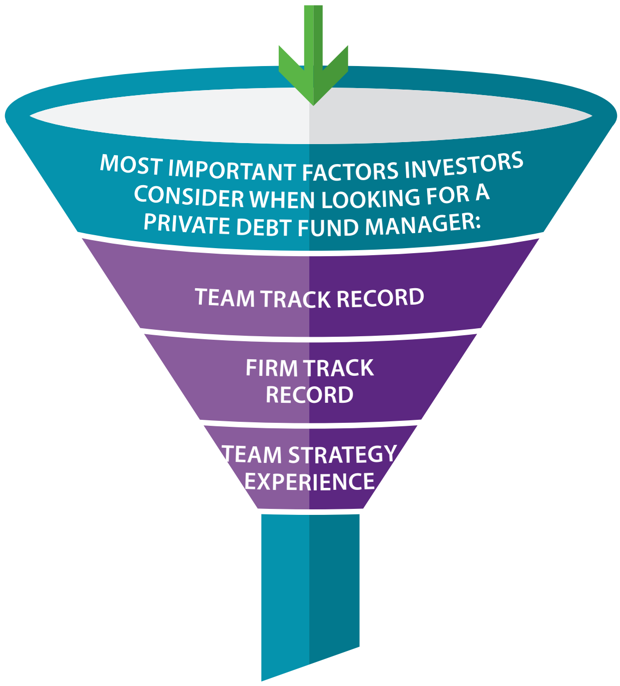
33% Mix of internal and external recommendations

13% Mainly approaches from GPs or marketers, some internal recommendations

3% Solely from external approaches

HOW INVESTORS SELECT FUNDS:

The average investor receives **84** fund proposals each year



52% of investors feel they get insufficient information on track record.

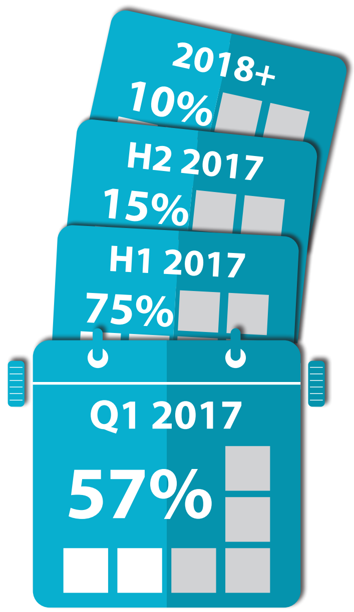
58% of investors feel they get insufficient information on the strategy of a fund.

KEY REASONS INVESTORS REJECT A GP:

- Below-average team track record
- Fees/terms
- Length of team track record

7% of proposals, on average, are sent through for a second round of screening.

INVESTORS' PLANS FOR THEIR NEXT FUND COMMITMENT:



The average investor makes **2** commitments to private debt funds each year.

SECTION SEVEN:
NATURAL RESOURCES

CRITICAL YEAR AHEAD FOR NATURAL RESOURCES

In December 2016, Preqin conducted interviews with over 130 institutional investors in natural resources to understand their views on the industry, including their satisfaction with investments, their future activity and the key issues affecting the asset class.

2016 has seen significant variations in commodity prices, an uncertain geopolitical outlook and growth concerns in major markets such as China, all of which have affected the returns from unlisted natural resources vehicles and been noticed by significant numbers of surveyed investors as a concern. Volatility/uncertainty in global markets and performance were both cited by the greatest number of respondents as the key issues that affected the natural resources asset class in 2016.

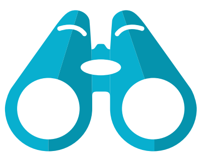
OPEC's decision to curb the supply of crude oil should help dampen the volatility witnessed in markets and may help natural resources fund managers to deploy capital over 2017. Fund managers seeking capital in the year ahead must be able to demonstrate strong performance over a difficult period for the industry. Those already on the road will find this challenging, considering many investors are not actively looking to increase their capital commitments in the short term. Unless performance improves, the industry could see a reduction in assets; a greater proportion of institutions interviewed are looking to reduce their allocation to the asset class in the long term than increase it.

While investors' perception of the industry improved slightly over the course of the year, natural resources still lags behind most other alternative asset classes in terms of investor satisfaction and the ability of investments to meet their expectations. If 2017 provides a more stable macroeconomic environment where fund managers can start to deliver sufficiently diversified, inflation-hedging returns, such as those that infrastructure funds have been capable of providing over the long term, then we could potentially see a significant improvement in sentiment and more commitments to natural resources funds in the future.

INVESTOR SATISFACTION

54%

of investors felt the performance of their natural resources portfolio fell short of expectations in 2016.



22%

of investors believe it is currently easier to find attractive opportunities than 12 months ago, the largest proportion among investors in all alternative asset classes tracked by Preqin.

FUTURE PLANS

26%

of investors will invest more capital in natural resources in 2017 than they did in 2016, compared to 22% that will invest less.

23%

of investors will reduce their natural resources allocation over the longer term, compared to 19% that will increase it.

EXPECTATIONS FOR 2017

35%

of investors believe their natural resources portfolios will perform better in 2017, while 21% believe they will perform worse.

41%

of investors believe volatility/uncertainty in global markets is the key issue in the natural resources industry for 2017 – an equal proportion believe performance is the key concern.

SATISFACTION WITH NATURAL RESOURCES

The natural resources asset class has faced sustained challenges over recent years, the repercussions of which have been felt by institutional investors allocating to the asset class.

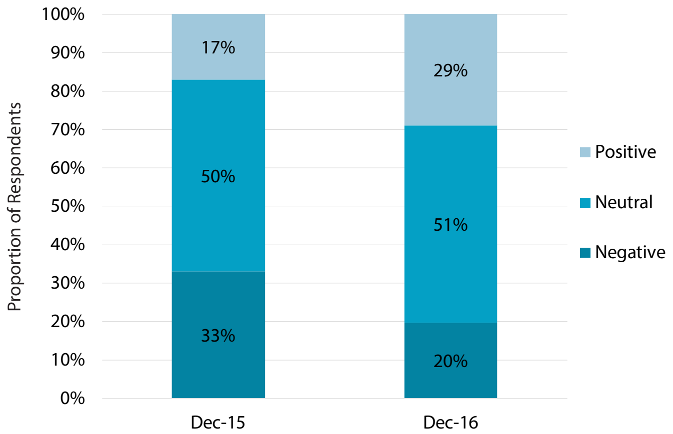
A fifth of surveyed investors have a negative view of the asset class at present – the second largest proportion among all alternatives – albeit this represents an improvement on 33% of investors at the end of 2015 (Fig. 7.1). Correspondingly, there has been a rise in the proportion of investors with a positive view of natural resources, up from 17% in December 2015 to 29% at the end of 2016.

Despite this improvement in the perception of the asset class, the majority (54%) of investors surveyed felt the performance of their natural resources portfolios had fallen short of their expectations over the past year – only 10% saw their expectations exceeded (Fig. 7.2). Of all alternative asset classes tracked by Preqin, only hedge fund investors (66%) were more disappointed with their investments.

Despite improved perception of and satisfaction with natural resources over the past 12 months, investors are concerned over the potential impact of commodity market volatility and the fall in oil prices on their natural resources portfolios; nearly two-thirds of surveyed investors felt that the performance of their natural resources investments over the past three years had fallen short of expectations, although a third found that investments had met expectations.

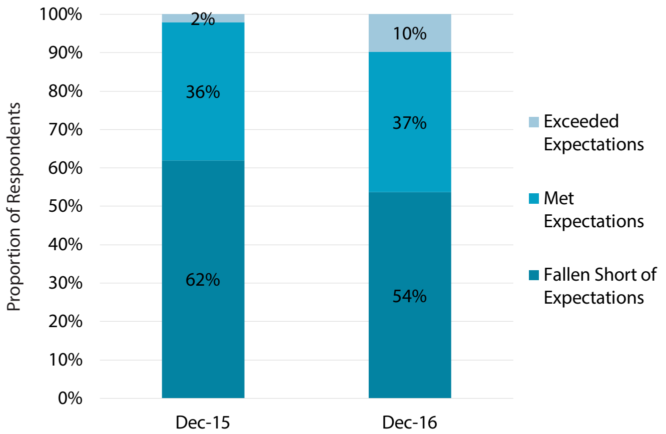
Unless performance improves, the industry could see a reduction in assets – a greater proportion of institutions surveyed are looking to reduce (23%) their allocation to the asset class over the long term than increase it (19%, Fig. 7.4).

Fig. 7.1: Investors' General Perception of the Natural Resources Industry, 2015 vs. 2016



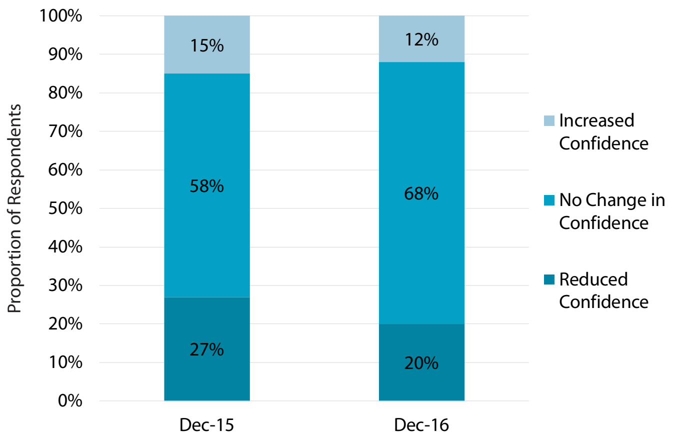
Source: Preqin Investor Interviews, December 2015 - December 2016

Fig. 7.2: Investor Views on Natural Resources Portfolio Performance over the Past 12 Months Relative to Expectations, 2015 vs. 2016



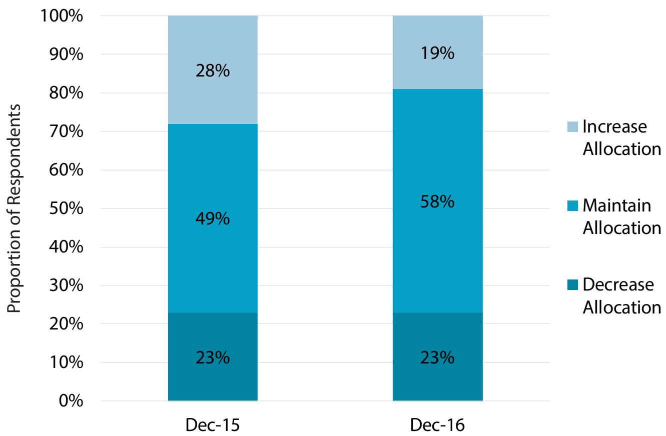
Source: Preqin Investor Interviews, December 2015 - December 2016

Fig. 7.3: Investors' Change in Confidence in the Ability of Natural Resources to Achieve Portfolio Objectives in the Past 12 Months, 2015 vs. 2016



Source: Preqin Investor Interviews, December 2015 - December 2016

Fig. 7.4: Investors' Intentions for Their Natural Resources Allocations over the Long Term, 2015 vs. 2016



Source: Preqin Investor Interviews, December 2015 - December 2016

KEY ISSUES IN 2017

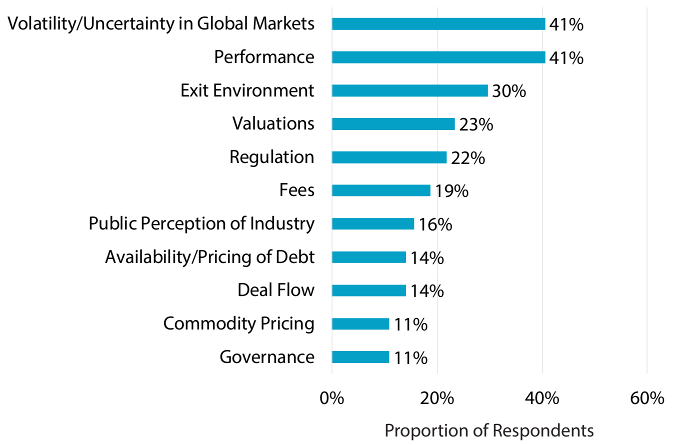
With significant shocks to commodity markets in recent years, as well as challenging geopolitical conditions, 41% of surveyed investors cited volatility/uncertainty in global markets as the key issue for the asset class in 2017 (Fig. 7.5). Correlated to this has been the underperformance of unlisted natural resources vehicles in the last two years, and therefore an equal proportion of surveyed investors stated that performance is a key concern.

Valuations – the biggest concern among private equity, real estate, infrastructure and private debt investors – was cited by only 23% of natural resources investors. With some natural resources assets struggling in the current environment, there are those that investors feel managers can acquire at relatively cheap prices, namely metals & mining, energy and water assets (Fig. 7.6). However, the majority of investors across each strategy feel assets are appropriately priced.

As discussed, commodity price volatility had a major impact on natural resources portfolios: 77% of respondents cited it as the macroeconomic factor that had the largest impact on their portfolios in 2016 (Fig. 7.7). Furthermore, the same proportion believe that price volatility will have the biggest impact in 2017.

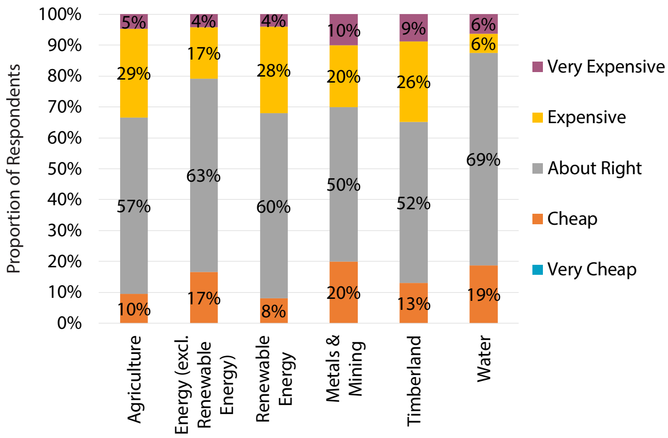
However, investors are not in agreement as to whether this volatility will have a positive or negative effect, illustrating the general uncertainty surrounding the natural resources asset class. A third of surveyed investors believe that managers may be able to capture the upside in the year ahead, although 28% believe it will negatively impact portfolios, as it has done in prior years (Fig. 7.8).

Fig. 7.5: Investor Views on the Key Issues Facing Natural Resources in 2017



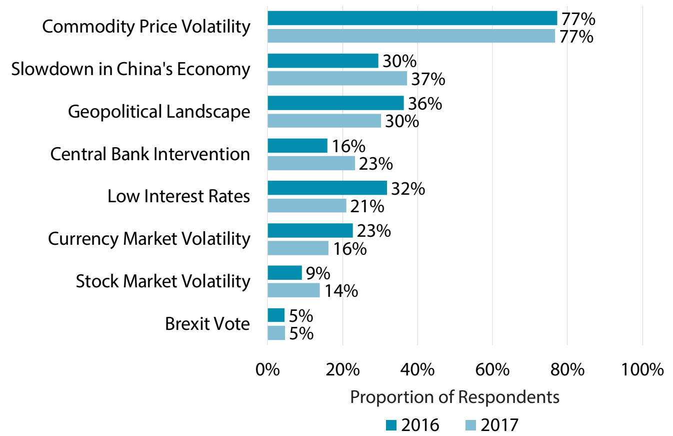
Source: Preqin Investor Interviews, December 2016

Fig. 7.6: Investor Views on the Pricing of Natural Resources Assets by Strategy



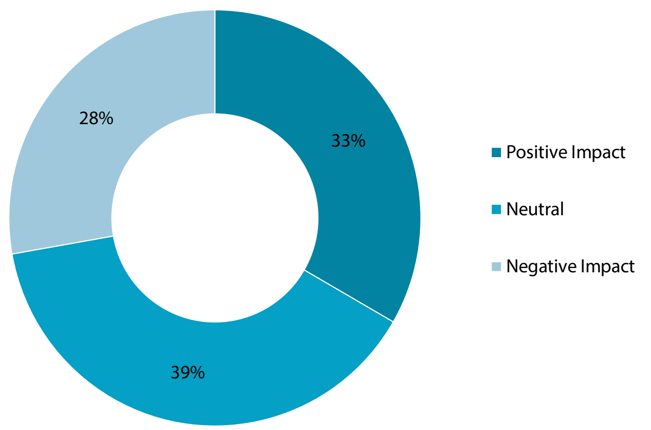
Source: Preqin Investor Interviews, December 2016

Fig. 7.7: Investor Views on the Macroeconomic Factors that Had the Biggest Impact on Their Natural Resources Portfolios in 2016 vs. Predictions for 2017



Source: Preqin Investor Interviews, December 2016

Fig. 7.8: Investor Views on the Impact of Commodity Prices on Their Natural Resources Portfolios over 2017



Source: Preqin Investor Interviews, December 2016

INVESTOR ACTIVITY IN 2017

It appears surveyed investors are taking a wait-and-see approach towards investment in natural resources funds over 2017. Just over half are planning to commit the same amount in 2017 as they did in 2016, while relatively even proportions will invest more than they did the previous year (26%) as will invest less (22%, Fig. 7.9).

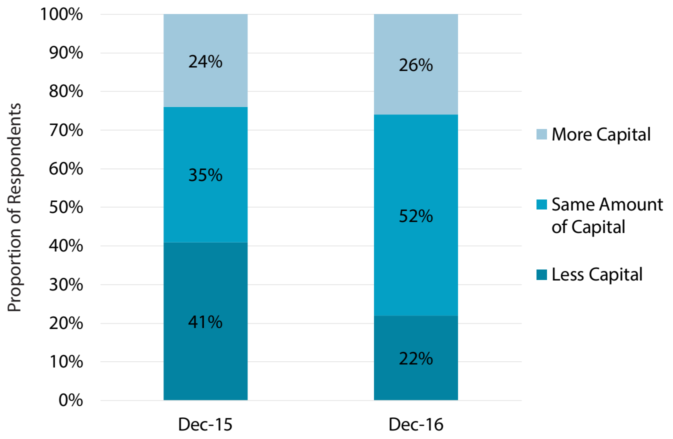
> ***"Investors are taking a wait-and-see approach in 2017***

INVESTOR PREFERENCES

Active natural resources investors will predominantly seek exposure to the asset class through unlisted funds (86%, Fig. 7.10), a reflection of the relative youth of the industry. Nearly half (49%) of active investors will seek investments globally in the year ahead (Fig. 7.11). With regards to specific regions, traditional markets are favoured for investment in 2017: 42% and 40% of fund searches issued target North America and Europe respectively, compared with 19% of investors seeking Asia-Pacific-focused funds and 6% targeting all other regions.

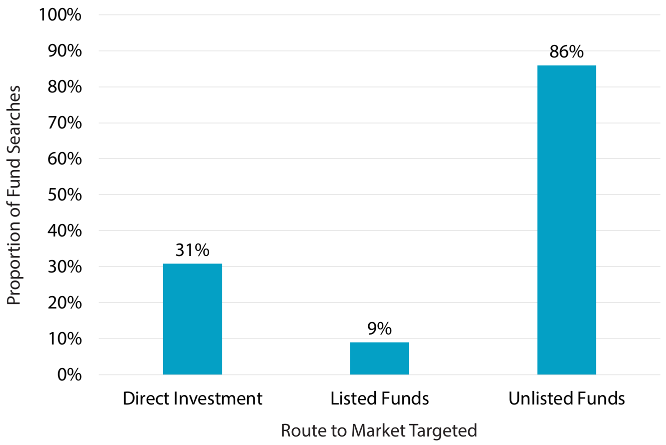
As expected, energy funds are sought by the largest proportion (88%) of active natural resources investors (Fig. 7.12), with other strategies registering interest from 20-25% of the active investor population. Of the active energy investors, the vast majority (88%) seek exposure to renewable energy, with only 28% targeting natural gas investments and 23% seeking exposure to oil investments.

Fig. 7.9: Investors' Expected Capital Commitments to Natural Resources Funds in the Next 12 Months Compared to the Previous 12 Months, 2015 vs. 2016



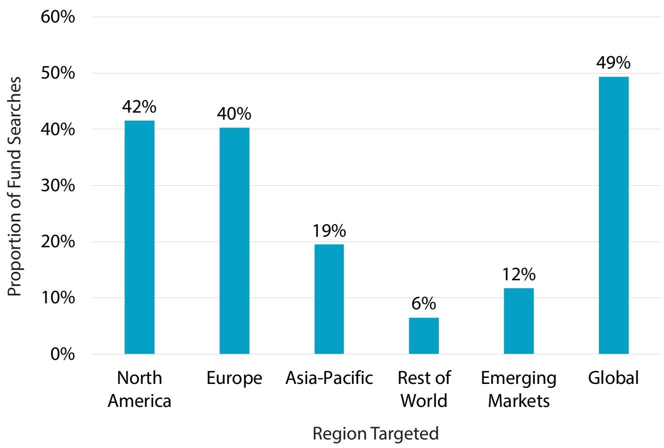
Source: Preqin Investor Interviews, December 2015 - December 2016

Fig. 7.10: Routes to Market Targeted in the Next 12 Months by Natural Resources Investors



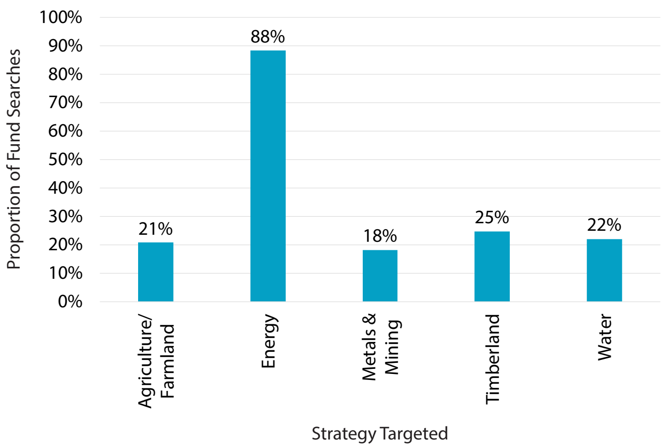
Source: Preqin Natural Resources Online

Fig. 7.11: Regions Targeted in the Next 12 Months by Natural Resources Investors



Source: Preqin Natural Resources Online

Fig. 7.12: Strategies Targeted in the Next 12 Months by Natural Resources Investors



Source: Preqin Natural Resources Online

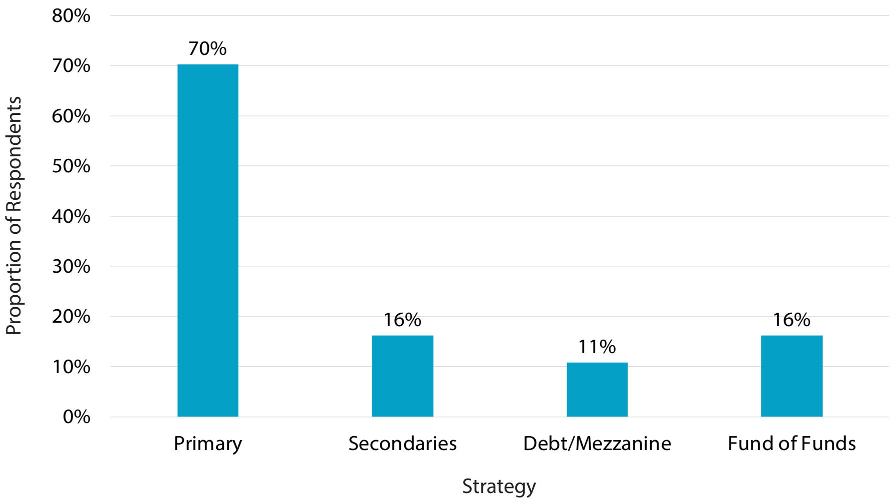
STRATEGIES AND GEOGRAPHIES TARGETED

STRATEGIES

Institutional investors in natural resources were asked about where they felt the best opportunities were in the asset class in the coming year. Due to the relative youth of the unlisted natural resources industry as a distinct asset class, primary unlisted fund commitments remain the predominant method for gaining exposure to the industry. As such, the majority (70%) of surveyed investors see primary vehicles as providing the best opportunities (Fig. 7.13).

While debt/mezzanine funds have grown out of private equity to form a separate asset class in its own right, real estate and infrastructure debt funds, and to a lesser extent natural resources, have only recently started to emerge. Only 11% of respondents feel these vehicles are presenting the best opportunities at present.

Fig. 7.13: Strategies* that Investors View as Presenting the Best Opportunities



Source: Preqin Investor Interviews, December 2016

SECTORS

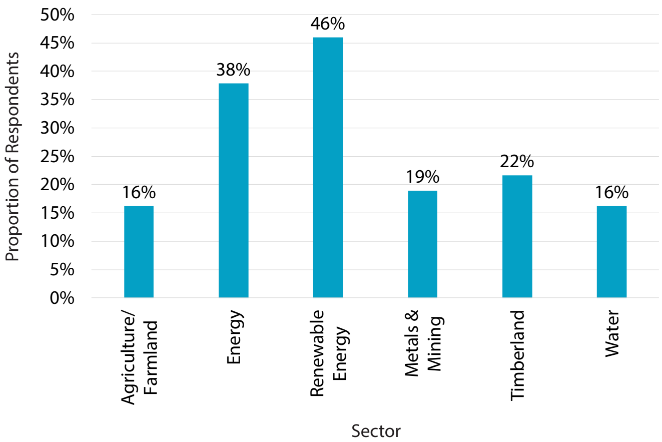
As the largest natural resources market by a long way, energy will continue to play an important role in the portfolios of natural resources investors. Thirty-eight percent of respondents believe energy funds will present the best opportunities in the coming months; however, the lack of detail on crude oil production limits, the relatively recent oil price decline and the ongoing trend towards clean sources of energy mean that the largest proportion of institutional investors surveyed believe that a subset of the energy industry – renewables – presents the best opportunities (Fig. 7.14).

Beyond energy and renewable energy investment, 22% of institutions believe timberland-focused funds are presenting the best opportunities, just ahead of metals & mining (19%), water (16%) and agriculture/farmland-focused funds (16%).

REGIONS

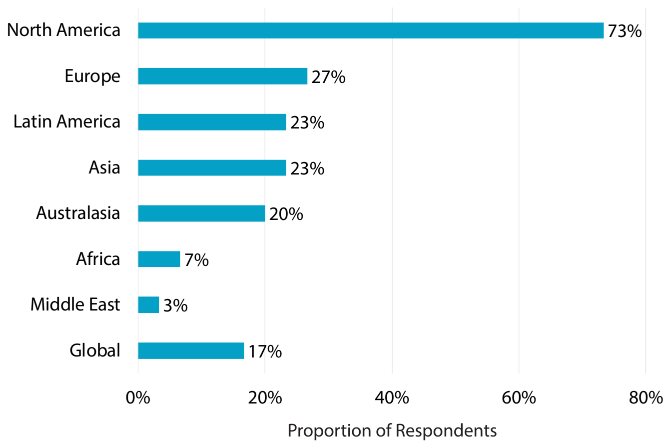
There is a clear consensus among natural resources investors that the best opportunities are found in North America (73%, Fig. 7.15). Investors' preference for North America may stem from Trump's campaign plan to invest in the US energy industry, which may provide opportunities for managers looking for projects. While Europe is seen as the next most promising region, it is not too far ahead of Latin America, Asia and Australasia.

Fig. 7.14: Sectors* Investors View as Presenting the Best Opportunities



Source: Preqin Investor Interviews, December 2016

Fig. 7.15: Regions* Investors View as Presenting the Best Opportunities



Source: Preqin Investor Interviews, December 2016

Respondents were not prompted to give their opinion on each strategy/sector/region individually but to name those they felt best fit these categories; therefore, the results display the strategies/sectors/regions at the forefront of investors' minds at the time of the survey.

SAMPLE NATURAL RESOURCES INVESTORS TO WATCH IN 2017

ENVIRONMENT AGENCY PENSION FUNDS
Type: Public Pension Fund
Location: Bristol, UK
AUM: £3.1bn
Current/Target Allocation to NR: 1%/2%
Considering further investment as it aims to meet its 2% target, investing in timberland, energy and agriculture funds on a global scale.

PFA PENSION
Type: Insurance Company
Location: Copenhagen, Denmark
AUM: DKK 587bn
Looking to invest DKK 37bn (€5bn) over the next five years in order to reach its 10% alternatives target, focusing on renewable energy and infrastructure assets.

MERCER PRIVATE MARKETS
Type: Infrastructure Fund of Funds Manager
Location: Zurich, Switzerland
AUM: $21.8bn
Seeking Asia- and North America-focused water and energy investments.

SWEDBANK PENSION
Type: Private Sector Pension Fund
Location: Tallinn, Estonia
AUM: €700mn
Targeting a timberland fund as an inflation hedge against traditional investments. Has a preference for domestic investments.

3SISTERS SUSTAINABLE MANAGEMENT
Type: Real Assets Fund of Funds Manager
Location: Philadelphia, US
AUM: $33mn
Targeting agriculture, energy and water-related vehicles on a global basis.

SHINKIN CENTRAL BANK
Type: Bank
Location: Tokyo, Japan
AUM: JPY 34.6tn
Considering investment in developed markets-focused unlisted natural resources funds through its private equity allocation.

SACRAMENTO COUNTY EMPLOYEES' RETIREMENT SYSTEM
Type: Public Pension Fund
Location: Sacramento, US
AUM: $7.7bn
Current Allocation to NR: 0.6%
Looking to commit to 3-6 unlisted real assets funds globally, which include infrastructure and natural resources vehicles.

HYUNDAI MARINE & FIRE INSURANCE
Type: Insurance Company
Location: Seoul, South Korea
AUM: KRW 30tn
Investing both directly and through unlisted funds in renewable energy assets in developed markets that include North America, Australia and Europe.

TEXAS TECH UNIVERSITY SYSTEM ENDOWMENT
Type: Endowment Plan
Location: Lubbock, US
AUM: $1.1bn
Current/Target Allocation to NR: 10%/10%
Not targeting a specific strategy but has previously shown a preference for energy- and metals & mining-focused funds.

PARAGON OUTCOMES MANAGEMENT
Type: Wealth Manager
Location: New York, US
AUM: $1.1bn
Plans to invest in global-focused real asset funds targeting power and energy assets.

COMPAGNIA DI SAN PAOLO
Type: Foundation
Location: Turin, Italy
AUM: €6.5bn
Current Allocation to NR: 1.5%
Will target agriculture, energy, metals & mining, timberland and water investments globally, typically through unlisted equity vehicles.

CHRISTIAN SUPER
Type: Superannuation Scheme
Location: Sydney, Australia
AUM: AUD 1.1bn
Will invest domestically and internationally in a wide range of natural resources sectors.

HOW INVESTORS SOURCE AND SELECT NATURAL RESOURCES FUNDS

20%
of investors are finding it harder to source attractive investment opportunities.

46%
of investors believe marketing documents fail to meet their needs.

HOW INVESTORS SOURCE FUNDS:

22%
Through internal investment team

31%
Mainly internal or consultant recommendations, some external approaches

27%
Mix of internal and external recommendations

18%
Mainly approaches from GPs or marketers, some internal recommendations

2%
Solely from external approaches

HOW INVESTORS SELECT FUNDS:

The average investor receives
161
fund proposals each year

50%
of investors feel they get insufficient information on track record.

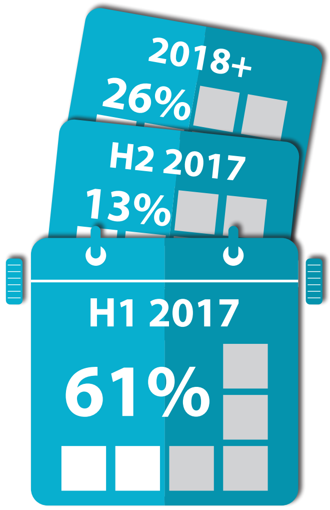
48%
of investors feel they get insufficient information on the strategy of a fund.

KEY REASONS INVESTORS REJECT A GP:

- Below-average team track record
- Length of team track record
- Fees/terms

8%
of proposals, on average, are sent through for a second round of screening.

INVESTORS' PLANS FOR THEIR NEXT FUND COMMITMENT:



The average investor makes
2
commitments to natural resources funds each year.

PREQIN INVESTOR OUTLOOK: ALTERNATIVE ASSETS

H1 2017

PREQIN

Alternative Assets Data & Intelligence

Preqin provides information, products and services to fund managers, investors, consultants and service providers across six main areas:

- **Investors** – Allocations, Strategies/Plans and Current Portfolios
- **Fund Managers** – Funds, Strategies and Track Records
- **Funds** – Fundraising, Performance and Terms & Conditions
- **Deals/Exits** – Portfolio Companies, Participants and Financials
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