PREQIN
INVESTOR OUTLOOK: INFRASTRUCTURE
H1 2018

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STRONG INVESTOR APPETITE CONTINUES

In December 2017, Preqin surveyed over 80 institutional investors actively committing to the infrastructure asset class to gauge their thoughts on the market and their appetite for investment opportunities in 2018.

High levels of capital distributions over the past two years, coupled with strong risk-adjusted returns, have left investors more than satisfied with the asset class. Ninety-three percent of respondents stated that the performance of their infrastructure investments had met or exceeded their expectations in the past 12 months, up from 77% and 89% of survey respondents in 2015 and 2016 respectively. With distributions high, investors have significant capital left to re-invest; it is therefore unsurprising to find that 39% of respondents expect to invest more capital in infrastructure over the next 12 months than in the previous year.

However, despite positive sentiment and continued growth in appetite for infrastructure investment, investors have identified key challenges facing the market that GPs should be aware of and address to ensure a successful fundraise. Increased participation in the asset class has created a competitive deal environment and pushed up prices for infrastructure assets, with 60% of investors surveyed citing asset pricing as a key issue for the industry in 2018. High prices may potentially eat into the eventual returns investors see from their infrastructure portfolios. Furthermore, investors face the challenge of identifying GPs that can achieve the best returns at an acceptable level of risk within a fiercely competitive fundraising market.

The majority (67%) of investors are under-allocated to the asset class as at January 2018, which makes it likely that GPs' strong fundraising efforts will continue. However, the influx of capital to the asset class has contributed to elevated dry powder levels and is likely to result in increased competition among GPs for attractive investment opportunities.

INVESTOR APPETITE

93%

of investors surveyed felt that their infrastructure investments met or exceeded expectations in 2017.

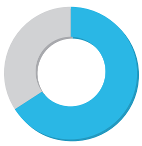
60%

of respondents identified valuations as they key issue for the infrastructure market in 2018.

39%

of investors expect to commit more capital to infrastructure funds in the next 12 months compared to the previous year.

MAKE-UP OF INVESTORS



66%

of investors have less than $10bn in assets under management.

$139bn

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

$24.8bn

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

EVOLUTION OF INVESTORS

4.1%

Investors' average current allocation to infrastructure, below the average target allocation of 5.6%.

67%

of investors are below their target allocation to infrastructure.

45%

of investors will not invest in first-time funds, the joint largest proportion in the period 2013-2018.

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SATISFACTION WITH INFRASTRUCTURE

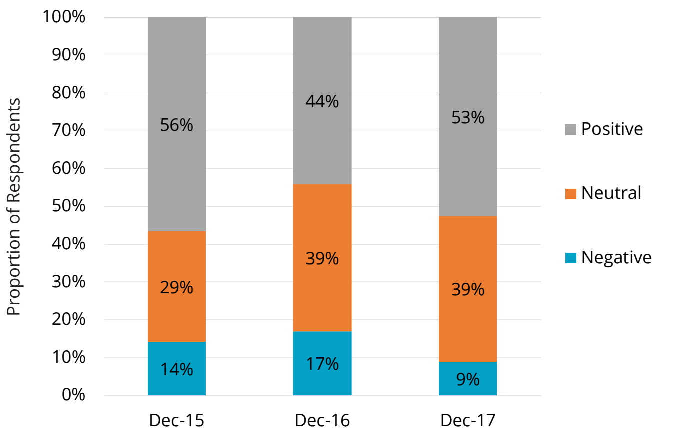
The majority (53%) of surveyed investors have a positive perception of the asset class – up from 44% in 2016 – and, correspondingly, fewer investors have a negative perception of infrastructure investment (Fig. 6.1). This is likely due to strong performance within the asset class in recent years, with funds of vintage 2009 onwards consistently generating median net IRRs around the 10% mark.

As shown in Fig. 6.2, 93% 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 7% (vs. 23% in 2015).

As at the end of 2017, 73% of investors reported no change in their level of confidence in infrastructure to achieve portfolio objectives over the past year – this is a greater proportion than 68% in December 2016 (Fig. 6.3). Likewise, a smaller proportion (12%) reported that their confidence in the asset class diminished over the year. Such views are likely a reflection of the sustained growth within the industry, as well as the ability of the asset class to achieve strong risk-adjusted returns.

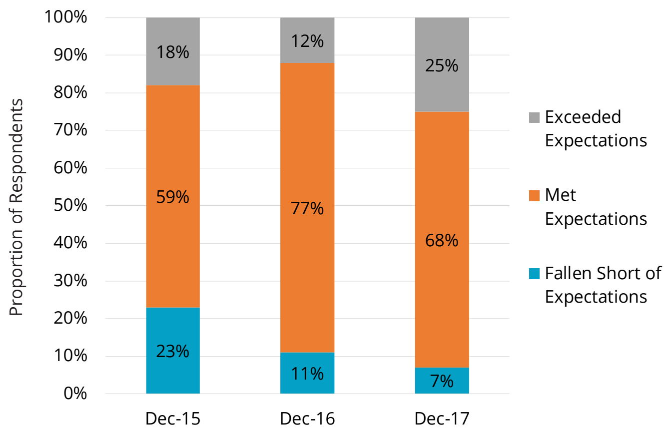
Fig. 6.4 shows that over the longer term, institutions remain committed to the asset class, with 55% of surveyed investors looking to increase their level of exposure and a further 41% planning to maintain their allocation to infrastructure. The fact that only 4% are likely to reduce allocations in the long term is indicative of investors' confidence in the asset class to meet portfolio objectives.

Fig. 6.1: Investors' General Perception of the Infrastructure Industry, 2015 - 2017



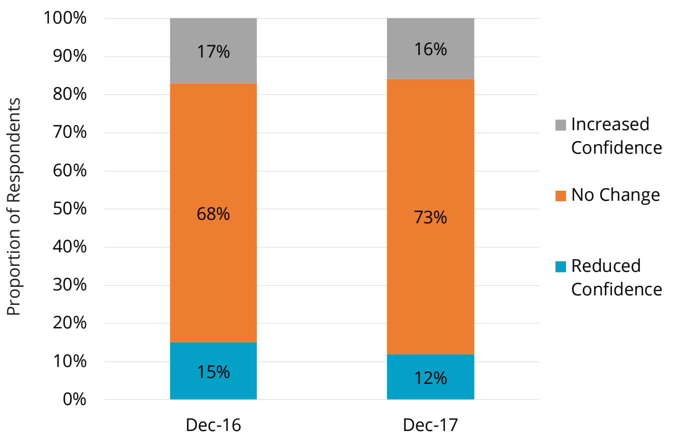
Source: Preqin Investor Interviews, December 2015 - 2017

Fig. 6.2: Extent to Which Investors Feel Their Infrastructure Fund Investments Have Lived up to Expectations over the Past 12 Months, 2015 - 2017



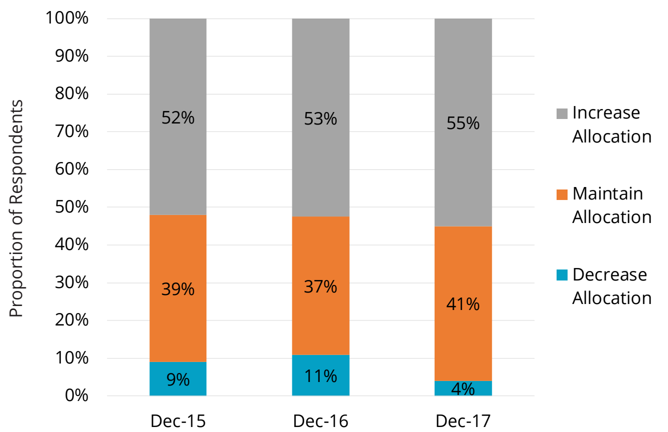
Source: Preqin Investor Interviews, December 2015 - 2017

Fig. 6.3: Investors' Change in Confidence in the Ability of Infrastructure to Achieve Portfolio Objectives over the Past 12 Months, 2016 vs. 2017



Source: Preqin Investor Interviews, December 2016 - 2017

Fig. 6.4: Investors' Intentions for Their Infrastructure Allocations in the Longer Term, 2015 - 2017



Source: Preqin Investor Interviews, December 2015 - 2017

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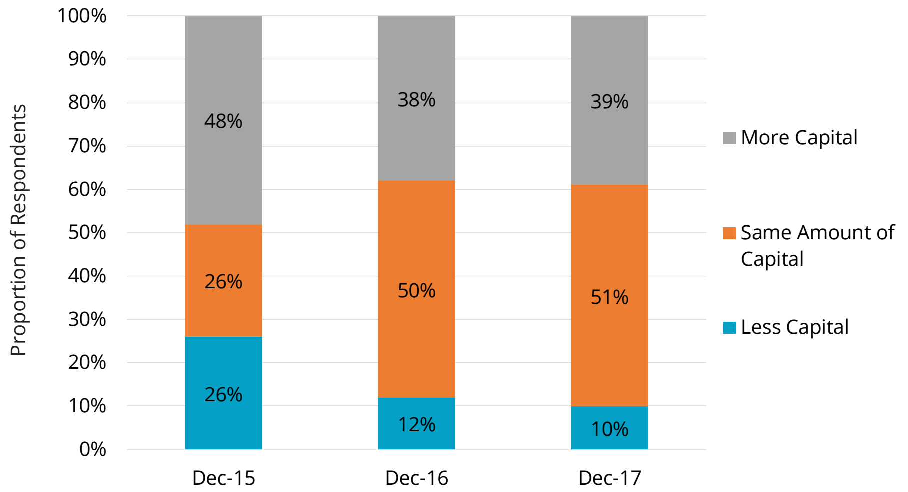
INVESTOR ACTIVITY IN 2018

Elevated amounts of capital distributed to investors in the past two years mean investors have significant amounts of capital left to re-invest and, with a high level of satisfaction in the asset class, are likely to make further commitments to infrastructure funds in the coming year. This is closely aligned with 39% of survey respondents expecting to invest more capital in the asset class over the next 12 months compared to the previous year (Fig. 6.5).

Fig. 6.5: Investors' Expected Capital Commitments to Infrastructure Funds in the Next 12 Months Compared to the Previous 12 Months, 2015 - 2017



Source: Preqin Investor Interviews, December 2015 - 2017

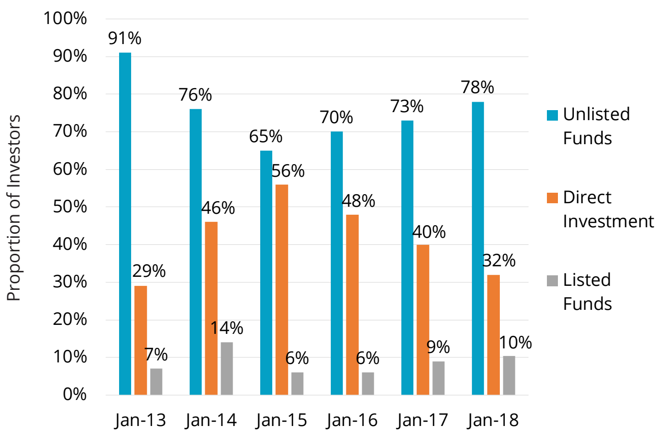
ROUTE TO MARKET

Unlisted funds remain the preferred route to market for infrastructure investors planning to invest in the asset class in the next 12 months, with the proportion of investors accessing the market via unlisted vehicles steadily rising since January 2015 (Fig. 6.6). The proportion of investors looking to make direct investments has decreased over the same period. The influx of new investors to the infrastructure asset class, as well as the resources and expertise investors need to successfully execute direct investment transactions internally, may explain the change over time. The proportion of investors that prefer listed infrastructure vehicles has steadily risen since January 2016, as the market continues to grow and investors recognize the benefits of holding investments in a more liquid format with typically smaller ticket sizes and more diverse industry exposure.

APPETITE FOR ALTERNATIVE STRUCTURES

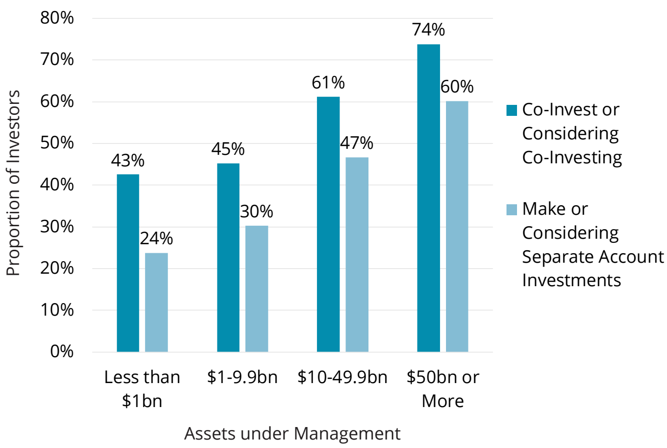
Investor appetite for alternative routes to market has been driven by many factors, including a desire for more control over their exposure and a more customizable fee structure. Twenty-eight percent of infrastructure investors look to utilize separate accounts, with a further 10% considering such structures, compared to 40% and 13% respectively that look to co-invest alongside GPs. There is a discernible correlation between investor AUM and the use of alternative investment methods: 60% of investors with at least $50bn in AUM make or consider separate account investments (Fig. 6.7), while 74% of investors with $50bn or more in AUM co-invest or are considering such opportunities, which reflects the less restrictive nature of such structures in terms of the capital outlay required compared to separate accounts.

Fig. 6.6: Preferred Route to Market of Infrastructure Investors Searching for New Investments in the Next 12 Months, 2013 - 2018



Source: Preqin Infrastructure Online

Fig. 6.7: Investor Appetite for Infrastructure Separate Accounts and Co-Investment Opportunities by Assets under Management



Source: Preqin Infrastructure Online

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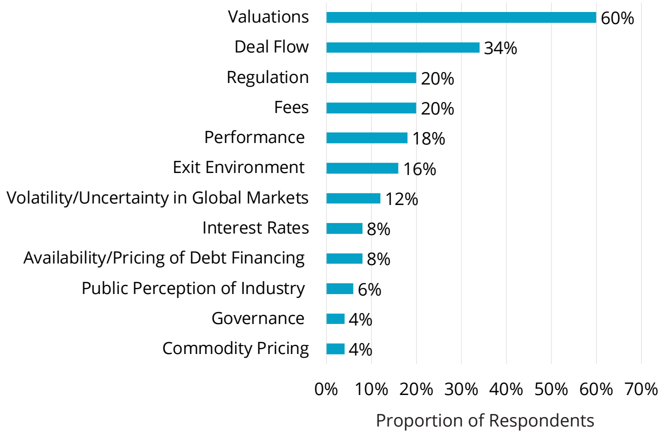
KEY ISSUES IN 2018

Participation in the asset class from strategic and institutional investors has increased over the past decade. While the proportion of investors employing direct investment strategies has declined slightly in recent years, they remain an important component of many institutions' overall investment strategy. Coupled with the large sums of capital raised by fund managers, this has made the infrastructure market more competitive. It is therefore unsurprising to find that the largest proportion (60%) of infrastructure investors interviewed have cited their key concern for the year ahead as the pricing of assets (Fig. 6.8). Deal flow is also a key issue on investors' minds, with high valuations affecting managers' ability to put capital to work.

While 37% of investors believe that infrastructure assets are fairly priced in the current market cycle, 59% feel they have been overvalued – although this includes 39% that feel a correction in the valuations of these assets is over a year away (Fig. 6.9). Growing investor appetite has led to fund managers having a record amount of dry powder to deploy. Furthermore, with plenty of capital and resources at their disposal, direct investment from sovereign wealth funds has resulted in a significant rise in asset prices. Among investors interviewed, 48% found it more difficult to identify attractive fund opportunities in 2017 than in 2016 (Fig. 6.10).

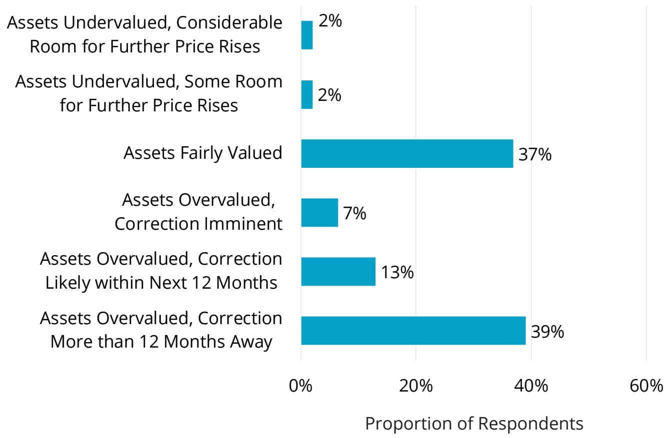
Seventy-two percent of surveyed investors felt that the current low interest rate environment affected their portfolios in the past year, while 39% expect it to impact upon their investments in the next year (Fig. 6.11). While only a quarter of respondents felt the prospect of rising interest rates impacted upon their portfolios, the largest proportion (49%) expect it to have the biggest impact in the next year.

Fig. 6.8: Investor Views on the Key Issues for Infrastructure in 2018



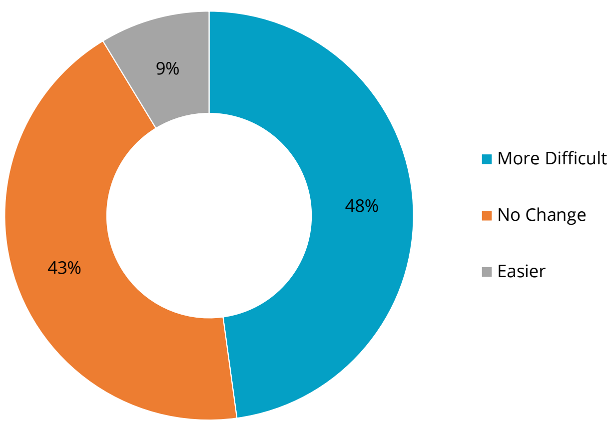
Source: Preqin Investor Interviews, December 2017

Fig. 6.9: Investor Views on Where Infrastructure Is in the Current Market Cycle



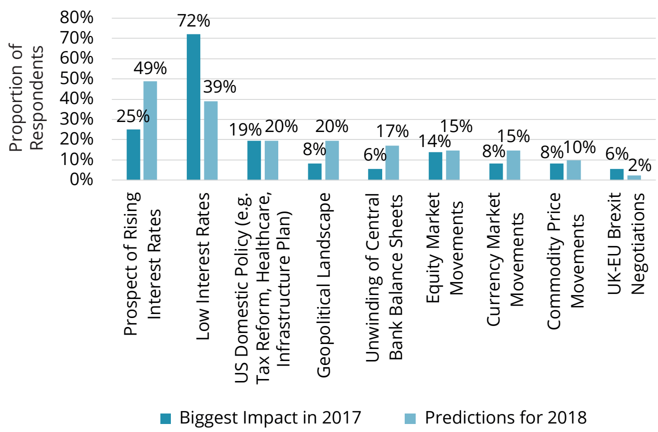
Source: Preqin Investor Interviews, December 2017

Fig. 6.10: Investor Views on the Difficulty of Finding Attractive Investment Opportunities Compared to 12 Months Ago



Source: Preqin Investor Interviews, December 2017

Fig. 6.11: Investor Views on the Macroeconomic Factors that Had the Biggest Impact on Their Infrastructure Portfolios in 2017 vs. Predictions for 2018



Source: Preqin Infrastructure Online

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STRATEGIES AND GEOGRAPHIES TARGETED

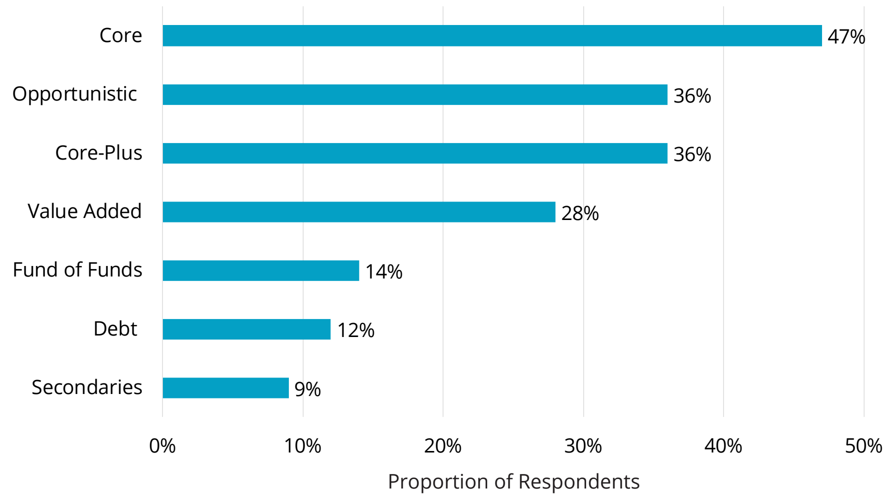
STRATEGIES

Despite the high levels of competition for mature assets, 47% and 36% of investors respectively believe core and core-plus strategies currently present the most attractive opportunities (Fig. 6.12). With 66% of respondents favouring brownfield projects, the demand reflects the stable cash flows generated from such assets. Investors also look favourably on higher-risk opportunistic (36%) and value added (28%) strategies, which may be due to heavy competition for core infrastructure assets.

SECTORS

The largest proportions of investors believe the conventional energy and renewable energy sectors currently present the most attractive opportunities (49% and 46% respectively, Fig. 6.13). Such interest in renewable energy investments reflects a growing number of investors that seek to take advantage of the opportunities created by technological improvements and falling costs in the sector. To meet this demand, investment in energy-related projects, technology and companies will increase in both the conventional and renewable energy markets, creating opportunities for fund managers searching for attractive assets and investors looking to deploy capital.

Fig. 6.12: Strategies that Investors View as Presenting the Best Opportunities



Source: Preqin Investor Interviews, December 2017

REGIONS

Fig. 6.14 shows that over two-thirds (69%) of respondents believe North America presents the most compelling opportunities, while 47% favour Europe, reflecting the large amount of capital sought by funds in market that are primarily targeting these regions. As competition for assets in established markets intensifies, resulting in higher valuations, investors may seek more affordable opportunities in markets elsewhere – at least a quarter of respondents favour Asia and emerging markets.

AGGREGATE CAPITAL RAISED BY UNLISTED INFRASTRUCTURE FUNDS CLOSED IN 2017 BY PRIMARY GEOGRAPHIC FOCUS

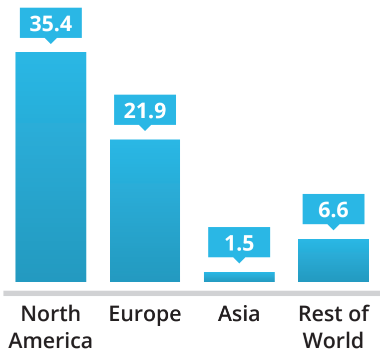
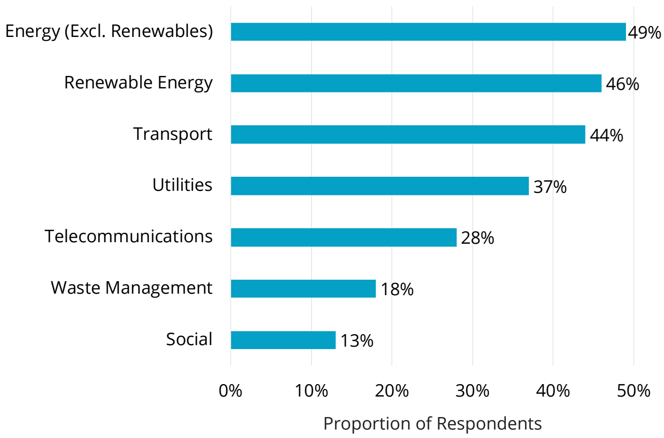
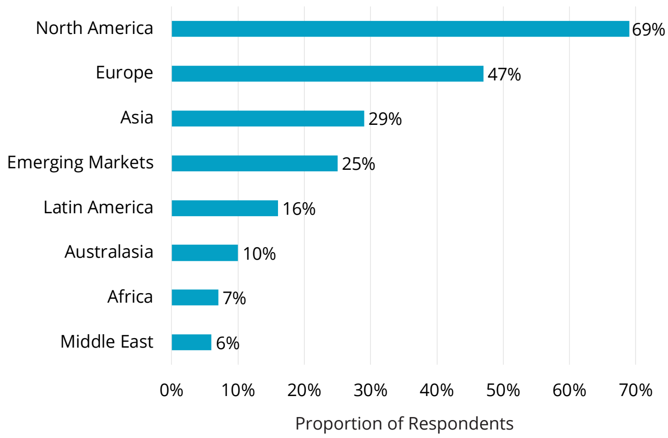


Fig. 6.13: Sectors that Investors View as Presenting the Best Opportunities



Source: Preqin Investor Interviews, December 2017

Fig. 6.14: Regions that Investors View as Presenting the Best Opportunities



Source: Preqin Investor Interviews, December 2017

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FUND TERMS AND ALIGNMENT OF INTERESTS

ALIGNMENT OF INTERESTS

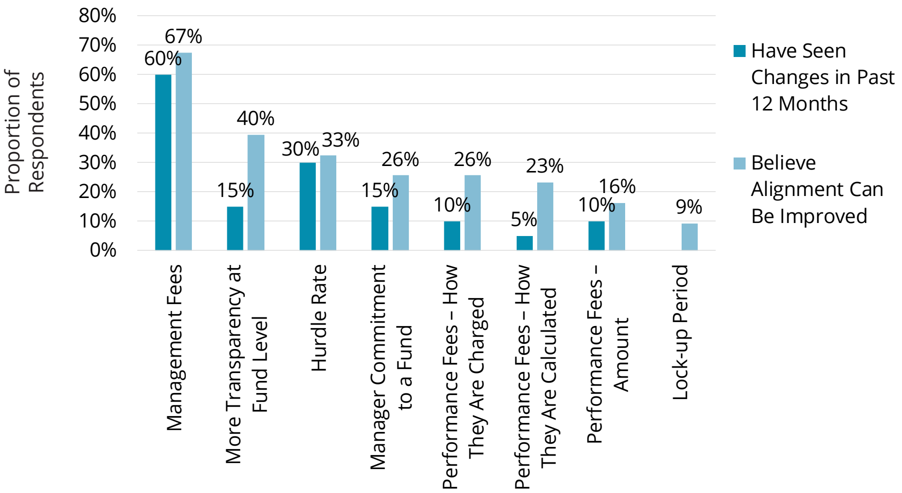
Since it is vital that institutional investors consider fund terms and conditions when looking to put capital to work, it is key for fund managers to ensure their fee structures are appropriate and aligned with the interests of their investors. Eighty-one percent of investors interviewed by Preqin in December 2017 believe that fund manager interests are properly aligned with their own, up from 61% of respondents in December 2016. This provides a strong indication that fund managers have continued to listen to, and address, concerns by adopting terms that meet investors' needs.

DEVELOPMENTS IN PREVAILING TERMS

Thirty percent of investors believe that there have been changes in prevailing fund terms in their favour over the past year, compared to a quarter of investors interviewed at the end of 2016. Fees remain a contentious issue for investors in the infrastructure industry, and in the wider alternative assets universe, amid a highly competitive fundraising environment. Management fees, greater transparency from fund managers and hurdle rates were cited by the largest proportions of investors as areas in which they would like to see improvements (Fig. 6.15). However, 60% of surveyed investors have seen changes to management fees in the past year, while 30% have witnessed changes to hurdle rates, suggesting that GPs are responding to investor concerns.

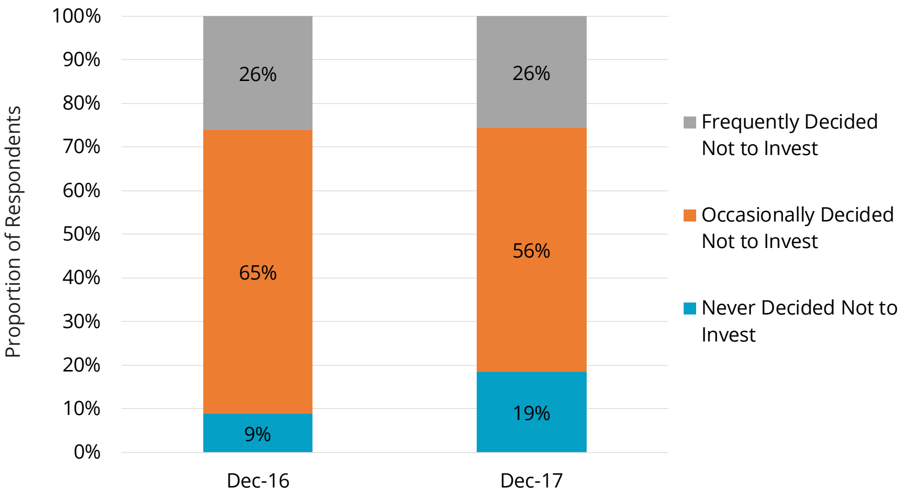
In a competitive fundraising environment which has seen capital increasingly concentrated among fewer fund managers, presenting favourable fund terms and conditions has become an important way for GPs to differentiate themselves from their competitors and entice LPs to make commitments to their funds. Eighty-two percent of investor respondents have either occasionally or frequently decided not to invest in a fund due to the proposed terms and conditions, remaining at a similar level to December 2016 (Fig. 6.16). There is therefore still a way to go in order to improve the alignment of interests between GPs and LPs.

Fig. 6.15: Areas in Which Investors Have Seen a Change in Prevailing Terms and Conditions over the Past 12 Months and Where They Believe Alignment Can Be Improved



Source: Preqin Investor Interviews, December 2017

Fig. 6.16: Frequency with Which Investors Have Decided Not to Invest in a Fund Due to the Proposed Terms and Conditions, 2016 vs. 2017



Source: Preqin Investor Interviews, December 2016 - 2017

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HOW INVESTORS SOURCE AND SELECT INFRASTRUCTURE FUNDS

In our December 2017 interviews with over 80 institutional investors, 48% revealed that they found it more difficult to identify attractive infrastructure fund opportunities in 2017 than in 2016. With this in mind, we examine in more detail the processes that investors use to source and screen funds based on data from our online platform and responses to our survey.

KEY STATS: AVERAGE SCREENING PROCESS FOR UNLISTED INFRASTRUCTURE FUNDS

METHODS USED BY INVESTORS TO SOURCE FUNDS:

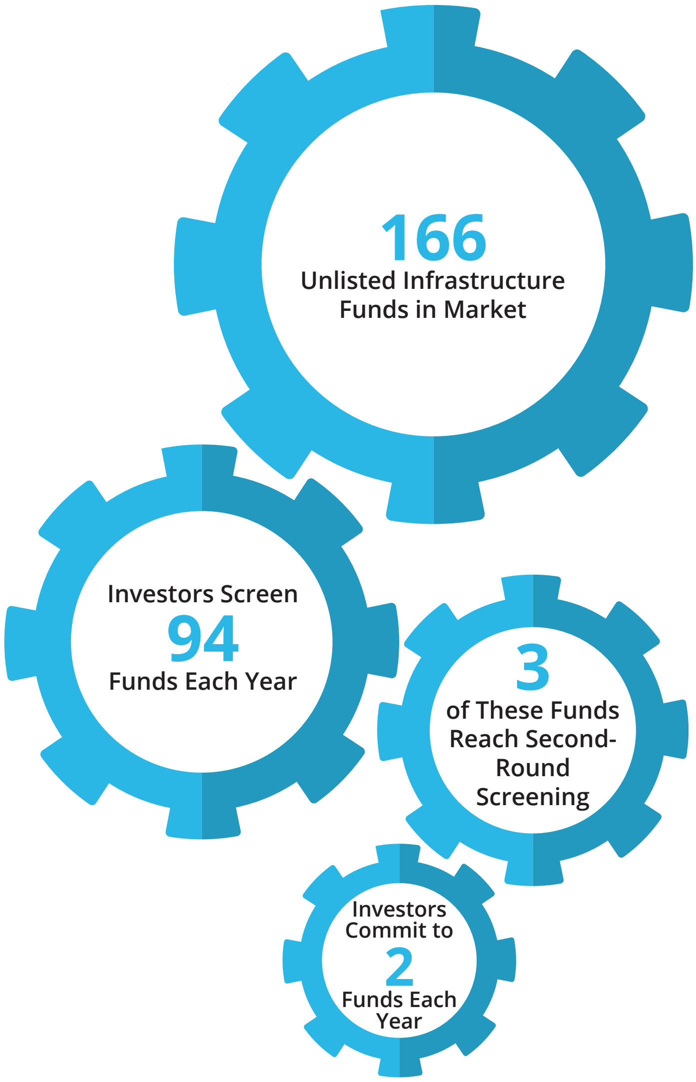
- Mix of internal sourcing and direct external approaches (47%)
- Only internal sourcing (20%)
- Only direct external approaches (2%)

LEADING FACTORS THAT RESULT IN INVESTORS REMOVING A FUND FROM THEIR SCREENING LIST:

- ✗ Lack of team track record (54%)
- ✗ Lack of firm track record (41%)
- ✗ Unfavourable fees/fund terms (41%)

MOST IMPORTANT FACTORS INVESTORS ASSESS WHEN SELECTING NEW FUNDS:

- ✓ Team track record (71%)
- ✓ Team strategy experience (71%)
- ✓ Firm track record (58%)



MARKETING MATERIALS FAIL TO MEET THE NEEDS OF 39% OF INVESTORS – WHY?

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SAMPLE INFRASTRUCTURE INVESTORS TO WATCH IN 2018

1

CANADIAN MEDICAL PROTECTIVE ASSOCIATION
Type: Foundation
Location: Ontario, Canada
Amount Investing in Next 12 Months:
CAD 30mn
Expects to invest in one unlisted value added infrastructure fund with a global reach and exposure to a wide variety of industries.

2

NIPPON LIFE GLOBAL INVESTORS AMERICAS
Type: Insurance Company
Location: New York, US
Amount Investing in Next 12 Months:
$150-420mn
Expects to invest in 5-6 unlisted infrastructure funds, targeting all industries (except for energy), focusing on Europe, North America and Rest of World.

3

UMR COREM
Type: Public Pension Fund
Location: Nantes, France
Amount Investing in Next 12 Months:
€60-90mn
Expects to invest in 2-3 funds focused on Europe and North America across a range of industries, using a mixture of new and existing managers in its portfolio.

4

PROFELIA
Type: Public Pension Fund
Location: Lausanne, Switzerland
Amount Investing in Next 12 Months:
CHF 100mn
Expects to make 5-10 investments both directly and through unlisted infrastructure fund of funds vehicles, focusing on Europe.

5

BAYERISCHE VERSORGUNGSKAMMER
Type: Public Pension Fund
Location: Munich, Germany
Amount Investing in Next 12 Months:
€800mn
Expects to invest in 3-4 unlisted infrastructure funds, focused on Europe and North America, targeting a diverse range of assets.

6

EQUITER
Type: Investment Company
Location: Turin, Italy
Will invest in unlisted infrastructure funds opportunistically in the next 12 months, focusing on the renewable energy industry in Europe. Will primarily use existing managers in its portfolio, along with some new ones.

7

NONGHYUP BANK
Type: Bank
Location: Seoul, South Korea
Amount Investing in Next 12 Months:
KRW 200-300bn
Expects to invest in unlisted infrastructure funds, targeting both primary and debt/mezzanine strategies, focusing on the renewable energy and utilities industries across Asia-Pacific.

8

DAIDO LIFE INSURANCE
Type: Insurance Company
Location: Tokyo, Japan
Expects to invest in unlisted infrastructure funds opportunistically, targeting the renewable energy, transportation and utilities sectors with a global reach, primarily focused on developed countries. Will use both new and existing managers in its portfolio.

9

AUSTRALIAN NATIONAL UNIVERSITY ENDOWMENT FUNDS
Type: Endowment Plan
Location: Canberra, Australia
Amount Investing in Next 12 Months:
AUD 10-15mn
Expects to make 2-3 investments both directly and through unlisted infrastructure funds, focusing on brownfield assets and environmentally friendly industries including clean technology and renewable energy.

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H1 2018

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- **Fund managers:** fundraising, portfolio monitoring and investor relations
- **Service providers and advisors:** business development and in-depth market knowledge
- **The wider alternative assets industry:** insight, understanding and information

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