Preqin Investor Outlook: Alternative Assets H1 2014

Private Equity | Hedge Funds | Real Estate | Infrastructure

preqin

alternative assets. intelligent data.

Contents

Datapack for Preqin Investor Outlook: Alternative Assets, H1 2014

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

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

www.preqin.com/investoroutlook

Foreword

Welcome to Preqin Investor Outlook: Alternative Assets, H1 2014, which provides a unique insight into institutional investors in private equity, hedge funds, real estate and infrastructure. This report examines the investment plans and views of more than 430 investors in alternative assets, compiled from a series of interviews carried out by Preqin's analysts in December 2013. The sample of investors was taken from Preqin's industry-leading online products, which feature extensive profiles for over 8,100 institutions actively investing in alternatives. As demonstrated below, interviews were conducted with investors based across the globe, with a range of investor types represented.

This report examines results across all asset classes to provide a comprehensive overview of investors' plans for the next 12 months and their activity over the previous year, exploring changes to allocations, fund searches and investors' views on the key issues impacting their alternatives portfolios.

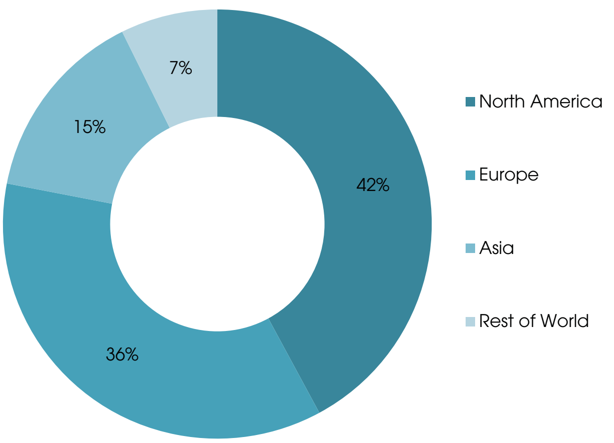
The total assets under management of the alternative assets industry now exceed $6tn, having grown by more than $600bn over the course of 2013. Nonetheless, with more than 13,000 private equity, hedge fund, real estate and infrastructure funds currently being marketed, competition for investor capital is extremely high. Fund managers need to ensure they get their funds in front of the largest audience possible.

For the first time, this edition of Preqin Investor Outlook takes a look at the activity of investors using Preqin Investor Network, gaining unique insight into areas of the alternatives market accredited investors are most interested in surveying. 5,600 investment professionals across 3,200 investing institutions use the Investor Network to discover and review funds being marketed. With investors now more proactive than ever in actively finding the best fund opportunities, their expansive use of the Investor Network makes for vital reading for managers and fund marketers interested in exploring all avenues of communication with investors. With investors keen to screen as much of the fundraising market as possible before making any commitments, and Preqin's new Enhanced Fund Listings service, which allows fundraisers to make information typically found in their PPMs available to accredited investors, Preqin Investor Network is a hugely valuable resource for investor relations teams and investors alike.

We hope you fund this report to be interesting and useful, and as ever we welcome any feedback or suggestions you may have for future editions. To find out more about our products and services, please do not hesitate to contact us at info@preqin.com or at our New York, London, Singapore or San Francisco offices.

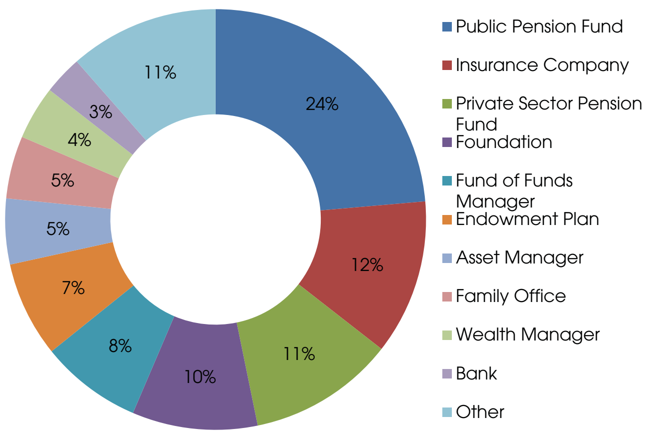
Breakdown of Respondents

Breakdown of Respondents by Investor Location



Source: Preqin Investor Interviews, December 2013

Breakdown of Respondents by Investor Type



Source: Preqin Investor Interviews, December 2013

Are You an Investor?

Join **Preqin Investor Network** for free to gain access to details of all alternative assets funds in market, key contact information and fund manager performance track records.

www.preqin.com/pin

Looking to Connect with Investors?

Share data on your funds on **Preqin Investor Network** to get in front of over 5,600 investment decision makers and generate incoming leads from investors.

www.preqin.com/sharedata

Industry Perceptions and Satisfaction with Returns

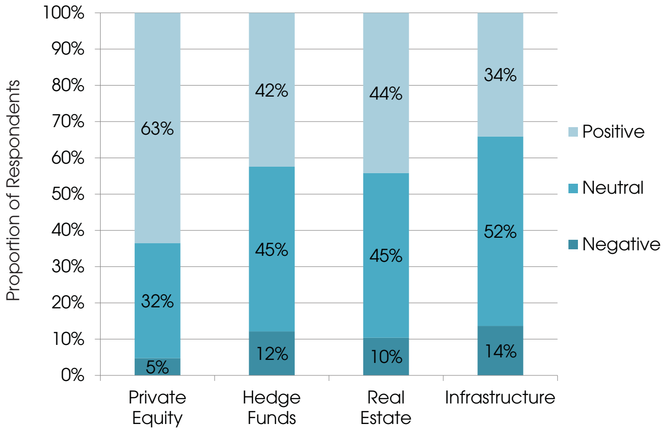
Investors' perceptions of each alternative asset class and their satisfaction with the performance of previous portfolio investments remains largely positive, with confidence in each asset class remaining at similar levels to the previous 12 months.

It is encouraging to note that the vast majority of institutions currently have either positive or neutral perceptions towards each alternative asset class, as shown in Fig. 1.1. Investors in private equity funds possess the most positive outlook, with almost two-thirds (63%) perceiving the industry positively. Infrastructure investors are the most ambivalent towards the asset class, with 34% having a positive perception of the infrastructure industry, although over half (52%) are neutral in their outlook. Real estate and hedge fund investors possess very similar perceptions concerning each industry, with 42% and 44% of hedge fund and real estate investors respectively perceiving these asset classes positively.

Furthermore the vast majority of investors believe that the performance of their investments in alternatives met expectations over the course of 2013 (Fig. 1.2). Hedge funds posted double digit returns for the second year in a row in 2013 and a considerable 21% of hedge fund investors stated that their investments had exceeded expectations, with 13%, 14% and 15% of private equity, real estate and infrastructure investors respectively also stating this.

When asked whether their confidence in each alternative asset class to meet portfolio objectives had changed in the last 12 months, Fig. 1.3 reveals that most investors surveyed have not changed their outlook. Again, private equity investors appear to have the most positive outlook towards the asset class, with a quarter stating that their confidence in the asset class had increased over the last year. With a large proportion of investors remaining satisfied with their investments in each asset class and perceiving the industry positively, it is likely that many will look to allocate further capital to alternative assets funds in 2014.

Fig. 1.1: Investors' Perceptions of Each Alternative Asset Class at Present



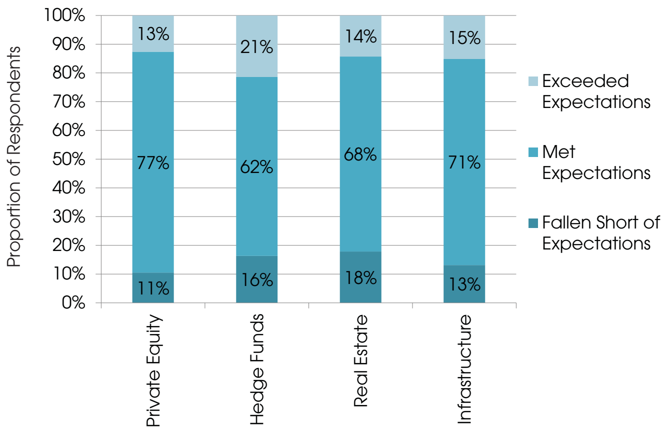
Source: Preqin Investor Interviews, December 2013

Research Center Premium

Preqin's **Research Center Premium** provides access to **free** alternative assets data and tools taken from Preqin's online products, as well as a wide range of free research reports and newsletters.

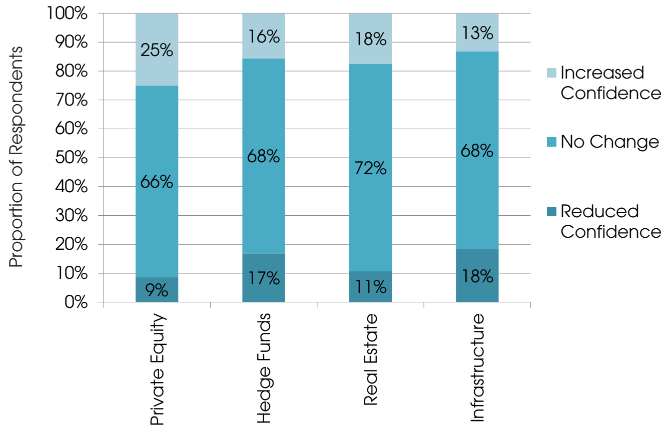
To register for free please visit: www.preqin.com/rcp

Fig. 1.2: Investors' Views on Whether Alternative Asset Class Investments Have Lived up to Expectations in 2013



Source: Preqin Investor Interviews, December 2013

Fig. 1.3: Investors' Views on Whether Their Confidence in Alternative Assets to Meet Portfolio Objectives Has Changed over the Past 12 Months



Source: Preqin Investor Interviews, December 2013

Investor Appetite for Alternatives in 2014

The outlook for alternative assets investment in 2014 is particularly positive, with large proportions of investors across all asset classes planning to put more or the same level of capital to work in the next 12 months as in the previous year, and allocations likely to rise for many investors over the longer term. Regulation, performance and investment opportunities, however, remain key concerns for many investors in the current market.

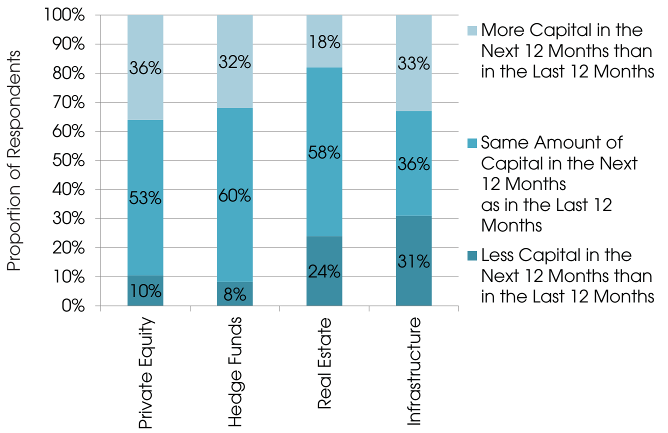
There is likely to be further growth in fundraising for alternative assets funds in 2014, with many institutional investors putting more capital to work than they did in 2013. In particular, the private equity and hedge fund asset classes may see strong fundraising, with 36% and 32% of investors in each asset class respectively looking to commit more capital in the next 12 months than in the previous year, as shown in Fig. 1.4. Real assets fundraising may not see as large an increase, with 24% of real estate investors expecting to commit less capital in 2014 than in 2013, and 31% of investors in infrastructure looking to put less capital to work, although a similar proportion do anticipate investing more in 2014 than in 2013.

The ever-increasing importance of alternative assets to institutional investors' portfolios is shown in Fig. 1.5, with many investors planning to increase allocations to each alternative asset class. Investors are most likely to increase their allocations to infrastructure, with 46% intending to do so, demonstrating how the asset class is becoming a core part of many institutional investors' portfolios. Only a small proportion of investors expect to decrease their allocations to alternative asset classes, with the majority expecting to maintain or increase these portfolio weightings in the coming years.

Key Issues and Regulation

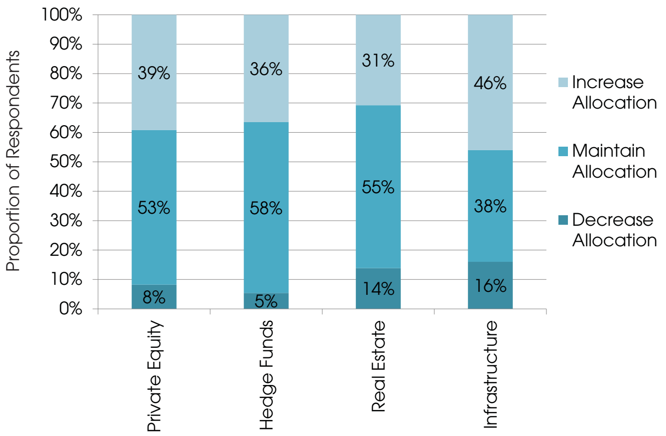
Fig. 1.6 displays the top three concerns of investors by asset class; as demonstrated, performance is a key concern across all asset classes and is the top issue for the largest proportion of hedge fund and infrastructure investors, with 30% of investors in these asset classes each stating this as their key concern in the market in 2014. Private equity and hedge fund investors each state – in a different order – regulation, performance and the economic environment as their top three concerns. A key concern in common for real estate and infrastructure investors is the availability of suitable investment opportunities, with 16% and 13% of investors respectively stating this as an important issue.

Fig. 1.4: Investors' Expected Capital Commitment to Alternative Assets Funds in the Next 12 Months Compared to the Past 12 Months



Source: Preqin Investor Interviews, December 2013

Fig. 1.5: Investors' Intentions for Their Alternative Assets Allocations in the Longer Term



Source: Preqin Investor Interviews, December 2013

Fig. 1.6: Top Three Key Issues for Investors in Alternatives in 2014 by Asset Class (Proportion of Respondents Stated in Parentheses)

	Private Equity	Hedge Funds	Real Estate	Infrastructure
1	Regulation (26%)	Performance (30%)	Economic Environment (24%)	Performance (30%)
2	Economic Environment (22%)	Regulation (24%)	Investment Opportunities (16%)	Fees (15%)
3	Performance (22%)	Economic Environment (13%)	Performance (15%)	Investment Opportunities (13%)

Source: Preqin Investor Interviews, December 2013

Despite regulation being one of the top three key concerns for both hedge fund and private equity investors in 2014, Fig. 1.7 demonstrates that many investors are still unsure of the impact of recent regulatory changes. A third of private equity investors believe that regulations are beneficial to the industry, with 40% unsure and 27% believing they are not beneficial for the industry. Similarly with hedge fund investors, a third believe that regulations are not beneficial, and 36% believe that they are. Among investors in real estate and infrastructure, even fewer have a clear view on the impact of new regulation, with the majority unsure if these are beneficial to these asset classes.

Despite signs of infrastructure managers responding to investor concerns regarding fees and other fund terms, this still remains a point of contention between fund managers and investors, with investors often unhappy with managers employing a traditional 2/20 private equity-style fund model in an asset class which typically has lower return expectations. As such, fees were the second key issue for infrastructure investors in 2014, with 15% stating this as a concern.

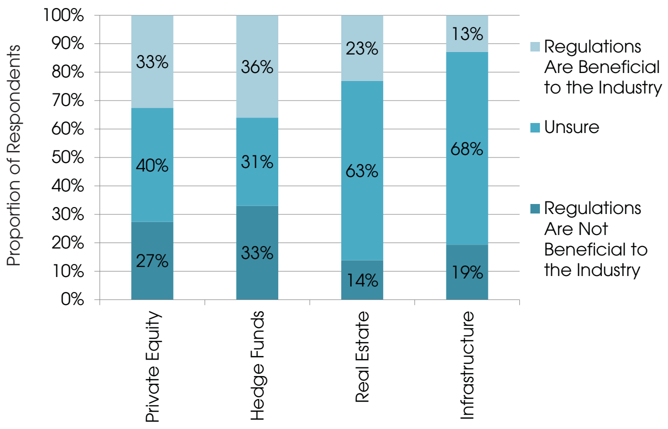
Manager Selection

The key considerations investors take into account when selecting new fund managers are broadly similar across all asset classes, albeit with notable variations between them, as revealed in Fig. 1.8. As might be expected the past performance and length of track record are important factors for investors across alternative asset classes. Private equity investors in particular believe that managers that have generated strong returns in the past are likely to repeat this in the future. Investors in hedge funds and infrastructure are more likely consider fund strategy the most important factor in manager selection. With hedge funds being more liquid investments, investors may be more likely to choose managers that have a strategy they view as attractive in the current market or that complements their overall portfolio. With very few infrastructure funds having completed a full cycle of investments and realizations, investors are more likely to look at a manager's strategy or the performance of their current investments.

Outlook for Alternatives

Overall, when investors were asked which alternative asset class is presenting the best investment opportunities in 2014, the largest proportion stated private equity (45%), as shown in Fig. 1.9. In an improving economic environment, it seems many investors are confident that private equity can generate the strong returns that are one of the inherent appeals of the asset class. Twenty-three percent of investors surveyed stated that hedge funds present the best investment opportunities, while fewer stated real estate (18%) or infrastructure (14%).

Fig. 1.7: Investors' Views on Whether the Regulations Introduced in 2011, 2012 and 2013 Are Beneficial to the Alternative Assets Industry by Asset Class



Source: Preqin Investor Interviews, December 2013

Preqin's Online Services

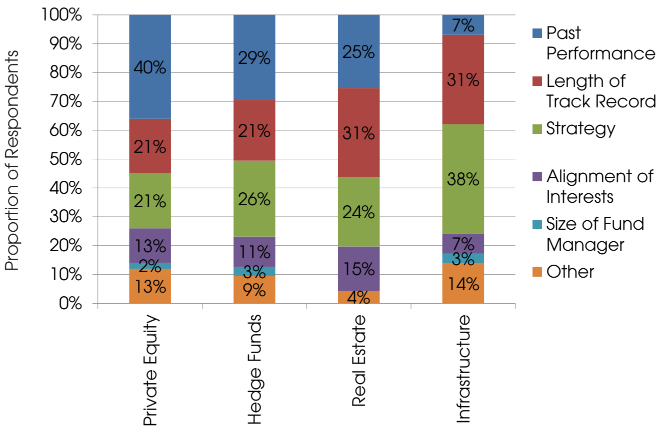
Preqin provides a range of online services covering all aspects of the private equity, real estate, infrastructure and hedge fund industries, including fund managers, funds, investors, performance, deals, fund terms and more.

Available as separate modules or integrated packages, Preqin's online services are relied upon by thousands of industry professionals every day.

For more information, or to register for a demonstration, please visit:

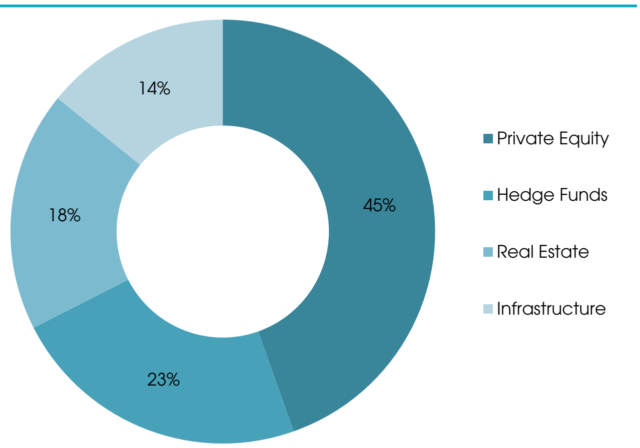
www.preqin.com

Fig. 1.8: The Key Factors Investors Assess When Looking for an Alternatives Fund Manager by Asset Class



Source: Preqin Investor Interviews, December 2013

Fig. 1.9: Investors' Views on Which Alternative Asset Class is Offering the Best Investment Opportunities in 2014



Source: Preqin Investor Interviews, December 2013

Alignment of Interests

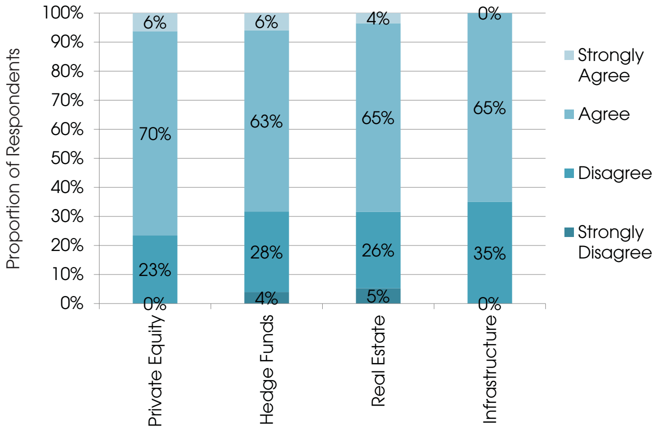
Investor satisfaction with the alignment of interests with fund managers is particularly high, with the majority of investors across all asset classes agreeing that interests are properly aligned. Managers appear to have made concessions to investors with regard to fund terms in recent years, as a large proportion of investors have seen changes in their favour in the past 12 months.

Ensuring alignment of interests between fund managers and investors is an important consideration for firms when structuring their funds. Many investors are keen for managers to lower their fees, and want to ensure managers are primarily rewarded through performance and not management fees. However, equally important is the need to incentivize and retain talent, and to ensure that lowering any fees does not impact the ability of the manager to successfully run a fund.

It is encouraging to note that the majority of investors across all asset classes agree that fund manager and investor interests are aligned (Fig. 1.10). Many private equity managers have responded to investor concerns surrounding fund terms in recent years, and, as a result, investors in private equity are the most satisfied with the alignment of interests. The least satisfied with the alignment of interests were infrastructure investors, with 35% stating that they disagreed that there was an alignment of interests, compared to 32% of hedge fund investors and 31% of real estate investors.

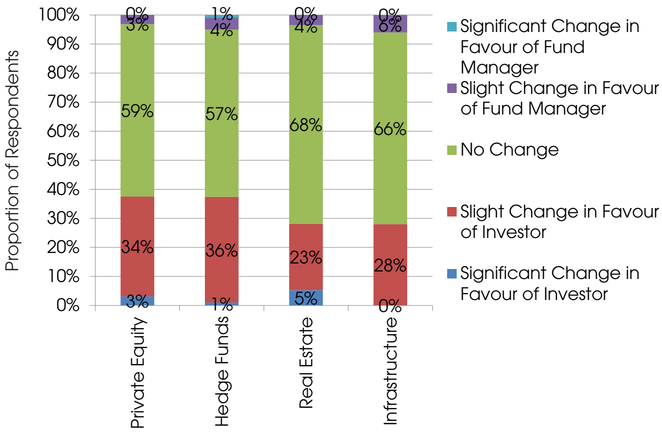
When asked if they had seen any change in fund terms over the last 12 months, the majority of investors across all asset classes stated that they had not (Fig. 1.11). However, there are indications that fund managers are making concessions in this area, with over a quarter of investors surveyed in each asset class stating that they had seen a change in favour of investors in 2013. In particular, private equity and hedge fund investors saw the most positive change in this regard, with 37% of investors in each asset class responding that they had seen either a slight or significant change in their favour over the last year.

Fig. 1.10: Investors' Views on Whether Fund Manager and Investor Interests Are Properly Aligned by Asset Class



Source: Preqin Investor Interviews, December 2013

Fig. 1.11: Investors' Views on Whether There Has Been a Change in Fund Terms in the Past 12 Months by Asset Class



Source: Preqin Investor Interviews, December 2013

Private Equity

Healthy LP Appetite Signals Continued Growth

The private equity industry went from strength to strength in 2013, recording the largest amount raised in capital commitments since the onset of the financial crisis in 2008. LP appetite was healthy, as demonstrated by the $481bn raised by 955 private equity vehicles that closed the last year, and following Preqin's latest survey, it appears that this momentum is likely to carry through 2014. This report collates responses from direct conversations with over 100 LPs, and covers topics from the most favoured private equity fund strategies and geographies (page 13), to future plans for asset class allocation and investment cycles (page 12).

Our survey serves as a valuable tool to gauge the attitudes of investors toward a range of topics within the private equity universe. Results revealed that the key issue perceived to most greatly affect the industry in 2014 is regulation. This is explored in more detail on page 10. We found, however, that despite a number of directives being announced some time ago, their effect on private equity investors is somewhat delayed. The majority (87%) of investors stated no change as yet has been made to their investment activities following regulatory changes and proposals such as the AIFMD and Solvency II.

It is interesting to note the advancement of LP portfolios, as the surrounding investment landscape changes, as well as the ever increasing sophistication and strengthening expertise of the investor community as a whole. Diversifying their portfolios has always been a risk management strategy for investors, and recent times have seen a notable rise in interest in the private debt sector in particular. Preqin's survey reveals that 59% of LPs currently have exposure to private debt, and 44% of those that said they do not, would consider private debt investments in the future.

Bifurcation seen in 2013's private equity fundraising figures, with only 7% of total capital garnered being raised by first-time fund managers and the remaining 93% attributed to established GPs, was supported by survey results on investor appetite for newly formed fund managers. When assessing private equity fund managers to partner with, investors value past performance and length of track record the most, with the largest proportions of investors interviewed (40% and 21% respectively) specifying these factors as the most important to consider when searching for GPs.

The recent strengthening of public markets as they recover at least some of the vibrancy of years past has indeed boosted economies worldwide, but investors continue to see the value of committing to the private equity asset class which is known to generate superior returns in the long term. The outlook for private equity is positive, with momentum fuelled by evidently vigorous investor appetite in the continuously evolving industry.

Key Facts

68% of investors interviewed by Preqin are looking to make their next commitments to private equity funds in H1 2014.

36% of investors expect to increase their allocations to private equity in the next 12 months.

76% of investors agree or strongly agree that GP and LP interests are properly aligned.

87% of investors feel their private equity investments have met or exceeded their expectations.

79% of investors would commit to a private equity fund before it has held an initial close and begun making investments, or would consider doing so.

45% of investors think private equity is the alternative asset class that will present the best opportunities in 2014.

Investor Activity in 2013

With the aggregate amount of capital secured by private equity funds closed in 2013 reaching its highest annual level since the global financial crisis, investor appetite for the asset class appears to be the strongest it has been in many years.

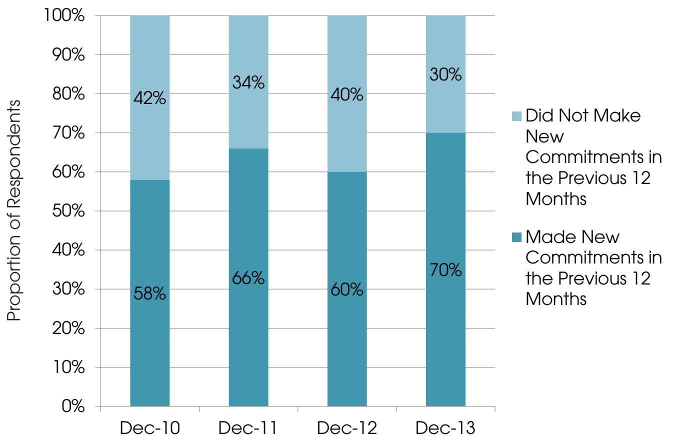
The latest statistics from Preqin's bi-annual survey of investors around the globe show the highest level of investor activity in recent years in terms of the proportion of investors that made new commitments to private equity funds within a 12 month period (Fig. 2.1). As of December 2013, 70% of investors interviewed had made a commitment to a private equity vehicle during the year, a notably large majority, and a marked increase from the corresponding 58% of respondents in December 2010 and even from the 60% in December 2012.

Renewed confidence in the economic stability of global markets, and specifically in the private equity asset class, could be one of the primary reasons behind the uptick in the level of commitments, and this is further reflected in the private equity fundraising figures from 2013. The year saw $481bn raised by the 955 private equity funds that closed, the greatest annual amount of capital commitments garnered by fund managers since the onset of the 2008 financial crisis.

The results from Preqin's December 2013 investor interviews also saw the lowest proportion of investors (44%) at their target allocation to private equity since December 2009, when the statistic was 42%. As of the end of 2013, 18% of investors were above their target allocations, while almost two-fifths were below their target allocations to the asset class (Fig. 2.2). The exact level of exposure an institutional investor has to alternatives is crucial not only for portfolio management, but also for ensuring compliance with any mandatory requirements as outlined by the law in their relevant jurisdictions. On pages 10-11 we discuss the impact the recent announcements of directives such as Basel III and Solvency II have had on investor activity within the private equity space.

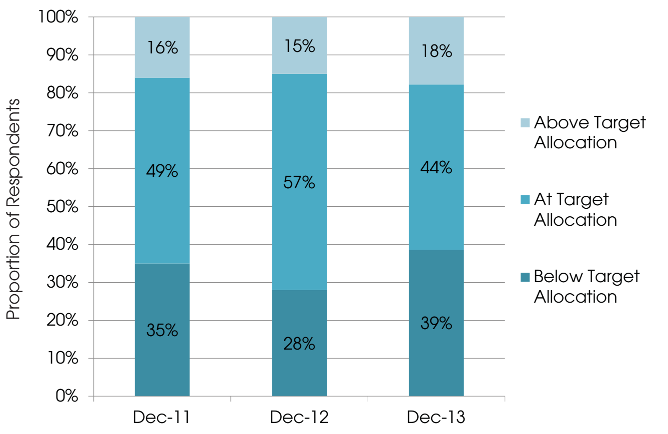
With the majority of investors interviewed appearing to be either short of, or in excess of, their target allocations, there is much potential for a shift in investor activity in the future as LPs either work to ramp up or scale down their private equity commitments.

Fig. 2.1: Proportion of Investors that Made New Commitments to Private Equity Funds in the Previous 12 Months, December 2010 - December 2013



Source: Preqin Investor Interviews, December 2010 - December 2013

Fig. 2.2: Proportion of Investors At, Above, or Below Their Target Allocations to Private Equity, December 2011 - December 2013



Source: Preqin Investor Interviews, December 2011 - December 2013

Satisfaction with Returns

Investor satisfaction with returns from private equity appears to be increasing, with 90% of investors we spoke to in December 2013 stating that the performance of their investments in the asset class had met or exceeded expectations.

Private equity as an alternative asset class is known for its potential for superior returns compared to other public indices over the long term. Preqin's investor interviews aimed to gauge how investors felt their private equity fund investments fared over the past year, with the results of our most recent interviews, and also the results of the previous two years, shown in Fig. 2.3. The chart shows the progressively increasing proportion of investors that feel the performance of their private equity fund commitments has either met or exceeded expectations. In particular, the proportion of those investors that believed their investments in the asset class had surpassed their expectations grew from 6% in 2011 to 11% in 2012 and 13% in 2013. While this could signal the general lowering of expectations of private equity investors as they appreciate the volatility of the economic environment around them, it is fundamentally a positive sign and will fuel investor confidence going forward.

One UK-based investor alluded to the crucial role fund managers play in working to minimize losses felt by portfolios: "None of us saw the scale of the down draught coming at the scale it did, but our managers have generally done good work to protect the portfolio". While macro factors may lie out of investor and fund manager control and be totally unpredictable, it is important that teams work to manage risk by controlling whatever micro factors they do have influence over, in order to try to ensure that investments do not fall short and the impact of negative external influences are as small as possible.

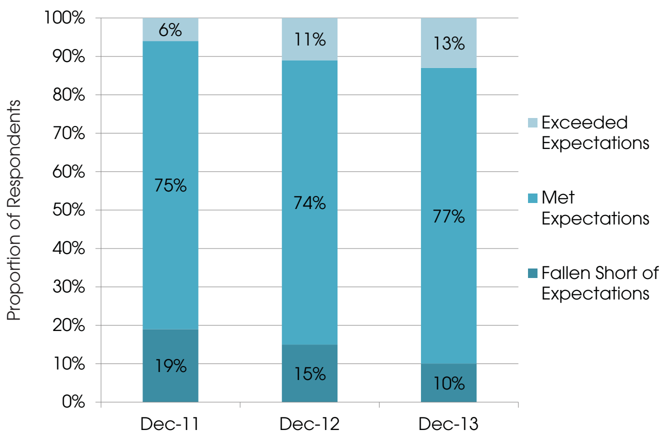
Comparisons to the Public Market

As the performance of public market indices in recent times has strengthened, investor confidence in the returns to be gained from investments in public markets has surged correspondingly.

While the private equity asset class has traditionally been considered to be more rewarding in the long term, the margin by which private equity is anticipated to outperform public markets has decreased slightly as a result of the improvements seen in the public indices, and this is reflected in the returns expectations of investors, as shown in Fig. 2.4.

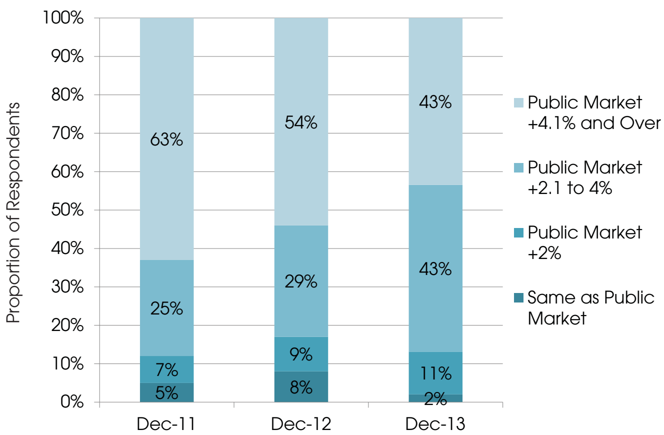
The chart shows the extent to which investors expect their private equity portfolios to generate superior returns compared to the public market. As of December 2013, the proportion of investors interviewed by Preqin that expect their private equity investments to outperform the public market by over 4.1% became a minority for the first time, with only 47% believing this, compared to 54% in December 2012 and 63% in December 2011.

Fig. 2.3: Proportion of Investors that Feel Their Private Equity Fund Investments Have Lived up to Expectations, December 2011 - December 2013



Source: Preqin Investor Interviews, December 2011 - December 2013

Fig. 2.4: Investors' Returns Expectations for Their Private Equity Portfolios, December 2011 - December 2013



Source: Preqin Investor Interviews, December 2011 - December 2013

Key Issues and Regulations

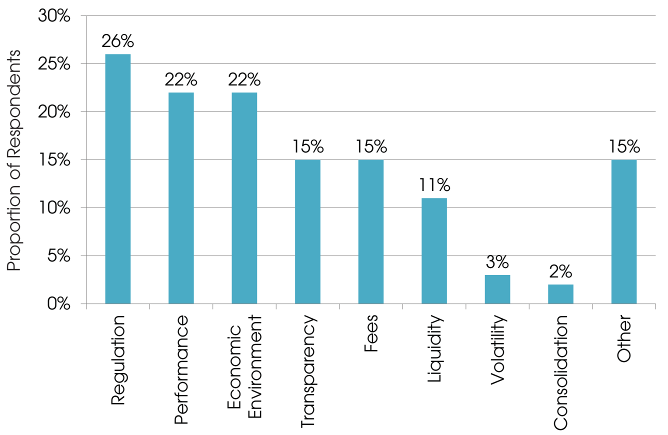
Though the dates of implementation for Solvency II and Basel III remain relatively distant, the deadline for existing fund managers to fully comply with the Alternative Investment Fund Managers Directive (AIFMD) looms closer and the effect that regulation has on the private equity industry has become a hot topic for discussion.

Preqin's survey of over 100 institutional investors across the globe in December 2013 revealed that over a quarter (26%) of LPs interviewed cited regulation to be one of the key challenges that the private equity investor community faces in 2014. The next most concerning issues that investors face in the year ahead are performance and the economic environment, both highlighted by 22% of the LPs surveyed, as shown in Fig. 2.5.

Regulation

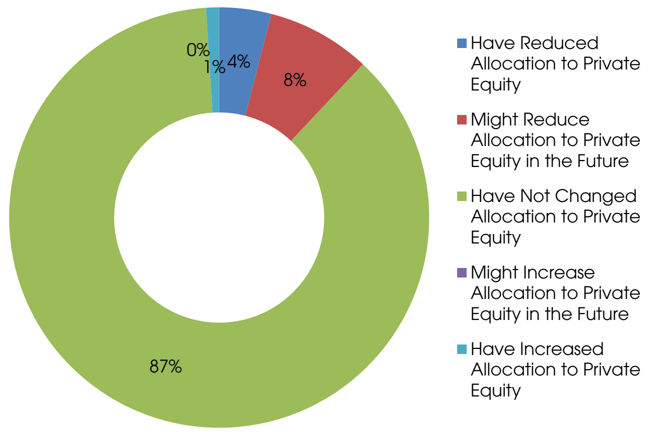
The three aforementioned directives, which will predominantly affect investors in the world's largest markets of North America and Europe, are examples of the changing laws across the globe that will impact on many players in the private equity universe. The scope of the AIFMD is broad and, with a few exceptions, covers the management, administration and marketing of alternative investment funds. The Directive will come into full effect in July 2014 and, although there may be a last-minute rush to comply, firms are by and large expected to be compliant by then. While private equity firms will be forced to swallow the additional costs of regulation, they are also unlikely to be deterred from investing in Europe as a result of regulation. Despite the largest proportion (26%) of investors surveyed citing regulation as the biggest challenge LPs currently face, it seems that the actual impact of recent regulation has been felt by a much smaller percentage, as shown in Fig. 2.6, with only 4% having reduced their private equity allocations and 8% stating that the new industry rules may affect their future allocations.

Fig. 2.5: Biggest Challenges Facing Investors Seeking to Operate an Effective Private Equity Program at Present



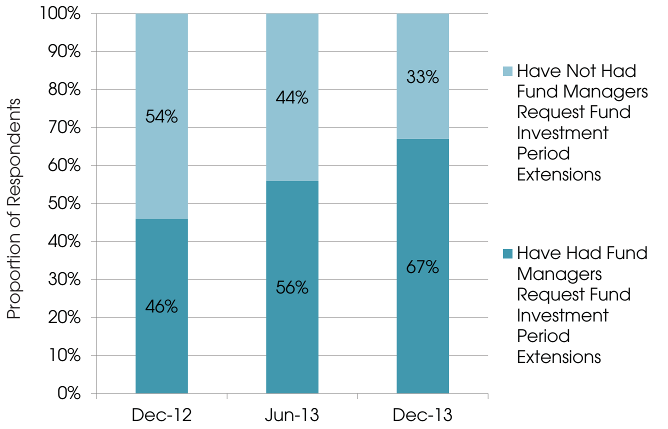
Source: Preqin Investor Interviews, December 2013

Fig. 2.6: Impact of Regulatory Changes and Proposals on Investors' Private Equity Allocations



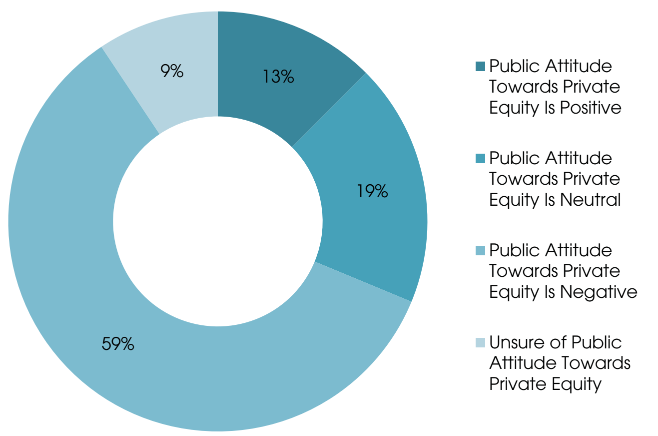
Source: Preqin Investor Interviews, December 2013

Fig. 2.7: Proportion of Investors that Have Had Fund Managers Request Fund Investment Period Extensions in the Past 12 Months



Source: Preqin Investor Interviews, December 2012 - December 2013

Fig. 2.8: Investors' Views on Public Attitudes Towards Private Equity



Source: Preqin Investor Interviews, December 2013

Previously, there was some assumption that several financial institutions would be winding down alternative investment allocations as part of a continued bid to reduce exposure to these assets. The implementation of the Volcker Rule for instance places limitations on the amount of capital that US banks are able to hold in private equity or hedge funds to no more than 3%. We must note, however, that only a small proportion of private equity investors are affected by regulatory changes as directives are applicable to only certain types of institutional investors operating in certain geographies; for example, Basel III is targeted at banks whereas Solvency II affects EU insurance companies. This is reflected in Preqin's survey results; when asked if regulation had affected their allocation to private equity, or they expected it to in the future, only a minority (13%) indicated it would.

It seems there is some uncertainty surrounding the regulations that were introduced in 2011-2013, with the largest proportion of investors surveyed (40%) stating they were fundamentally unsure on whether the changes were beneficial to the private equity industry. A third of respondents said that the regulations are good for the asset class and 27% were of the opinion that they would be detrimental.

Fund Investment Period Extensions

In a fund operating agreement, terms are set for the GP outlining a time-limited investment period. A private equity fund is only permitted to enter into new investments during this set time, typically of around four to six years from the closing of its first investment or final close of the vehicle. After this defined window, the firms lose access to the funding. These built-in deadlines to invest the money raised place some pressure on fund managers to find ways to deploy their capital before their time limit is reached. It is possible for the firms to request extensions from their investors, though this could be perceived as unfavourable to the GP's reputation and can even negatively affect fundraising efforts in the future.

Fig. 2.7 depicts the recent trend of fund managers seeking fund extensions. The proportion of LPs that have been approached by their GPs to request a change of terms has risen steadily from 46% in December 2012 to 56% in June 2013 and 67% in December 2013. This gives a strong indication of the challenges that teams face in order to deploy capital in the originally allocated investment period. If fund extensions are granted, the GPs have more time to find suitable deal opportunities and have the opportunity to maximize returns which fundamentally benefits the investors as a result.

Public Perception of the Asset Class

Fig. 2.8 shows the split in opinion of LPs with regard to the public perception of private equity. The majority (59%) of investors surveyed felt that the public see the industry negatively, while only 13% think the public perceive private equity positively, and 19% think the public are neutral. A number of investors we surveyed attributed the negative perception in part to a lack of public education of what private equity truly involves, as well as the damaging portrayal of the industry that is frequently seen in the media.

Investor Activity in the Coming Year and the Longer Term

Preqin's interviews with investors reveal strong appetite for investing in private equity, with the vast majority of investors satisfied with their current exposure to the asset class, or planning to increase their exposure over the next 12 months and the longer term.

Within the next 12 months, 90% of investors interviewed are looking to maintain or increase their allocations to private equity; this figure increases to 92% in the longer term (Fig. 2.9). Specifically, over a third of investors (36%) will be seeking to increase their allocations over the next 12 months, and this proportion rises to 39% over the longer term. This is encouraging news for those fund managers currently seeking capital or planning to launch private equity vehicles in the future.

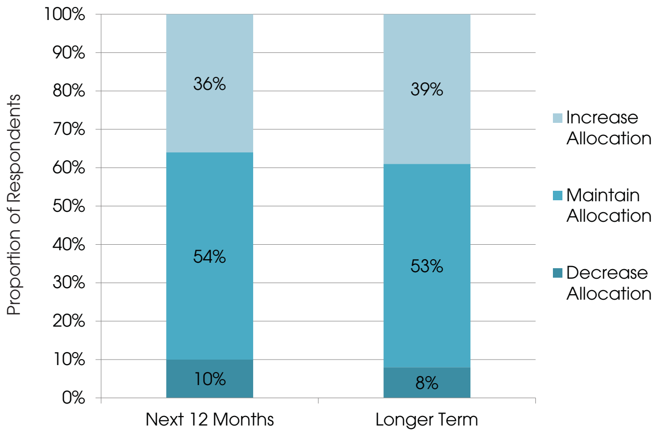
As discussed earlier, these statistics hint at the impact certain regulatory changes relating to investors' private equity portfolios have had on investors so far, and will have in the foreseeable future. The very small proportion (8%) of investors interviewed that are looking to decrease their allocations in the longer term may be a result of repeated delays in the implementation of both the Solvency II Directive and Basel III. The EU legislative act Solvency II is scheduled to come into effect in January 2016, having been pushed back numerous times before, whereas Basel III has had its implementation period extended until March 2018, despite previously being scheduled to be introduced from 2013 to 2015.

New GP Relationships

Fig. 2.10 shows that investors are generally content with their current GP relationships and are largely not looking to end them in search of new fund managers, with only 2% of investors interviewed solely looking to invest with new managers and the remaining 98% intending to re-up with existing managers in varying proportions. The process of forging a new partnership with a new manager requires much time and effort on both parts, involving stringent due diligence. The long-term nature of the private equity asset class means that investors are understandably cautious before committing to a new relationship with a fund manager that is unfamiliar, and need to feel fully secure in their choice. Past performance is usually seen as the greatest indicator for an investor when judging a fund manager (see page 5) and, within existing manager relationships, investors have more transparent access to the private equity firm's historical performance data and benefit from the time and resource efficiency of re-upping.

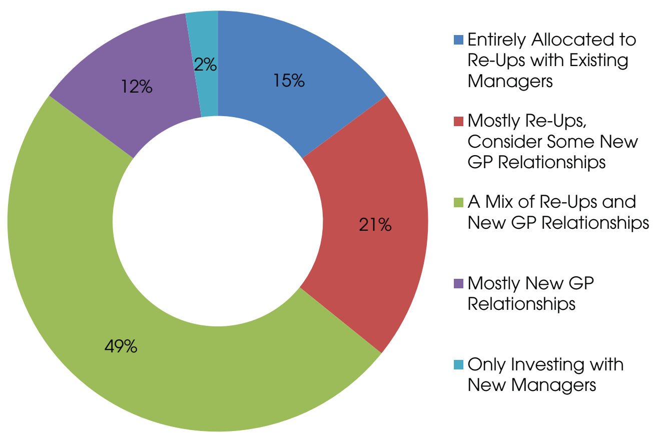
A more detailed breakdown of the statistics reveal that 15% of private equity investors expect to solely re-up with existing managers in their portfolio in the next 12 months (Fig. 2.10), 21% will consider some new GP relationships but will mostly re-up, and 49% intend to have a mix of re-ups and new GP relationships in their investment portfolios in the next year.

Fig. 2.9: Investors' Intentions for Their Private Equity Allocations



Source: Preqin Investor Interviews, December 2013

Fig. 2.10: Investors' Intentions for Forming New GP Relationships over the Next 12 Months



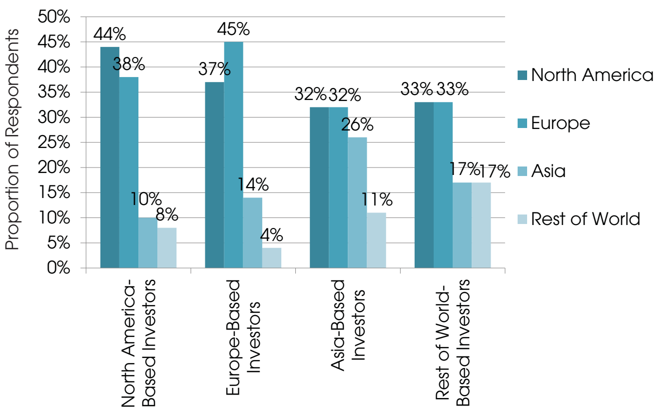
Source: Preqin Investor Interviews, December 2013

Strategies and Geographies Targeted

Investor appetite for different regions is changing; investors are now reverting back to the established markets of North America and Europe and are moving away from emerging markets. In terms of fund type, small to mid-market buyout funds remain most favoured by LPs, although investor appetite for large to mega buyout funds is returning.

Fig. 2.13 shows that North America- and Europe-based private equity investors largely show a preference for their domestic regions for their investments. The largest proportions of investors based in North America (44%) and Europe (45%) respectively cited their own regions as holding the most attractive private equity opportunities. These two markets are also the most favoured by investors based in Asia and other regions, with around a third of investors based in these geographies selecting Europe and North America ahead of their home regions as presenting the best private equity investment opportunities.

Fig. 2.13: Regions Found Attractive by Private Equity Investors by Investor Location



Source: Preqin Investor Interviews, December 2013

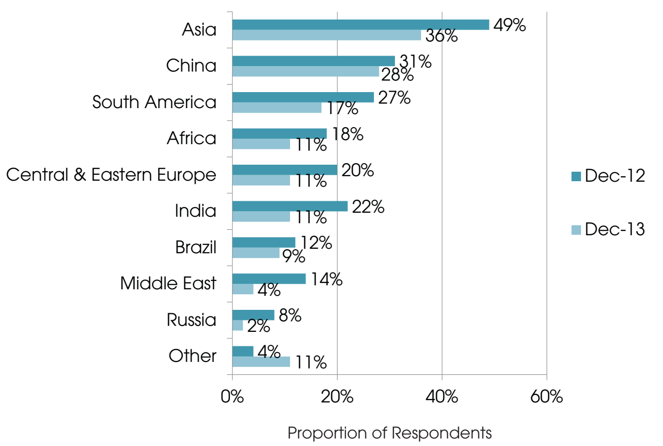
Investor Appetite for Emerging Markets

Parallel to the recent bounce back of traditional markets of North America and Europe following the financial crisis in 2008, emerging markets seem to have fallen out of favour with private equity investors. This is particularly reflected in the proportion of investors interviewed that view Asia as the region within emerging markets presenting the best investment opportunities. Fig. 2.14 compares the results from December 2012 and December 2013, showing the decline in investor interest in all emerging market regions and countries. Asia has suffered the greatest proportional drop in investors that view it as an attractive investment destination, from 49% in 2012 to 36% in 2013. This is likely due to concerns about slowing economic growth and an absence of exit avenues in Asia, which can negatively impact investor confidence.

Fund Types Targeted

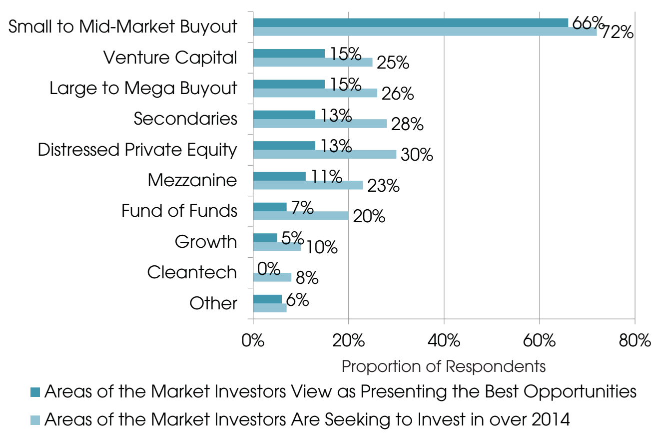
Preqin's investor interviews also investigated which private equity fund types are particularly attractive to investors, and found that, as has been the trend in previous years, small to mid-market buyout funds drew the most attention. The majority (72%) of investors we spoke to were seeking to specifically invest in vehicles following a small to mid-market buyout strategy in 2014, and 66% view it as the strategy that presents the best opportunities (Fig. 2.15). Venture capital and large to mega buyout were the next most favoured fund types, with a quarter of investors respectively seeking to invest in these vehicles in the year ahead. This is somewhat unsurprising given the home-run returns these strategies have the potential to produce.

Fig. 2.14: Countries and Regions within Emerging Markets that Investors View as Presenting the Best Opportunities*



Source: Preqin Investor Interviews, December 2012 - December 2013

Fig. 2.15: Investor Attitudes towards Different Fund Types at Present*



Source: Preqin Investor Interviews, December 2013

**Respondents were not prompted to give their opinions on each region/fund type individually; therefore, the results display the regions/fund types at the forefront of investors' minds at the time of the survey.*

The Investor Spring: Proactive Private Equity Investors

Private equity investors today are different from investors of even a few years ago. With ever greater reliance upon alternatives to meet their returns objectives, investors are increasingly likely to survey as much of the market as possible before committing to a fund. Preqin Investor Network, the most comprehensive funds in market resource for investors around, shows just how expansive investors are in their search for the best private equity funds.

The idea of an Investor Spring is one gaining momentum within the alternative assets industry. A look at investor activity in private equity shows us that this Spring is not something that will soon blossom; it is already upon us. There has been a significant rise in investor activity within alternative assets, coupled with a more proactive approach being taken by investors to actively seek out new private equity investments. Traditionally, investors waited for investment opportunities to come to them from fund managers, placement agents and consultants, but they are now more likely to actively approach potential investments themselves.

With growing internal and regulatory pressure on investors to be more diligent with their investments and alternative assets increasingly relied upon within investment portfolios to meet liabilities, it is more important than ever to find the best available investment opportunities. Preqin's recent studies indicate that more than half (51%) of investors use their own internal investment teams as one of their main ways of sourcing new opportunities, and furthermore, 50% of those questioned stated that they take a proactive approach to seeking out investments.

Proactive Investor Universe

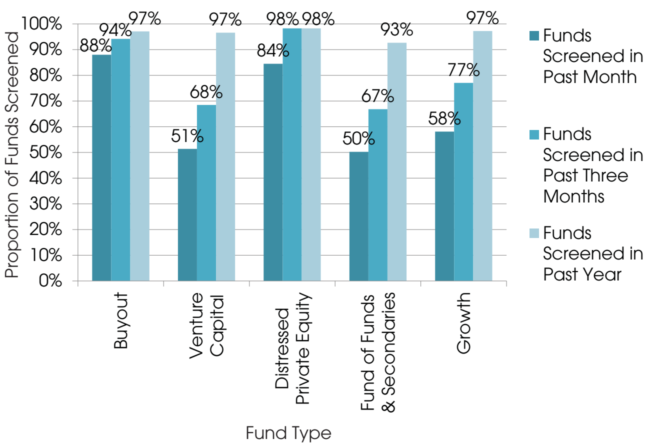
Preqin Investor Network demonstrates just how proactive investors are in discovering and researching potential investment opportunities. Over 5,600 investment professionals across 3,200 accredited institutions use Preqin Investor Network to get overview and contact information for all 2,117 private equity funds in market. More than 140,000 pages of fund, firm, performance, market overview and benchmark data are reviewed by investors every month, with screenings of funds in market alone amounting to over 5,400 a month. Furthermore, managers signed up to the Enhanced Fund Listings service have been receiving direct requests from investors seeking confidential information on their funds typically found in PPMs since 5 November.

Surveyors of the Market

Investors have become surveyors of the market, with 96% of all private equity funds in market having been reviewed on Preqin Investor Network over the past year. Funds big and small, established and first-time, are screened via Preqin Investor Network; it is a key way for both new and established fund managers to get their fund material in front of potential investors. Of first-time and non-first-time private equity funds, 55% and 66% were reviewed during January 2014 by investors respectively. Over the past year, 97% and 96% of first-time and experienced fund managers' funds have been screened by investors respectively. Fig. 2.11 shows that in terms of strategy, the greatest proportion of funds in market screened by investors during January 2014 was buyout and distressed private equity funds. In fact, 88% of the 274 buyout funds in market were reviewed in January 2014, consisting of 1,650 individual reviews, and 84% of distressed debt funds were screened.

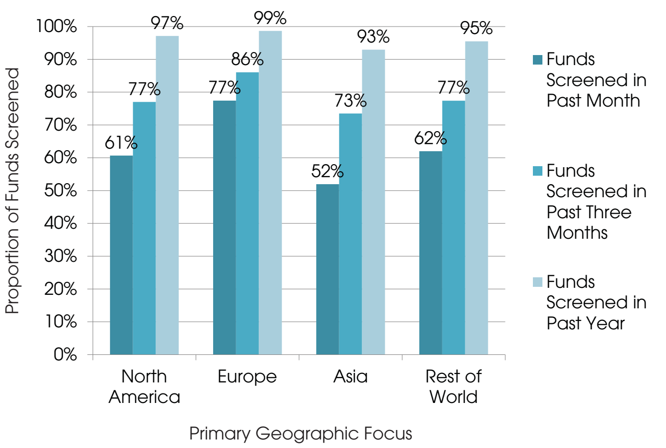
While North America-focused funds attracted the greatest number of investor views in the past month, with 1,862 reviews, a greater proportion of Europe-focused funds were surveyed than North America-focused funds, with 77% and 61% of such funds screened respectively in January 2014, as shown in Fig. 2.12. The proportion of European funds reviewed increased to 86% over the past quarter, and 99% of funds across the past year, with 77% of North America funds screened in the last quarter and 97% in the past year.

Fig. 2.11: Proportion of Private Equity Funds Screened by Investors on Preqin Investor Network by Fund Strategy (As at 01 February 2014)



Source: Preqin Investor Network

Fig. 2.12: Proportion of Private Equity Funds Screened by Investors on Preqin Investor Network by Primary Geographic Focus (As at 01 February 2014)



Source: Preqin Investor Network

Attracting LP Capital and Due Diligence

With over 2,100 private equity funds on the road as of February 2014, there is intense competition for investor capital and investors must be ever more scrupulous in their fund selection processes; this includes ESG policies and considering whether to invest in a fund before a first close or commit to first-time funds.

When we asked investors about their methods of due diligence, we found that 70% use an in-house team and 51% employ an external consultant. Investors may utilize the skills of an external consultant to draw on their expertise in a specific fund strategy, industry sector or a geographic region that is less familiar to the investor's internal team.

ESG Policies

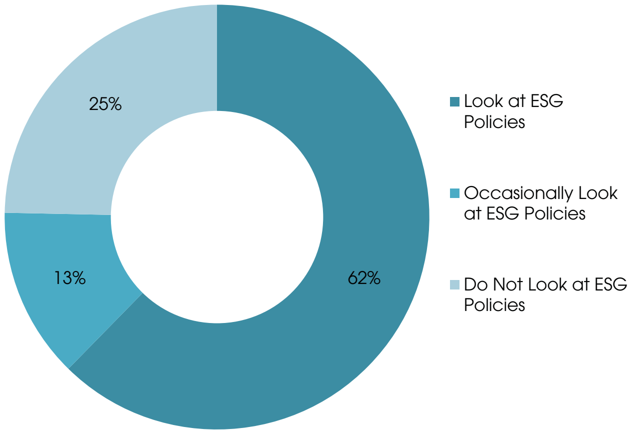
Responsible investment is an investment approach that has had increasing prominence within the private equity asset class and Preqin's survey indicates that many investors in fact do make it a mandatory consideration in their due diligence process. Sixty-two percent of investors consistently look at a firm's Environmental, Social and Governance (ESG) policies before making a commitment (Fig. 2.16). In an intensely competitive fundraising environment, managing ESG risks and opportunities is additional way for private equity firms to distinguish themselves.

First Closes and First-Time Fund Managers

The risk of investing in a fund before it has held an interim close is offset by fund managers in an attempt to attract capital commitments by offering benefits such as co-investment rights or an "early-bird discount", whereby management fees are often reduced. Indeed, the majority (79%) of investors interviewed state they would commit to a fund before it has reached a first close, or at least consider doing so, as shown in Fig. 2.17.

Similarly, investing in a first-time fund, i.e. a debut vehicle from a newly established firm, holds some significant risk potential, as the experience and expertise of the fund manager is untested.

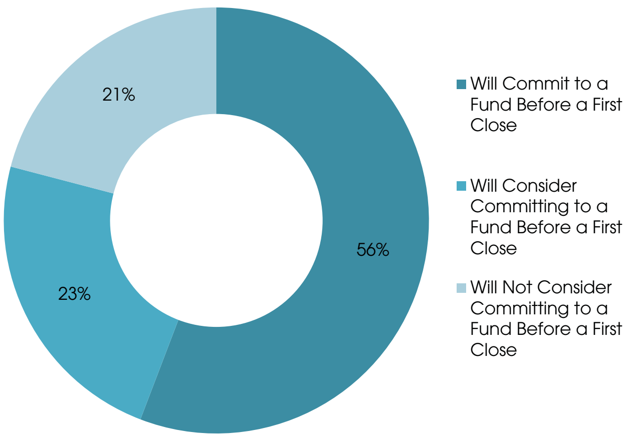
Fig. 2.16: Proportion of Investors that Look at a GP's Environmental, Social and Governance (ESG) Policies Before Making a Commitment



Source: Preqin Investor Interviews, December 2013

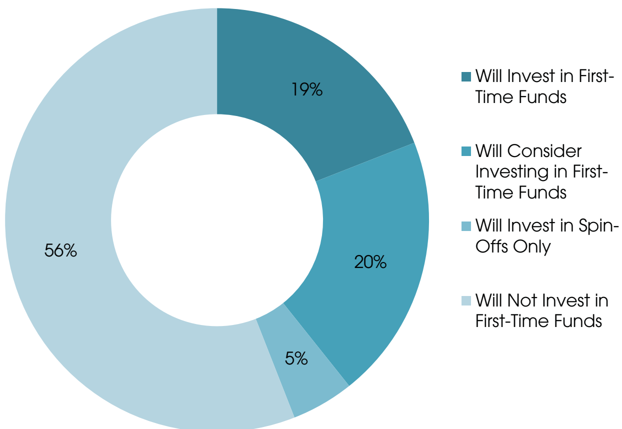
Without a proven track record behind them, first-time fund managers may find securing capital commitments a challenge, and the majority (56%) of investors interviewed will not invest in a maiden fund (Fig. 2.18). Private equity fundraising figures for 2013 reinforce this, as the proportion of total private equity capital commitments in the year that can be attributed to first-time fund managers was a mere 7%. Not only has the dominance of more established fund managers been a consistent trend, but the level of bifurcation is also getting wider. The 7% of capital raised by first-time fund managers in 2013 is a four percentage point decrease compared to the proportion first-time fund managers raised in 2012, and is also the lowest proportion seen since 2004.

Fig. 2.17: Investor Attitudes towards Investing in a Fund Before a First Close



Source: Preqin Investor Interviews, December 2013

Fig. 2.18: Investor Attitudes towards Investing in First-Time Funds



Source: Preqin Investor Interviews, December 2013

Alternative Methods of Accessing the Asset Class

The maturation of economic markets, the private equity asset class and the investor community, has led to a number of developments and shifts in trends within the private equity landscape, such as the rise of separate account mandates and increased levels of activity in the secondary market and direct investments.

Separate Accounts

In recent years, billions of dollars have been allocated to separate account mandates by private equity investors across the globe. The benefits of such an arrangement with a fund manager include the ability to gain customized exposure to private equity, tailored specifically for the need of the individual investor, along with investor participation in decision making. Separate account mandates are often awarded to fund of funds managers, which serve an important function to smaller and less experienced investors looking to gain exposure to the asset class, as well as to more experienced investors that want to access newer markets. Such offerings tend to be more attractive from a fees perspective to investors, compared to investing in a traditional commingled vehicle.

Though only 23% of the investors Preqin interviewed in December 2013 were investing in separate account vehicles, over half of these investors (55%) indicated that separate account commitments will become a permanent part of their investment strategy. Of those investors that do not currently have separate account investments, 30% are considering doing so, as shown in Fig. 2.19.

Direct Investments

Direct investments involve investors working in conjunction with their fund managers, furthering their relationships, providing return benefits and a first-hand view of how the fund managers add value to companies in the portfolio. Over a third of investors interviewed (34%) co-invest alongside GPs in portfolio companies, and 53% are looking to increase their level of activity in this area over the course of 2014. Thirty percent invest as a direct investor on a proprietary basis, with 41% of investors intending to increase such operations in the upcoming year.

Secondary Market

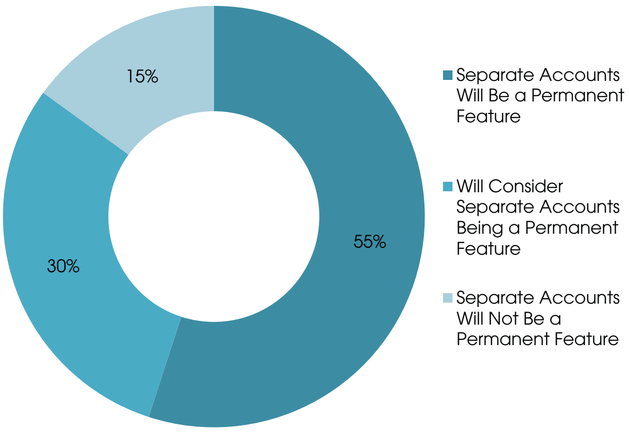
The secondary market is a helpful tool for investors in an abundance of ways: it provides investors with the ability to buy fund stakes at a discount to NAV, create vintage year diversification and access top performing managers. Investors are also attracted to the secondary market as it offers the opportunity to mitigate the effect of the J-curve; buying a stake in a fairly mature private equity fund enables investors to avoid the negative returns in the early years of investment and take advantage of the investment gains in the later stages as the underlying portfolios of companies mature. Fig. 2.20 shows two-thirds of investors interviewed will be increasing their level of secondary market activity as a direct participant in 2014. All remaining investors interviewed would be looking to maintain their level of secondary investments; none intend to decrease their activity.

Preqin's Secondary Market Monitor: A Vital Tool

Preqin's Secondary Market Monitor provides detailed information on all aspects of the secondary market, including investors buying and selling fund interests, secondaries funds, transactions, and much more.

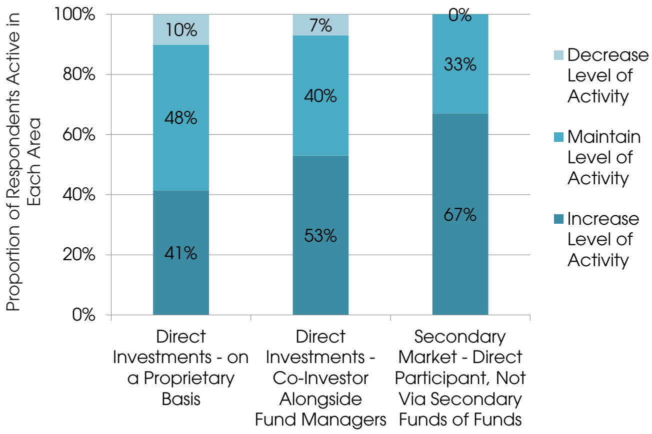
For more information, please visit: www.preqin.com/smm

Fig. 2.19: LPs Investing in Separate Accounts: Proportion that Expect Separate Accounts to Be a Permanent Feature of Their Private Equity Portfolios



Source: Preqin Investor Interviews, December 2013

Fig. 2.20: Investors' Expectations of Their Direct Investment and Secondary Market Activity in 2014



Source: Preqin Investor Interviews, December 2013

Fees and Alignment of Interests

There is a positive picture for private equity relations as we move through 2014, with more than three-quarters of investors believing that GP and LP relations are properly aligned. Despite this, however, LPs still believe there is room for improvement with certain fund terms and conditions.

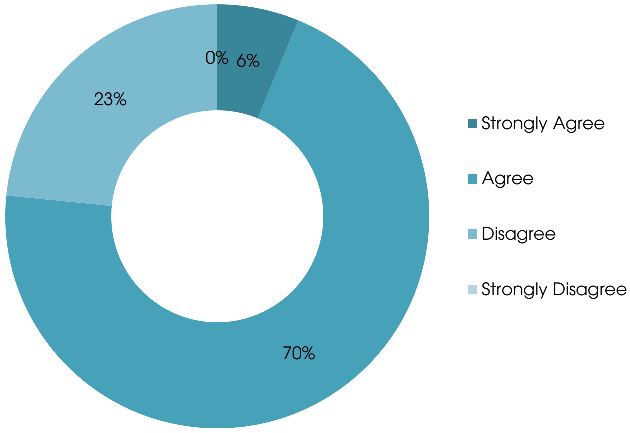
According to Preqin's interviews with investors in December 2013, 70% of investors agree that LP and GP interests are properly aligned, and 6% strongly agree this is the case (Fig 2.21). In contrast, only 23% of investors interviewed believe LP and GP interests are not properly aligned.

Eighteen percent of investors plan to reduce the number of GP relationships in their portfolios in the next two years, which will enable them to reduce their spread of focus and form more strategic relationships. A further 34% are planning to maintain the same number of managers, although for fund managers that have failed to meet expectations, or broken terms in their outlined LP Agreement, investors may have decided not to invest in their next offering.

By increasing the number of fund manager relationships in their private equity portfolios, as 48% of investors interviewed intend to do in the longer term (Fig. 2.22), investors open themselves up to the opportunity of gaining exposure to niche strategies or new geographies that their existing managers may not offer.

Fig. 2.23 illustrates the weight many investors place on various fund terms, with management fees in particular cited by the greatest proportion (56%). A fifth (20%) feel that in order for LP and GP relations to be improved, there needs to be a move away from paying fees on capital not yet invested, and 15% are of the opinion that the typical rebate of deal-related fees needs to be amended. One Iceland-based public pension fund summed up by asserting, "if there isn't something done with regards to fees, it will harm the private equity market". This alludes to the power that these factors have on deterring investors, and how important it is for fund managers to balance these issues when the drawing up of their fund's terms and conditions.

Fig. 2.21: Proportion of LPs that Feel LP and GP Interests Are Properly Aligned



Source: Preqin Investor Interviews, December 2013

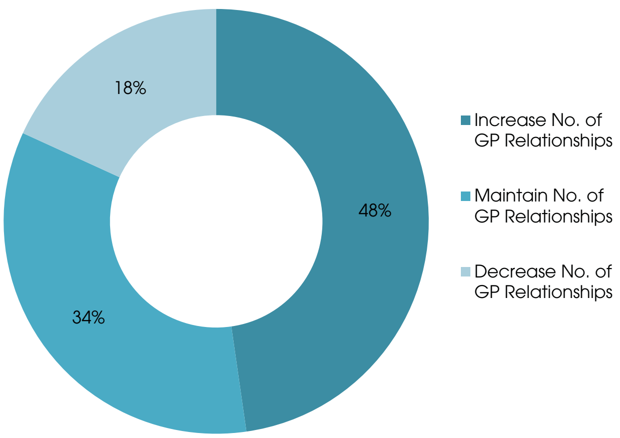
In-Depth Private Equity Fund Manager Data

Preqin's **Fund Manager Profiles** contains detailed information for over 7,500 private equity fund managers. Access league tables of the most prominent fund managers, performance track records, investment preferences, known investors, key contact details, and much more.

For more information, please visit:

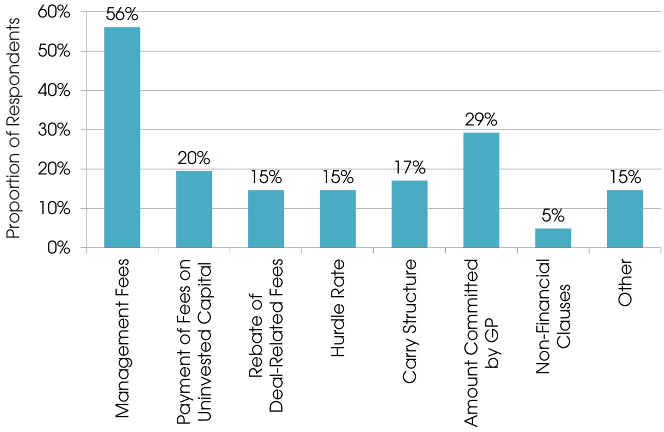
www.preqin.com/fmp

Fig. 2.22: Investors' Intentions for GP Relationships over the Next Two Years



Source: Preqin Investor Interviews, December 2013

Fig. 2.23: Fund Terms Investors Feel Need to Be Amended to Improve LP and GP Relations



Source: Preqin Investor Interviews, December 2013

Hedge Funds

Improving Investor Confidence is Leading to Increased Allocations

2013 was a record year in terms of investor satisfaction with hedge fund returns, with 84% of investors stating that hedge fund returns met or exceeded expectations over the year. Investors are changing the way in which they include hedge funds in their portfolios and some have adopted different return objectives, targeting low volatility of returns and strong risk-adjusted performance rather than just high levels of performance. Performance remains the key issue in fund selection and redemptions and so it is important managers continue with positive returns in 2014 in order to maintain this investor satisfaction.

This increased optimism with hedge fund returns is set to lead to further inflows into hedge funds from institutional investors in 2014 and beyond. The majority of investors expect to either maintain or increase their hedge fund allocations over both the next 12 months and the longer term. Long/short equity funds look set to be the main winners, with 46% of investors believing that the strategy is presenting good investment opportunities in 2014. Event driven funds are also likely to pick up mandates as a result of positive performance in 2012 and 2013, while investors remain attracted to macro funds due to their benefits in terms of non-correlation and diversification.

A range of different managers could pick up mandates in 2014; the highest proportion of investors are targeting managers with \$1-5bn in assets, with the lowest proportion targeting funds with greater than \$5bn, suggesting that investors are moving away from simply investing with the largest funds. Investors are willing to consider smaller managers for investment, although they generally expect to see a strong track record; 47% of respondents cited track record as a key factor in manager selection and 45% of investors look for a manager to have a track record of at least three years.

Preqin conducted detailed interviews with 148 institutional investors in December 2013 in order to gauge their feelings towards issues such as performance, regulation, fund terms, future outlook for the industry and more. Here we present a detailed analysis of the key topics affecting hedge fund investors in 2014 and beyond.

Data Source:

Preqin's **Hedge Fund Investor Profiles** tracks over 4,500 active investors, and is the leading source of intelligence on institutional investors in hedge funds, sourced and updated as a result of direct communication with investors by our large team of multi-lingual analysts. For more information, or to arrange a demonstration, please visit:

www.preqin.com/hfip

Key Facts

84% of investors believed that hedge fund returns met or exceeded their expectations in 2013.

36% of investors believe new hedge fund regulations to be positive, a decrease from 49% in 2012.

92% of investors expect to maintain or increase their hedge fund allocations over the next 12 months.

78% of investors cite performance concerns as a key factor in choosing to redeem from a hedge fund.

50% of investors are looking for improvement in the way performance fees are charged in 2014.

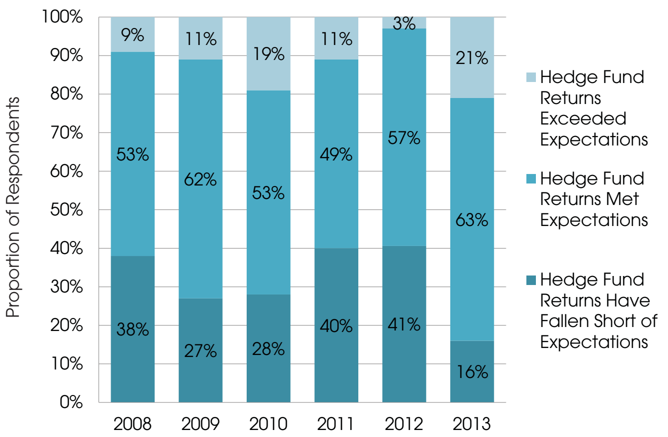
57% of investors expect to target investments with managers in the \$1-5bn AUM bracket in 2014.

Satisfaction with Returns

Hedge funds are under constant pressure to deliver attractive returns to investors and previous Preqin studies have shown investors to be dissatisfied with the returns provided. However, the latest investor interviews show a more positive outlook and the majority of investors were satisfied with the performance of hedge funds in 2013.

2013 was a record year in terms of investor satisfaction with the performance of hedge funds; collectively, 84% of investors stated that hedge fund returns met or exceeded their expectations in 2013, which is the highest level of satisfaction recorded since Preqin began conducting this study in 2008. Only 16% of investors stated that returns had fallen short of expectations (Fig. 3.1). This is a notable improvement on 2012, when there were high levels of dissatisfaction with the hedge fund asset class, with 41% of investors believing that returns had fallen short of expectations as a result of the unfavourable economic environment and increased volatility in the market at that time. The increase in investor satisfaction is due to positive performance in the second half of 2012 and 2013, and also perhaps as a result of investors adopting more realistic return expectations. The proportion of investors reporting that hedge funds have exceeded expectations also increased from just 3% for 2012 returns to 21% for 2013 returns, again suggesting that hedge funds succeeded in meeting portfolio objectives over the course of the year.

Fig. 3.1: Hedge Fund Portfolio Performance Relative to Expectations of Institutional Investors, 2008 - 2013



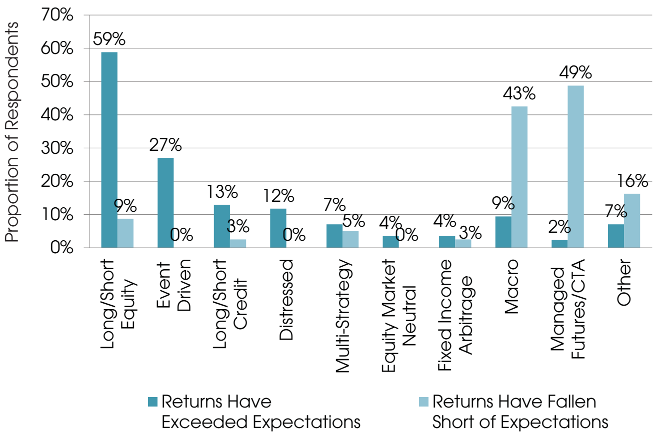
Source: Preqin Investor Interviews, December 2008 - December 2013

Fig. 3.2 shows the specific investment strategies that investors believe exceeded or fell short of expectations in 2013. Directional strategies won favour with institutional investors during 2013, with 59% of investors believing that long/short equity funds had exceeded their expectations, marking a substantial improvement from 2012, when 28% of investors believed the strategy had fallen short of expectations. Event driven was the best performing strategy in 2013 and these funds were also viewed positively by investors, with 27% of the investors we interviewed believing the strategy exceeded expectations in 2013.

In contrast, macro and managed futures/CTA funds struggled to post positive performance in 2013 and this is reflected in investor sentiment, with 43% and 49% of investors stating these strategies had underperformed respectively. Both long/short credit and distressed strategies had a favourable year, with 13% and 12% of investors noting that these strategies had exceeded expectations respectively.

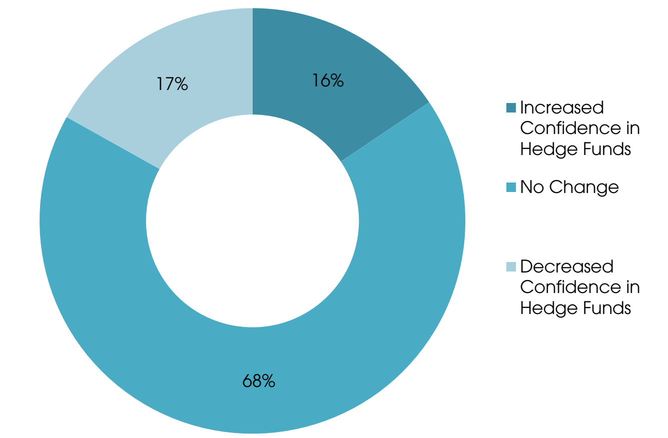
Investor confidence in hedge funds remained relatively unchanged over the course of 2013, with 68% of investors reporting that there had been no change in their confidence in hedge funds to perform portfolio objectives, as shown in Fig. 3.3. Those reporting a change were almost equally split, with 17% reporting decreased confidence in hedge funds and 16% stating that their level of confidence in the asset class had increased.

Fig. 3.2: Hedge Fund Portfolio Performance Relative to Expectations in 2013, by Strategy



Source: Preqin Investor Interviews, December 2013

Fig. 3.3: Change in Investor Confidence in Hedge Funds over the Last 12 Months



Source: Preqin Investor Interviews, December 2013

Key Issues and Regulation

There are many important issues affecting investors in hedge funds, including fund performance, regulations and fund terms. Performance remains top of the list in 2014, while an increasing number of investors seem unconvinced of the benefits of recent regulatory changes.

Key Issues Facing the Hedge Fund Industry in 2014

Institutional investors interviewed by Preqin were asked what they felt would be the key issues facing the hedge fund industry in 2014, with the results presented in Fig. 3.4. Performance was the most commonly cited issue with it being mentioned by 30% of respondents; however, this is a decrease from the 47% of investors that stated performance as a key issue in December 2012. Hedge fund performance was largely positive in 2013 and this provided much needed reassurance to investors, which had their confidence had been affected by the poor returns of 2011 and early 2012.

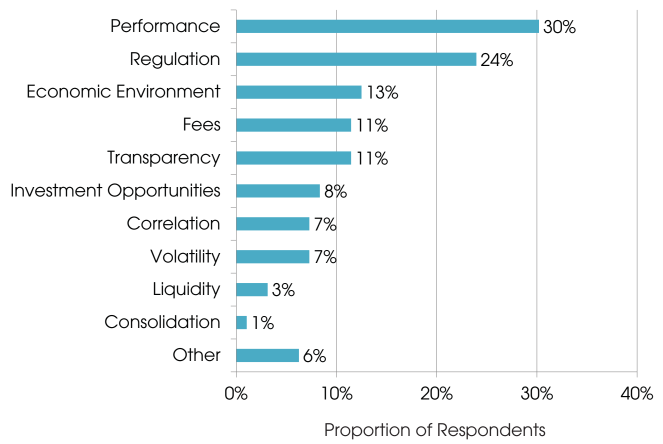
Fees and transparency remain important to investors and some investors are continuing to look for further improvement in these areas, with each of these factors cited as a key issue for 2014 by 11% of respondents. However, these proportions are significantly lower than in previous Preqin studies, suggesting that fund managers have made concessions in these areas in order to appease investors. Thirteen percent of respondents highlighted the current economic environment as an important issue for the hedge fund industry in 2014.

Impact of Regulations on Hedge Fund Investors

Regulation continues to be an important topic of discussion in the hedge fund industry, with 24% of investors naming this as a key issue for 2014, an unchanged proportion from a previous study in December 2012 (Fig. 3.4). There was continuing change in terms of regulation over the course of 2013, including the introduction of the Alternative Investment Fund Managers Directive (AIFMD), and many investors are still waiting to see how they will be affected by the new legislation. There has been a 13 percentage point decrease in the proportion of investors which feel regulation is having a positive effect, from 49% in December 2012 to 36% in December 2013 (Fig. 3.5), with a corresponding 13 percentage point increase in those which are unsure about the impacts of regulation. This increase in investor uncertainty highlights the fact that many investors are still unsure of the full implications of recent regulatory changes and as a result do not see a clear trend for the impact of these regulations in the future.

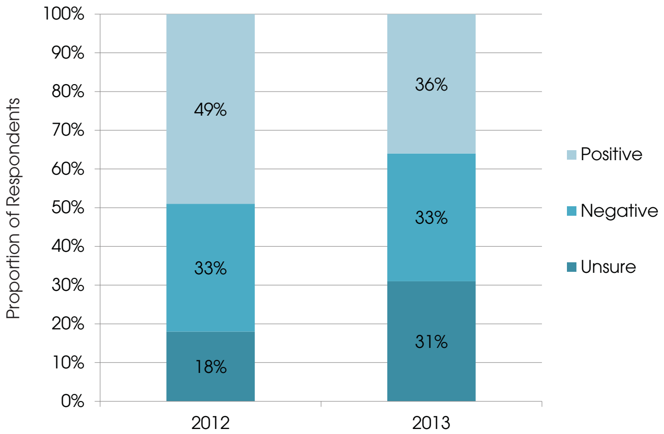
Of those investors that view increased regulation as positive, many believe that having a consistent regulated standard for hedge funds along with more transparent reporting could help them in assessing quality managers. However, a major concern with an increase in regulation is a lack of clarity and some investors fear that this could lead to a tougher environment and a reduction in choice for investors, as some funds are priced out of the market by the costs of compliance. This is something which is particularly true with the AIFMD as a result of each European member state having a different adaptation of the Directive.

Fig. 3.4: Key Issues Facing the Hedge Fund Industry According to Institutional Investors



Source: Preqin Investor Interviews, December 2013

Fig. 3.5: Investor Outlook on Hedge Fund Industry Regulations Introduced in Recent Years, 2012 - 2013



Source: Preqin Investor Interviews, December 2012 - December 2013

Investor Activity in 2014

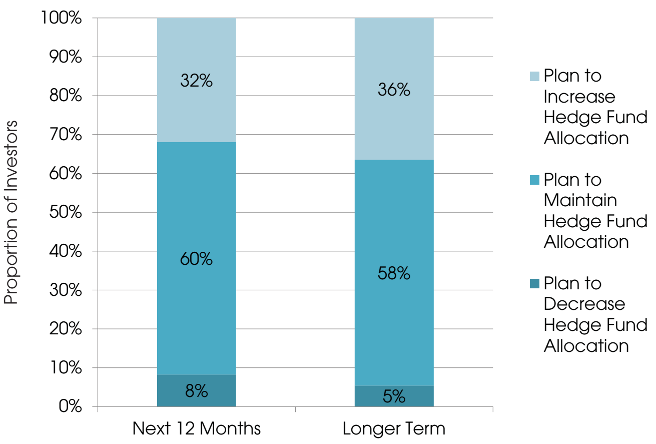
With investor satisfaction with hedge funds reaching record levels in 2013, it is likely that we will see further allocations to the asset class from the institutional community in 2014. The majority of investors interviewed expect to maintain or increase their hedge fund allocations and this should lead to capital flowing into the industry over the coming year.

As shown in Fig. 3.6, 92% of hedge fund investors interviewed expect to either increase or maintain their current allocations to the asset class in 2014. Only 8% of investors intend to reduce their current level of exposure, a noticeable reduction on the 20% of investors which expected to decrease their allocations in December 2012. Many investors are operating at their optimum hedge fund allocation, and activity from institutional investors will remain strong in 2014, which is positive news for hedge fund managers and is likely to lead to additional capital flowing into the industry. A similar pattern emerges in terms of longer term plans for hedge fund allocations, with 36% of investors expecting their allocations to the asset class to increase compared to just 5% that expect it to decrease.

Fig. 3.7 illustrates the breakdown of the amount of capital institutional investors will be looking to commit to hedge funds over the next 12 months. Forty-nine percent of investors will be looking to allocate up to $49mn towards new investments. Although less numerous, the 13% of investors looking to allocate over $500mn to hedge funds are extremely significant both in terms of the amount of capital they will commit and the number of investments they will make. It is these investors that will drive most of the inflows to the industry in 2014. US-based public pension funds, in particular, will contribute to these inflows, with the $24bn Employees' Retirement System of Texas and the $48bn New York City Employees' Retirement System examples of public pension funds that expect to substantially increase their hedge fund allocations in 2014.

Investors are also looking to make allocations to a number of different funds, with 69% of investors which have initiated searches expecting to add at least three new funds to their portfolios over the next 12 months (Fig. 3.8). The majority of active investors are seeking multiple investments in order to reduce risk and increase diversification, rather than placing all of their emphasis on a single fund. This is positive for the hedge fund industry and means that there should be plenty of opportunities for managers to secure institutional capital in 2014 and beyond.

Fig. 3.6: Investors' Intentions for Their Hedge Fund Allocations in the Next 12 Months and the Longer Term



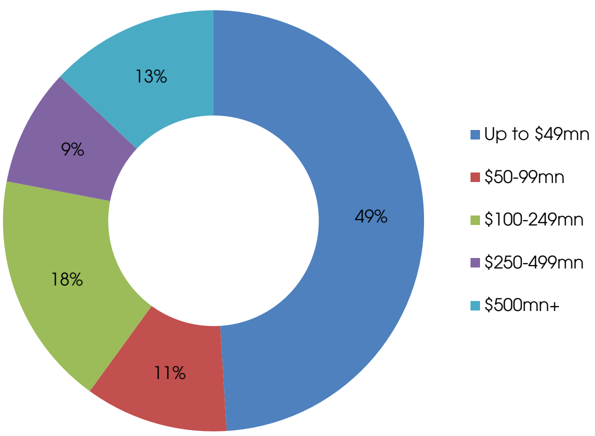
Source: Preqin Hedge Fund Investor Profiles

Track Investor Fund Searches and Mandates

The **Future Fund Searches and Mandates** feature on Preqin's **Hedge Fund Investor Profiles** is the perfect tool to pinpoint those institutions that are seeking new hedge funds for investments now. For more information, please visit:

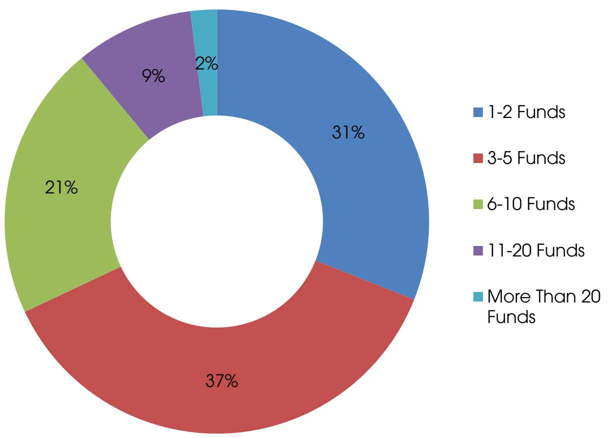
www.preqin.com/hfip

Fig. 3.7: Amount of Fresh Capital Institutional Investors Expect to Invest in Hedge Funds over the Next 12 Months



Source: Preqin Hedge Fund Investor Profiles

Fig. 3.8: Number of Hedge Funds Institutional Investors Expect to Add to Their Portfolios over the Next 12 Months



Source: Preqin Hedge Fund Investor Profiles

Strategies and Structures Targeted

As shown in the previous section, institutional investors are likely to make substantial allocations to hedge funds over the coming 12 months. In this section we analyze the strategies and structures that investors feel are presenting the best opportunities.

Strategies Presenting Good Opportunities in 2014

Investors were asked for their opinion on which hedge fund strategies would present the best opportunities for investment in 2014. Long/short equity funds performed well in 2013 as a result of buoyant equity markets and it seems investors expect this positive performance to continue in 2014, with 46% of respondents stating that the strategy is presenting good opportunities (Fig. 3.9). Event driven funds have also performed well in both 2012 and 2013 and investors seem keen to take advantage of this success, with 22% citing these funds as presenting good opportunities for the year ahead.

Macro funds had an underwhelming 2013 in terms of performance but this has not deterred investors, which remain interested in the strategy due to the benefits that these funds can provide in terms of diversification and uncorrelated returns. These managers will be aiming to improve performance in 2014 and 19% feel that macro funds are currently presenting good opportunities for investment. The outlook is less positive for CTAs, however, with the poor performance of these funds leading to a reduction in investor appetite; just 5% of respondents suggested that the strategy is presenting good opportunities in 2014.

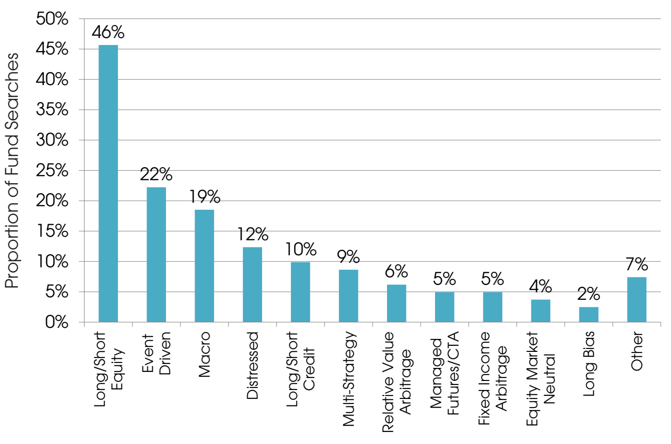
Direct vs. Funds of Hedge Funds

Investing via commingled single-manager hedge funds was the most favoured investment approach in 2013, with more than 85% of searches including this structure. Unsurprisingly, fund of hedge funds managers continue to be a key source of capital for hedge funds, representing 55% of direct investment searches (Fig. 3.10). There was also resurgence in the amount of capital being allocated to hedge funds by private wealth firms over the course of 2013. Family offices and wealth managers combined represent 12% of searches for single managers, a substantial increase from the 6% of searches that these investors represented in the previous year.

Public pension funds are the most receptive to fund of hedge funds structures, with these investors making up 31% of searches for multi-manager funds. There has also been an increased interest in funds of hedge funds from endowment plans and foundations, partly as a result of managers offering access to new niche or customized vehicles. Fourteen percent of searches initiated for funds of hedge funds included a search for managed accounts, which further highlights that there is a desire for greater control from some investors. Typically funds of hedge funds have been associated with newer and less experienced investors, but offering customized portfolios provides an opportunity to attract some more established groups or institutions.

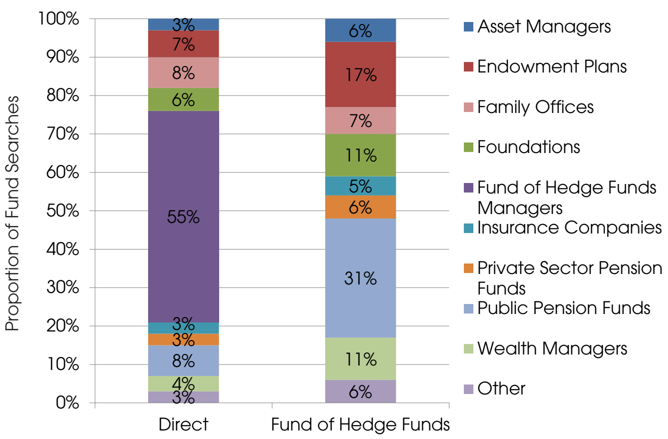
There has also been a demand for UCITS-compliant funds, with 9% of investors targeting this regulated structure, a slight increase from the 7% of searches it represented in 2012. The majority of searches for UCITS funds initiated in 2013 were from European fund of hedge funds managers targeting more transparent and liquid vehicles for the benefit of their investors. The UCITS wrapper will continue to remain a relatively niche preference among hedge fund investors moving into 2014, but it remains a signifier of investor demand for regulated vehicles.

Fig. 3.9: Hedge Fund Strategies Investors Feel Are Presenting the Best Opportunities in 2014



Source: Preqin Hedge Fund Investor Profiles

Fig. 3.10: Breakdown of Investors Searching for Funds of Hedge Funds vs. Direct Investments by Investor Type



Source: Preqin Hedge Fund Investor Profiles

Attracting Investor Capital

With an ever-demanding institutional investor universe, it is vital for fund managers to assess the key factors that are considered in the fund selection process. Performance remains the key issue, but there are a number of other important requirements that hedge fund managers need to take into account in order to attract investment.

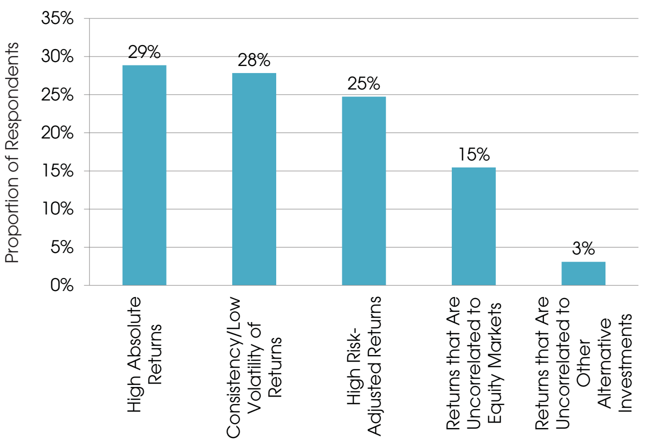
Return Objectives

Investors were asked about their objectives from their hedge fund investments in terms of what type of returns they seek, with the results presented in Fig. 3.11. High absolute returns are a key objective for many investors, with 29% of investors stating this as their primary target. However, many respondents considered other factors aside from absolute returns to be their main priority. A number of institutional investors allocate to hedge funds in order to reduce volatility and risk in their portfolios, and 28% and 25% of investors stated that they target consistency of returns and high risk-adjusted returns respectively. As a result, it is reasonable to conclude that some investors may be forgiving of lower short-term returns if a fund has consistent risk-adjusted performance.

Key Factors in Manager Selection

Fig. 3.12 shows the key factors that institutional investors take into consideration when assessing prospective hedge fund managers. Performance remains the most important factor in the selection process, with returns cited by 48% of investors as a key factor. Investors are also continuing to evaluate potential opportunities critically and value previous experience from fund managers; the presence of an established track record and management experience were the next most commonly mentioned factors, cited by 47% and 43% of investors respectively. As demand for lower volatility of investments and better risk-adjusted returns continues, characteristics such as the risk profile and liquidity profile of funds come into the forefront as key factors; 29% and 20% of investors mentioned these as important criteria respectively.

Fig. 3.11: Investor Return Objectives from Hedge Fund Investments

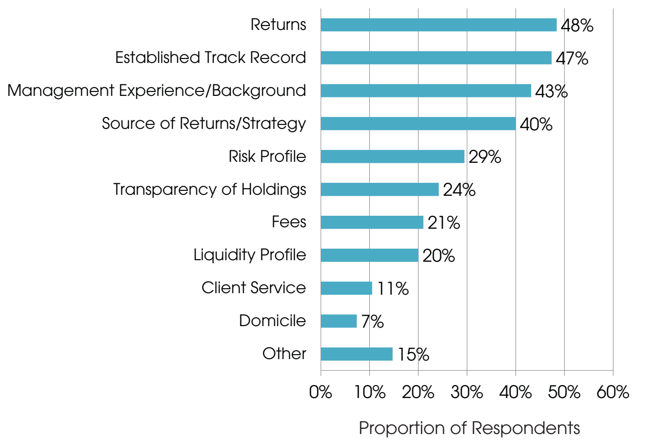


Source: Preqin Investor Interviews, December 2013

Reasons for Redeeming From Hedge Funds

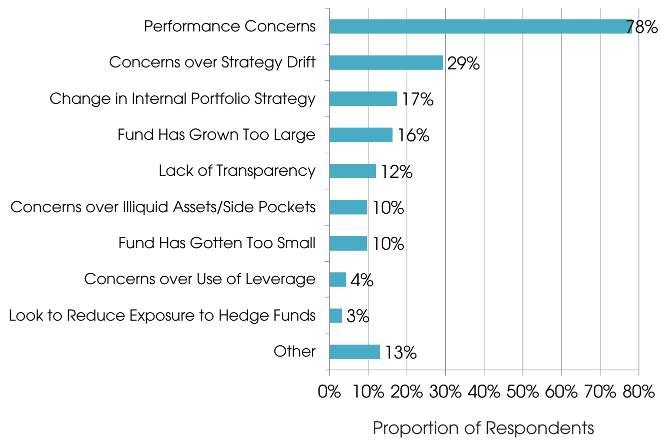
Investors are showing a willingness to redeem and replace managers in their hedge fund portfolios if they feel they are failing to live up to expectations. Poor performance is by far the most common reason for investor hedge fund redemptions, with 78% of investors interviewed stating this as a key reason for withdrawing capital from a fund (Fig. 3.13). Investors also expect funds they invest with to stick to a clearly defined strategy; 29% of investors mentioned concerns over fund strategy drift as a reason for redeeming an investment. Other factors contributing to redemptions were mentioned by a smaller proportion of investors, including a change in internal portfolio strategy (17%), funds becoming too large (16%) and a lack of transparency (12%).

Fig. 3.12: Key Factors Used by Institutional Investors to Evaluate Hedge Fund Managers



Source: Preqin Investor Interviews, December 2013

Fig. 3.13: Institutional Investors' Reasons for Exiting Hedge Fund Investments



Source: Preqin Investor Interviews, December 2013

Fees and Alignment of Interests

Fund terms and conditions remain an important consideration for investors when choosing a fund for investment. Fund managers must listen to the demands of investors and improve the alignment of interests, or risk losing out on valuable capital from these allocators.

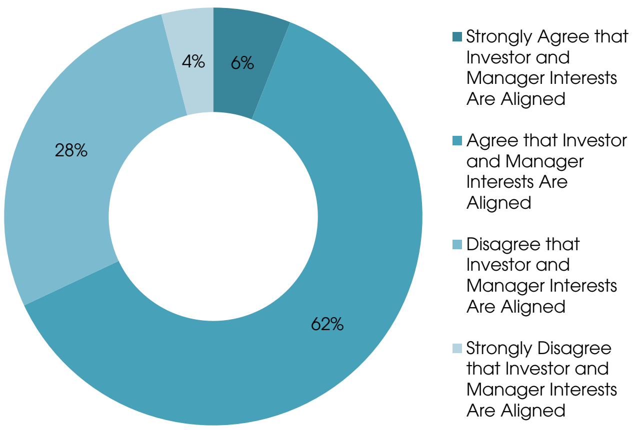
The trade-off between the needs and objectives of an institutional investor with those of the fund managers which invest their money has been a long-standing source of negotiations between the two groups. The majority of investors are currently satisfied with the fund terms being offered, with 62% of investors agreeing that investor and manager interests are aligned and a further 6% strongly agreeing that this is the case (Fig. 3.14). Just under a third of investors feel that interests between fund managers are not aligned; therefore, there is continued work needed from the fund management community to convince these investors that their interests are considered.

In terms of how the alignment of interests has changed over the past 12 months, the majority of investors (58%) stated that there had been no significant change (Fig. 3.15). However, there has continued to be a shift in the number of investors seeing concessions in their favour, with 36% of investors seeing a slight change in favour of the investor in 2013, compared to 26% in 2012. Managers are continuing to be willing to enter into negotiations over fund terms and conditions with investors in order to harmonize their own interests with those of the investor; just 5% of investors reported seeing a shift towards managers over the course of 2013.

The fees being charged by hedge fund managers continues to be the principal issue for many investors, with the '2&20' fee structure no longer being universally accepted. Investors have noted some improvement in terms of the fees being charged by managers, with 59% and 47% of investors noting an improvement in management fees and performance fees respectively in 2013 (Fig. 3.16). However, some investors still feel there is room for further improvement, with 45% and 43% of investors looking for improvements in the levels of management fees and performance fees charged respectively in 2013. However, this is a notable reduction on the 55% and 58% of investors respectively that were looking for further improvements in these areas in 2012.

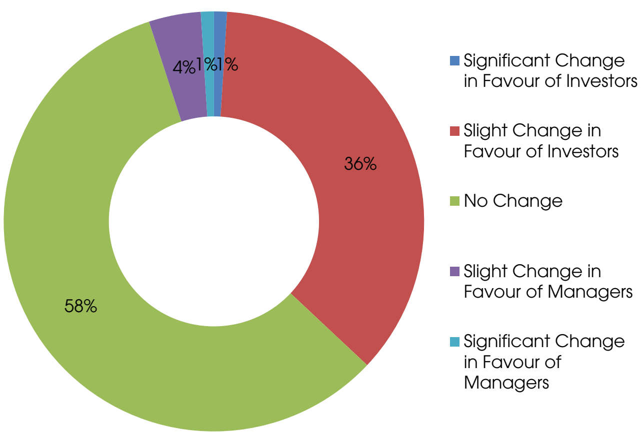
A key area where investors are looking for improvement is in how performance fees are charged, with 50% of investors seeking changes in how performance fees are structured. Investors feel that they should only be paying fees when fund performance justifies this; factors such as claw-back provisions can help protect investors from prolonged spells of poor performance, and managers should reconsider both how and how often they charge performance incentives in order to convince those investors which are sceptical of the current system.

Fig. 3.14: Investor Opinion on the Alignment of Interests between Investors and Managers



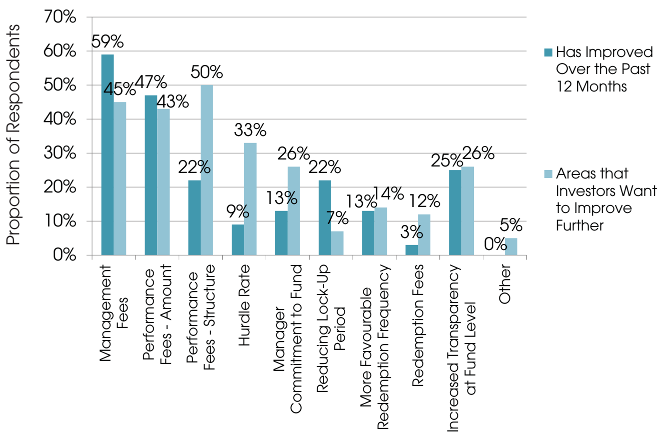
Source: Preqin Investor Interviews, December 2013

Fig. 3.15: Investor Opinion on Changes in the Alignment of Interests between Investors and Managers over the Past 12 Months



Source: Preqin Investor Interviews, December 2013

Fig. 3.16: Areas of Fund Terms Investors Feel Have Shown the Most Improvement over the Past 12 Months and that Need to Improve Further in 2014



Source: Preqin Investor Interviews, December 2013

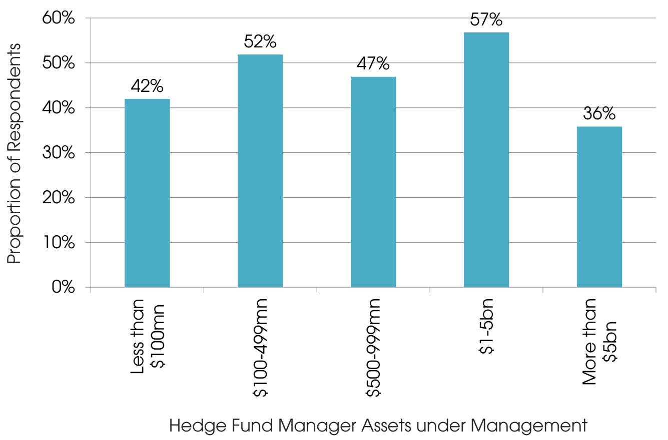
Size and Track Record Requirements

Extra-large hedge funds have been the biggest winners in recent years as investors look for the perceived security associated with investing in established firms. However, smaller funds are now being considered by investors and we could see a broad range of managers pick up mandates in 2014.

Sizes of Managers Being Targeted in 2014

Much of the capital inflow over the past few years has been to just the largest hedge funds in the industry, and as a result it has been difficult for smaller funds to gain traction from the institutional market. With this in mind investors were asked about the sizes of hedge fund managers they were likely to consider for investment in 2014, with the results presented in Fig. 3.17. Track record and management experience are attractive characteristics for many hedge fund investors, and the largest number of investors (57%) stated that they expect to invest with managers with assets under management of between $1bn and $5bn in 2014. However, the size category with the lowest proportion of investor interest was for managers with more than $5bn in assets, suggesting that investors are beginning to look towards the mid-to-large funds, and away from the behemoths of the industry. A number of investors are open to investing with smaller managers in 2014, with 52% of investors set to target managers of between $100mn and $499mn and 42% open to investing in managers with less than $100mn in assets. This indicates that investors are at least in principle willing to work with smaller managers, although the track record and other characteristics of larger funds remain appealing.

Fig. 3.17: Hedge Fund Manager Sizes Targeted by Investors in 2014



Source: Preqin Investor Interviews, December 2013

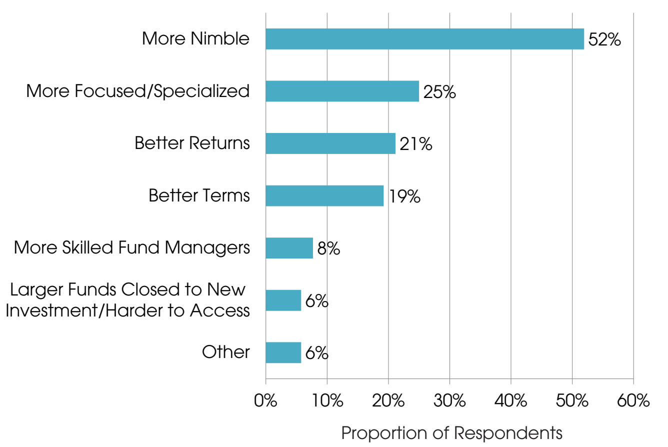
The Case for Smaller Managers

Smaller managers have a number of characteristics which can be attractive to investors (Fig. 3.18). These managers are often better placed to take advantage of a wider opportunity set due to their smaller position sizes and more than half (52%) of investors targeting smaller managers cited their nimbleness as a key characteristic. One UK-based investment company stated “smaller managers on the whole tend to be more nimble and less concerned with accumulating management fees than the larger managers”, and, overall, 19% of investors said they prefer investing with smaller managers due to these firms offering more attractive fund terms. With investors also seeking unique and individual investment strategies, the more focused edge of smaller fund managers can be appealing, with a quarter of investors naming a more specialized investment approach as a key characteristic of these managers.

The Case for Larger Managers

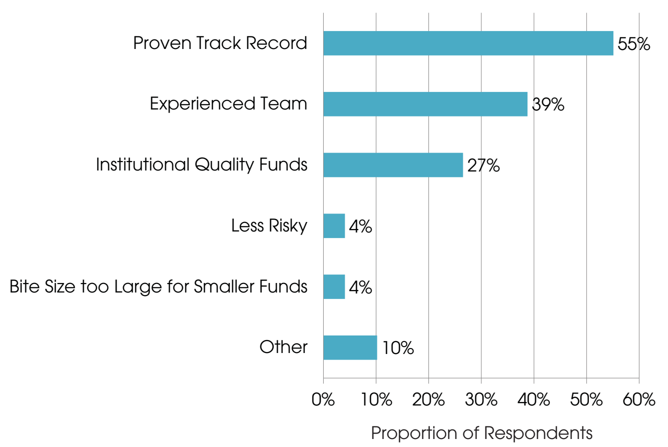
A strong previous track record continues to be a vitally important factor for a number of hedge fund investors and 59% of respondents stated this as a key reason for targeting investments with larger managers (Fig. 3.19). The level of experience within these teams was also named as a

Fig. 3.18: Reasons for Investors Preferring Managers With Less than $1bn in Assets



Source: Preqin Investor Interviews, December 2013

Fig. 3.19: Reasons for Investors Preferring Managers With More than $1bn in Assets under Management



Source: Preqin Investor Interviews, December 2013

preferential characteristic of these managers, mentioned by 39% of respondents, as investors look to tap into the specialized knowledge of these larger firms, where the principals may have decades of specific sector knowledge. Twenty-seven percent of investors cited institutional quality funds as a reason for targeting larger managers, as smaller funds are often less well developed in terms of infrastructure and back office operations, and may be less equipped to deal with the sizeable assets invested by institutional investors.

Emerging Manager Preferences

With investors showing a willingness to at least consider smaller managers in 2014, Preqin conducted a more in-depth study into investor attitudes towards emerging funds. There has been an overall reduction in appetite for emerging managers among institutional hedge fund investors since Preqin last conducted this study in October 2012. Thirty-seven percent of investors will invest in first-time funds (Fig. 3.20), compared to 42% in 2012. This continues a trend of decline from 54% in 2010 and 48% in 2011, suggesting that investors have moved towards investing with more established fund managers as they often perceive such investments to be less risky.

Interest in investing with spin-off teams has also dropped over the past year, with 35% of investors currently targeting such investments compared to 38% in 2012. Spin-off funds provide access to experienced industry professionals but they do not always offer exposure to the value-added niche strategies that investors typically look for in an emerging manager allocation. Seeding new hedge funds is a more niche aspect of the hedge fund industry, with such opportunities typically taken up by fund of hedge funds managers or investors with a large capital base. The proportion of investors interested in seeding opportunities has declined from 19% in 2012 to 15%, with this market dominated by specialist seeding firms.

Minimum Track Record Requirements

In line with a reduction in appetite for emerging managers, the average minimum track record required by hedge fund investors before committing to manager has increased. In 2012, 16% of investors were willing to invest with a manager with less than a year's track record, but this has decreased to 10%, as shown in Fig. 3.21. Investors are becoming more demanding when selecting hedge fund managers and, as a result, they want to see a significant track record before investing. There has been an increase in the proportion of investors requiring a track record of four years or more over the past year from 22% to 26%. The most common minimum track record requirement is three years, with 45% of investors having this policy.

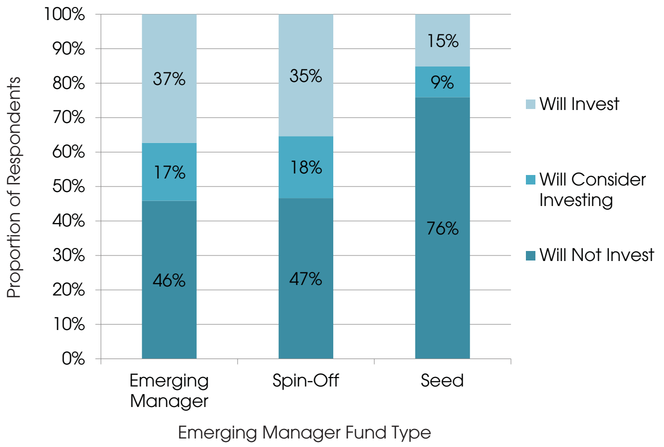
Investor Screening of the Market

The investors interviewed by Preqin in December 2013 indicated that they are searching for funds across all size ranges; however, how is this translating into actual fund searches? Looking at investor activity on Preqin Investor Network, we can see just how proactive investors are in discovering and researching potential investment opportunities across various fund sizes. Over 5,600 accredited investors across 3,200 institutional firms use Preqin Investor Network to get overview and contact information for all hedge funds open to investment. More than 140,000 pages of alternatives fund, firm, performance, market overview and benchmark data are reviewed by investors on Preqin Investor Network every month.

As Fig. 3.22 clearly shows, every month all of the largest funds on the platform are reviewed by investors. It is unsurprising that the largest hedge fund in the world today, Bridgewater All Weather Strategy, is the most viewed hedge fund on the Network; however more surprisingly, among the top 20 most viewed funds on the network over the past 12 months there are four funds with less than $100mn in assets under management. As Fig. 3.22 also shows investors are casting a broad net when screening funds on PIN, with at least two-thirds of funds in all size ranges having been considered by investors on the Network over the last year. The wide fund size scope that the surveyed fund investors indicated they are searching across in Fig. 3.22 is translating into fund screening on Preqin Investor Network.

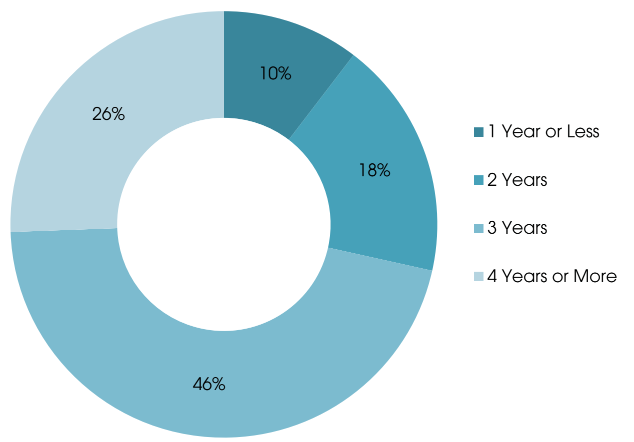
Fig. 3.23 shows the proportion of funds incepted in each year since 2000 which have been reviewed on Preqin Investor Network over the past 12 months. 2013 is excluded as this does not represent a full year of page views. The reduced appetite for

Fig. 3.20: Institutional Hedge Fund Investor Attitudes Towards Emerging Manager Fund Types



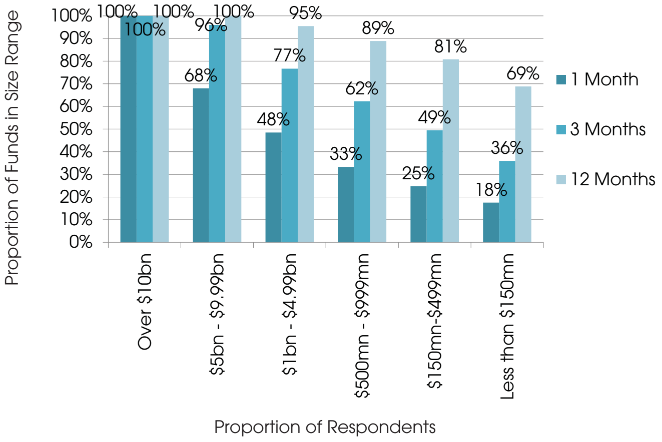
Source: Preqin Investor Interviews, December 2013

Fig. 3.21: Minimum Fund Manager Track Record Required by Institutional Investors in Hedge Funds



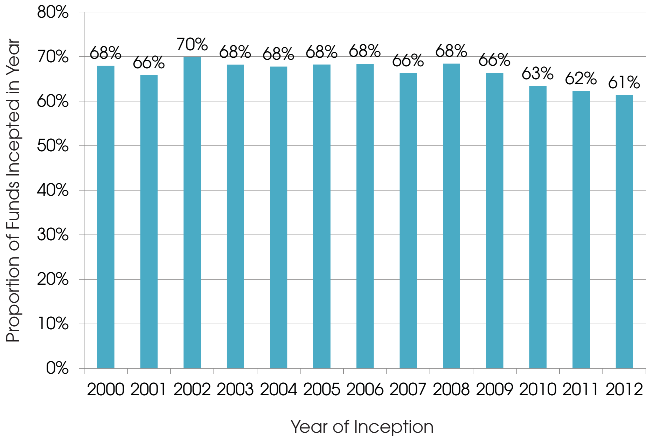
Source: Preqin Investor Interviews, December 2013

Fig. 3.22: Proportion of Funds In Each Size Group which Have Been Screened by Investors on Preqin Investor Network, over One, Three and 12-Month Periods



Source: Preqin Investor Network

Fig. 3.23: Proportion of Funds by Year of Inception which Have Been Screened by Investors on Preqin Investor Network, over a 12-Month Period



Source: Preqin Investor Network

funds with less than a three-year track record, as highlighted in Fig. 3.21, is apparent as fund views drop off for funds incepted since 2010. However with over 60% of funds with less than a three-year track record being reviewed by the investors on the Network over the past year, managers of newer funds can take confidence that many investors are regularly looking at funds with shorter track record, possibly not for immediate investment but more as potential future investments when a longer history of fund returns has been built.

Outlook

Investors are looking at a wide range of hedge fund managers for investment in 2014, with a number of different criteria to be considered in the manager selection process. Track record is the most common reason for investors preferring funds with more than $1bn in assets and investors value the investment experience typically associated with these managers. As a result there has been an overall reduction in the proportion of investors targeting newer managers over the past year as investors focus on investing with established firms.

However, the majority of investors are willing to consider smaller managers with less than $500mn in assets, with the nimbleness of these firms a particularly attractive characteristic. In addition a number of the largest hedge funds are becoming closed to new investment and this is another factor which could lead to investors looking at smaller managers. As a result, there are opportunities for these managers, although funds will need to build an impressive track record in order to be successful. There will be opportunities for both smaller and larger managers to secure institutional capital in 2014 and those managers that can differentiate themselves from their competitors in terms of both strategy and performance are likely to be most successful.

Real Estate

Larger Investors Dominate New Allocations

Despite 2013 seeing private real estate fundraising reach a five-year high, with $77bn raised from 168 funds reaching a final close, only 41% of investors surveyed in December 2013 committed to private real estate funds in the previous 12 months. This trend looks likely to continue in the year ahead, with many investors remaining cautious of committing capital to private real estate funds in 2014, as only 35% of investors surveyed intend to make new commitments over the next 12 months.

Activity in 2014 is likely to vary significantly according to institution size, with 59% of investors with $10bn or more in total assets under management expecting to make new commitments compared to just 26% of investors with less than $10bn in assets. Additionally, many active investors intend to commit to multiple funds in 2014, with 65% of investors planning to place capital in three or more private real estate funds. As such, despite only relatively few investors intending to make new commitments to the asset class in the year ahead, those that do commit are likely to placing sizeable amounts of capital in multiple funds. However, with 31% of investors planning to increase their allocations to the asset class both in the next 12 months and the longer term, there is the potential for significant amounts of capital to flow into private real estate in the coming months.

A preference for higher risk/return profile strategies is particularly prevalent among investors in the year ahead, with value added and opportunistic funds targeted by 49% and 45% of active investors respectively; comparatively, appetite for core funds has declined from 52% targeting the strategy in December 2012 to 43% in December 2013. There are also likely to be considerable regional variations, with 70% of Asia-based investors likely to make new commitments, compared to just 34% and 25% of North America- and Europe-based investors respectively. Institutions are also likely to target domestic opportunities in 2014, with 73%, 59% and 60% of North America-, Europe- and Asia-based investors planning to invest domestically respectively.

Fund manager track record and performance are increasingly scrutinized by investors, with these factors the most important considerations for 31% and 25% of investors respectively when deciding which managers to place capital with. As such, the fundraising environment for first-time managers in the year ahead is likely to be particularly challenging, with the proportion of investors that will invest in first-time funds falling to 17% in December 2013, compared to 41% in December 2009. Managers seeking capital in the crowded fundraising market must ensure they structure their funds to effectively align their interests with potential LPs; encouragingly, 69% of investors agree or strongly agree that fund manager and investor interests are properly aligned, although management fees remain the key concern for investors in the current market, with 48% stating this as an area where alignment can be improved.

Key Facts

35% of investors plan to make new commitments in 2014, down from 53% in December 2012.

31% of investors intend to increase their allocation to the asset class in the next 12 months.

59% of investors with $10bn or more plan to make new commitments in the year ahead, compared to 26% of investors with less than $10bn in total assets.

49% of investors will target value added funds in 2014, with 45% targeting opportunistic funds.

24% of investors view the economic environment as the key issue facing the private real estate market in 2014, a decrease from 40% in December 2012.

68% of investors agree or strongly agree that fund manager and investor interests are properly aligned.

Investor Activity in 2013

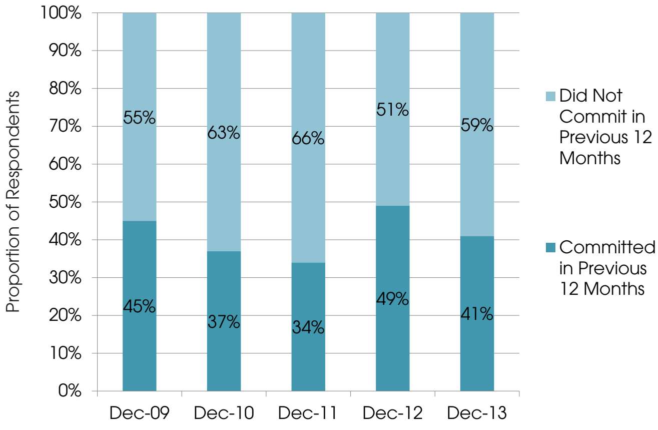
2013 saw a decrease in the proportion of investors committing to private real estate funds, with a growing distinction between larger and smaller investors. Regionally, Asia-based institutions were considerably more likely to have committed to funds over the year, with appetite low among Europe-based investors in particular.

Despite the improvement in real estate fundraising seen in 2013, many investors remained wary of committing significant amounts of capital to the asset class, with Fig. 4.1 showing that only 41% of institutions interviewed in December 2013 invested in private real estate funds in the last 12 months, compared to 49% in December 2012. Nonetheless, appetite among investors for private real estate investment remained above the low seen in December 2011, when only 34% of investors had committed to the asset class in the previous 12 months.

When looking at which investors made commitments to real estate in the last 12 months by their assets under management, we see that larger investors were significantly more likely to commit capital to private real estate funds, and therefore accounted largely for the increase in capital raised in the year. Fifty-six percent of institutions with $10bn or more in assets under management invested in private real estate funds in 2013, compared to only 35% of investors with less than $10bn in total assets, as shown in Fig. 4.2.

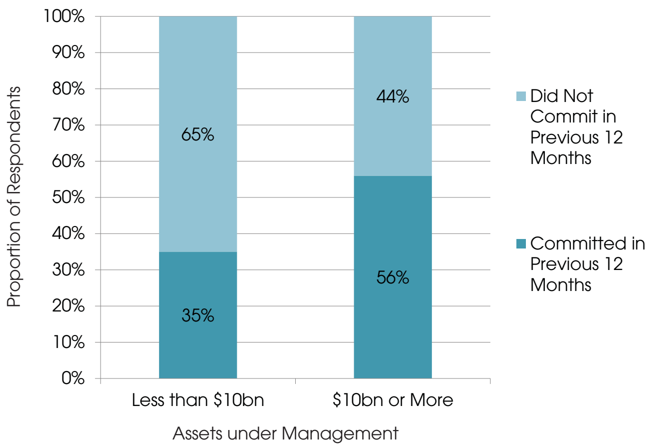
Regionally, changing regulations and a shift in attitudes towards the asset class have led many investors located in Asia to increase their exposure to real estate. Institutions based in Asia and those located in regions outside North America and Europe were the most active in 2013, with 55% committing to at least one private real estate fund over the year, as shown in Fig. 4.3. In contrast, 43% of North America-based investors made commitments in the past year and Europe-based institutions trailed behind, with only 35% having invested in private funds during the same time frame.

Fig. 4.1: Proportion of Investors that Committed to Private Real Estate Funds in the Previous 12 Months, December 2009 - December 2013



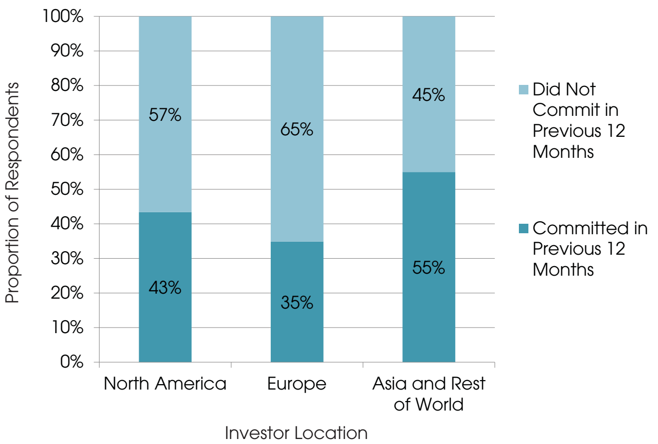
Source: Preqin Investor Interviews, December 2009 - December 2013

Fig. 4.2: Proportion of Investors that Committed to Private Real Estate Funds in the Previous 12 Months by Assets under Management



Source: Preqin Investor Interviews, December 2013

Fig. 4.3: Proportion of Investors that Committed to Private Real Estate Funds in the Previous 12 Months by Investor Location



Source: Preqin Investor Interviews, December 2013

Investor Activity in 2014 – Likelihood of New Commitments

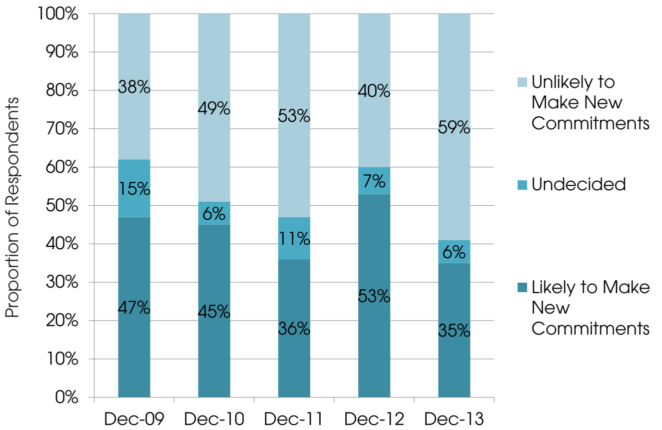
The outlook for private real estate fundraising in 2014 is likely to remain similar to that seen in the previous year, with a relatively small proportion of investors looking to make new commitments, and larger investors considerably more likely to do so. Asia-based investors are likely to once again be the most active, with many Europe- and North America-based investors remaining cautious of new commitments.

The proportion of investors that are likely to make new private real estate commitments in the next 12 months has fallen to its lowest point in the five-year period shown in Fig. 4.4, with only 35% of investors looking to make new commitments in the 12 months from December 2013, compared to 53% in December 2012. This is similar to the low seen in December 2011, when 36% of investors planned to make new commitments in the year ahead, and further demonstrates the particularly cautious nature of many investors in private real estate. Consequently, with only a small proportion of investors surveyed intending to commit new capital to the asset class in the year ahead, competition among fund managers for investor capital will be very high.

However, as was the case in 2013, investment activity in private real estate in 2014 will vary greatly depending on institution size, as demonstrated in Fig. 4.5. Fifty-nine percent of investors with $10bn or more in total assets expect to make commitments in 2014 compared to just 26% of real estate fund investors with assets of less than $10bn. As such, although a large proportion of investors are unlikely to invest new capital in the private real estate industry in 2014, many of those investors with greater assets under management have a positive outlook on real estate, and many are likely to place large amounts of capital in the asset class in the year ahead.

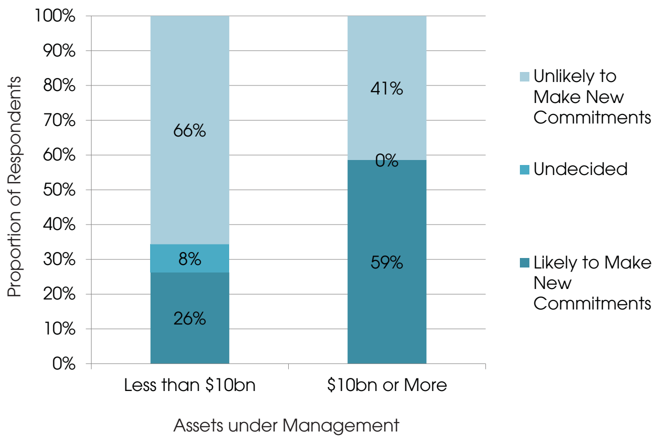
Overwhelmingly, investors located in Asia are set be the most active in the private real estate market, with 70% of respondents likely to make new commitments in the next 12 months, as shown in Fig. 4.6. In contrast, only 34% of North America-based and 25% of Europe-based investors are likely to commit capital to private real estate funds over this period, with a large proportion of investors based in these regions remaining wary of the asset class.

Fig. 4.4: Investors' Intentions for Private Real Estate Investments in the Following 12 Months, December 2009 - December 2013



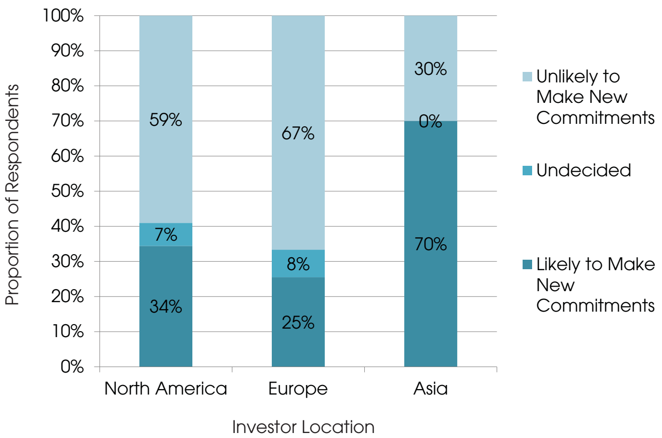
Source: Preqin Investor Interviews, December 2009 - December 2013

Fig. 4.5: Investor Intentions for Private Real Estate Investments in the Next 12 Months by Assets under Management



Source: Preqin Investor Interviews, December 2013

Fig. 4.6: Investor Intentions for Private Real Estate Investments in the Next 12 Months by Investor Location



Source: Preqin Investor Interviews, December 2013

Investor Activity in 2014 – Capital Outlay

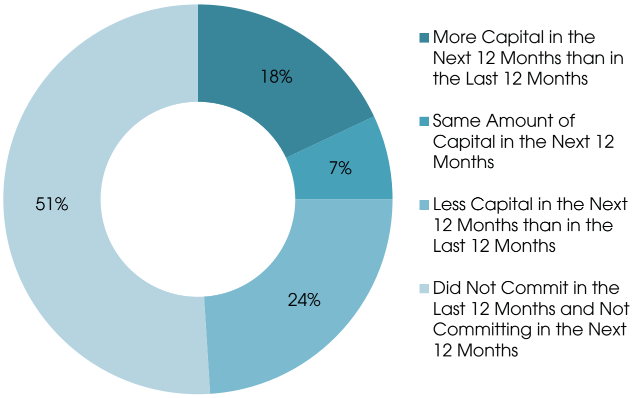
Despite only a small proportion of investors planning to commit more capital to private real estate funds in the next 12 months, those that are looking to invest are likely to place capital in multiple funds, with over a third of investors intending to commit $100mn or more in the year ahead.

Corresponding with the relatively low investor appetite for private real estate fund commitments in 2013, only a small proportion of investors interviewed in December 2013 intend to commit more capital to the asset class in the year ahead (Fig. 4.7), with 18% planning to do so. The majority of investors (51%) did not commit to private real estate in the previous 12 months and will not do so in the year ahead, and 24% intend to commit less capital in 2014 than in 2013.

Through frequent direct contact with over 4,200 investors in private real estate tracked by Preqin's Real Estate Online service, we are able to build an accurate insight into the strategies and regions targeted by investors in the year ahead, as well as the amount of capital they plan to put to work. The number of fund commitments likely to be made by those investors that will be investing in private real estate in 2014 offers encouragement for managers that are currently marketing funds. Fig. 4.8 reveals that 39% of these active investors stated that they plan to invest in three funds, and 26% responded that they intend to place capital in four or more private real estate funds in 2014. As such, despite a large proportion of investors responding that they do not intend to commit to real estate in the year ahead, those investors that will be placing capital with private real estate fund managers are likely to commit to several funds.

While the majority of investors that are planning commitments expect to commit less than $100mn to private real estate in the next 12 months, Fig. 4.9 reveals that there are institutions that will put a sizeable amount of capital to work, with 37% of investors planning to commit $100mn or more to private real estate funds in the year ahead. Additionally, 13% of investors will be committing more than $300mn to private real estate in the next 12 months.

Fig. 4.7: Investors' Expected Capital Commitment to Private Real Estate Funds in 2014 Compared to 2013



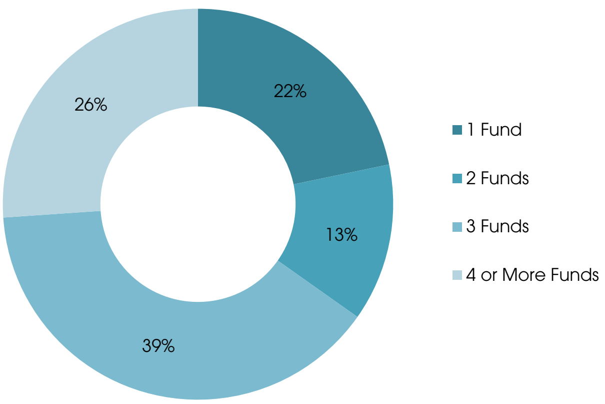
Source: Preqin Investor Interviews, December 2013

In-Depth Data on All Private Real Estate Funds in Market

Preqin's **Real Estate Online** features extensive information on all 480 closed-end private real estate funds currently seeking capital. Access details on a fund's strategy, geographic focus, target size, key contact details and much more. For more information, please visit: www.preqin.com/reo

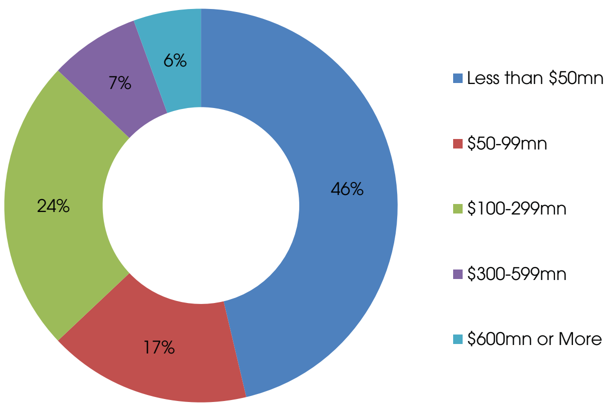
If you are an accredited investor you can access this information for free on **Preqin Investor Network**, as well as the track records of all managers with a fund in market. To register for free, please visit: www.preqin.com/pin

Fig. 4.8: Investors' Expected Number of Private Real Estate Fund Commitments in 2014



Source: Preqin Real Estate Online

Fig. 4.9: Amount of Fresh Capital Investors Plan to Invest in Private Real Estate in the Next 12 Months



Source: Preqin Real Estate Online

Strategies and Regions Targeted and Appetite for First-Time Funds

Higher-risk strategies are the most sought after among private real estate investors in the next 12 months, with most investors seeking to place capital in domestic real estate opportunities. Appetite for first-time funds has seen a dramatic decline, as investors increasingly seek more experienced managers.

Investor appetite for higher risk/return profile strategies is particularly prevalent among those investing in the coming year, with 49% of investors seeking value added opportunities and 45% targeting opportunistic funds in the next 12 months (Fig. 4.10). Appetite for core funds also remains strong, although this has declined from 52% in December 2012 to 43% in December 2013; concerns over the rising price of core assets and increasing competition have caused some investors to move away from funds focusing on core investments.

When looking at the regional investment preferences of investors, the majority target domestic real estate opportunities. This is particularly noticeable among North America-based investors, of which 73% are seeking funds focusing on domestic real estate opportunities in the next 12 months (Fig. 4.11). Additionally, 59% of Europe-based investors and 60% of Asia-based investors target funds focusing on domestic opportunities. Overall, Asia-based investors appear to have more regionally diversified investment mandates for the next year, with 48% and 44% including North America and Europe within their fund searches respectively.

Data Source:

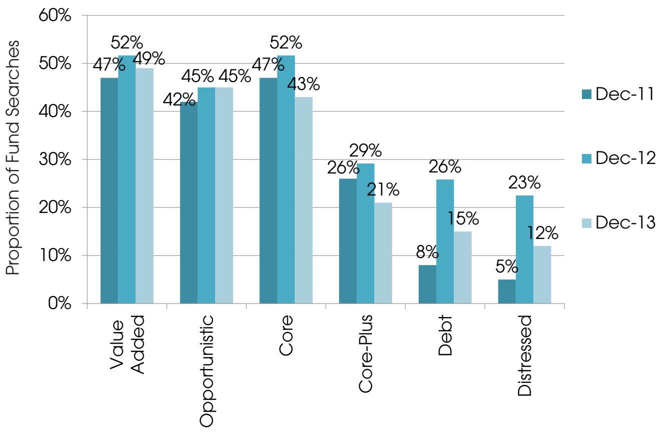
Preqin's **Real Estate Online** service features extensive profiles of over 4,200 active investors in real estate, including known past investments, fund managers invested with, allocations to the asset class, future investment plans, key contact information and much more.

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

www.preqin.com/reo

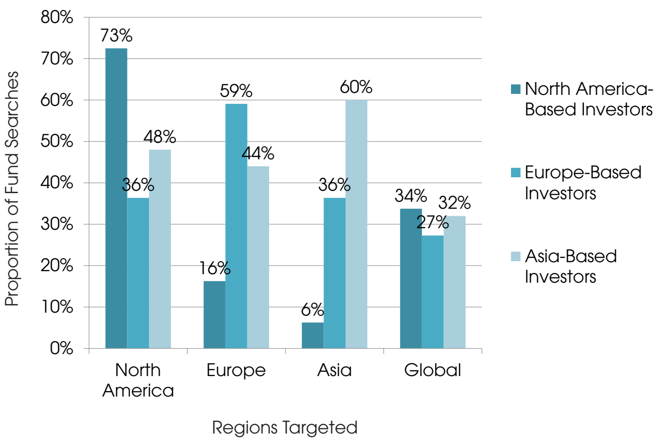
With many institutions increasingly looking for managers with a strong track record, there has been a significant decline in appetite for first-time funds, as shown in Fig. 4.12. From December 2009 to December 2013, the proportion of investors which would invest in first-time funds fell from 41% to 17%, demonstrating how investors are increasingly looking to place their capital with more experienced fund managers. The majority of investors (63%) have entirely ruled out first-time funds as of December 2013, compared to only 28% of investors which stated so in December 2009. There has been an increase in the proportion of investors that would consider investing in first-time funds over the past 12 months, from 4% to 12%, perhaps demonstrating a slight shift in sentiment.

Fig. 4.10: Strategies Targeted in the Next 12 Months by Private Real Estate Investors, December 2011 - December 2013



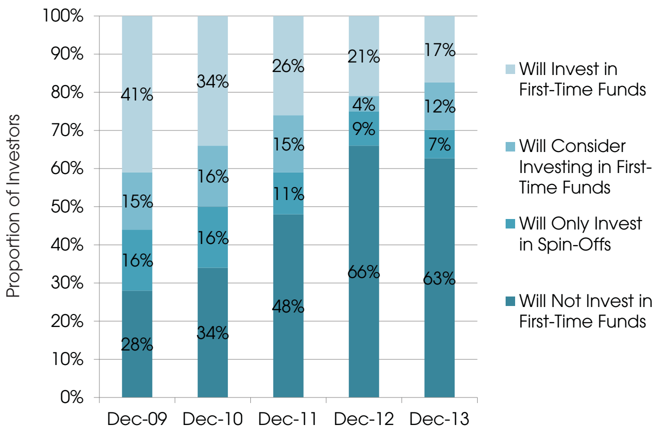
Source: Preqin Real Estate Online

Fig. 4.11: Regions Targeted in the Next 12 Months by Private Real Estate Investors



Source: Preqin Real Estate Online

Fig. 4.12: Changing Investor Attitudes towards First-Time Private Real Estate Funds, December 2009 - December 2013



Source: Preqin Real Estate Online

The Investor Spring: Proactive Real Estate Investors

Investors in alternatives are increasingly proactive in discovering and researching funds for their investment portfolios. Real estate investors are no different. As demonstrated by their activity on Preqin Investor Network, where investors can find and research all 479 closed-end real estate funds in market, investors want to screen large sections of the real estate market before allocating capital.

Proactive Investor Universe

As witnessed across other areas of the alternative assets space, the real estate industry has also demonstrated clear evidence that the Investor Spring is upon us. Sixty-five percent of investors planning new commitments will invest in three or more funds in the coming year, and the passive mode of investors of just a few years ago has been widely replaced with proactive investors surveying as many fund opportunities as possible. Rather than waiting for PPMs and marketing materials to come, often unsolicited, to them, real estate investors are scanning the investment landscape and seeking out information on viable fund investments.

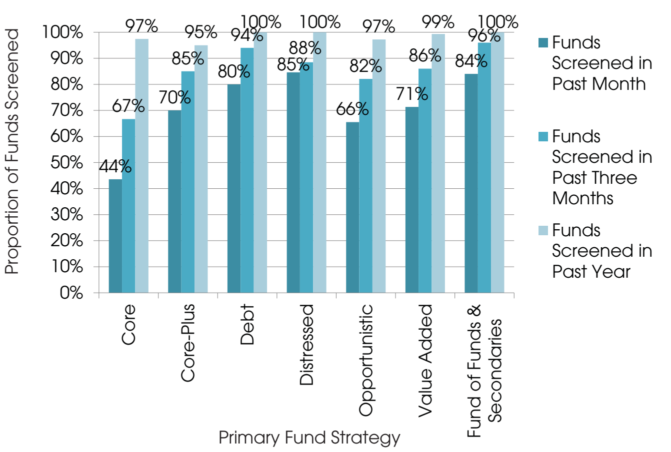
Surveyors of the Market

Through Preqin Investor Network, which accredited investors use to discover and research investment opportunities, investors have screened overview and contact information for funds in market over 2,500 times in the past quarter. Furthermore, 98% of all real estate funds raising capital have been reviewed by investors on Preqin Investor Network in the past year, demonstrating just how expansive and proactive investors are in surveying the entire real estate space. When using Preqin Investor Network to compare investor interest in first-time funds with interest in more experienced fund managers' funds, although there is a significant difference in the proportions of funds screened in the short term, this diminishes in the longer term. In January 2014, 54% of first-time funds and 75% of non-first-time funds were reviewed by investors, but over the past year, 98% and 99% of funds were screened respectively.

Fig. 4.13 demonstrates by primary fund strategy, the proportions of real estate funds surveyed by investors on Preqin Investor Network. Those with a distressed or debt strategy were the funds investors were most keen to find material on, with 85% and 80% of these funds viewed in the past month respectively. However, funds in market with a value added primary strategy attracted the highest total number of investor screenings in the past quarter, with almost 900 fund reviews. Although a smaller 44% of core funds were screened over the past month, when looking over the past 12 months, nearly all (97%) core funds were reviewed by investors.

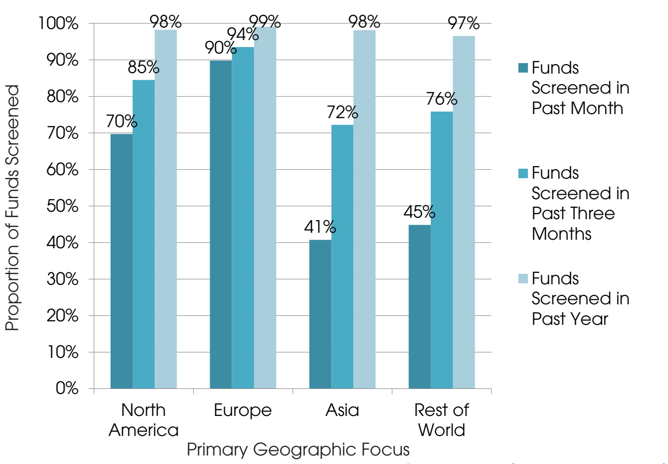
When analyzing investor activity by fund geographic focus, Preqin Investor Network shows that Europe-focused funds attract the most interest in terms of percentage of market reviewed, with 90% of all real estate funds focused on the continent surveyed by investors in the past month alone, and 94% of funds reviewed across the past quarter, as shown in Fig. 4.14 North America-focused funds were screened the highest number of times in the past quarter, with almost 1,300 reviews by investors. Seventy percent of North America-focused funds were reviewed by investors in the past month, and 85% were over the past quarter.

Fig. 4.13: Proportion of Real Estate Funds Screened by Investors on Preqin Investor Network by Fund Strategy (As at 01 February 2014)



Source: Preqin Investor Network

Fig. 4.14: Proportion of Real Estate Funds Screened by Investors on Preqin Investor Network by Primary Geographic Focus (As at 01 February 2014)



Source: Preqin Investor Network

Allocations and Confidence in the Asset Class

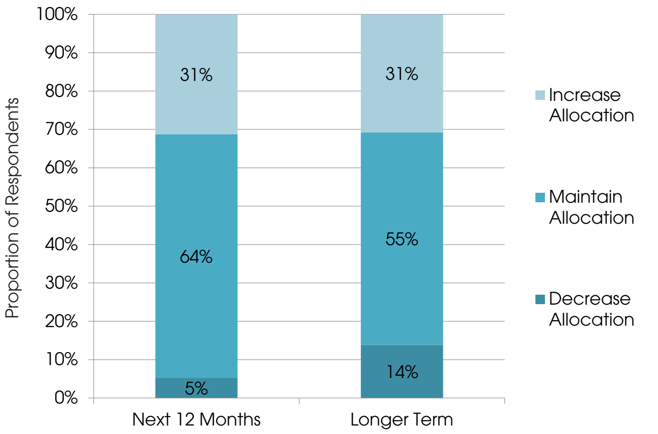
Investor appetite for private real estate looks positive in the next 12 months, with a large proportion of investors expecting to maintain or increase their allocations to the asset class. Investors largely believe that investments have met expectations, with confidence in real estate remaining unchanged over the last year.

Examining investors' intentions concerning their allocations to private real estate in the next 12 months and the longer term demonstrates the continuing importance of the asset class within investors' portfolios. As shown in Fig. 4.15, the majority of investors surveyed expect to maintain their allocations, with 64% and 55% of investors looking to do so in the next 12 months and over the longer term respectively. Promisingly, almost a third of institutions (31%) expect to increase their private real estate allocations, both in the next 12 months and in the longer term, indicating that a significant amount of capital is likely to flow into private real estate in the future as institutional investors make commitments to move closer to their strategic targets.

This encouraging outlook is likely to have been influenced by recent improvements in private real estate fund performance. Fig. 4.16 shows that although nearly a fifth of investors felt that their private real estate investments had fallen short of their expectations, 68% believed they had met expectations and 14% said they had exceeded expectations. This is a significant increase on the 3% of investors interviewed in December 2012 that said their investments had exceeded expectations in the preceding 12 months.

Real estate performs a number of important objectives within investors' portfolios, such as offering a range of risk/return profiles, acting as an inflation hedge and providing steady income streams that make it a useful liability matching tool. The confidence investors have in the asset class to perform these objectives will likely greatly impact the level of capital they commit to the asset class going forward. Over the past 12 months, the vast majority of investors (72%) have had no change in their confidence concerning the ability of private real estate to achieve portfolio objectives, as can be seen in Fig. 4.17. Additionally, 17% of interviewed investors stated that their confidence had in fact increased over the last year.

Fig. 4.15: Investors' Intentions for Their Private Real Estate Allocations in the Next 12 Months and the Longer Term



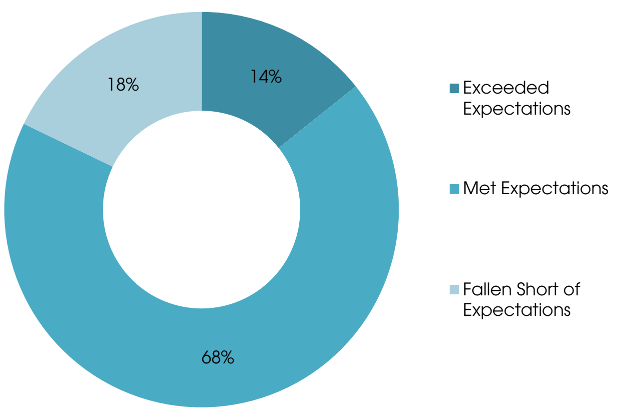
Source: Preqin Investor Interviews, December 2013

Access Industry-Leading Real Estate Performance Data

Preqin's **Real Estate Online** features net-to-LP performance data for over 1,100 individual named private real estate funds. For more information, or to arrange a demonstration, please visit:

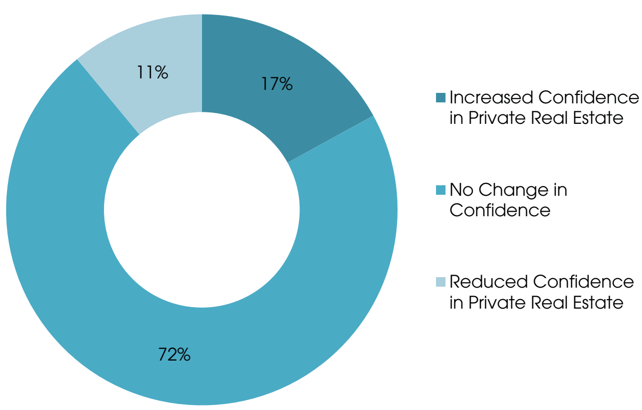
www.preqin.com/reo

Fig. 4.16: Proportion of Investors that Feel Their Private Real Estate Investments Have Lived up to Expectations over the Past 12 Months



Source: Preqin Investor Interviews, December 2013

Fig. 4.17: Investors' Confidence in Private Real Estate to Achieve Portfolio Objectives in the Past 12 Months



Source: Preqin Investor Interviews, December 2013

Fees and Alignment of Interests

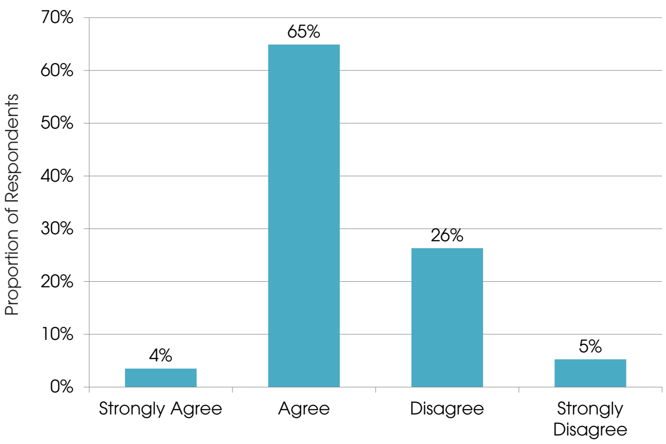
The alignment of interests between fund managers and investors has shown signs of improvement over the last year, with investors increasingly satisfied with the terms offered by managers. Despite this, management fees in particular remain a key area where investors believe alignment can be improved.

Fund terms and conditions, when structured well, align interests between fund managers and their investors, but can also frequently be an area of contention. Encouragingly, the majority (69%) of investors interviewed by Preqin agree or strongly agree that fund manager and investor interests are properly aligned (Fig. 4.18). For investors that disagreed, the top concern was management fees; 48% identify this as a key area for improvement (Fig. 4.19), with investors stating that management fees should be enough to cover operating costs, but not be a source of profit for the manager.

Fig. 4.20 reveals that 28% of investors have seen either a slight or a significant change in fund terms in favour of investors over the past year. Only 4% of respondents reported a slight change in favour of fund managers, while none of the institutions interviewed had seen a significant movement towards more manager-friendly terms.

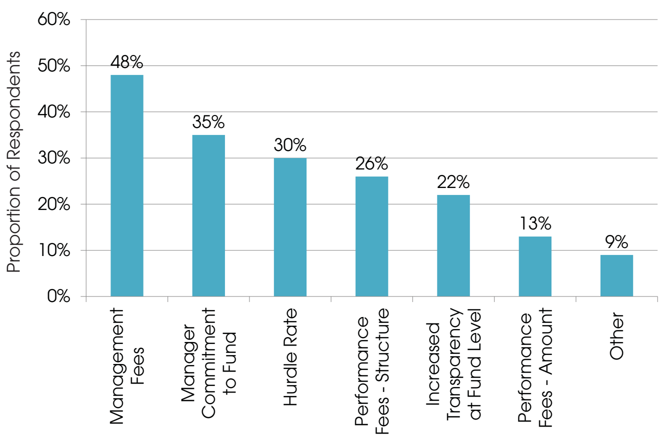
In terms of where these changes have occurred, 61% of investors have seen a change in management fees, which signals that some managers are responding to investor concerns and are prepared to make concessions in this area, as shown in Fig. 4.21. In a sign that managers are responding to investor demands for more information, 28% of investors have seen more transparency at the fund level, such as providing more detailed fund reports. Performance fees are another area where investors have seen changes, with 33% of the investors interviewed stating this.

Fig. 4.18: Proportion of Investors that Feel Fund Manager and Investor Interests Are Properly Aligned



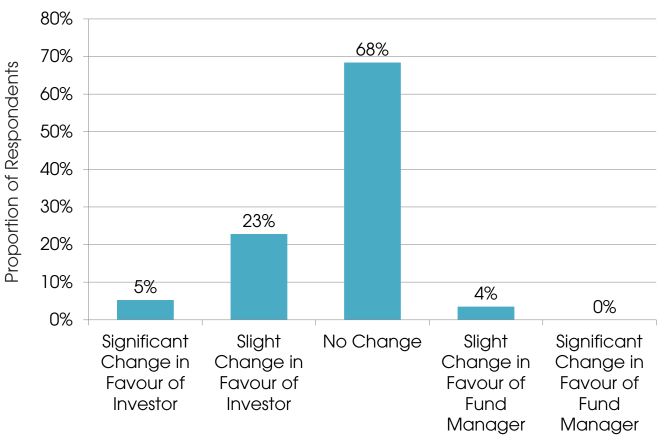
Source: Preqin Investor Interviews, December 2013

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



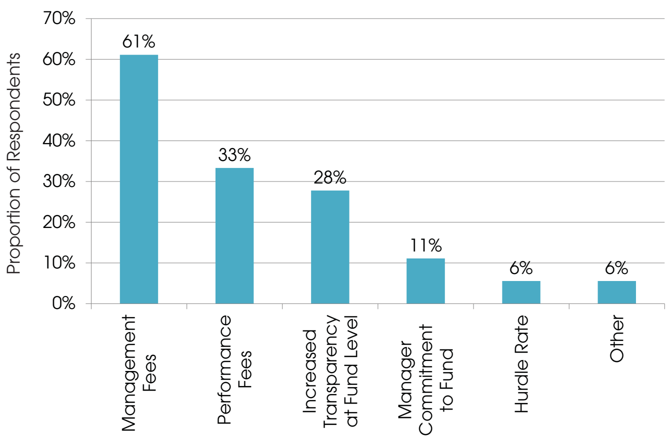
Source: Preqin Investor Interviews, December 2013

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



Source: Preqin Investor Interviews, December 2013

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



Source: Preqin Investor Interviews, December 2013

Key Issues and Manager Selection

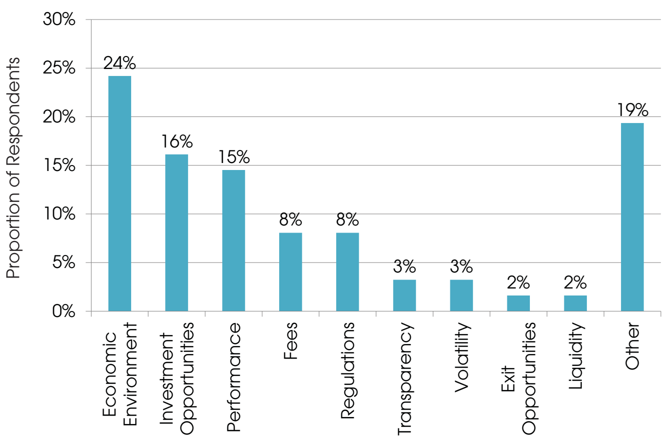
The economic environment continues to be the key issue for investors in the current real estate market, with recent regulation a less significant concern as investors are largely unsure of its impact. In seeking fund managers, investors continue to look at past performance and track record as key indicators.

When investors were asked what they viewed as the key issue facing the private real estate industry in 2014, unsurprisingly the largest proportion (24%) stated the economic environment (Fig. 4.22). However, this represents a significant decrease from the 40% of investors which viewed this as their key concern in December 2012, indicating a shift in attitudes towards the global economy, and the impact this may have on real estate markets. However, another key concern for investors in 2014 is investment opportunities, with 16% of respondents stating this as an issue; the availability of suitable assets for investment in core real estate markets appears to be of growing concern to investors, with intense demand driving up asset prices. Performance is a key concern for 15% of respondents, although this has also seen a decrease since December 2012, when 20% of investors surveyed stated this as the main issue in the market.

A number of regulatory changes have been introduced in recent years that impact the alternative investment industries, including the JOBS Act, Solvency II, Basel III and the AIFMD. Despite this, regulations were stated as a key concern in the current real estate market for only 8% of respondents. Additionally, when asked whether recent regulatory changes were beneficial to the private real estate industry, investors were still largely unclear of the impact of these new regulations, with the majority (63%) stating that they were unsure of any benefit, 23% stating that regulations are beneficial and 14% stating that they are not (Fig. 4.23).

When deciding which fund managers to form new relationships with, investors now scrutinize certain attributes more closely than ever. When asked to state the most important factor they consider when searching for a real estate fund manager, 31% of respondents deemed length of track record to be the most important and 25% cited past performance (Fig. 4.24). With investors placing so much emphasis on track records, firms raising their maiden vehicles are likely to find the fundraising process very difficult, while managers with a proven track record in the space are likely to continue to attract a larger proportion of investor commitments. Fund strategy was the most important factor for 24% of investors interviewed and alignment of interests between fund managers and investors was the key factor for 15% of respondents.

Fig. 4.22: Investors' Views on the Key Issues Facing the Private Real Estate Market in 2014

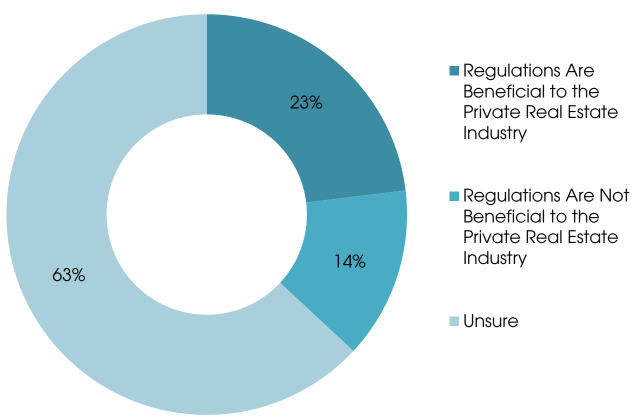


Source: Preqin Investor Interviews, December 2013

Looking to Connect with Investors?

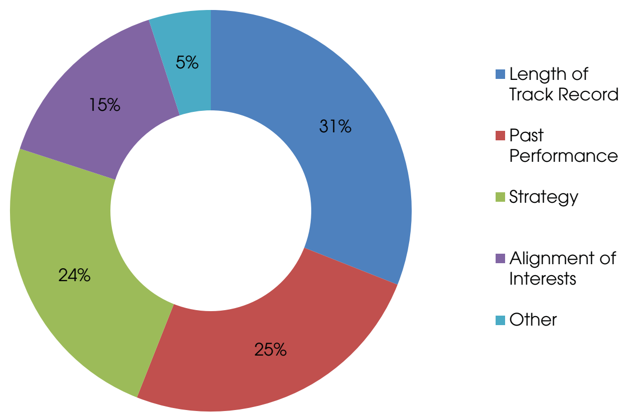
Share data on your funds on **Preqin Investor Network** to get in front of over 5,600 investment decision makers and generate incoming leads from investors. For more information, please visit: www.preqin.com/sharedata

Fig. 4.23: Investors' Views on Whether the Regulations Introduced in 2011, 2012 and 2013 Are Beneficial to the Private Real Estate Industry



Source: Preqin Investor Interviews, December 2013

Fig. 4.24: The Most Important Factor Investors Assess When Searching For Private Real Estate Fund Managers



Source: Preqin Investor Interviews, December 2013

Appetite for Co-Investments, Joint Ventures and Separate Accounts

Use of alternative methods of accessing private real estate has seen an increase in recent years, although these continue to be largely the preserve of investors with significant assets under management.

Recent years have seen investors increasingly looking at alternatives to investments in blind-pool funds, with structures such as separate accounts, co-investments and joint ventures targeted by a significant proportion of investors as of the start of 2014. As shown in Fig. 4.25, of the more than 4,200 investors on Preqin's Real Estate Online service, 38% make co-investments, with the same percentage investing in joint ventures and separate accounts. The advantages of this from an investor's perspective compared to fund commitments include having greater control over where their capital is invested, increased accountability of the management team, and the ability to negotiate more effectively concerning fees, while still being able to take advantage of the skill and resources of an external manager.

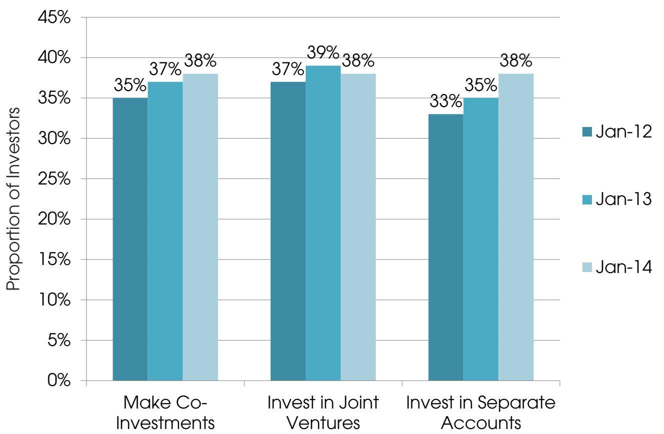
However, as shown in Fig. 4.26, the use of these structures correlates strongly to investors' assets under management; 64% of investors with more than $10bn in assets under management invest in separate accounts, 58% make co-investments and 68% form joint ventures. Comparatively, for investors with less than $1bn in assets under management, 23% make co-investments, 20% form joint ventures and 20% invest in separate accounts. Many smaller investors do not have the resources and knowledge needed to be able to undertake the necessary due diligence and ability to monitor investments on an ongoing basis to make these routes viable. As such, it is likely that the primary route to the real estate market for many investors will remain the private real estate fund model.

Appetite for separate account investments varies by investor type, as can be seen in Fig. 4.27. Asset managers will frequently have the sophisticated investment teams and the resources required to evaluate, select and monitor separate account investments. As such, 52% of these investors actively invest, or are considering investing, in separate accounts. Similarly, for public pension funds with large capital bases, separate accounts offer the opportunity to put significant amounts of capital to work; 44% of public pension funds invest or would considering investing through separate accounts.

Preqin tracks the future investment plans of investors in private real estate funds, allowing subscribers to **Real Estate Online** to source investors actively seeking new real estate commitments via the **Fund Searches and Mandates**. For more information, or to arrange a demonstration, please visit:

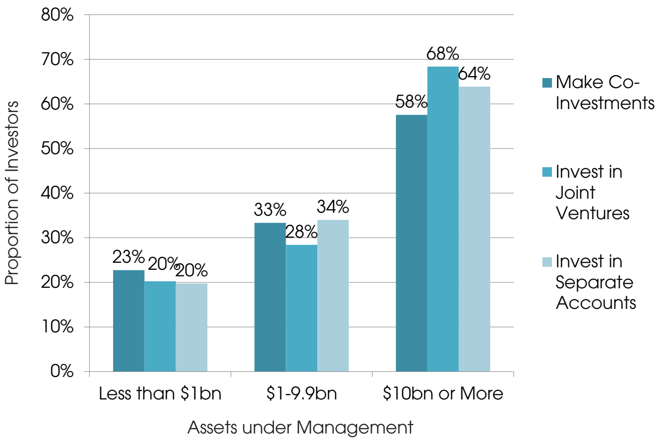
www.preqin.com/reo

Fig. 4.25: Investor Appetite for Co-Investments, Joint Ventures and Separate Accounts, January 2012 - January 2014



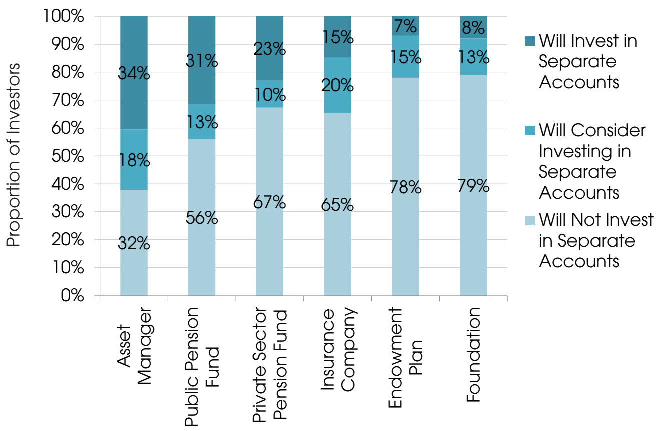
Source: Preqin Real Estate Online

Fig. 4.26: Investor Appetite for Co-Investments, Joint Ventures and Separate Accounts by Investor Size



Source: Preqin Real Estate Online

Fig. 4.27: Investor Appetite for Real Estate Separate Accounts by Investor Type



Source: Preqin Real Estate Online

Infrastructure

Continued Investor Demand

Institutional investor appetite for infrastructure looks set to remain strong over the next year, with a third of investors surveyed intending to commit more capital to the asset class over the next 12 months. 2013 was a strong year for unlisted infrastructure fundraising, with $40bn raised by 52 unlisted infrastructure funds holding final closes, the largest amount of capital raised in a single year since 2008. With 46% of investors intending on increasing their allocations to the asset class in the year ahead, further improvement in unlisted infrastructure fundraising in 2014 is likely as investors commit more capital to the asset class in order to move towards their strategic targets.

Many investors expect to commit a sizeable amount of capital to the asset class, with 43% of surveyed investors expecting to commit $100mn or more to infrastructure in the year ahead, and 11% planning on investing $500mn or more. Additionally, as infrastructure becomes ever more established within investors' portfolios, many investors intend on making multiple commitments. Fifty-six percent of investors are intending to make at least three infrastructure investments in the next 12 months.

Despite the relative youth of the infrastructure asset class, manager experience is the most sought-after attribute for investors when selecting new managers, with 80% of respondents stating this as a key factor. As such, capital may become more concentrated among the handful of very experienced managers. For those managers hoping to stand out from the crowd in the current competitive market, achieving an alignment of interests is vital for building successful, long-term relationships with investors. There has been considerable improvement in this regard in recent years, with 65% of investors feeling that fund managers' and investors' interests are aligned, compared to just 27% of investors surveyed in 2010. Many investors remain dissatisfied with certain aspects of fund terms however, with 61% of surveyed investors stating that management fees are a key area in need of improvement.

Nonetheless, the outlook for the infrastructure asset class in the year ahead is positive, with a large proportion of investors intending to increase their allocations and many targeting multiple investments. The crowded fundraising market is likely to make attracting investor capital a challenging prospect for managers, particularly those raising their first vehicle, but those firms which can show evidence of a strong track record, and which can respond to any concerns surrounding their fee structures are likely to attract significant levels of capital.

Key Facts

69% of investors expect to commit more or the same level of capital to unlisted infrastructure funds in 2014.

43% of investors plan to commit $100mn or more in the next 12 months, with 11% planning to invest at least $500mn.

46% of investors expect to commit to between three and four funds in 2014.

87% of investors feel the performance of their infrastructure portfolios met or exceeded expectations in 2013.

80% of investors highlighted manager experience and background as the key factor when selecting new fund managers.

65% of investors feel that fund manager and investor interests are aligned.

Satisfaction with Returns in 2013 and Confidence in the Asset Class

Investors are largely positive towards the infrastructure asset class, with investments either meeting or exceeding expectations for the majority of surveyed institutions, and confidence in the asset class remains strong.

Satisfaction with Returns

Overall, infrastructure investors appear satisfied with the returns received from their fund investments over the last 12 months, with a significant 87% of surveyed investors feeling that their infrastructure portfolios either met or exceeded expectations in 2013. This suggests that infrastructure investments have largely performed positively over the past year.

Seventy-two percent of surveyed investors stated that their infrastructure investments had met expectations and a further 15% felt their returns exceeded expectations, as shown in Fig. 5.1. Although this is slightly less than the 93% of surveyed investors that felt their infrastructure portfolios had either met or exceeded expectations in August 2013, it still demonstrates that infrastructure investments contributed well to overall portfolio performance in 2013.

Investor Confidence in Infrastructure

The risk/return profile of the infrastructure asset class is quite diverse depending on the type of fund and chosen strategy. Some investors commit to infrastructure funds as an extension of their return seeking private equity portfolio, while others are looking for lower longer-term yields. We asked investors whether their confidence in infrastructure to achieve portfolio objectives had changed over the past 12 months; a significant 68% of investors surveyed reported no change and remained largely positive towards the infrastructure space, as shown in Fig. 5.2. Thirteen percent of investors felt their confidence had increased, while 19% reported a decrease in confidence.

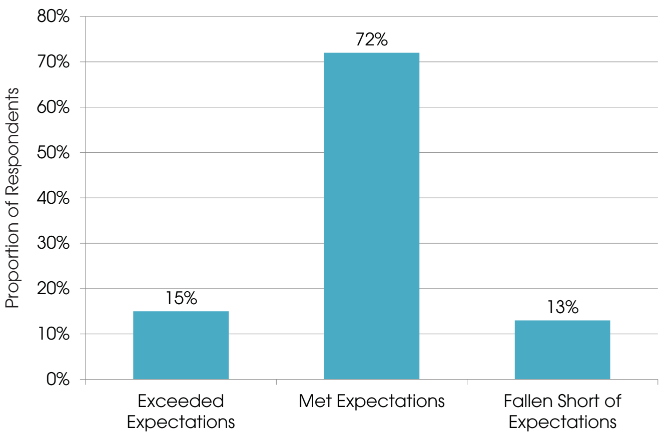
In terms of investors' general perception towards the infrastructure industry, 34% of surveyed investors are positive, while a further 52% have a neutral outlook, as illustrated in Fig. 5.3. Despite general positivity towards infrastructure, 14% of investors surveyed have a negative perception of the infrastructure asset class. Investors may be concerned about issues such as increased competition for assets and the impact increasing valuations may have on returns.

In-Depth Infrastructure Performance Data

Preqin's **Infrastructure Online** features individual fund returns for over 140 separate named infrastructure funds, including percentage called and distributed, net IRR and much more.

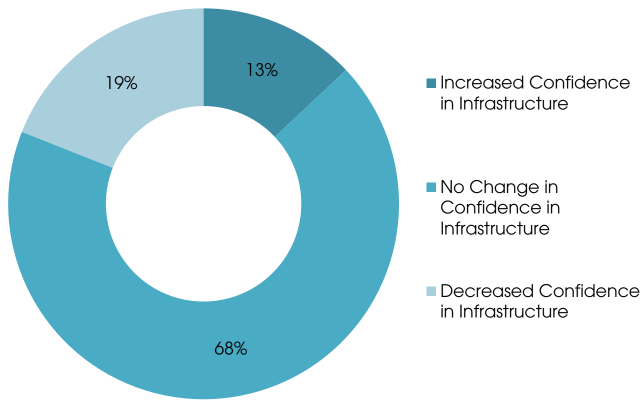
www.preqin.com/infrastructure

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



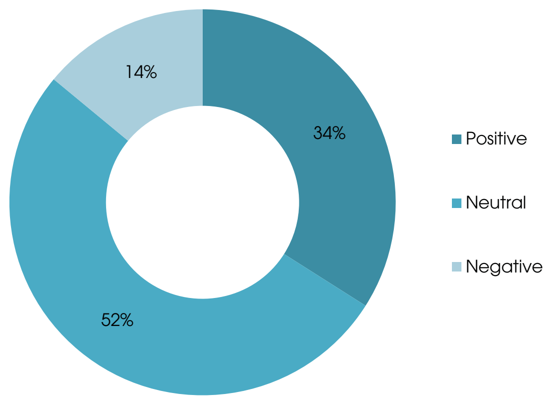
Source: Preqin Investor Interviews, December 2013

Fig. 5.2: Investors' Confidence in Infrastructure to Achieve Portfolio Objectives in the Past 12 Months



Source: Preqin Investor Interviews, December 2013

Fig. 5.3: Investors' General Perceptions of the Infrastructure Industry at Present



Source: Preqin Investor Interviews, December 2013

Investor Activity in 2014 – Capital and Allocations

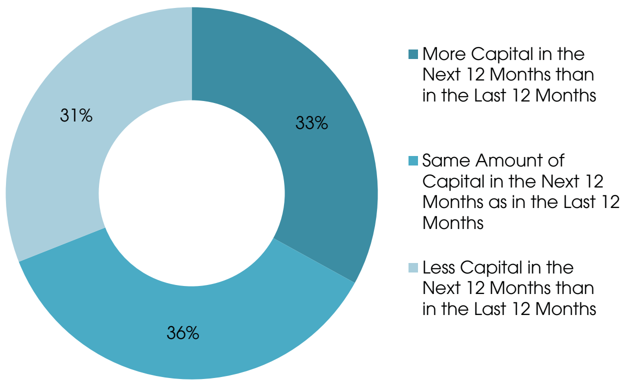
Infrastructure investors remain committed to the asset class, with a large proportion intending to invest more or the same level of capital in the year ahead. Allocations over the longer term are also likely to rise for many investors, with institutions based in Europe the most likely to do so.

Investors' infrastructure commitments in 2014 when compared to the previous year look to be relatively stable, with the majority (69%) of institutional investors surveyed expect to commit more or the same level of capital to private infrastructure funds in the coming 12 months compared to the previous year, as illustrated in Fig. 5.4. This includes 33% of respondents that plan to invest more capital in 2014 than in 2013. Although this is positive news for the industry, a similar proportion (31%) expect to decrease the amount of capital they will commit to infrastructure funds in the next 12 months.

Although infrastructure is still a relatively new asset class for many investors, as institutions become more comfortable and familiar with the risk/return potential of infrastructure funds, allocations to the space are likely to rise. The outlook for infrastructure is very positive, with a significant 46% of surveyed investors planning to increase their allocations to infrastructure over the long term, while 38% plan to maintain their current level of exposure, as illustrated in Fig. 5.5. Just 16% of surveyed investors expect to decrease their infrastructure allocations in future.

Regionally, the majority of Europe-based investors are looking to increase their allocations to infrastructure over the longer term, with 56% intending to do so, demonstrating the particularly active market in Europe regarding infrastructure investment, as shown in Fig. 5.6. Forty-seven percent of North America-based investors are also looking to increase their allocations to infrastructure in the longer term, with a considerable 37% seeking to maintain their allocations. No investors surveyed based outside North America or Europe are seeking to decrease their allocations, although the vast majority (67%) intend to maintain it over the longer term.

Fig. 5.4: Investors' Expected Capital Commitments to Infrastructure Funds in the Next 12 Months Compared to the Last 12 Months



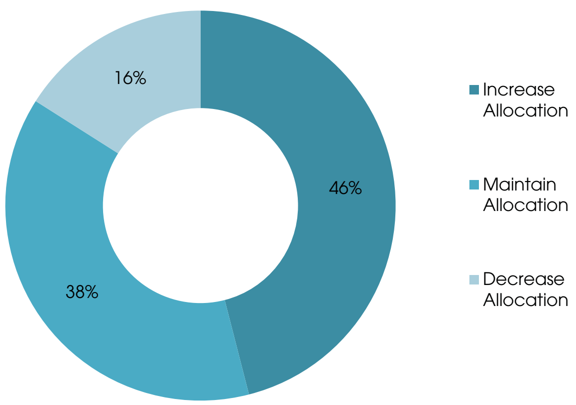
Source: Preqin Investor Interviews, December 2013

Raising Capital for an Infrastructure Fund?

Preqin's **Infrastructure Online** features detailed profiles for more than 2,100 active investors worldwide, with assets under management in excess of $76tn. Preqin's dedicated team of research analysts is in regular direct contact with all active investors, allowing us to provide detailed information on current and target allocations, fund type and geographic investment preferences and future investment plans, key contact information and much more. For more information, please visit:

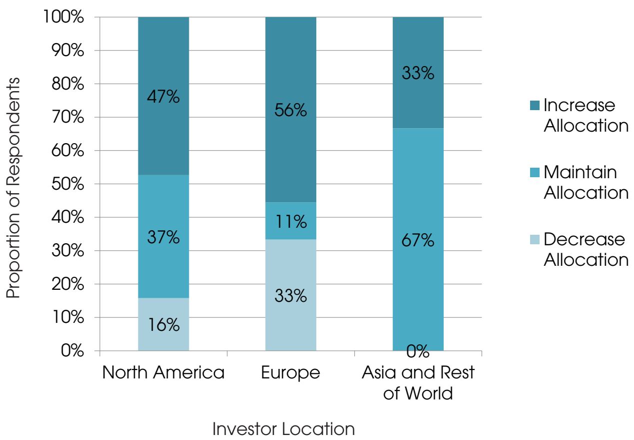
www.preqin.com/infrastructure

Fig. 5.5: Investors' Intentions for Their Infrastructure Allocations over the Long Term



Source: Preqin Investor Interviews, December 2013

Fig. 5.6: Investors' Intentions for Their Infrastructure Allocations over the Long Term by Investor Location



Source: Preqin Investor Interviews, December 2013

The Investor Spring: Proactive Infrastructure Investors

Infrastructure investors are placing growing importance on their infrastructure portfolios. Sixty-nine percent of institutional investors expect to invest more or the same amount of capital in infrastructure funds over the next year compared to last year, and 46% intend to increase their allocations over the longer term. However, institutional investors no longer wait for opportunities to find their way to them; most also proactively source funds themselves.

Proactive Investor Universe

Investors' proactivity in sourcing new infrastructure investments can be seen in their use of Preqin Investor Network, which allows accredited investors to survey fund material on all infrastructure vehicles currently in market, as well as being able to perform searches for funds suited to their individual investment criteria. Over the past quarter, there have been almost 1,500 investor reviews of the 161 infrastructure funds raising capital. Of all infrastructure funds in market, almost all (96%) have been reviewed by institutional investors over the past year.

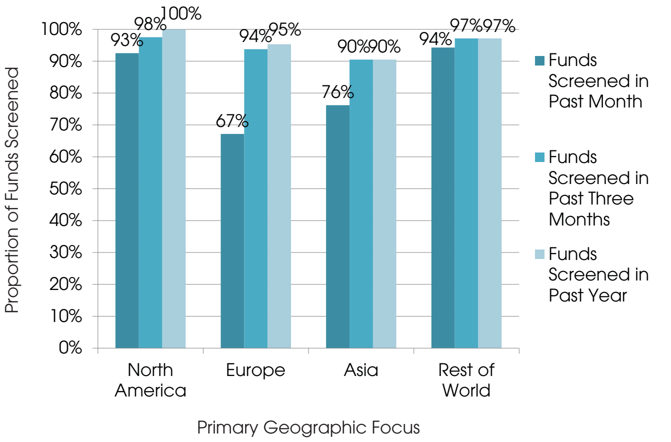
Surveyors of the Market

Preqin Investor Network data shows us that investors are similarly interested in finding out about first-time funds as they are in non-first-time funds, with 80% and 81% of these funds surveyed in January 2014 by investors respectively. Over the past year, 94% of first-time funds, and 98% of funds being raised by experienced fund managers, have been screened by investors. These figures are encouraging for first-time fund managers, with investors actively scanning the whole market for the best opportunities.

When broken down by primary geographic focus, investors used the Network over the past quarter to screen the 41 funds in market primarily focused on North America almost 600 times, making this the most reviewed region by primary geographic focus. Ninety-eight percent of North America-focused funds have been surveyed over the past quarter by investors, and all funds focused on the region have been reviewed across the past 12 months, as shown in Fig. 5.7. By proportion of funds screened, Rest of World-focused funds attracted the most interest, which is most likely a reflection of the smaller number of funds focused on the region.

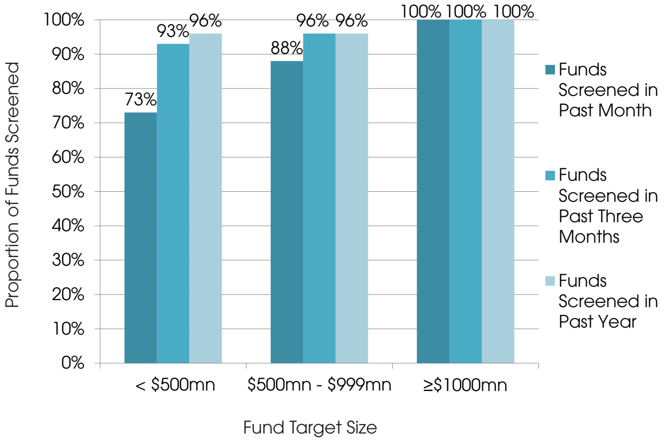
Interestingly, although fund target size has some effect on investor interest, funds of all sizes are under review from today's investor base. Despite funds of at least $1bn receiving the greatest interest, with almost 700 investor reviews in the past quarter, a significant 93% of funds under $500mn were screened over the past quarter by investors, as shown in Fig. 5.8. Today's more proactive investor attitude means that all infrastructure funds in market are being surveyed by investors, regardless of target size.

Fig. 5.7: Proportion of Infrastructure Funds Screened by Investors on Preqin Investor Network by Primary Geographic Focus (As at 01 February 2014)



Source: Preqin Investor Network

Fig. 5.8: Proportion of Infrastructure Funds Screened by Investors on Preqin Investor Network by Fund Target Size (As at 01 February 2014)



Source: Preqin Investor Network

Future Searches and Capital Outlay

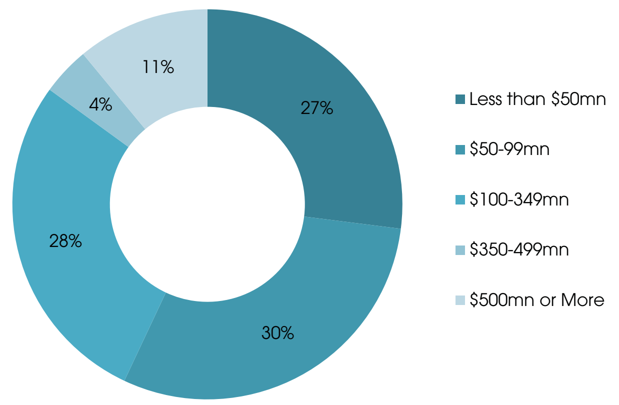
Investor commitments to infrastructure are likely to be considerable over the next 12 months, with a large proportion intending to commit $100mn or more to the asset class, and many seeking to place capital in multiple funds. The unlisted primary fund route remains the most widely sought-after, and regionally, infrastructure investors continue to favour global or diversified funds.

Through direct contact with over 2,100 active investors featured on Preqin's Infrastructure Online, we are able to build a clear picture of the investment strategies and plans for future investment of these institutions. Fig. 5.9 shows that many active investors expect to allocate substantial amounts of capital to the asset class in the coming year. Only 27% of investors with plans to make further investments in 2014 have reserved less than $50mn for such opportunities. In contrast, 43% of investors expect to invest at least $100mn over the course of the next year, with 11% planning to invest $500mn or more.

With infrastructure becoming more established within institutional investors' portfolios, many investors expect to make numerous unlisted infrastructure investments in the year ahead. This is demonstrated in Fig. 5.10, which shows that the largest proportion of investors (46%) are looking to make between three and four infrastructure investments in the next 12 months, with 10% seeking to make five or more investments.

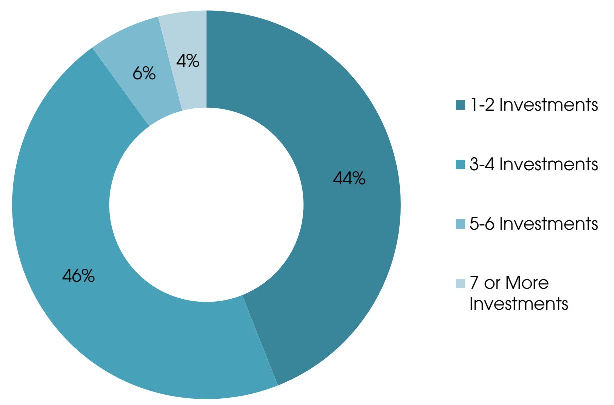
Although the vast majority (76%) of investors planning on allocating capital to infrastructure in 2014 intend to do so via the traditional unlisted fund route, a significant proportion are looking at accessing the asset class directly (46%), as shown in Fig. 5.11. A growing number of investors are considering direct investments in the asset class, but these are typically the larger institutions that have the resources and expertise to do so. Of the investors

Fig. 5.9: Amount of Fresh Capital Institutional Investors Plan to Invest in Infrastructure over the Next 12 Months



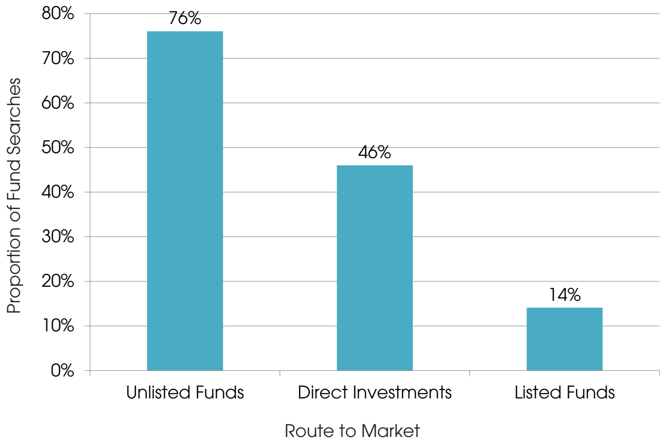
Source: Preqin Infrastructure Online

Fig. 5.10: Number of Infrastructure Investments Institutional Investors Plan to Make over the Next 12 Months



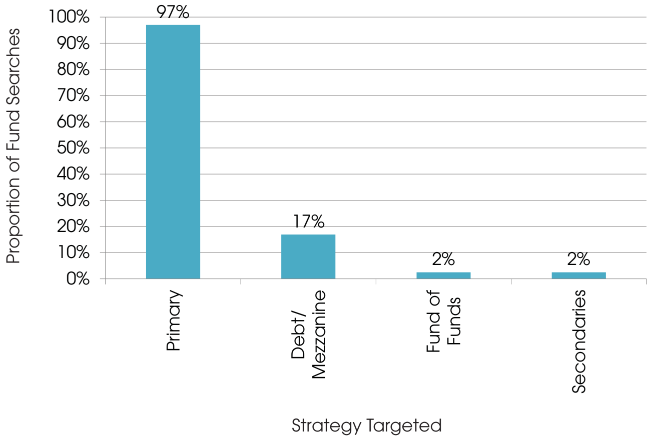
Source: Preqin Infrastructure Online

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



Source: Preqin Infrastructure Online

Fig. 5.12: Strategies Targeted in the Next 12 Months by Infrastructure Investors



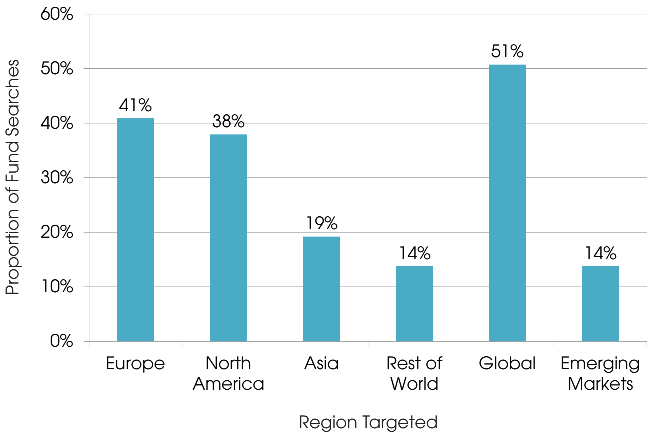
Source: Preqin Infrastructure Online

with more than $10bn in assets under management that are planning new investments, 61% are targeting direct investments. In contrast, just 38% of investors with less than $10bn of assets expect to invest directly.

The majority of investors prefer to invest via the primary unlisted infrastructure fund route, as shown in Fig. 5.12, with 97% of investors seeking this strategy in the next 12 months. Debt/mezzanine funds are sought by 17% of investors, with funds of funds and secondaries targeted by only 2% of investors each.

As infrastructure vehicles often invest globally, targeting geographically diversified portfolios, it is unsurprising that a large proportion of investors are targeting infrastructure vehicles focused on global opportunities in the next 12 months, with 51% doing so (Fig. 5.13). Regarding specific regional investment, Europe is the most favoured region, with 41% targeting Europe-focused funds, although a significant proportion of investors (38%) are targeting infrastructure funds focusing on North America. Investor appetite for Asia and countries outside of these core regions remains low, with 19% targeting Asia-focused vehicles and 14% looking to invest in other regions.

Fig. 5.13: Regions Targeted in the Next 12 Months by Infrastructure Investors



Source: Preqin Infrastructure Online

In-Depth Infrastructure Investor Data

Preqin's Infrastructure Online is the leading source of profiles and information on institutional investors in infrastructure. With more than 2,100 active investors profiled, you can use the service to:

- **Identify** and **profile** potential investors for new vehicles.
- **Receive** customized email alerts on key updates to investors' strategies and plans.
- **View** direct contact information for key personnel.
- **Keep up to date** on the investment plans of individual institutions, updated following direct communication with our dedicated teams of research analysts.

For more information on how Infrastructure Online can help you, or to arrange a demonstration, please visit:

www.preqin.com/infrastructure

Manager Selection, Fees and Alignment of Interests

Investors remain cautious and highly selective when choosing infrastructure fund managers, particularly in scrutinizing manager experience and background. Additionally, although the alignment of interests between managers and investors has seen an improvement in the last year, fees remain a key area of dissatisfaction among investors.

Fund Manager Selection

Although the infrastructure asset class is still relatively young, a significant 80% of investors surveyed highlighted manager experience and background as a key factor when selecting an infrastructure fund manager (Fig. 5.14). With relatively few fund managers able to illustrate a strong history and track record in the sector, those infrastructure fund managers with a long track record look best placed to raise capital in 2014, while inexperienced firms may find it difficult to attract institutional interest. When considering that 61% of the fund manager universe is made up of managers that have raised only one fund or are currently raising their first fund, it is likely that investor capital will become increasingly concentrated in 2014 among those relatively few managers with a longer track record of investing infrastructure.

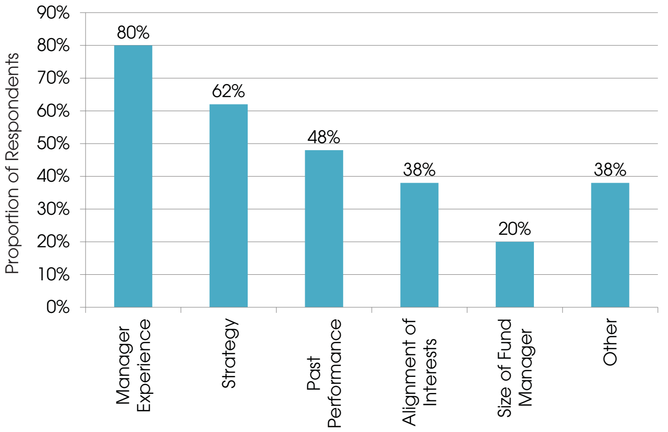
Other key factors highlighted by investors surveyed include the fund manager's investment strategy (62%), past performance (48%) and alignment of interests with investors (38%). A further 38% of respondents cited other factors, with several highlighting the need for co-investment and re-up opportunities.

Alignment of Interests and Fees

Achieving an alignment of interests with investors is crucial for fund managers when looking to build successful relationships with institutions and to attract investor capital. Encouragingly, 65% of surveyed investors feel that investors' and fund managers' interests are properly aligned, as revealed in Fig. 5.15. The proportion of investors that feel interests are aligned has increased considerably in recent years, with just 27% of surveyed investors stating this in June 2010, demonstrating that investors are becoming more satisfied with their fund manager relationships. However, there is still some work that can be done to improve investor and fund manager relations further, and only those managers willing to do this will successfully raise capital in such a competitive market.

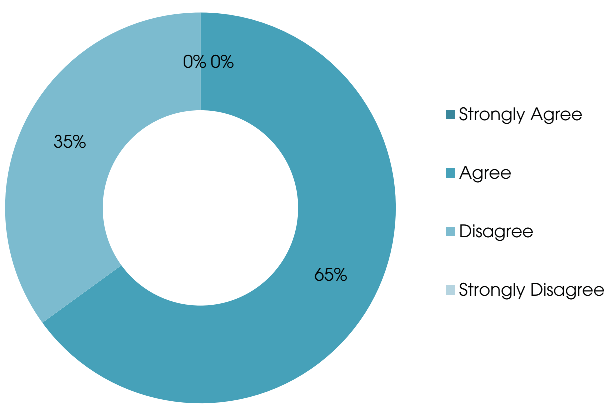
A particular area for improvement regarding aligning the interests of managers and investors is the fees charged by unlisted infrastructure fund managers, which remain a point of contention within the infrastructure asset class. Investors are now largely unwilling to buy into the traditional 2 and 20 private equity fee structure when gaining exposure to lower risk/return infrastructure

Fig. 5.14: Key Factors that Investors Assess When Looking for an Infrastructure Fund Manager



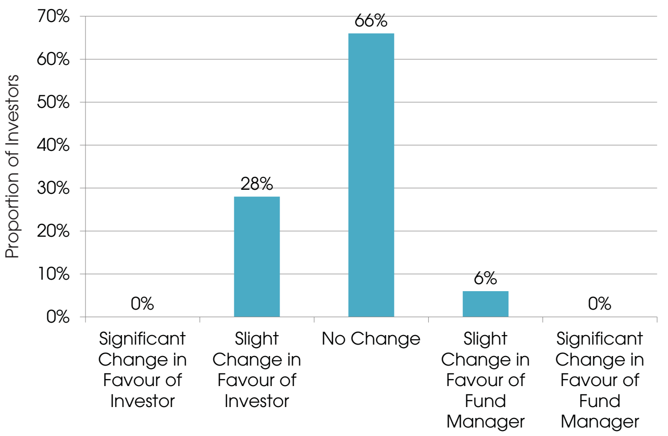
Source: Preqin Investor Interviews, December 2013

Fig. 5.15: Proportion of Investors that Feel Fund Manager and Investor Interests Are Properly Aligned



Source: Preqin Investor Interviews, December 2013

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



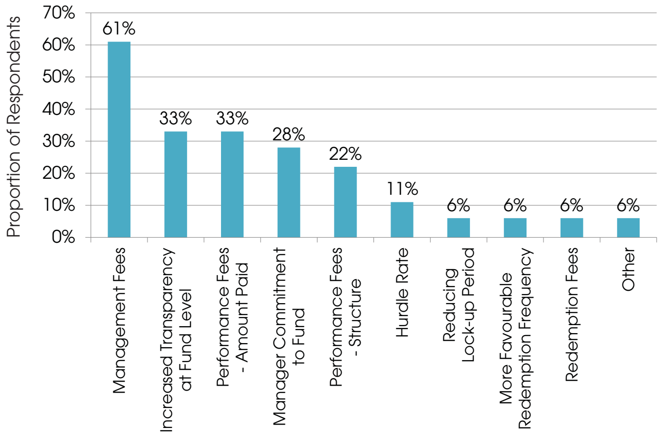
Source: Preqin Investor Interviews, December 2013

assets, which has resulted in some fund managers making concessions in this area in order to attract fresh commitments.

As shown in Fig. 5.16, 28% of surveyed investors saw a slight change in fund terms throughout 2013 in favour of the investor. However, a sizeable 66% of respondents did not see a change in the structure of fund terms and conditions in the last year, while 6% saw a slight change in favour of the fund manager. This partly reflects the efforts made by some fund managers to improve the alignment of interests with investors, but demonstrates that many investors have yet to see any significant change regarding the fund terms offered by managers.

There is little sign of significant change in fund terms despite increasing investor pressure for more investor-friendly terms, with 63% of vintage 2012-2013 infrastructure funds and those infrastructure funds currently raising capital charging a management fee of at least 2.0%. As such, it is unsurprising that a considerable 61% of surveyed investors believe that the level of management fee charged by fund managers is a key area where alignment can be improved (Fig. 5.17). Thirty-three percent feel that the structure of performance fees can be improved, while other key issues in need of improvement include the level of manager commitment to their own fund (28%) and the need for increased transparency at the fund level (33%).

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



Source: Preqin Investor Interviews, December 2013

Preqin Investor Outlook: Alternative Assets H1 2014

preqin

alternative assets. intelligent data.

Preqin: Alternatives Data and Intelligence

With global coverage and detailed information on all aspects of alternative assets, Preqin's industry-leading online services keep you up to date on all the latest developments in the private equity, hedge fund, real estate and infrastructure industries.

Source new investors for funds and co-investments

Find the most relevant investors, with access to detailed profiles for over 8,000 institutional investors actively investing in alternatives, including current fund searches and mandates, direct contact information and sample investments.

Identify potential fund investment opportunities

View in-depth profiles for over 2,100 private equity, real estate and infrastructure funds currently in the market and over 11,000 hedge funds open to new investment, including information on investment strategy, geographic focus, key fund data, service providers used and sample investors.

Find active fund managers in alternatives

Search for firms active in alternative investments. View information on key contacts, firm fundraising/AUM and performance history, key investment preferences, known investors, and more.

See the latest on buyout, venture capital and infrastructure deals and exits

View details of more than 95,000 buyout, venture capital and infrastructure deals, including deal value, buyers, sellers, debt financing providers, financial and legal advisors, exit details and more. Identify forthcoming exits and expected IPOs.

Benchmark performance

Identify which fund managers have the best track records, with customizable fund performance benchmarks and performance details for over 15,100 individual named private equity, real estate, infrastructure and hedge funds.

Examine fund terms

See the typical terms offered by funds of particular types, strategies and geographical foci, and assess the implications of making changes to different fees.

View detailed profiles of service providers

Search for active administrators, custodians, prime brokers, placement agents, auditors and law firms by type and location of funds and managers serviced. Customize league tables of service providers by type, location of headquarters, and total known number of funds serviced.

Find out how Preqin's range of products and services can help you:

www.preqin.com

If you want any further information, or would like to apply for a demo of our products, please contact us:

New York:

One Grand Central Place
60 E 42nd Street
Suite 630, New York
NY 10165

Tel: +1 212 350 0100
Fax: +1 440 445 9595

London:

Equitable House
47 King William Street
London
EC4R 9AF

Tel: +44 (0)20 7645 8888
Fax: +44 (0)87 0330 5892

Singapore:

One Finlayson Green, #11-02
Singapore 049246

Tel: +65 6305 2200
Fax: +65 6491 5365

San Francisco:

580 California Street
Suite 1638, San Francisco
CA 94104

Tel: +1 415 635 3580
Fax: +1 440 445 9595

Email: info@preqin.com
Web: www.preqin.com