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Infrastructure: Trying Times

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Trying Times

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- Fund Performance
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- Deals

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- San Antonio Fire and Police Pension Fund
- Buckinghamshire County Council Pension Fund

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The 2010 Preqin
Infrastructure Review

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Infrastructure: Trying Times

In terms of fundraising, 2009 proved to be a difficult year for the unlisted infrastructure industry. Whether as a niche sector within private equity, or more recently as a stand-alone asset class, the infrastructure fundraising market has never before experienced such a dramatic downturn.

After the record-breaking year of 2007, the annual amount of capital raised by unlisted infrastructure funds declined dramatically for two successive years, as Fig. 1 shows. The 2009 aggregate fundraising total of \$7.8bn represents an 83% reduction on the \$44.8bn raised two years previously. Fundraising conditions are expected to remain challenging throughout 2010, but recent fundraising figures and positive investor sentiment towards infrastructure suggest that commitments to the asset class from investors will continue to strengthen in the near future.

Of the funds that have closed, the proportion doing so below their initial fundraising target has steadily increased over recent years. As shown in Fig. 2, only 32% of funds that closed in 2009/H1 2010 achieved or exceeded their original targeted amount, compared with 79% and 70% for funds closed in 2007 and 2008 respectively.

Although infrastructure fundraising has declined in recent years, the number of funds on the road has continued to increase. There are currently 105 infrastructure funds seeking an aggregate \$80.8bn. This is 21 more funds than were fundraising in January 2009, implying that poor fundraising conditions have not deterred fund managers from launching infrastructure funds. However, the aggregate capital sought as of June 2010 represents a 10% drop on last year's figure, suggesting that fund managers have lowered their fundraising targets.

The significant decrease in infrastructure fundraising since the onset of the global economic downturn may have come as a surprise given the attributes of infrastructure investments. The defensive properties of infrastructure assets would appear to be appealing to investors

in a downturn, offering refuge from more volatile investment types. However, over the last 18 months it transpired that while investor interest in the asset class continued to grow, the flow of commitments to funds ebbed away.

The global economic downturn had a negative impact on fundraising across all alternative investment funds, but infrastructure was one of the sectors most severely hit. The amount of capital being called by recently closed infrastructure funds has fallen, and these funds are therefore not yet making significant distributions. While investors wait for this capital to be called, they are reluctant to make further commitments to new funds. Additionally, the slowdown in distributions means that investors do not need to make new fund commitments to maintain their infrastructure allocations.

Deal Flow

The decline in capital call-ups made by unlisted infrastructure funds is reflected in the fall in the number of deals being made by the managers of these funds. As Fig. 3 shows, the number of deals completed fell in 2009 for the first time since 2004, decreasing by 9% from the 217 deals made in 2008. The figure for H1 2010 suggests that the annual total for this year will again be lower than the previous year, unless a significant upswing occurs in the second half of the year.

The fall in the number of deals can in part be attributed to the lack of available debt to finance traditionally highly leveraged infrastructure deals. To compensate for the lack of debt we have seen a decrease in the debt/equity ratio of infrastructure transactions and a reduction in the overall size of deals. The proportion of deals of \$1bn or more in size has fallen from 17% in 2008 to 12% in both 2009 and H1 2010.

Investor Sentiment

Preqin's research suggests that investors remain keen to invest in infrastructure funds over the long term. Over 100 new institutions are considering establishing maiden allocations to infrastructure and

Fig. 1:

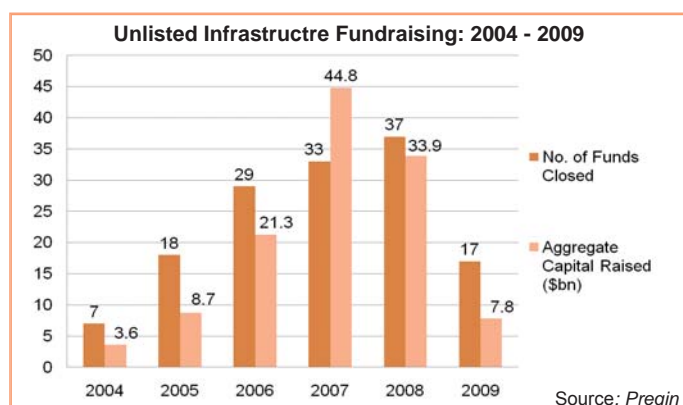
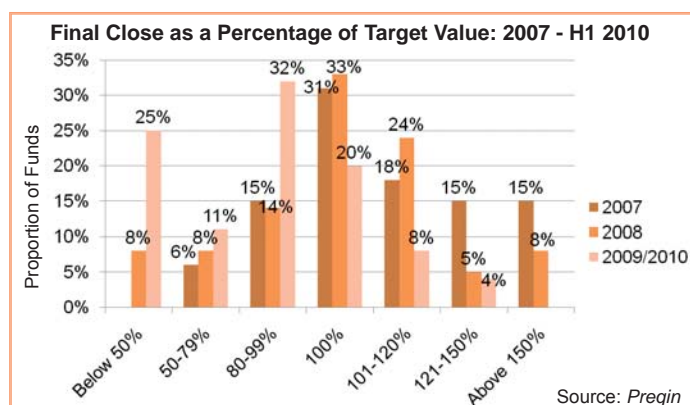


Fig. 2:



experienced investors plan to make further infrastructure commitments.

The results from Preqin's June 2010 infrastructure investor survey reflect infrastructure investors' continued optimism towards unlisted funds, with 43% of investors planning to commit to at least one infrastructure fund during the next 12 months, and a further 27% stating they will invest opportunistically.

The survey also conveys the general heightening of investor caution, which has contributed to the difficult fundraising conditions over the last 18 months. Infrastructure assets are widely considered to be low-risk investments with stable and predictable long-term returns. However, the difficult economic environment and the contraction of the debt markets have highlighted the fact that investments in the asset class are not infallible. Factors that have contributed to the recent increased investor caution include:

- The saturation of the unlisted fund market in such a short space of time resulted in too many managers chasing a limited number of suitable assets. This resulted in some funds paying inflated prices for assets;
- Infrastructure encompasses a broad range of industries that produce varied risk-return profiles and cash flows. Many infrastructure funds were derived from the rigid private equity model and were not customized to the nature of the underlying assets;
- Investors have raised concerns regarding the inclusion of quasi-infrastructure and infrastructure-related companies in fund portfolios that do not meet the risk-return profile of traditional infrastructure assets or reflect the strategy that was marketed to them at the time they made their fund commitment. The relative youth of the asset class means that the boundaries of infrastructure investing are blurred, and due to the intense competition for conventional assets it appears that some fund managers are resorting to non-traditional infrastructure investments;
- The credit crunch has resulted in the absence of the cheap debt that previously enhanced the profitability of many infrastructure investments;
- It has become apparent that some infrastructure sectors, such as transport, were more susceptible to demand risk during

an economic downturn than many first thought. Transport infrastructure is a common investment preference amongst fund managers, with 59% of all unlisted infrastructure funds ever launched seeking some degree of exposure; however, in many instances, cash flows have fallen short of investor expectations.

- Investors have mixed feelings about the long-term viability of the private equity fund model for the infrastructure asset class: 40% of respondents believe that the private equity model will be replaced by either direct investment or evergreen structures, while just over half believe the private equity model will still be utilized.

Conclusion

The unlisted infrastructure fund industry has made impressive progress in the last decade, emerging from a niche sector within private equity to a widely accepted separate asset class. The current infrastructure fund investor universe features an array of different types of institution from 68 different countries, with 53% of investors having established a separate allocation to the asset class.

The current fundraising market features 94 direct funds, complemented by 11 infrastructure-specific funds of funds, and a burgeoning market for debt funds. However, if the unlisted fund industry is going to make a greater contribution to infrastructure project finance and the global infrastructure funding deficit, both infrastructure firms and investors must play their part to overcome the key issues that still hinder the development of the asset class.

The recent downturn in infrastructure fundraising has prompted investors to push for more favourable terms of investment. Historically, the orientation of fund terms has been biased towards fund managers, but investors are now in the position whereby they can redress the balance.

Investors will continue to invest in unlisted infrastructure funds over the coming years, but investors and fund managers must accept that a compromise from both parties is crucial if the capital is to generate optimal but stable returns while contributing to the socio-economic development of a region.

Richard Stus

Fig. 3:



This feature article is taken from the 2010 Preqin Infrastructure Review, which is out now.

More information available at:
www.preqin.com/infrastructure



2010 Preqin Infrastructure Review: Order Form

The market for unlisted infrastructure funds has grown dramatically in recent years, as an abundance of new opportunities in both developed and emerging markets has paved the way for increasing numbers of vehicles to successfully raise capital. Despite the impact of the financial crisis, there are currently more funds on the road than ever before, as governments around the world establish new initiatives for private sector involvement in infrastructure projects, enabling the industry to continue its expansion into new areas and geographies.

Now in its third year, the 2010 Preqin Infrastructure Review is the most comprehensive examination of the unlisted infrastructure fund market ever produced. Key features of this year's publication include:

- Detailed analysis sections showing the latest trends in all areas of the industry: deals, fundraising, investors, terms and conditions, history and development and more...
- Profiles for 270 infrastructure firms and 450 funds, including 79 with performance data. Profiles include strategy and deals data, direct contact information for key contacts and more...
- Profiles for over 170 investors in the sector, including investment plans, strategic preferences and key contact details plus results of our investor survey.
- Detailed listings for all funds ever closed, plus funds currently raising capital.
- Information gathered from numerous data sources, including via direct interaction with fund managers to ensure the information in the Review is as accurate, comprehensive and exclusive as possible.



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Fundraising Spotlight

The tough fundraising conditions experienced in 2009 carried over into H1 2010, with the 11 funds that closed in the first half of the year raising an aggregate \$12.6bn, as Fig. 1 shows. This is considerably less than the \$17.1bn raised by 19 funds closed in H1 2008, but much higher than the \$3.5bn raised by the seven vehicles that closed in H1 2009. This suggests improved investor sentiment towards unlisted infrastructure funds following the financial crisis, with 2010 fundraising already exceeding the total raised in 2009 by \$5bn.

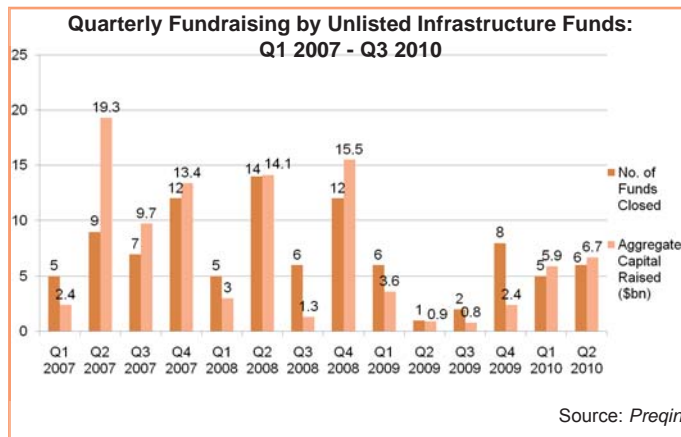
The largest funds closed in H1 2010 are shown in Fig. 2. Although infrastructure fundraising improved in the first half of 2010, it is worth noting that \$8.8bn of the \$12.6bn raised in H1 2010 was raised by three vehicles: the \$4.1bn Alinda Infrastructure Fund II, the \$3.1bn GS Infrastructure Partners II and the \$1.6bn Macquarie Infrastructure Partners II. All three funds were in market for over two years and closed below their original fundraising targets. Despite increased investor optimism in 2010, fundraising continues to be slow.

In terms of geographic focus, five funds were focused on North America, three on Asia and Rest of World and three on Europe. North America-focused funds were also the most significant in terms of aggregate capital raised, with the five vehicles accounting for 73% of the total capital.

Funds on the Road

There are currently 105 unlisted infrastructure funds on the road targeting \$80.8bn in investor commitments. This is significantly less than the \$96.8bn that was being sought by 94 funds in market in July 2009. This shows that fund managers are lowering target sizes of funds in order to compensate for fewer and smaller investor commitments in the wake of the financial crisis. The average unlisted infrastructure fund currently on the road is targeting \$770mn, compared to just over \$1bn in July 2009.

Fig. 1:



Source: Preqin

There are 33 infrastructure funds on the road targeting \$1bn or more, eight of which are targeting at least \$2bn. Such funds account for 67% of the total capital sought by infrastructure funds currently in market. The 10 largest unlisted infrastructure funds on the road are shown in Fig. 3 overleaf.

Fig. 2:

Top Five Unlisted Infrastructure Funds Closed in Q2 2010			
Fund	Manager	Size (mn)	Manager Location
Alinda Infrastructure Fund II	Alinda Capital Partners	4,097 USD	US
GS Infrastructure Partners II	GS Infrastructure Investment Group	3,100 USD	US
Macquarie Infrastructure Partners II	Macquarie Capital Funds	1,600 USD	Australia
JPMorgan Asian Infrastructure & Related Resources Opportunity Fund	JPMorgan - Infrastructure Investments Group	858 USD	US
EnCap Energy Infrastructure	EnCap Investments	792 USD	US

Source: Preqin

Fig. 3:

10 Largest Unlisted Infrastructure Funds on the Road			
Fund	Manager	Target Size (mn)	Manager Location
RREEF Pan-European Infrastructure Fund II	RREEF Infrastructure	3,000 EUR	UK
Energy Capital Partners II	Energy Capital Partners	3,500 USD	US
Highstar Capital Fund IV	Highstar Capital	3,500 USD	US
Macquarie European Infrastructure Fund III	Macquarie Capital Funds	2,500 EUR	Australia
CVC European Infrastructure Fund	CVC Infrastructure	2,000 EUR	UK
KKR Infrastructure Fund	Kohlberg Kravis Roberts	2,500 USD	US
Blackstone Infrastructure Fund	Blackstone Infrastructure Partners	2,000 USD	US
Macquarie State Bank of India Infrastructure Fund	Macquarie Capital Funds	2,000 USD	Australia
AXA Infrastructure Fund III	AXA Private Equity	1,500 EUR	France
Marguerite Fund	Marguerite Adviser	1,500 EUR	Luxembourg

Source: Preqin

As shown in Fig. 4, of the 105 infrastructure funds currently on the road, 46 (44%) have held at least one interim close in order to begin investing capital. 43% of these interim closes occurred in the first half of 2010, showing good momentum in the market. This included several sizeable interim closes such as the second and third closes of Energy Capital Partners II on cumulative totals of \$3 bn and \$4 bn respectively, and the fourth close of Brookfield Americas Infrastructure Fund on a cumulative total of \$1.3bn. Additionally, 39% of funds yet to hold a close have stated that they expect to do so before the end of 2010.

More funds in market are focused on Asia and Rest of World than on either Europe or North America. As shown in Fig. 5, a total of 46 funds

are focused outside of the European and North American markets, representing the increasing demand for infrastructure development in these regions. However, in terms of aggregate capital sought, Europe and North America-focused funds are more significant, targeting \$34bn and \$25.6bn respectively.

In terms of project stage focus, 67% of funds currently raising capital will consider investing in greenfield projects, 72% in brownfield assets and 36% in more mature secondary stage opportunities. The majority of funds in market will consider investing in a range of project stages in order to maximize portfolio diversity.

Elliot Bradbrook

Fig. 4:

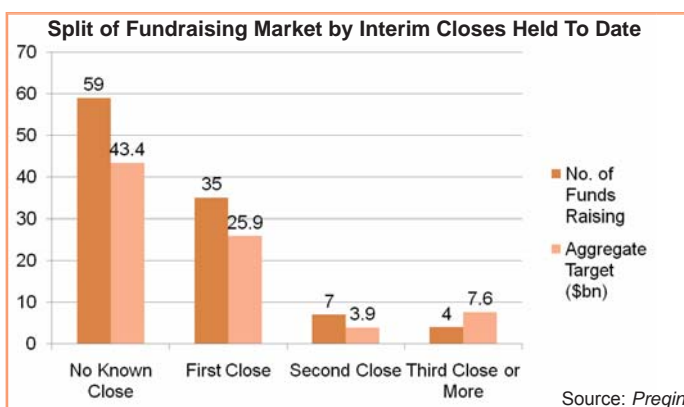
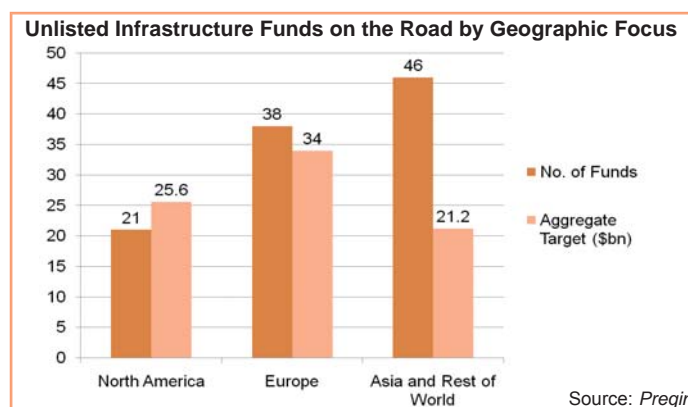


Fig. 5:



Deals Spotlight

Although unlisted infrastructure fundraising improved slightly in the first half of 2010, the aftershocks of the the financial crisis were still being felt. The lack of available, cheap bank debt means that many deals are dependent on increased equity ratios and/or a reduction in asset valuations.

As shown in Fig. 1, unlisted infrastructure fund managers completed 57 deals in H1 2010, 30% less than the number reported in H1 2009 and half the number of deals reported in H1 2008. Q2 2010 yielded the lowest quarterly number of deals since Q3 2007.

Deal Activity by Region

Fig. 2 shows the geographic location of the infrastructure deals made in H1 2010. Europe and North America were the most prominent regions, accounting for 26 and 17 deals made during the period respectively. Eight deals were made relating to assets located in Asia, three in South America, two in Australasia, while a single deal was made in Africa.

Deal Activity by Industry

Unsurprisingly, core infrastructure assets such as energy, utilities, transportation and telecommunications continued to dominate H1 2010 deal activity. As shown in Fig. 3, core infrastructure accounted for 50 of the 57 deals completed in the first half of 2010: 25 in the energy sector, 12 in both utilities and transportation, and one in the telecoms industry. Five transactions were made in healthcare assets and a single deal in each of the logistics and public buildings sectors was also completed.

Significant Deals Made in H1 2010

A number of significant deals were made in H1 2010 including the Eiffarie consortium's purchase of an additional 13.73% stake in the Autoroutes Paris-Rihn-Rhone toll road in France for EUR 854 million in June. The consortium, which consists of Macquarie European Infrastructure Fund II, Macquarie Atlas Roads and Eiffage, originally took an 81.48% stake in the toll road for EUR 5.9 billion in 2006. The

Fig. 1:



13.73% stake was purchased from Elliott Associates and Sandell Asset Management.

In the US, SteelRiver Infrastructure Fund North America finalized its USD 780 million purchase of The Peoples Natural Gas Company from Dominion in February. The natural gas distribution utility is located in Pittsburgh, Pennsylvania, and serves over 350,000 homes. Bayerische Landesbank, BNP Paribas Capital, Scotia Capital and Union Bank of California provided debt financing for the transaction.

In Australia, UBS International Infrastructure Fund I and Retail Employees' Superannuation Trust gained a 100% stake in the Collgar Wind Farm from Investec for AUD 740 million in March. The Collgar Wind Farm is a 206MW wind power facility located in Merredin, Western Australia, generating 790,000MWh of renewable energy per year and supplying power to over 125,000 homes.

Elliot Bradbrook

Fig. 2:

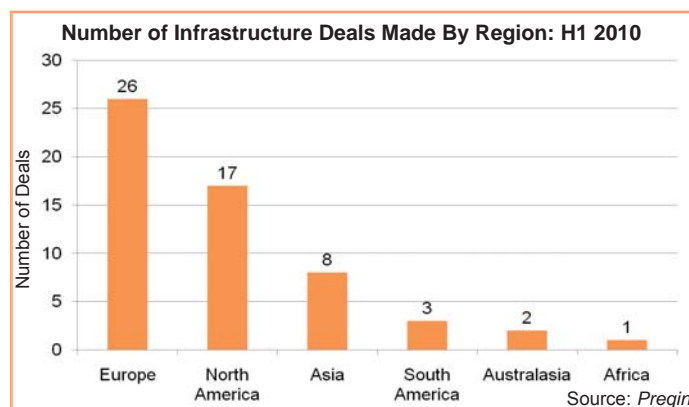


Fig. 3:



Conferences Spotlight: Forthcoming Events

CONFERENCE/EVENT	DATES	LOCATION	ORGANIZER
Finance & Development Asia India Summit 2010	26 - 27 Aug	Delhi	Incisive Media
Infrastructure Investment World Asia 2010	31 Aug - 3 Sept 2010	Hong Kong	Terrapinn
Infrastructure Investment World Brazil 2010	31 Aug - 1 Sept 2010	Rio de Janeiro	Terrapinn
5th Annual North American Energy and Infrastructure Finance Forum	16-17 Sept 2010	New York	Euromoney Seminars
Institutional Investing in Infrastructure	31 Oct-2 Nov	Washington DC	IREI
AIS 2010 Abu Dhabi Showcase of Alternative Investment Funds	3-4 Nov	Abu Dhabi	Leoron Events
Infrastructure Investment World Africa 2010	8-10 Nov 2010	Johannesburg	Terrapinn
Infrastructure Investment World India 2010	22-24 Nov 2010	Mumbai	Terrapinn
Infrastructure Investment World Europe 2010	30 Nov-3 Dec 2010	London	Terrapinn

Infrastructure Investment World Asia 2010

Date: 31 Aug - 3 Sept 2010
Location: Conrad, Hong Kong
Organiser: Terrapinn

Infrastructure Investment World Asia is an event that brings together infrastructure developers, governments, investors, financiers and supporting industries to assess investment, project development and capital raising opportunities across Asia's infrastructure landscape.

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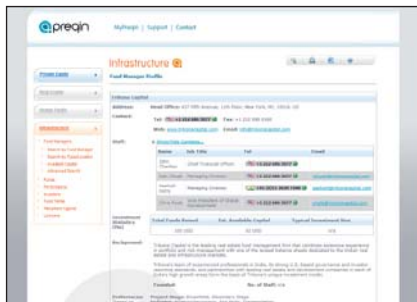
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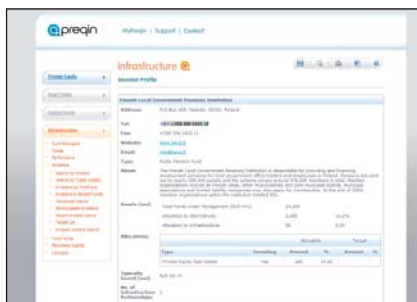
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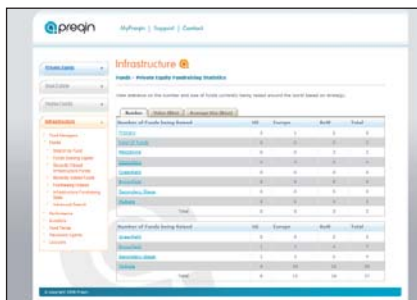


INVESTORS: See detailed profiles for over 600 investors who are actively investing in infrastructure funds. Investors include infrastructure fund of funds, pension funds, endowments, family offices and other institutional investors. Detailed profiles include background, contact details, investment plans, preferred fund strategies and known previous investments in infrastructure funds.



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Investor Spotlight: Investor News

Public Investment Corporation allocates ZAR 30 billion to infrastructure investment

The South Africa-based asset manager has allocated ZAR 30 billion to expand investment in the infrastructure asset class on behalf of its largest client, the ZAR 819 billion Government Employees Pension Fund. These new investments will increase Public Investment Corporation's exposure to projects in the economic sector, primarily energy and clean technology projects in South Africa. Public Investment Corporation has previously committed to several South African unlisted funds, including African Infrastructure Investment Fund and Pan African Infrastructure Development Fund, which provide exposure to the energy, telecom, aviation, water, transportation and waste management sectors. Future investments will continue to focus on South Africa and will primarily be in the form of direct equity investments and bonds purchased in state-owned companies.

San Antonio Fire and Police Pension Fund in search for infrastructure manager

The USD 1.8 billion pension fund has decided to make a maiden investment in infrastructure. San Antonio Fire and Police Pension Fund has initiated a search for an unlisted infrastructure fund manager to handle a USD 30 million mandate. This step was taken at a recent board meeting, following the recommendation of its consultant, Consultant Services Group. The pension fund previously carved out a 5% allocation to real assets, into which infrastructure investments will fall. The real assets allocation also includes existing investments in timber and may incorporate commodities investments in the future.

Buckinghamshire County Council Pension Fund has renewed its contract with Mercer Investment Consulting.

The GBP 1.4 billion public pension fund has extended its contract with Mercer Investment Consulting, its general consultant, for a further three years with the possibility of two further extensions of three years each. Buckinghamshire County Council Pension Fund had been in search of a consultant as Mercer's contract was set to expire. Proposals were due on April 26, 2010 and Mercer was allowed to rebid for the position. Buckinghamshire County Council Pension Fund is a small but active investor in the infrastructure asset class. It considers funds that invest across project stages and has a preference for fund of funds vehicles.

Teacher Retirement System of Texas (TRS) commits USD 300 million to infrastructure fund

The USD 96 billion retirement system has made its sixth infrastructure fund investment through a USD 300 million commitment to Zachry Hastings Infrastructure Fund. This will increase its exposure to the energy, utilities and transportation sectors in North America. The retirement system's allocation to infrastructure now stands at USD 1.43 billion, having also recently committed to such funds as First Reserve Energy Infrastructure Fund and Alterna Core Capital Asset Fund. TRS began investing in the asset class in 2008 as part of its real assets allocation, and has typically been committing between USD 100 million and USD 300 million to each fund. The retirement system may make further infrastructure fund commitments over the next 12 months as it moves towards a 15% allocation to real assets. It has a preference for assets in economic sectors but will invest on a global scale, and will also consider emerging markets.

Alastair Scott

Each month Spotlight provides a selection of the recent news on institutional investors in infrastructure.

This month, 13 new investors have been added and 261 investor profiles updated. More news and updates are available online for Infrastructure Online subscribers.

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

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