Infrastructure Spotlight

August 2010 / Volume 3 - Issue 8

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Welcome to Infrastructure Spotlight, the monthly newsletter from Preqin providing insights into performance, investors, deals and fundraising. Infrastructure Spotlight contains information from our online product, Infrastructure Online.

Lost in Transition? Investor Survey Results

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Lost in Transition?

An in-depth look at infrastructure investor preferences and plans for investment in the next 12 months. Data is taken from a recent Preqin survey conducted for the 2010 Preqin Infrastructure Review.

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- Fundraising
- Fund Performance
- Investor Profiles
- Deals

We take an in-depth look at the product, and how it can help you. Includes information on ordering and registering for a demo.

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All the latest news on investors in infrastructure, including:

- Korea Investment Corporation
- Starling Group
- IOOF

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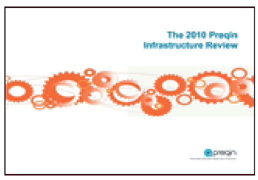


Infrastructure: Lost in Transition?

The unlisted infrastructure market is in a period of transition. Therefore, in June 2010, Preqin surveyed institutional infrastructure investors from around the world to find out more about investor sentiment towards the key issues facing the asset class. Respondents were asked about their views on the alignment of investor and fund manager interests, specific issues such as management fees and carry structures, the future of the private equity fund model in infrastructure, and their future plans for infrastructure investment.

Alignment of LP and GP Interests

As shown in Fig. 1, almost 75% of investors surveyed disagree or strongly disagree that the interests of investors and fund managers are properly aligned. Many investors highlighted the discrepancy between the risk/return profile of infrastructure assets and the level of management fees charged by fund managers utilizing the private equity fund model. Others suggested that there is a fundamental difference between the reasons why investors look to gain exposure to infrastructure assets (such as for long-term, stable yield) and the profit-orientated aims of fund managers when raising an infrastructure fund. One investor stated: "There is too much reliance on the private equity fund model, essentially the 2 and 20 structure," while another claimed: "I believe [interests] are trending in the right direction, but most are still trying to apply the private equity model, which may not work for core and core-plus type infrastructure investments."

Infrastructure projects are characterized by a lower level of risk and a longer holding period than private equity assets, meaning investors are concerned about the reliance on a relatively short-term fund model for long-term infrastructure assets. One respondent reflected this concern saying: "There is tension between the long-lived nature of infrastructure assets and the shorter-term focus of private equity funds, which call for shorter holding periods, realizations and distributions of capital, profits and carry."

However, just over a quarter of those investors questioned believe interests are aligned. One respondent commented: "In Australia they are. The market mainly consists of fund managers running open-ended infrastructure funds rather than closed-ended private equity-style funds." This statement reflects the notion that other fund structures, such as open-ended or evergreen funds, may be better suited to infrastructure investment than the private equity fund model.

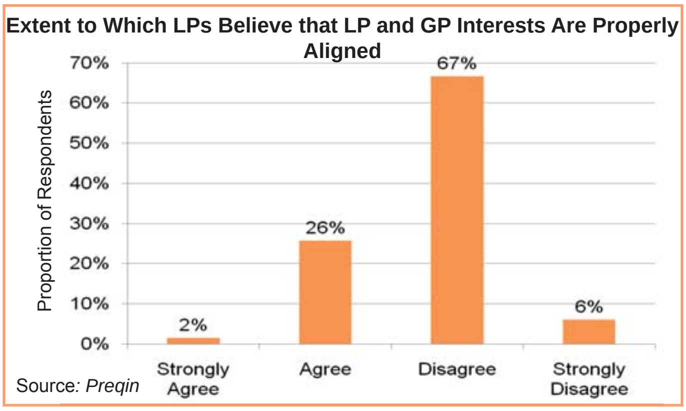
Areas of Improvement

Specific areas in which investors believe interests need improving are shown in Fig. 2. The level of management fee charged and carry structures were the most prevelant areas perceived to be in need of improvement, with 72% of investors citing each issue as a problem. One investor stated: "The fee structure is set up for an asset class capable of returning 20%, but expected [infrastructure] returns are much lower than that."

According to Preqin data, the majority of unlisted infrastructure funds (76%) target a net IRR of between 10% and 20%. This is lower than the level of returns traditionally sought by fund managers operating private equity or real estate funds. Also the potential for very high returns is much lower in infrastructure than in these other strategies, with only 2% of infrastructure funds targeting an IRR of over 25%.

As shown in Fig. 3, when compared to other private equity strategies, older infrastructure funds have performed well, with the median net IRR for funds of vintages 1993-2004 at a similar level to both private equity and real estate. However, this is as a result of the limited number of unlisted infrastructure funds in existence prior to 2005 and the abundance of highly profitable opportunities in need of financing during this period. It is still too early to make solid performance predictions about more recent funds, but the likelihood is that future IRRs will be towards the lower end of the 10-20% range. Therefore infrastructure investors are largely unwilling to buy into the traditional

Fig. 1:



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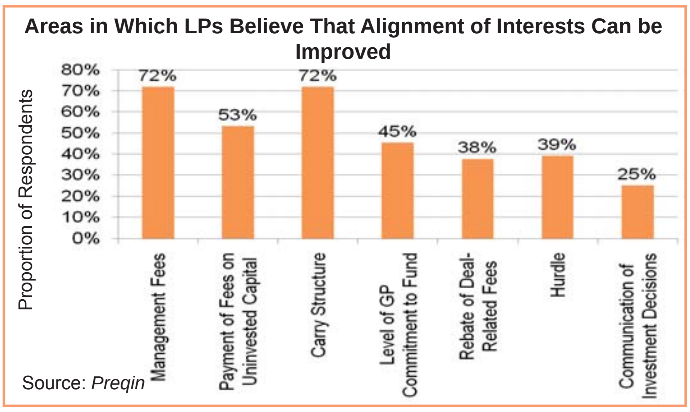
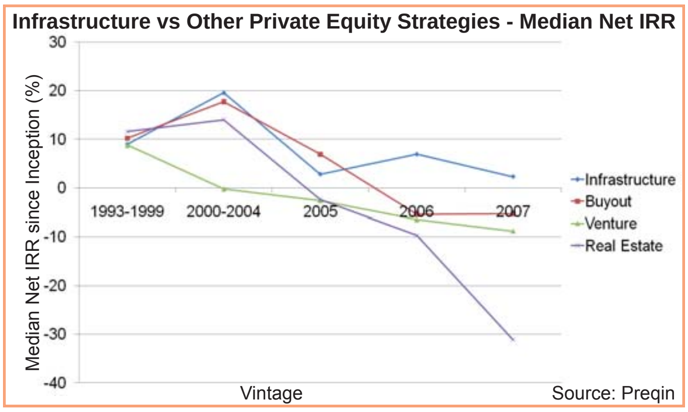


Fig. 3:



2/20 fee structure, when forecasted infrastructure returns are less than in private equity.

One investor suggested that the fee structure often utilized by core real estate funds is a more appropriate model for infrastructure, stating: "Management fees should likely resemble what is seen in real estate as you move from core to opportunistic infrastructure. For core investments, the hurdle should be a moving target (i.e. real return or a premium over LIBOR)." This suggests that fees should be based on the risk/return profile of the fund and the types of infrastructure assets being targeted. Another investor commented: "It is simple. Managers should earn significant money (above cost recovery) only when investors earn decent returns."

Aside from management fees and carry, investors also highlighted several other issues that they feel need to be resolved to improve alignment. 53% of investors take issue with having to pay fees on capital that has not yet been invested, while 45% think fund managers need to address their level of commitment to their own funds. 25% of investors surveyed believe there needs to be greater interaction between investors and fund managers when making investment decisions.

The Future of the Private Equity Fund Model in Infrastructure

As previously stated, the use of the traditional private equity fund model in infrastructure investment is a heatedly debated topic. As shown in Fig. 4, over 50% of investors surveyed believe the private equity model will be utilized going forward, although this is dependent on the resolution of key issues already raised such as fund structure and fees. Of those investors that believe the private equity fund model will not be used in the future, almost half think it will be replaced by direct investment, although this will limit the level of exposure smaller investors are able to gain to infrastructure assets.

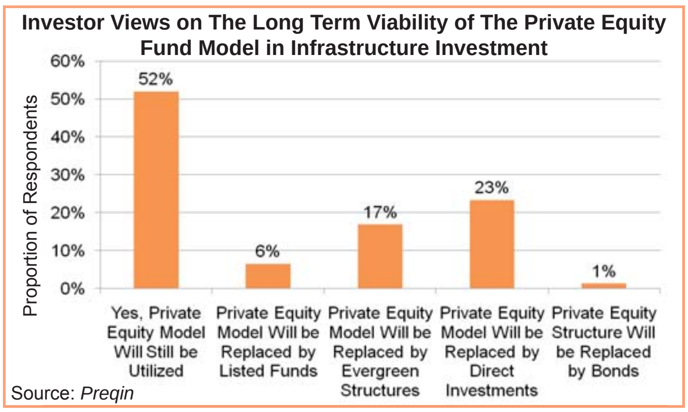
Direct investment is attractive to investors as it removes the cost of third-party fund manager fees. A growing number of large infrastructure investors are beginning to turn to direct project financing to avoid paying fees and maximize returns as they gain more experience in the asset class and become more confident in executing infrastructure deals themselves. However, the resources required to make direct investments means they are an unrealistic option for smaller investors, so a solution to the issues relating to the private equity fund model is essential if these investors are to continue investing in the asset class. One investor believes that the fund model used will depend on the type of infrastructure fund being raised, stating: "I do [believe the private equity model has a long-term future in the asset class] but core strategies might be best accessed through open-ended funds, while opportunistic infrastructure might be best in a private equity structure. Direct investments are the best way to access the asset class, but are not a viable option for the majority of investors." In this case, an option could be to tailor fund structures based on the type of infrastructure assets being targeted.

Similarly, another investor suggested that fund structures could be tailored to individual investors in the future as well as to certain asset types, saying: "More customized structures for smaller groups of investors may be a likely avenue, including some advanced structures for public private partnerships."

Other investors believe a variety of fund models will continue to be utilized in the infrastructure industry in the future, with the private equity model complementing other structures like open-ended, evergreen and listed funds. One investor suggested: "We believe a combination of closed-end structures, direct investment and cost-efficient core funds will exist in parallel."

On the whole, investors believe that the private equity model will continue to be used in infrastructure investment but must be adapted to fit the needs and demands of both fund managers and investors. Investors make infrastructure investments for a number of reasons, such as diversification, to act as a hedge against inflation and because of the potential for stable long-term returns. Therefore fund managers must relate to these demands when formulating their fund and fee structures.

Fig. 4:



Outlook

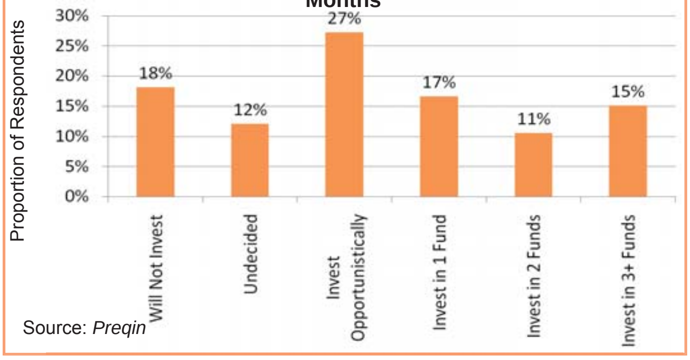
Investor confidence is beginning to return to the infrastructure market following the financial crisis. As shown in Fig. 5, 70% of investors surveyed plan to make infrastructure fund commitments in the coming 12 months, as opposed to just 40% that stated such an intention in our October 2009 survey. Of these investors, more plan to make multiple commitments than those that plan to make a single investment in the coming year.

However, the survey highlights a number of key issues facing the asset class that need to be overcome to ensure continued growth within the unlisted infrastructure market. Infrastructure fund managers will have to make sure that their fund terms, especially those relating to management fees and the carry structure, satisfy investors if they are to be successful in an increasingly competitive fundraising market. The resolution of these key issues will directly affect investor confidence and therefore impact future fundraising and deal flow.

Elliot Bradbrook

Fig. 5:

Investor Plans for Infrastructure Fund Investment in The Next 12 Months



Source: *Preqin*

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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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Interview: Cube Infrastructure Fund

Cube Infrastructure Fund is a brownfield infrastructure fund focusing on regulated assets on the European market. Cube's investment strategy targets growing companies and projects in transport, energy, water, and public services. Cube's general investment strategy is to partner with industrial champions and management teams. This strategy relies on the industrial profile of the management team, and its extensive experience across the infrastructure space. To date, Cube has committed to invest €290 million in six infrastructure assets – water distribution, waste management, renewable power generation, fibre-optic telecom cables and rail infra-structure – across Spain, France and the UK.

This month we speak to one of the management team, Henri Piganeau, to find out more about the fund, the challenges they faced while fundraising and the steps they took to achieve success...

The Cube Infrastructure Fund closed above target at a time when fundraising was very difficult. What do you think contributed to this success?

Although it is difficult to identify specific reasons, there are a few factors that helped us to achieve success. For one thing, the fact that the asset class itself is becoming more recognized certainly helped. The fact that the team has extensive experience within the industry was valued by investors; we have handled the assets from an operational perspective in the past and therefore hopefully have a good insight as to what the risks are. We also developed a specific strategy that is focused more on propriety transactions. The support of competent placement agents and finally, possibly a little bit of good luck!

What were the main issues you faced during the fundraising period?

It was a very lengthy process that took approximately two years – longer than we anticipated. We realized after some months that our product was not properly positioned. Initially the fund was supposed to become public with a clause that was directed to an IPO in five years, but after a period of time we came to realize that investors weren't looking for that. We therefore restructured the fund as a closed-end, 12-year fund and once this was done we were quite successful.

A recent Preqin survey showed that around half of infrastructure investors felt that closed end private equity fund structures were not suitable for infrastructure investments, yet the CUBE fund became more appealing to investors following the change in strategy. Why do you think investors were more keen to invest in the restructured fund?

While investors recognize the long-term nature of infrastructure, they want to have a rendez-vous with the market much sooner. Investors are also interested in a short-term yield and are not always keen to lose control of things for 25 years. Plus you invest as a team, and who knows what that team will be like in 20 years time.

That said, it's not necessarily the end once the 12-year period is up. In five or 10 years some investors might come and say that they really want to get out after 12 years as anticipated, others may ask you to continue to manage under a new scheme that can be negotiated. This gives everyone the best of both worlds – the capacity to stretch over the very long term, while at the same time giving the legitimate possibility of exit.

Liquidity is an important issue and you should address the needs of some investors to get out of fund. Alignment of interests is also important, especially in long-term commitments. There is a very real possibility that investors may survive the manager, and each party has different needs, both in the long and short term. It is important that you compromise and find something in between.

You mention the importance of alignment of interest, what specific steps did you take to ensure that interests were aligned between investors in and managers of the CUBE fund?

Firstly the manager has invested alongside investors under the same conditions, as have the four partners. There are 22 investors, and they and the lawyers all have different requests. We came to a fair compromise.

Clauses that are common now didn't used to be three or four years ago, such as the no-fault divorce clause, which allows investors by supermajority to decide to take away the management contract from the company even if nothing has been done wrong. Ultimately the client is the one that decides.

More specifically, we tried to address the management fee structure. It depends on the size of the ticket of each investor and the recognition that if you manage one investor with a €100 million investment it is easier than managing 50 with €2 million invested each – so it is a reduction by size of ticket. There is also a reduction according to the global size of the fund, and recognition of the economies of scale. You can manage a fund of a billion, or 1.1 billion, almost with same size team. We tried to recognize that in our fee structure and investors were receptive of that.

The partnering strategy within the Cube fund is very unique. Can you explain a bit more about it?

We partnered with industry players. Some of the companies have performed their services for 20/50/150 years; we know this as we used to work for these companies. The public have confidence in them, they have local contacts, reputations to protect and they have to properly manage, handle and enhance the quality of the public service. We are a small team of 12 investment managers, we can't do what these companies have been doing for decades. It's not appropriate to compete with them, so we deliberately decided not to and chose to partner with them instead.

Do you feel that your partnership strategy could be used by other infrastructure fund managers going forward?

It could become the general model. We were probably the pioneers of the strategy, but I'm confident that there will be some replication, provided that the teams profile is of an industrial nature.

What were the key issues for investors investing in the Cube fund?

We were a first-time team, raising a first-time fund, and as a result it was difficult to convince institutions that despite this, we could represent a prudent investment. Once we had completed five or six transactions, that helped us to establish a track record as a team, and the structure and proprietary features of those investments was felt to be interesting. We were also able to deliver a yield from the first year, which is something that was valued, helping us to overcome the drawbacks of being first timers. We adopted a cautious approach to the market and were keen to invest slowly, as we believed that there were still high valued assets. We had to pick up the good assets and good management teams and not put too much emphasis on investing too quickly, or too expensively.

Many of the investors surveyed by Preqin were wary of investing with new, inexperienced infrastructure fund managers. What advice would you give to those looking to launch an infrastructure fund for the first time?

Finance is a tool, not a goal. Understanding the asset is far more important than having financial knowledge. You can always find the resources to help, the core competence is operating the asset. Almost everyone in our team is an engineer - in fact 80% of the team are engineers.

What did you learn from the fundraising process?

We learnt to identify the appropriate future horizons of investors, and what investors are receptive towards. I think that we realized that there is a higher interest in the yield than we thought when we started to launch the placement.

There is probably growing interest in securing a yield in the short term. I'm not sure that the current typical private equity alignment of interest really captures that. The carried interest maximizes the IRR, but within the IRR contract the investors would clearly favour a project that gives them reasonable yield from the beginning, rather than a very large pay out when you sell the asset. This is not fully captured in the current management fee or carried performance fee etc. I feel there must be some innovation to be creative and we will pay attention to this market trend for fund two.

Do you have any idea how you would go about resolving this issue in any future funds you were to raise?

We have some ideas. But we have to be cautious and not get swept up in a new scheme/fad that we don't really understand. We will take our time, probably by that time there will be some innovation presented by other funds or demanded by investors. I am convinced that this will be an area of change within the asset class and it's really motivating the managers on delivering yield.

What do you think the outlook is for the infrastructure industry?

The asset class has a brilliant future and it's getting more mature. There are enormous infrastructure needs, both in green and brownfield projects, and the states don't have the means to address the needs of the citizens on their own. The population is growing, but the earth is remaining the same so you have to structure and organize and it's becoming more and more costly, especially when you consider environmental constraints.

The governments are becoming more and more experienced and understand better how to use private money to deliver public services, while it's becoming more safe to invest in more and more countries and there is better understanding of the public-private joint venture. The needs are there, the government experience is there and the investors recognize the value of infrastructure investments in their portfolios.

Henri Piganeau is a managing partner, and joined the Cube Infrastructure Fund in August 2007.

Fundraising Spotlight

Fig. 1:

Number of Funds on the Road				
Primary Geographic Focus	North America	Europe	Asia & ROW	Total
Number	23	39	47	109
Total Target Value ($bn)	26.2	34.4	21.2	81.8
Average Target Size ($bn)	1.1	0.9	0.5	0.8

Recently Closed Fund: DIF Infrastructure II

Manager – DIF
Target Size (mn) – 500 EUR
Final Close (mn) – 500 EUR (June 2010)
Target IRR (Net) – 10%+
Geographic Focus – Europe (Belgium, France, Germany, Ireland, Netherlands, Spain, UK)
Industry Focus - Education Facilities, Energy, Government Accommodation, Healthcare/Medical Facilities, Judicial Buildings, Prisons, Railway, Renewable Energy, Roads, Social, Transportation, Utilities
Placement Agent – Atlantic-Pacific Capital
Lawyer - Loyens & Loeff
Sample Investors – Achmea, APG – All Pensions Group, DSM Pension Services, European Investment Bank, KBC Pensioenfonds, SPF Beheer, Stichting Grafische Bedrijfsfondsen

Fig. 2:

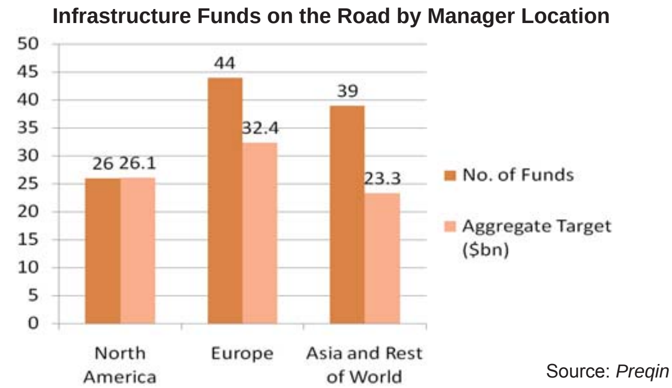

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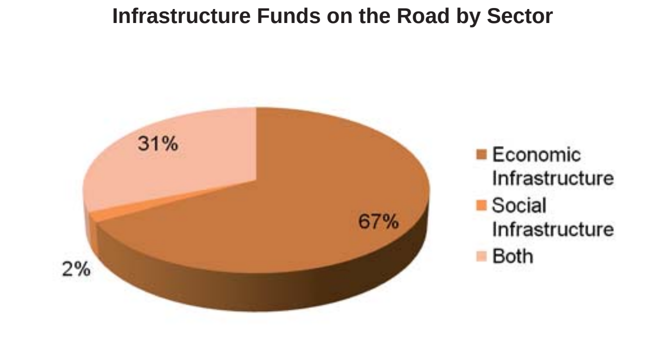
Fig. 3:



Source: *Preqin*

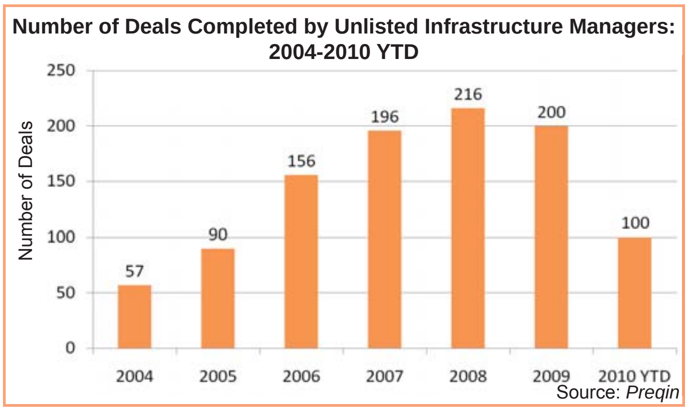
Fig. 4:

10 Largest Infrastructure Funds on the Road			
Fund	Manager	Size (mn)	Manager Country
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
Marguerite Fund	Marguerite Adviser	1,500 EUR	Luxembourg
AXA Infrastructure Fund III	AXA Private Equity	1,500 EUR	France

Source: *Preqin*

Deals Spotlight

Fig. 1:



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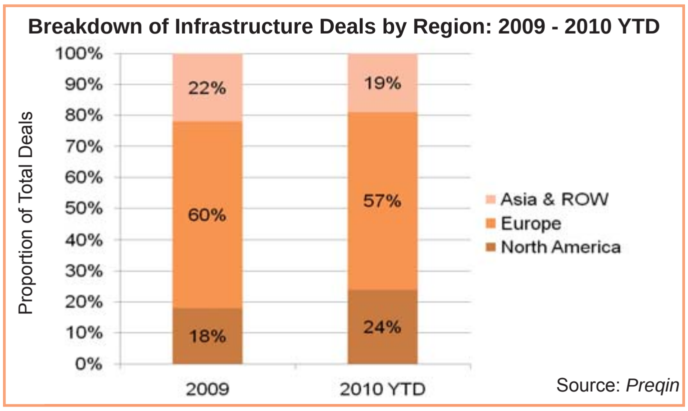

Recent Deal:

Ytterberg Wind Farm
In August 2010, Hg Renewable Power Partners Fund II provided equity for the development of the Ytterberg Wind Farm, a 44MW wind power facility located in the Malå Municipality of Västerbotten County, Sweden. The facility will be constructed by Nordisk Vindkraft and the wind turbines supplied by Vestas. A 17-year project financing facility was underwritten by Commerzbank.

Deal Date – August 2010

Stake – 100%

Investors - Hg Renewable Power Partners Fund II, Nordisk Vindkraft, Vestas

Debt Provider – Commerzbank

Project Stage - Greenfield

Fig. 3:

10 Most Active Unlisted Infrastructure Fund Managers in the Last 12 Months

Fund Manger	Number of Investments in Last 12 Months	Total Raised through Unlisted Infrastructure Funds (bn)
Macquarie Capital Funds	12	USD 19.8
LS Power Group	11	USD 4.3
DIF	11	EUR 0.8
Equitix	11	GBP 0.1
EnerCap Capital Partners	8	EUR 0.1
Innisfree	7	GBP 1.8
Energy Capital Partners	6	USD 6.2
NIBC Infrastructure Partners	6	EUR 0.3
EnCap Investments	5	USD 0.8
ArcLight Capital Partners	5	USD 6.8

Source: *Preqin*

Conferences Spotlight: Forthcoming Events

CONFERENCE/EVENT	DATES	LOCATION	ORGANIZER
Finance & Development Asia India Summit 2010	26 - 27 Aug 2010	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 2010	Washington DC	IREI
AIS 2010 Abu Dhabi Showcase of Alternative Investment Funds	3-4 Nov 2010	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.

www.terrapinn.com/2010/iiahk/

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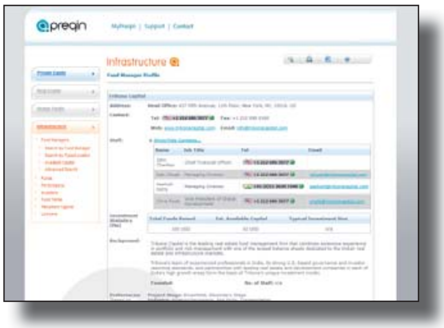
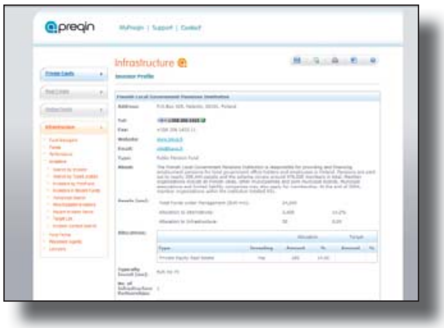
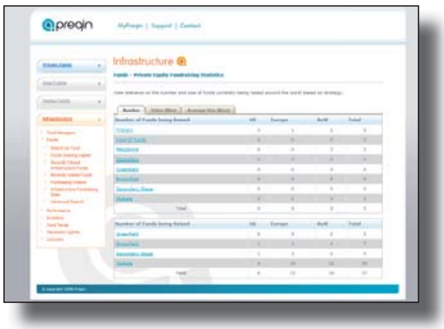
Infrastructure Online is the most comprehensive resource available to infrastructure professionals today. Whether you're a GP, LP, fund of funds, placement agent, lawyer, consultant or advisor this is a vital information service for you.







INVESTORS: See detailed profiles for over 700 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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DEALS: Details on which funds are bidding for, buying or selling infrastructure assets. Includes information on the type of infrastructure asset and location, data on the equity invested and the percentage stake acquired by the fund, information on the deal date, structure and duration plus names of funds' co-investors in transactions.

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Investor Spotlight: Investor News

Korea Investment Corporation to commit to another infrastructure fund in next 12 months

The USD 31 billion sovereign wealth fund, which already has an allocation to infrastructure of around USD 150 million spread across two unlisted funds, is looking to add another infrastructure fund commitment to its investment portfolio over the next 12 months. Korea Investment Corporation primarily seeks economic assets in emerging markets, and typically invests between USD 50 million and USD 100 million in each fund. These investments are the result of a USD 10 billion mandate the investment corporation was given by the Korean government in Q1 2009 to be invested opportunistically in a range of different strategies.

Starling Group seeking maiden infrastructure investments

The UAE-based family office is actively looking to make initial investments in infrastructure via commitments to unlisted funds. Any infrastructure investments will be made opportunistically through Starling Group's allocation to private equity. It will only consider investments in Asia and South America, and particularly in India, China and Brazil. It will invest in core economic infrastructure and infrastructure-related services, such as the transportation, telecom and utilities sectors.

Leica Pensionskasse commits CHF 10 million to fund of funds

The CHF 500 million pension plan has made its maiden infrastructure investment through a CHF 10 million commitment to an infrastructure fund of funds vehicle. The fund of funds is primarily focused on Europe and will invest in a diverse spectrum of infrastructure industries. The 2% infrastructure allocation which this commitment will provide will be monitored over the next 12 months before additional investments are made. The pension plan will consider first-time infrastructure fund managers but will not seek investments in PPP/PFI projects.

IOOF to expand infrastructure portfolio

The AUD 101 billion asset manager is looking to add further unlisted fund commitments to its infrastructure portfolio in the coming 12 months. IOOF, which has previously invested capital in RARE Infrastructure Value Fund, is an opportunistic investor in the infrastructure asset class and is actively seeking further investments to complement its existing portfolio. The asset manager typically invests USD 10 million per fund and will consider both domestic and global investment opportunities. It has previously acquired exposure to transportation, utilities and water assets.

Washington University in St. Louis Endowment to invest opportunistically in infrastructure over next 12 months

The USD 4.5 billion endowment plan will invest in infrastructure via its allocation to real assets in the remainder of 2010 and 2011, but only if the right opportunities arise. It will primarily look to commit to unlisted infrastructure funds but will also consider direct investments. Washington University in St. Louis Endowment will invest globally and has no specific industry preferences. The endowment plan will typically invest in excess of USD 15 million and will mainly invest with experienced infrastructure managers or spin-off firms. It will not consider PPP/PFI opportunities.

Alastair Scott and Louise Taggart