Preqin Research Report

Is Infrastructure Living Up To Expectations? (1)

Since the emergence of unlisted infrastructure funds in the 1990s, private investment in infrastructure has grown rapidly with a variety of institutional investors and fund managers entering the marketplace. Infrastructure is now by a majority of investors viewed as a separate independent asset class, but the evolution of the sector is far from complete.

Investors and fund managers continue to debate over the most appropriate fund structure, with the 10-12 year investment period employed by the private equity fund model possibly conflicting with the long-term nature of infrastructure assets. The question also remains as to the role the private sector should take in the funding of public infrastructure projects through PPP/PFI initiatives. Also, as few infrastructure funds were raised before 2004, there is only limited data available to create meaningful performance benchmarks for the industry.

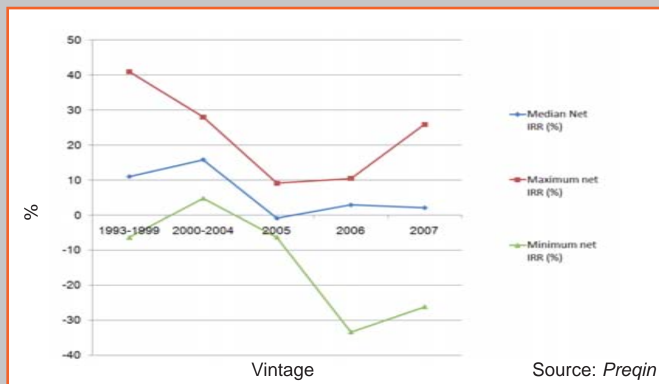
Preqin currently holds performance data for 72 unlisted infrastructure funds, the majority of which have been raised in recent years. However, using the new **Preqin Infrastructure Benchmark**, we can begin to analyse the performance of older infrastructure funds for an indication as to what investors can expect from younger funds, and to make comparisons with other private equity style strategies.

Median Net IRR by Vintage Year

As expected, median net IRRs for the most recent vintage years remain around the 0% mark. Many of these funds still have dry powder available to invest and/or contain relatively immature assets. It is still too early to predict future long-term returns for these vehicles, but there is evidence that older infrastructure funds have delivered reasonable returns.

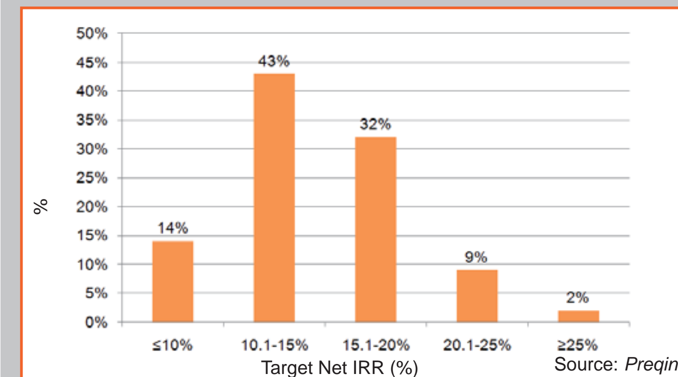
Fig. 1 shows the median net IRRs since inception for infrastructure funds of vintages 1993-2007, as well as the maximum and minimum net IRRs for each vintage year. Infrastructure funds with a vintage 1993-1999 have yielded 11% median net IRR, which increases to 15.8% for funds of vintages 2000-2004. This shows that older infrastructure

Fig. 1: Median Net IRR For Infrastructure Funds 1993 - 2007



Source: *Preqin*

Fig. 2: Split of Target Net IRRs



Source: *Preqin*

funds have performed positively. The graph also shows that infrastructure funds have the potential to achieve a net IRR well above 20%, similar to many private equity vehicles.

The performance achieved is in line with the IRRs that infrastructure funds are targeting. As Fig. 2 shows, the most populated range for net IRRs targeted by fund managers is the 10.1-15% group, with 43% of funds falling into this section. The next largest group is the 15.1-20% target range, comprising 32% of funds. 75% of funds are therefore targeting a net IRR of 10-20%, which is realistic as it correlates with the actual IRRs achieved by funds with a vintage of 1993-2004, as shown in Fig. 1.

Median Net Multiple Returns by Vintage Year

Net multiple returns are used by investors to determine how much they have gained or are likely to gain on an investment. It does not take into account the timings of capital call-ups and distributions, although it does provide a good indication of fund performance.

Fig. 3 shows the median net multiple returns for infrastructure funds by vintage year. Again, funds of a vintage 1993-1999 provide a representative indication of infrastructure fund performance due to their relative maturity and because many have already been liquidated. To date, funds with these vintages have provided strong returns, with a median multiple of 1.69x. Funds of vintages 2000-2004 are also showing good returns, with a median multiple of 1.35x. More recent vintages have multiples of around 1.0x, which is again expected to improve as these funds mature, and is at least in part a reflection of the J-curve.

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Is Infrastructure Living Up To Expectations? (2)

Infrastructure vs. Other Private Equity Strategies

Investors make infrastructure investments for a number of reasons, such as for diversification, to act as a hedge against inflation and because of the potential for stable long-term returns. It is therefore interesting to compare performance data for infrastructure funds with other private equity strategies in order to see whether the asset class is living up to expectations.

Fig. 4 shows the median net IRRs achieved by infrastructure, buyout, venture and real estate funds of vintages 1993-2007. In comparison with these other strategies, infrastructure funds have performed well, with the median net IRR for funds of a vintage 1993-2004 at a similar level to both private equity and real estate. This suggests that infrastructure funds are able to produce attractive returns for investors even when compared to asset classes that shoot for higher returns.

Fig. 4 also proves the stability of infrastructure funds when compared to other private equity strategies. Recent infrastructure funds have maintained a median net IRR of close to 0%, as expected for younger funds, while both private equity and real estate funds have fallen well into the red, with real estate funds in particular suffering as a result of the sub-prime crisis. Infrastructure seems to be performing as expected by generating

Fig. 3: Median Net Multiple Returns for Infrastructure Funds By Vintage Year

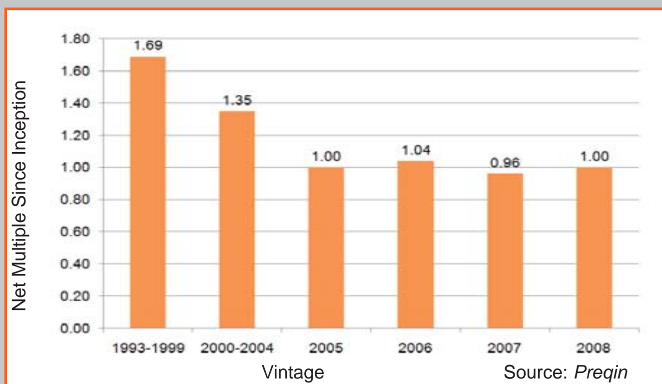
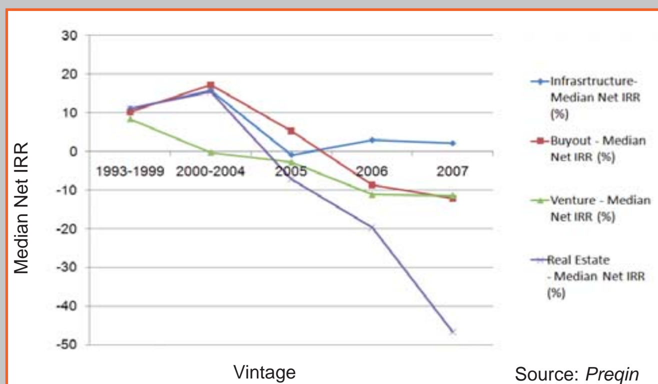


Fig. 4: Infrastructure vs Other Private Equity Strategies - Median Net IRR.



attractive returns, while also maintaining a level of stability and providing a degree of resilience during recent economic volatility.

This is also proven by the standard deviation of infrastructure funds when compared to other strategies. Standard deviation of infrastructure funds of a vintage 1993-2007 amounts to 15.2%, much less than the 23.2% for buyout, 53.9% for venture and 25.6% for real estate funds. This shows that infrastructure funds are less risky than other strategies, although the potential for significant levels of return is greatly reduced.

Overview

Although the majority of unlisted infrastructure funds have been launched in recent years, the performance of older vintage funds provides an insight into what can be expected in the future. The majority of infrastructure fund managers are targeting a net IRR of between 10% and 20%, which matches the median net IRR achieved by funds of a vintage 1993-2004 ranging from 11% to 15.8%. These funds have also yielded attractive median net multiple returns over the same period.

The risk/return profile of the infrastructure asset class is such that investors can expect moderate returns in exchange for a lower level of risk. This is demonstrated by the level of stability shown by recent infrastructure funds in relation to private equity and real estate strategies. It is also interesting to note that median net IRR figures for older infrastructure funds are similar to those of private equity and real estate, although the potential for very high returns is reduced.

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