

# Preqin Investor Outlook: Alternative Assets H2 2015



Private Equity | Hedge Funds | Real Estate | Infrastructure | Private Debt



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## Data Pack for Preqin Investor Outlook: Alternative Assets, H2 2015

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

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

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# Foreword

Welcome to Preqin Investor Outlook: Alternative Assets, H2 2015, a unique and in-depth look at the appetite, plans, expectations and concerns of institutional investors in private equity, hedge funds, real estate, infrastructure and private debt. This report presents the views of more than 460 surveyed institutions alongside the in-depth data for more than 12,500 investors available to users of Preqin's industry-leading online services. We hope you find this report informative and valuable, and would welcome any suggestions for future editions.

Institutional investors allocate capital to alternative assets to diversify their portfolios and to achieve a broad range of other objectives. The high absolute returns generated by private equity, hedge funds' ability to reduce volatility, the reliable income generated by private debt and the inflation-hedging characteristics of real assets are just some of the attractions for sophisticated investors.

It is clear that the institutional community remains confident in the ability of alternatives to help them meet their return objectives. The majority feel returns are meeting or exceeding expectations and, as a result, a much larger proportion of investors plan to increase their exposure to alternatives than plan to reduce it.

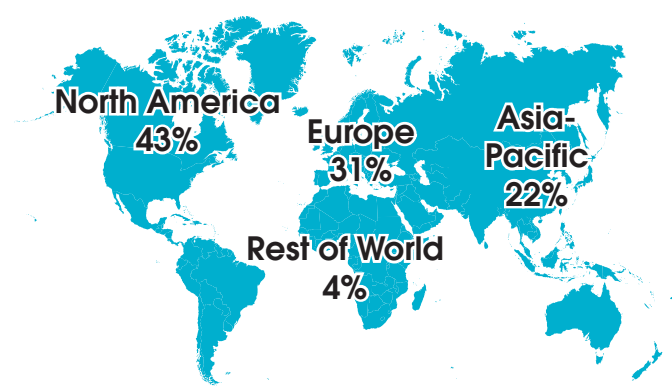
There remains huge scope for the alternative assets industry to grow in future years, both as investors build up existing allocations, and as they also further diversify their portfolios to include a wider range of asset classes. Less than one in five institutions has exposure to four or more alternative asset classes, but with sectors such as private debt and infrastructure becoming ever more established, we are likely to see more and more investors with broadly diversified portfolios comprising of different alternative asset classes.

Preqin's online services are indispensable fundraising and investor relations tools for any firm managing or looking to manage institutional capital. Thousands of professionals use Preqin every day to source new investors, access exclusive information on new RFPs and fund searches, monitor the market and track competing firms.

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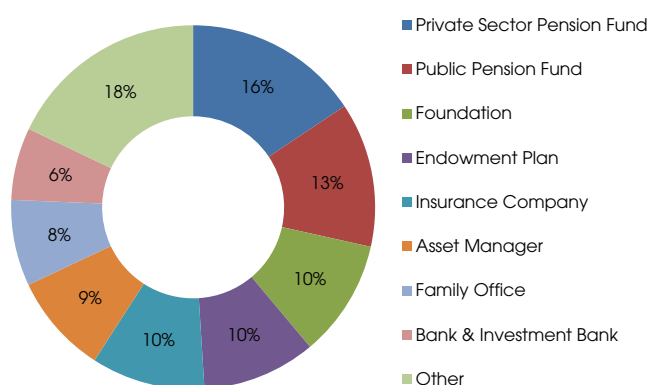
## Breakdown of Respondents

Breakdown of Respondents by Investor Location



Source: Preqin

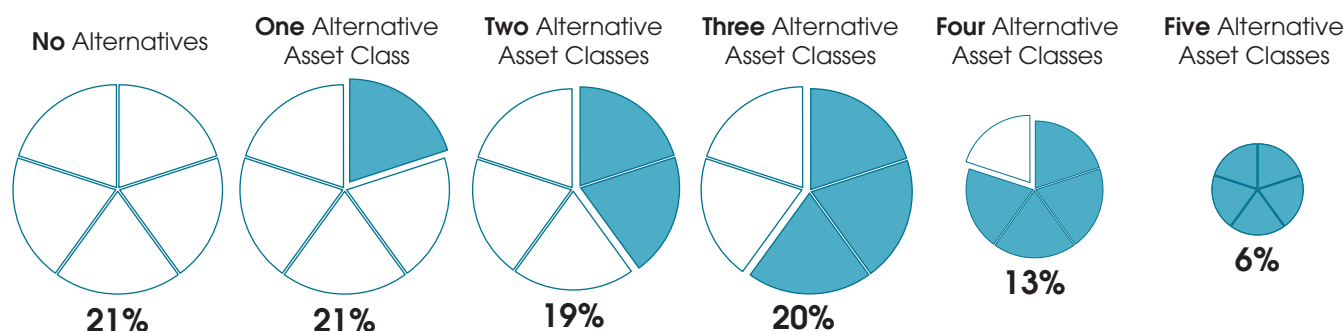
Breakdown of Respondents by Investor Type



Source: Preqin

# Participation in Alternative Assets

## Institutional Investors by Number of Alternative Asset Classes Invested In

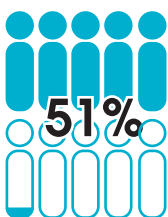


## Proportion of Institutional Investors Allocating to Each Alternative Asset Class

### Private Equity



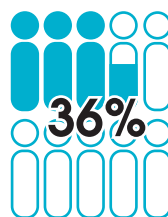
### Hedge Funds



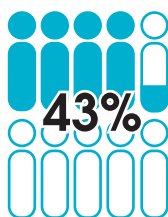
### Real Estate



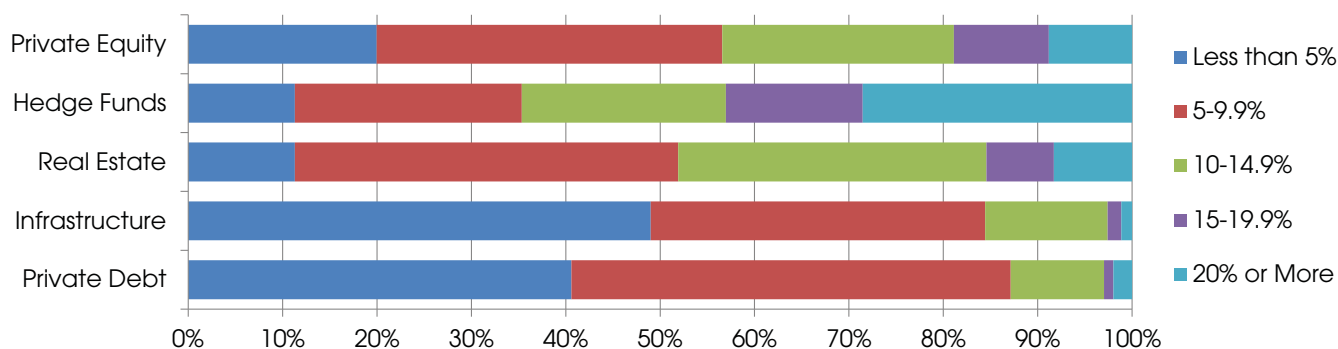
### Infrastructure



### Private Debt



## Breakdown of Institutional Investors in Alternative Assets by Target Allocation to Each Asset Class (As a % of AUM)



## Institutional Investors' Plans for Allocations in the Longer Term

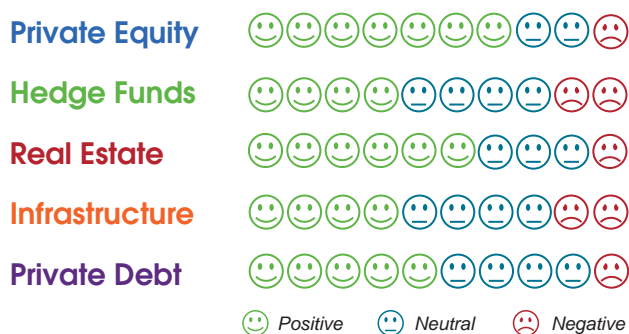
### Reduce Allocation

### Increase Allocation

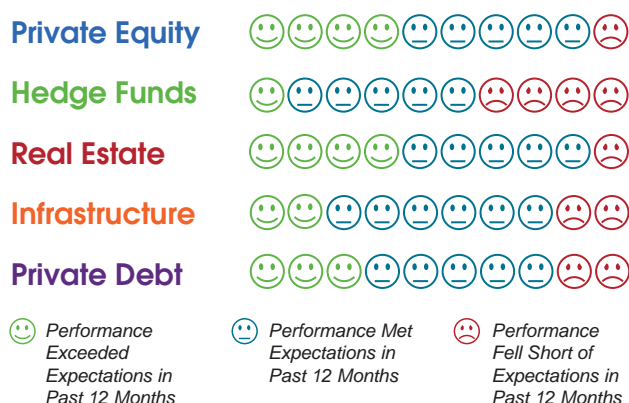


# Views on Alternatives and Future Plans

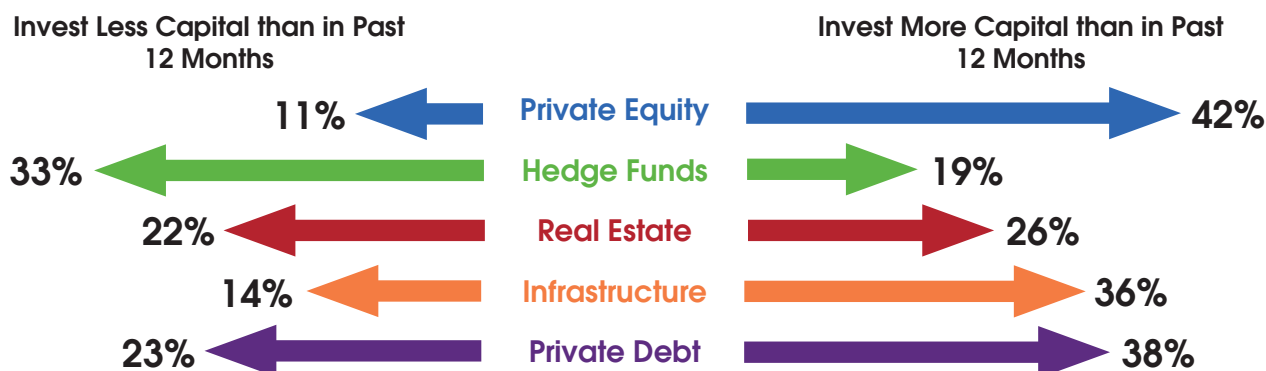
## Institutional Investors' General Perception of Alternative Asset Classes



## Institutional Investors' Perception of Performance of Alternative Asset Classes



## Plans for the Coming Year



### Data Source:

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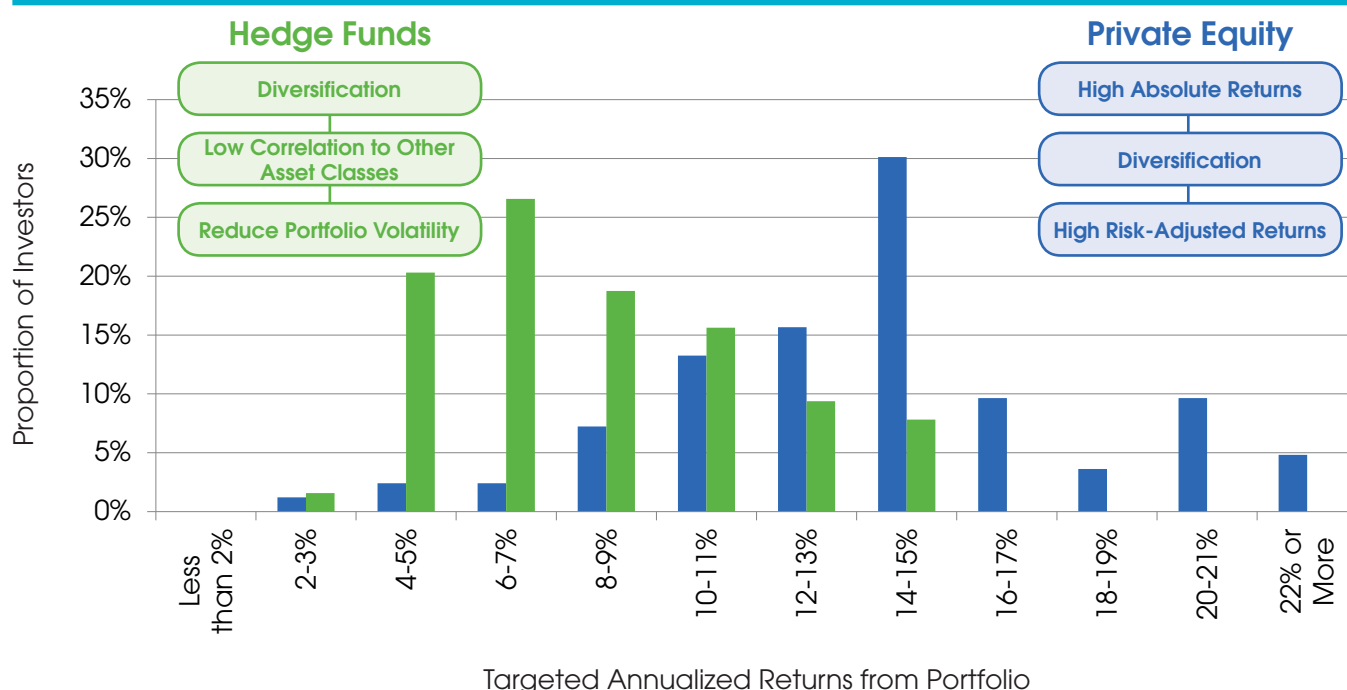
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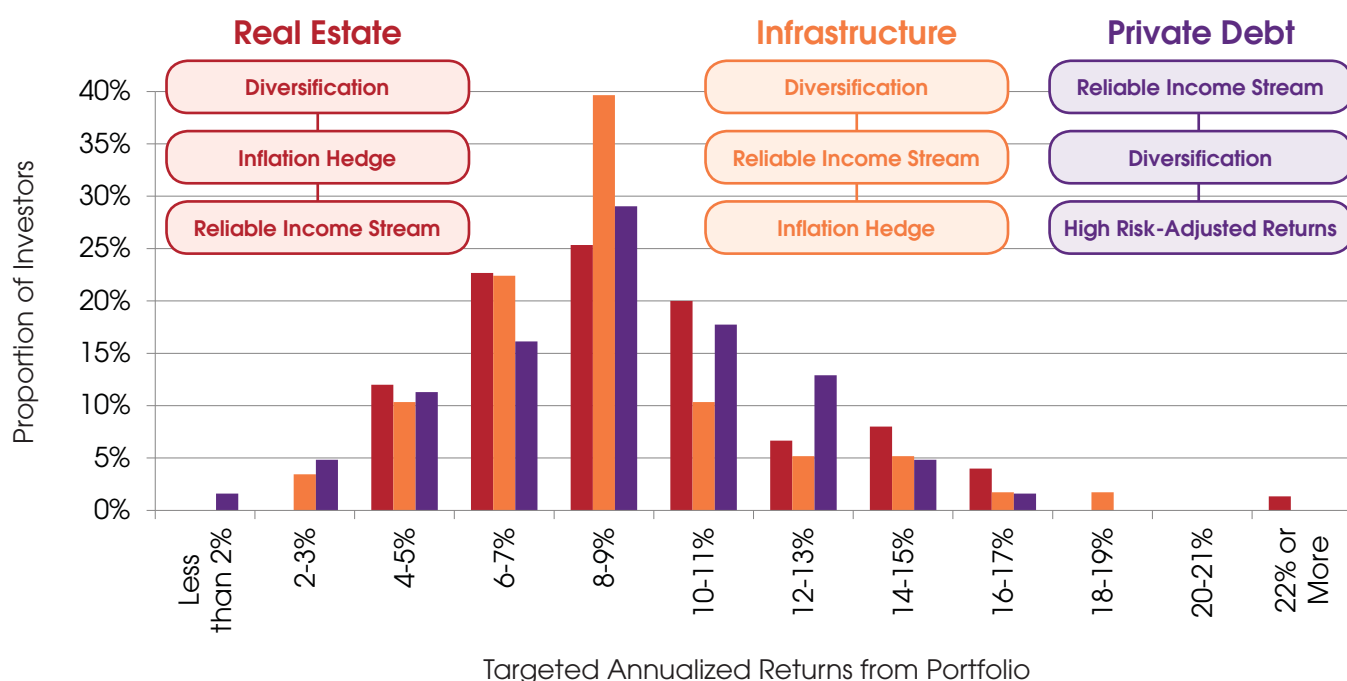
# Targeted Returns and Main Reasons for Investing in Alternatives

Investors' targeted absolute returns by asset class are shown below, alongside the top three reasons why investors allocate to that asset class. Investors target high returns from their private equity portfolios, while primarily using hedge funds for portfolio diversification, low correlation with other asset classes and reduced volatility. Meanwhile, real assets are targeted for their inflation-hedging characteristics and because they generate reliable income, while investors also expect private debt to deliver both steady cash flows and strong risk-adjusted returns.

## Private Equity vs. Hedge Funds: Targeted Annualized Returns and Main Reasons for Investing



## Real Estate, Infrastructure and Private Debt: Targeted Annualized Returns and Main Reasons For Investing



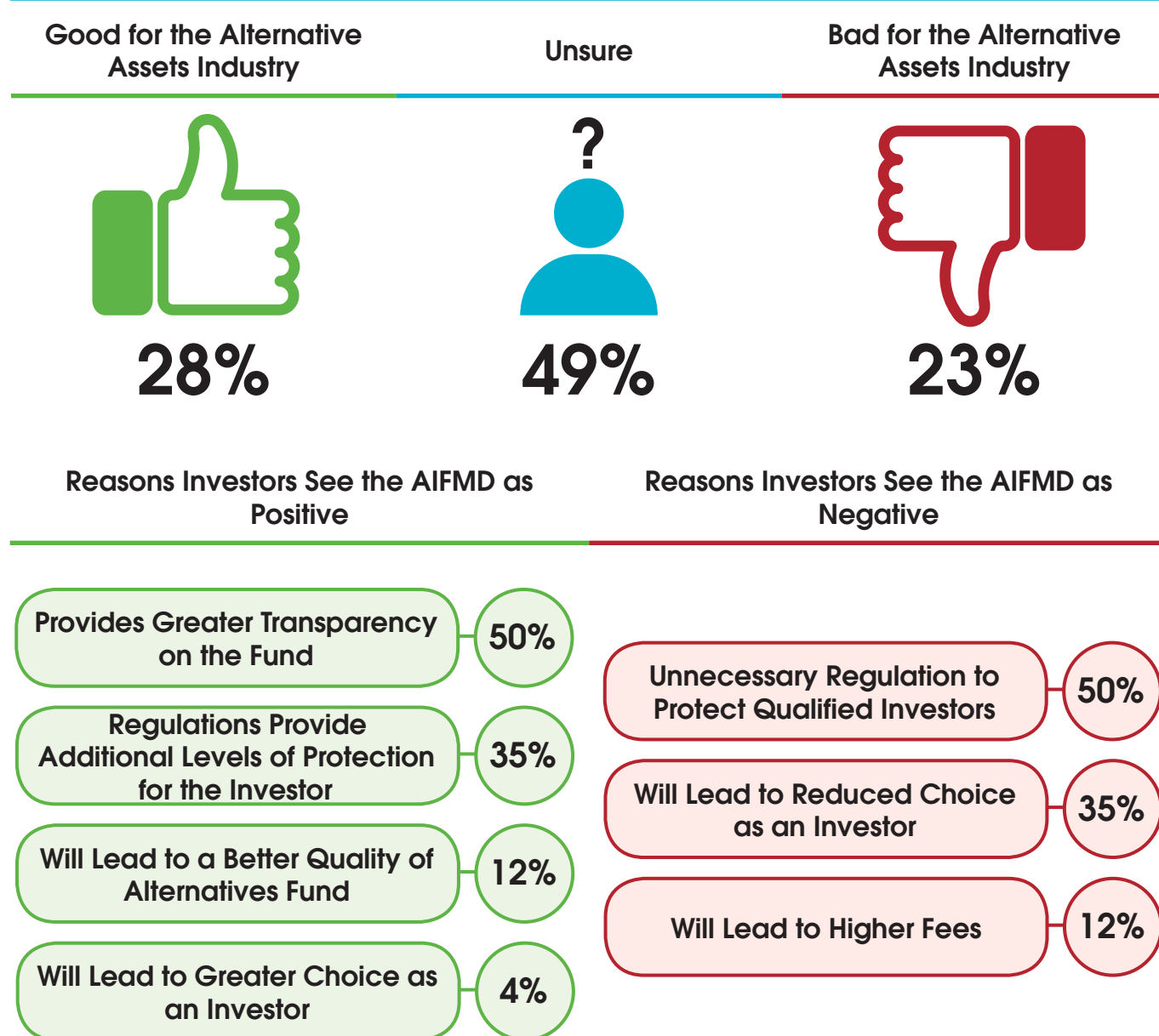


# Views on the Alternative Investment Fund Managers Directive (AIFMD)

The Alternative Investment Fund Managers Directive (AIFMD), the European Union (EU) regulation introduced to harmonize regulatory standards across all alternative investment managers across the economic region, has been the topic of much debate since it was first approved in 2011.

Investors are split over whether the directive is having a beneficial or negative impact. Some believe that it provides greater transparency and more protection, while others believe that there is no need to protect sophisticated investors and that there will be reduced choice as a result of some firms choosing not to register to market in the EU.

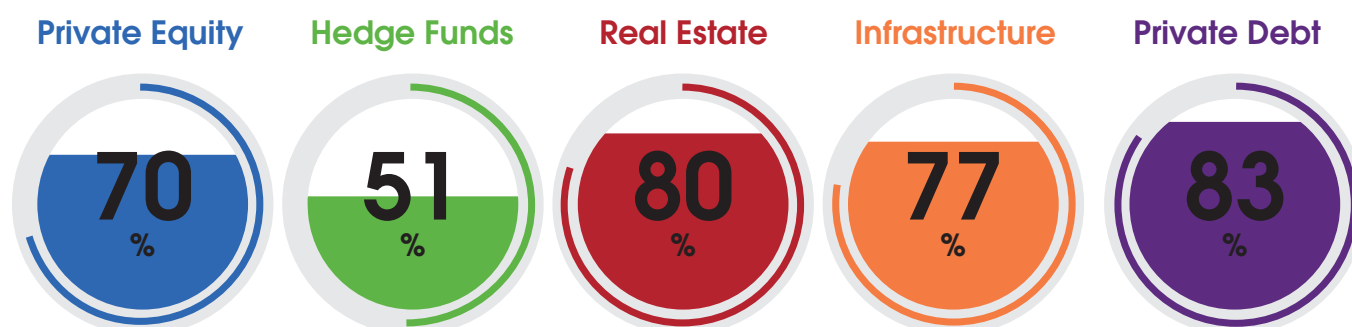
## Investor Views on the AIFMD



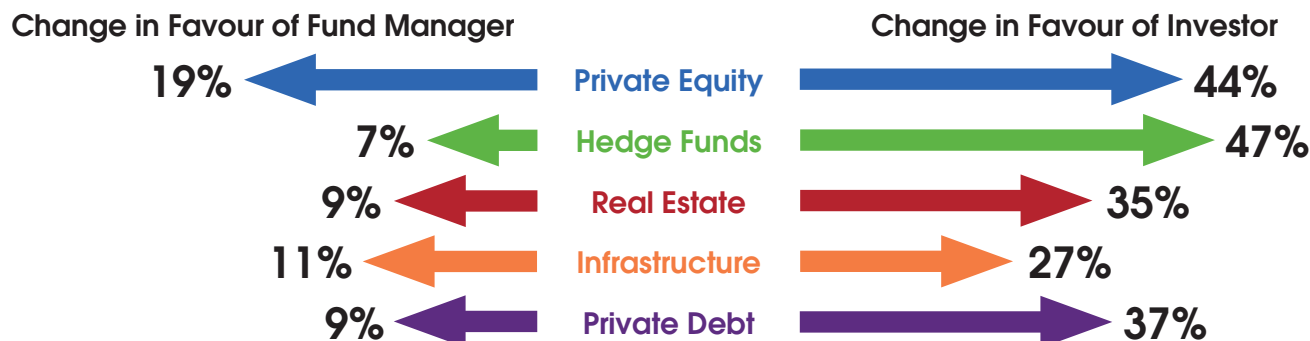
# Fund Terms and Alignment of Interests

Investors largely feel that their interests are aligned with those of fund managers in most asset classes. The exception is hedge funds however, with almost half stating that investor interests are not appropriately aligned with those of fund managers. There does seem to be movement towards more investor-friendly terms by hedge fund managers in response to these concerns, with 47% of respondents seeing fund terms becoming more investor friendly. It is clear that managers must ensure the fees they charge are appropriate and aligned with the market, with more than 80% of investors rejecting funds across alternative asset classes based on fund terms.

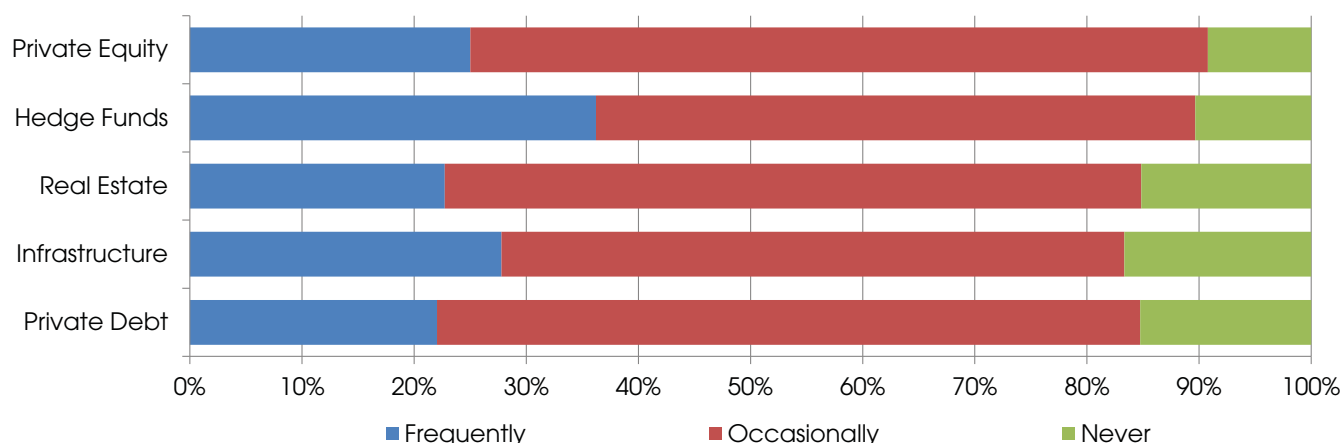
## Proportion of Investors that Feel Fund Manager and Investor Interests Are Properly Aligned



## Investor Views on Changes in Prevailing Fund Terms over the Last Year



## Frequency with Which Investors Have Decided Not to Invest in a Fund Due to the Proposed Terms and Conditions







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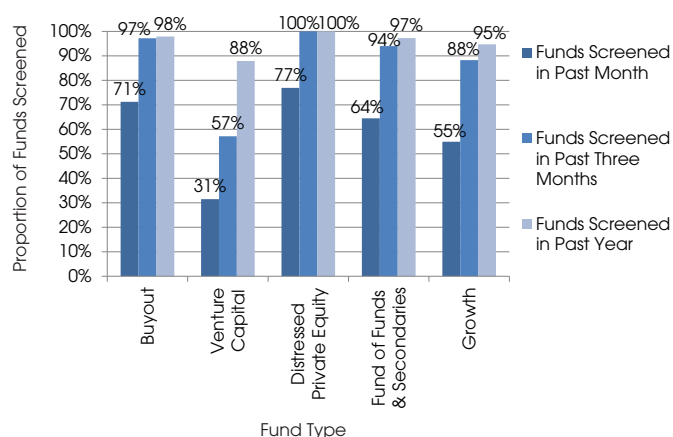
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# Investor Activity on Preqin Investor Network

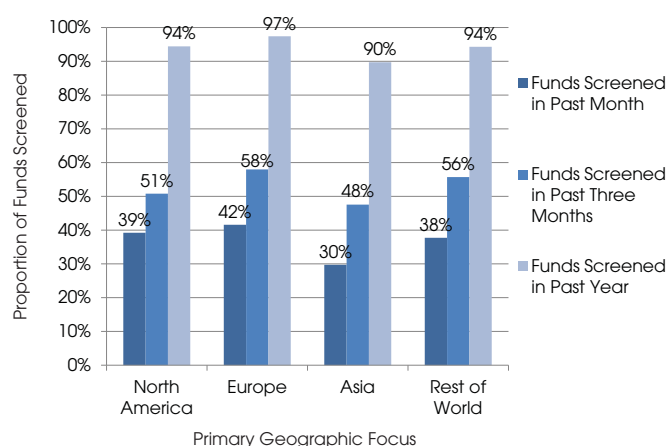
Preqin Investor Network provides asset allocators with free access to key information on all 2,200 private equity, private real estate and private infrastructure funds and 15,000 hedge funds currently open to investment. This section takes a look at the types of funds in market that investors have paid particular attention to over the past year.

**Fig. 1.1:** Proportion of Private Equity Funds Screened by Investors on Preqin Investor Network by Fund Type



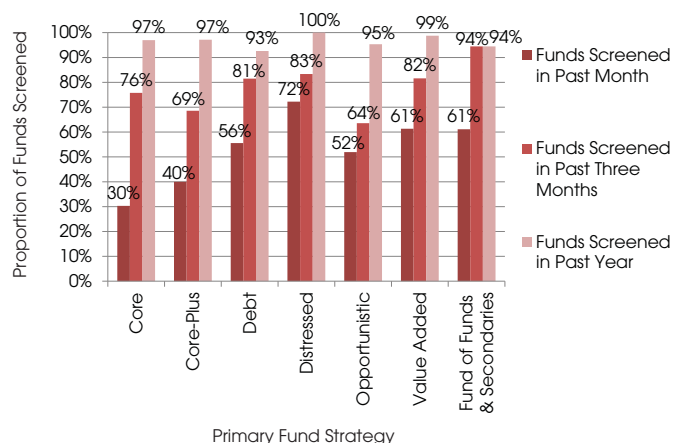
Source: Preqin Investor Network

**Fig. 1.2:** Proportion of Private Equity Funds Screened by Investors on Preqin Investor Network by Primary Geographic Focus



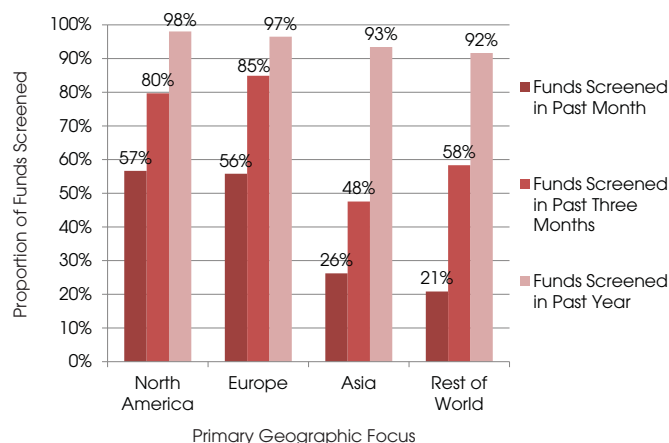
Source: Preqin Investor Network

**Fig. 1.3:** Proportion of Real Estate Funds Screened by Investors on Preqin Investor Network by Primary Fund Strategy



Source: Preqin Investor Network

**Fig. 1.4:** Proportion of Real Estate Funds Screened by Investors on Preqin Investor Network by Primary Geographic Focus



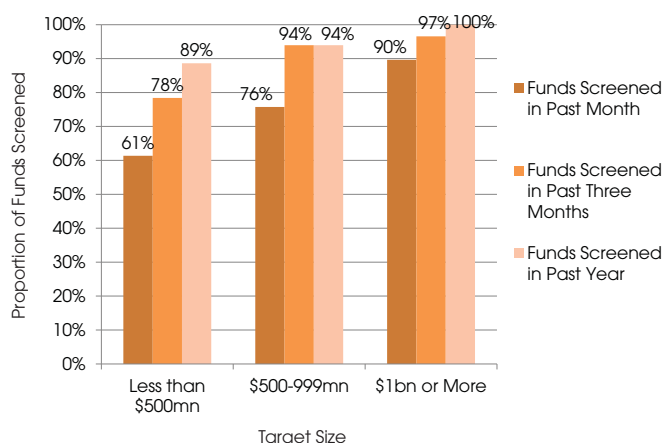
Source: Preqin Investor Network

## Preqin Investor Network

Over 7,100 investment professionals looking to make new commitments use **Preqin Investor Network** to access **free** detailed information on alternative funds open for investment. Share data with Preqin to ensure these investors have the most up-to-date information on your funds.

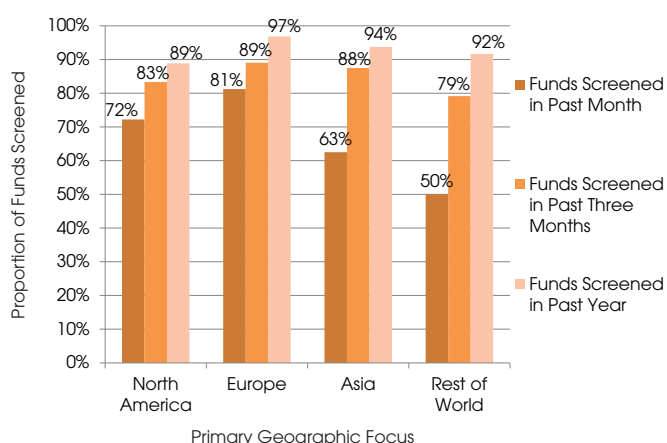
For more information, or to update your firm and fund profiles, please visit: [www.preqin.com/sharedata](http://www.preqin.com/sharedata)

**Fig. 1.5:** Proportion of Infrastructure Funds Screened by Investors on Preqin Investor Network by Target Size



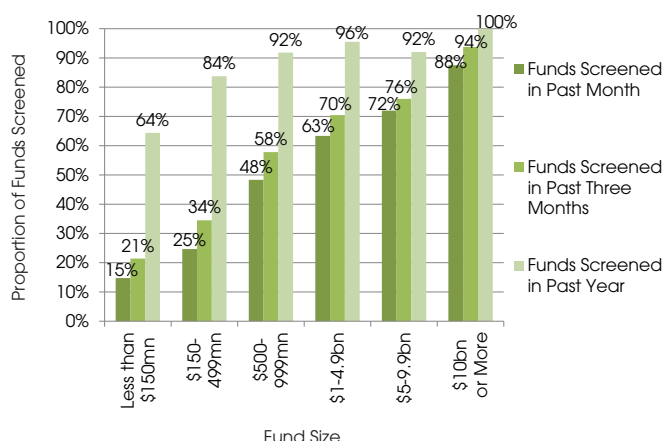
Source: Preqin Investor Network

**Fig. 1.6:** Proportion of Infrastructure Funds Screened by Investors on Preqin Investor Network by Primary Geographic Focus



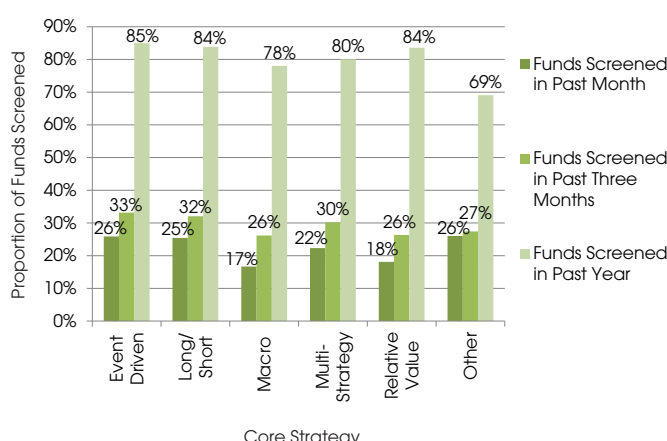
Source: Preqin Investor Network

**Fig. 1.7:** Proportion of Hedge Funds Screened by Investors on Preqin Investor Network by Fund Size



Source: Preqin Investor Network

**Fig. 1.8:** Proportion of Hedge Funds Screened by Investors on Preqin Investor Network by Core Strategy



Source: Preqin Investor Network

## Identify and evaluate alternative investment opportunities on Preqin Investor Network.

- **View** all alternative investment funds currently raising capital
- **Track** fund-level past performance for managers with a fund in market
- **Easily request** marketing materials from managers
- **Access** valuable market analysis and benchmarking tools

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# Private Equity

## Positive Outlook Despite Slowing Investor Activity

The first half of 2015 has seen a further increase in the levels of private equity dry powder available for fund managers to invest, with \$965bn\* in uncalled capital at the start of July 2015. With such large levels of unspent capital, fundraising and investor activity seems to have slowed slightly in H1 2015. LPs may be putting off investments while they wait for previously committed capital to be put to work. Despite this, attitudes towards the asset class remain positive, with the vast majority (87%) of investors reporting that their private equity investments have either met or exceeded expectations in the past year. In fact, only 11% of investors surveyed indicated they are looking to invest less capital in private equity compared to 12 months before, the smallest proportion across all asset classes (page 14).

This shows that LPs are still willing to commit significant amounts of capital to fund managers and it is therefore

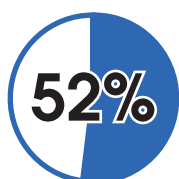
imperative fund managers know the attitudes of LPs in order to access this money. Preqin's most recent survey of over 100 institutional investors in private equity provides fund managers that are looking to nurture new and existing LP relationships with valuable insight, capturing a wealth of information on investor sentiment and investment preferences.

According to Preqin's latest survey, just 9% of private equity investors are looking to reduce the number of GP relationships they maintain in their portfolio over the next two years, compared with 14% six months ago. This will be welcome news to fund managers, as the statistic suggests that the LP community at large is not following the lead of CalPERS, the world's largest institutional investor that was widely reported to be actively looking to cut its number of GP relationships. In terms of fund types, the majority of LPs still see small to mid-market buyouts

as offering the best opportunities in private equity, with 50% of respondents looking to invest in this fund type in 2015. Notably, 23% of private equity investors see venture capital funds as presenting the best opportunities, followed by distressed private equity and mezzanine funds, which were viewed as presenting the best opportunities by 17% and 14% of private equity investors respectively.

First-time fund managers continue to be at a disadvantage when looking to secure capital, with 51% of LPs indicating that they would not commit to a debut fund managed by a new GP. Just under half (47%) of LPs deem the length of a GP's track record as the most important factor to take into account when deciding whether to commit to a fund, highlighting that experience remains vital to a GP's fundraising success.

### Key Facts



Proportion of investors that made a commitment to a private equity fund during the first half of 2015, compared to 62% in H1 2014.

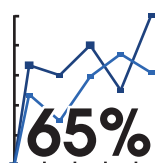
42%



Proportion of investors that are looking to increase their allocation to private equity over the next 12 months, up from 29% in H1 2014.



Proportion of investors that are looking to make their next private equity commitment either in H2 2015 or 2016.



Proportion of investors that see valuations as the biggest challenge facing investors seeking to operate an effective private equity program.

22%



Proportion of investors that are expecting to increase their direct investments through co-investing alongside fund managers in the next 12 months.



Estimated aggregate capital\* invested in private equity as of 31 December 2014.

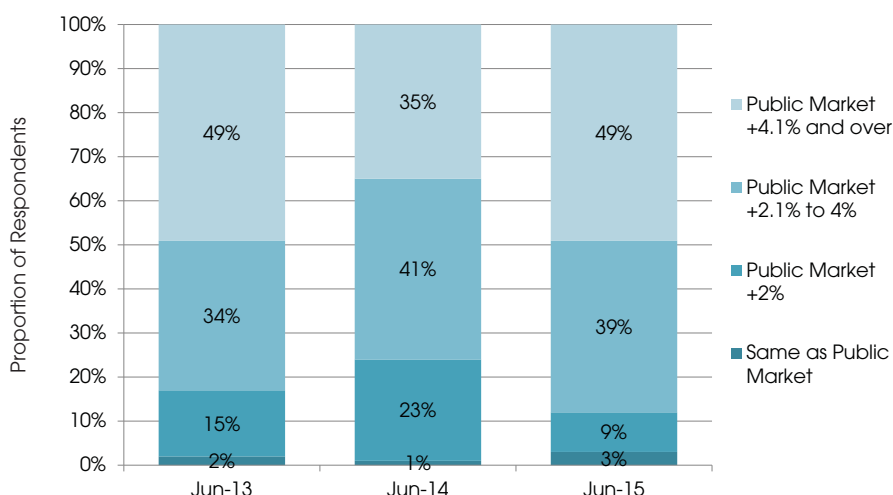


# Satisfaction with Returns

While the private equity asset class is renowned for its outperformance over public markets over the longer term, Prequin has aimed to gauge more specifically what margin is expected from investors, and how they feel their private equity investments have fared in the last year. Between 2013 and 2014, a notable period for bull market conditions with significant stock market highs, there was a decrease in the proportion of investors that expected their private equity portfolios to beat the public market by more than 2%. In June 2015, despite public market indices nearing record highs, the largest proportion of investors (49%) have indicated they expect their private equity investments to exceed public market returns by more than 4%. This would be driven by the apparent success of respondents' private equity investments in the last 12 months.

Fig. 2.2 shows that over a third (35%) of respondents stated that their private equity fund investments had exceeded their expectations in the last year, which is a substantial increase on previous years. In recent times, the proportion of investors that had their expectations surpassed for their private equity portfolios has been declining, falling from 18% in June 2013 to 12% in June 2014. The proportion of LPs that felt

**Fig. 2.1: Investors' Returns Expectations for Their Private Equity Portfolios, June 2013 - June 2015**



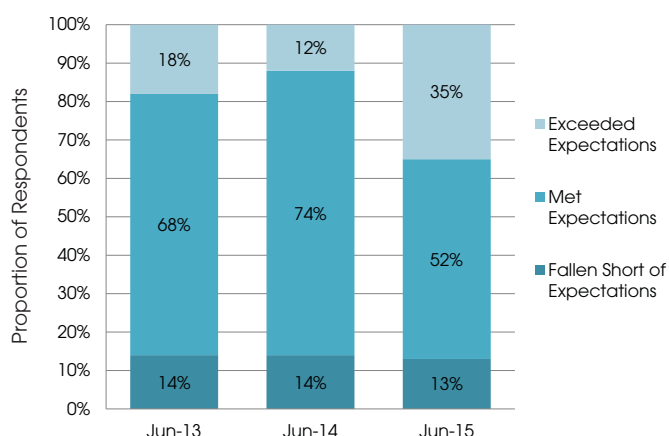
Source: Prequin Investor Interviews, June 2013 - June 2015

their investments in the asset class had fallen short of expectations has remained relatively constant at 13%.

However, there is some notable disparity in satisfaction with returns between regions. According to Prequin's survey, half of investors based in Europe had their expectations exceeded by the performance of their private equity

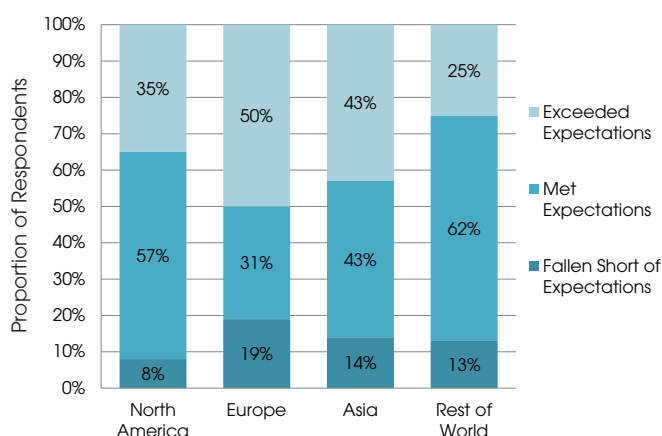
fund investments over the past year, as shown in Fig. 2.3. But with 19% of Europe-based investors reporting that their private equity portfolio had fallen short of expectations, the region has the largest proportion of dissatisfied LPs.

**Fig. 2.2: Proportion of Investors that Feel Their Private Equity Fund Investments Have Lived up to Expectations, June 2013 - June 2015**



Source: Prequin Investor Interviews, June 2013 - June 2015

**Fig. 2.3: Proportion of Investors that Feel Their Private Equity Fund Investments Have Lived up to Expectations by Investor Location**



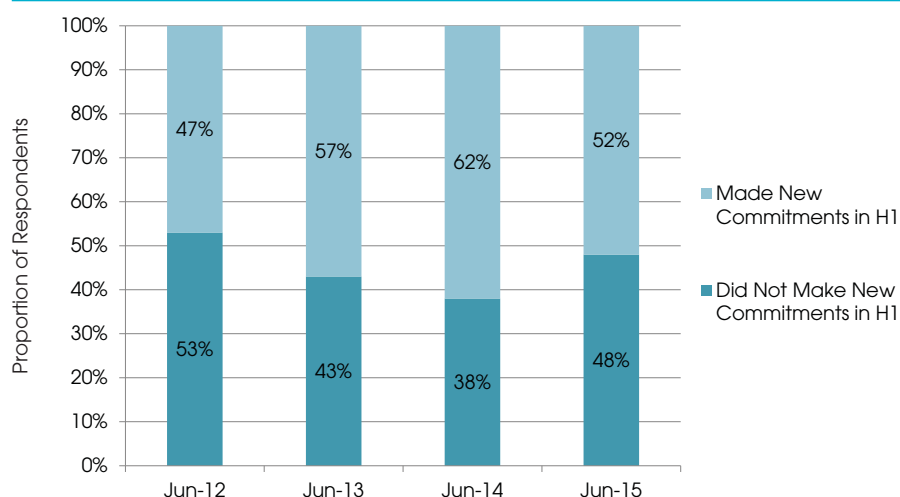
Source: Prequin Investor Interviews, June 2015

# Investor Activity in H1 2015

Global fundraising was relatively subdued during H1 2015, with a total of 509 private equity funds raising an aggregate \$253bn, notably lower than the \$272bn collected by 656 vehicles in H1 2014. Preqin's recent investor survey has revealed a slight decline in investor activity too, with only 52% of respondents making private equity fund commitments in the first half of 2015, a decrease from the 62% of investors interviewed in June 2014. This is somewhat surprising given the significant levels of capital being distributed back to investors, but could be the result of record levels of dry powder available within the asset class being a concern to investors.

Asia-based LPs were the most cautious towards the asset class in the first half of 2015, with only 35% making commitments to new private equity funds (Fig. 2.5), a stark contrast to the 75% of investors in the region committing to new funds in H1 2014. This is likely due to the high levels of dry powder Asia-based fund managers have ready to put to work, with investors reluctant to make new commitments until unallocated capital has been invested. The majority of investors based in North America, Europe and all other regions outside Asia, however, committed fresh capital to private equity funds in H1 2015, with 56%, 55% and 67% doing so respectively, reflecting healthy private equity investor activity and a positive stance towards the asset class among investors in those regions.

**Fig. 2.4:** Proportion of Investors that Made New Private Equity Fund Commitments in H1, June 2012 - June 2015



Source: Preqin Investor Interviews, June 2012 - June 2015

## Target Allocations

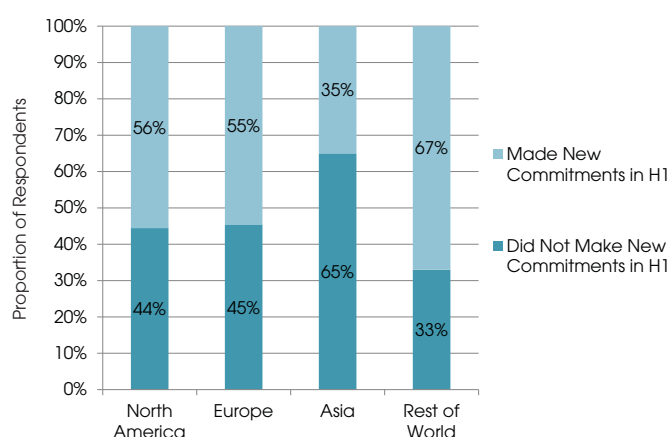
Fig. 2.6 indicates that 52% of investors interviewed are currently below their target allocation to private equity and a further 45% are at their target allocation. Encouragingly, despite a slight slowdown in activity in the first half of the year, this suggests that the vast majority of investors interviewed are likely to make new private equity fund commitments going forward in order to maintain or work towards their target allocation.

### Data Source:

Preqin's **Private Equity Online** is the leading source of intelligence on the industry and includes details for all aspects of the asset class, including fund performance, fundraising, institutional investors, fund managers and more.

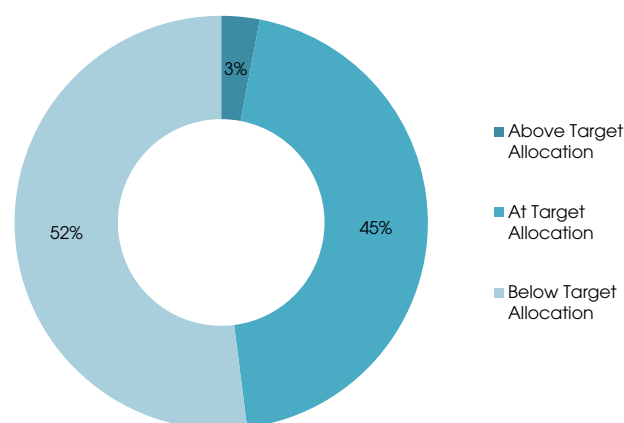
[www.preqin.com/privateequity](http://www.preqin.com/privateequity)

**Fig. 2.5:** Proportion of Investors that Made New Private Equity Fund Commitments in H1 2015 by Investor Location



Source: Preqin Investor Interviews, June 2015

**Fig. 2.6:** Proportion of Investors At, Above or Below Their Target Allocations to Private Equity



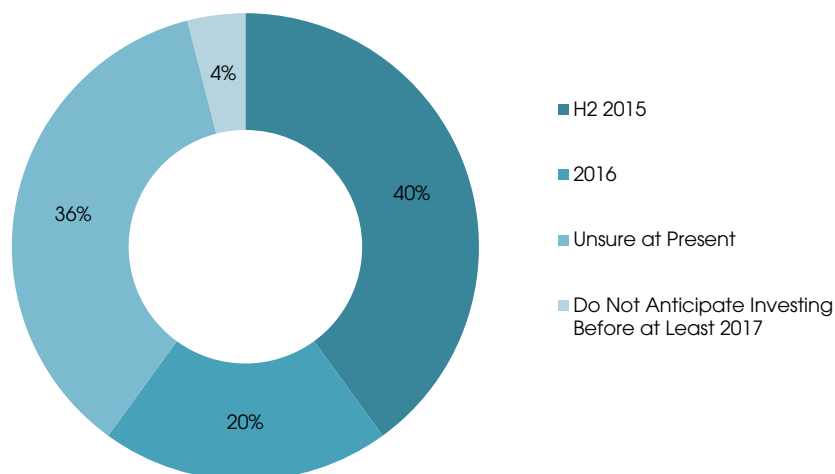
Source: Preqin Investor Interviews, June 2015



# Investor Activity in the Next 12 Months and the Longer Term

Despite a slight slowdown in the investment activity of LPs seen in H1 2015, the majority (60%) of investors interviewed by Preqin are looking to commit to their next private equity fund either in H2 2015 or at some point in 2016. A large proportion (36%) of investors are currently unsure as to when they will make their next commitment, with potential regulatory changes or economic uncertainty likely provoking a more cautious approach. However, only 4% of investors do not anticipate investing before at least 2017, as shown in Fig. 2.7. The fact that over half of investors surveyed are looking to make their next commitments in the near future should bode well for fund managers currently in market and seeking capital over the coming months.

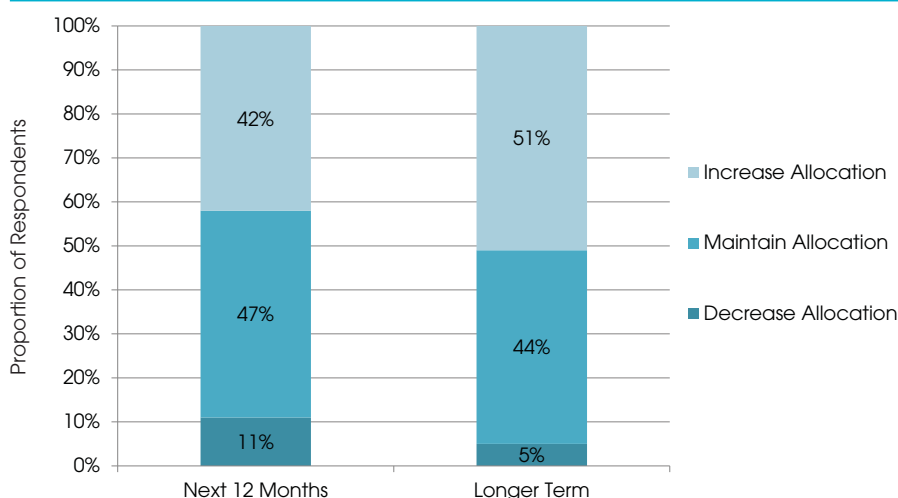
**Fig. 2.7:** Investors' Timeframe for Their Next Commitment to Private Equity Funds



Source: Preqin Investor Interviews, June 2015

Preqin's recent interviews confirm that investors retain confidence in the asset class, with 89% of investors either looking to increase or maintain their allocations over the next 12 months (Fig. 2.8). Furthermore, 95% intend to increase or maintain their allocations to private equity in the longer term.

**Fig. 2.8:** Investors' Intentions for Their Private Equity Allocation



Source: Preqin Investor Interviews, June 2015

## Data Source:

Preqin's **Investor Intelligence** provides detailed information on over 5,800 active investors in private equity from around the world.

The **Fund Searches and Mandates** feature on **Investor Intelligence** is the perfect tool to pinpoint those institutions that are seeking new private equity funds for investment now. Search for potential investors by their preferred fund structure, fund strategy and regional preferences.

For more information, please visit: [www.preqin.com/ii](http://www.preqin.com/ii)

# Strategies and Geographies Targeted

## Fund Types

Small to mid-market buyout funds continue to be perceived as presenting the best opportunities in the current financial climate, with 51% of LPs favouring this fund type (Fig. 2.9). Half of the investors interviewed are actively seeking to invest in these types of vehicles over the coming year too, while venture capital, funds of funds and distressed private equity were the next three most prominent fund types in terms of areas LPs are seeking to invest in over the next 12 months, cited by 26%, 20% and 17% of respondents respectively.

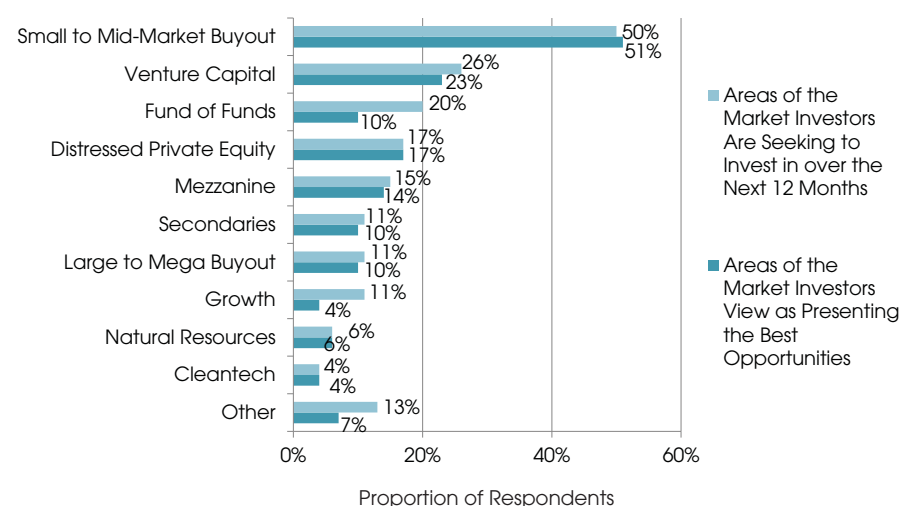
## Preferred Geographies

Our interviews revealed that North America-based and Europe-based LPs show a strong preference for their respective domestic markets (Fig. 2.10). Asia-based investors also exhibit a strong domestic preference, with 66% of these LPs selecting Asia as an attractive location to invest, a significant increase from just 33% seen last year. The greatest proportion (46%) of all investors interviewed globally stated that North America is currently presenting the best investment opportunities, with the smallest proportion of LPs (14%) indicating that they are avoiding this region, in line with sentiment seen in previous years' surveys. Twenty-nine percent of respondents perceive Europe as a region that they are currently looking to avoid, which may be reflective of concerns over the current instability surrounding Greece and the eurozone, as well as the AIFMD.

## Opportunities in Emerging Markets

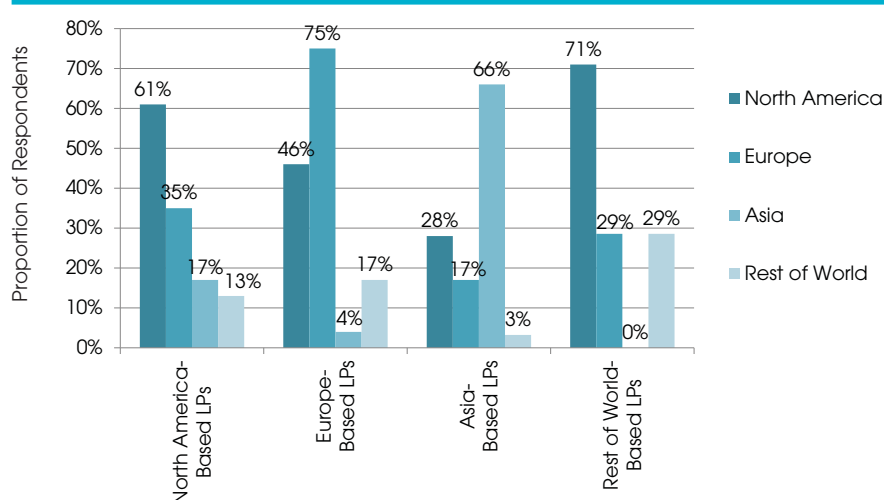
After last year's drop in appetite for investing in emerging markets, LP interest in these geographies has improved. A significant 61% of LPs interviewed by Preqin plan to maintain their allocations to investments in emerging markets over the next 12 months and a further 24% plan to increase their exposure to these regions. Over the longer term, 92% of LPs plan to increase or maintain their allocation to investments in emerging markets, indicating that private equity in these regions may be set for a recovery among investors.

Fig. 2.9: Investor Attitudes towards Different Fund Types at Present\*



Source: Preqin Investor Interviews, June 2015

Fig. 2.10: Regions Investors View as Attractive at Present by Investor Location



Source: Preqin Investor Interviews, June 2015

Attitudes towards private equity investment in China have improved, with 28% of investors noting that the country provides the best opportunities within emerging markets, up five percentage points from Preqin's June 2014 survey. However, investor interest in Latin America and, in particular, Brazil has fallen significantly over the past year; 21% and 13% of investors viewed these regions as presenting the best opportunities in June 2014 respectively,

but the figures now stand at 4% each. This suggests that as investor attitudes towards Asian regions within emerging markets grow increasingly positive, appetite for the continent may be drawing focus away from Latin America.

\*Fig 2.9 - Respondents were not prompted to give their opinions on each region/fund type individually but to name those they felt best fit these categories; therefore, the results display the regions/fund types at the forefront of investors' minds at the time of the survey.

# Alternative Methods of Accessing the Asset Class

There are a variety of ways investors can access the private equity asset class aside from primary commitments to funds. Prequin's latest survey investigates investor appetite for direct investments, separate accounts and the secondary market.

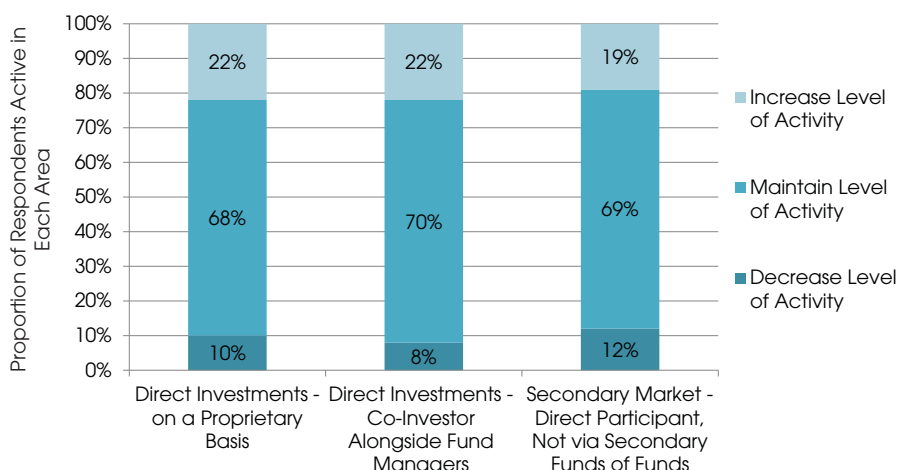
## Direct Investments

As the limited partner universe becomes more sophisticated, direct investment is becoming an increasingly common way for investors to access private equity opportunities. There was an increase from 25% of investors surveyed in June 2014 to 33% in June 2015 that invest directly in companies on a proprietary basis. LPs are seeking greater transparency from their fund managers and by investing directly in portfolio companies, it allows them to have more governance in the company and more insight into how their capital is being utilized. Twenty-two percent of these direct investors are expecting to increase their activity in direct investments over the next year, whereas the majority (68%) are satisfied with their current level of direct investment activity, expecting it to remain the same (Fig. 2.11). Twenty-three percent of investors surveyed currently co-invest alongside their fund managers, a drop from the 36% of respondents in June 2014, but 92% of these investors are looking to increase or maintain their level of co-investment activity over the coming year.

## Separate Accounts

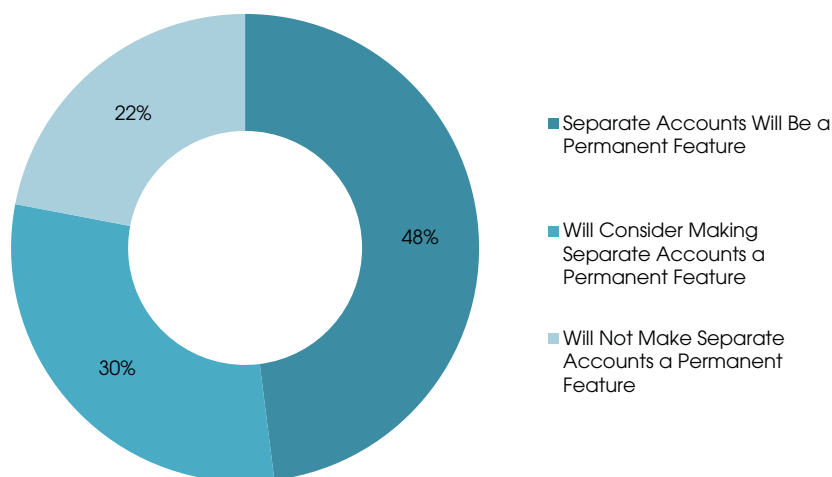
Just over a fifth (21%) of investors surveyed invest, or have invested, via separate account mandates with GPs. Separate accounts also offer lower carried interest and management fees and a greater level of involvement regarding investment strategy. This allows the LP to form a closer relationship with the respective fund manager, creating a better position from which to negotiate future terms, as well as encouraging a better level of reporting and communication from the GP. It is therefore not surprising that a large proportion (48%) of separate account investors surveyed will make it a permanent part of their investment strategy going forward (Fig. 2.12)

**Fig. 2.11: Investors' Expectations of Their Direct Investment and Secondary Market Activity in the Next 12 Months**



Source: Prequin Investor Interviews, June 2015

**Fig. 2.12: LPs Investing in Separate Accounts: Proportion that Expect Separate Accounts to Be a Permanent Feature of Their Private Equity Portfolios**



Source: Prequin Investor Interviews, June 2015

## Secondary Market

With estimates for total secondary market transaction volume breaking records year on year, market conditions and LP appetite for secondary investments are at healthy levels. Nineteen percent of investors surveyed expect their level of involvement in buying private equity fund stakes on the secondary market to increase in 2015, and the majority

(69%) of LPs active in the secondary market believe they will maintain their current level of activity. This is unsurprising considering some of the benefits secondary investments can offer investors, including access to top fund managers and mitigation of the J-curve effect.

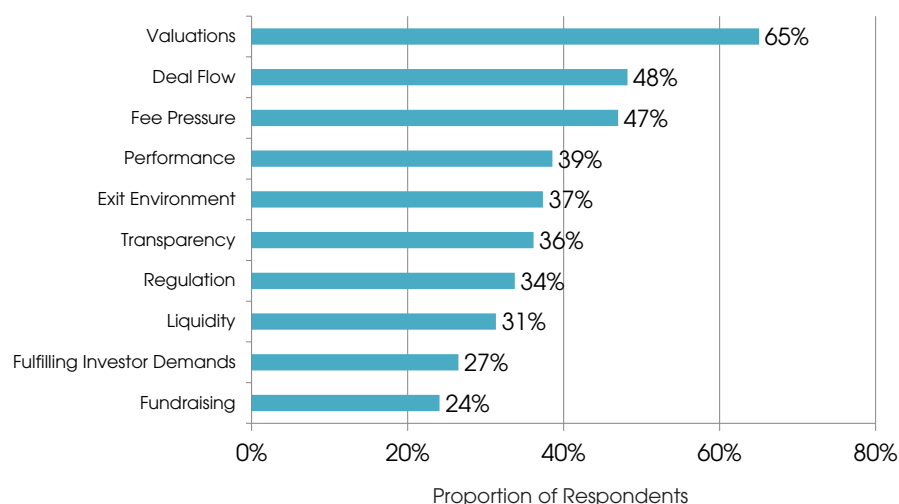
# Key Issues and Regulation

Preqin's recent survey exposed valuations, deal flow and fee pressure as some of the biggest challenges investors face while seeking to operate an effective private equity portfolio. While regulation has been cited as a key issue by over a third of LPs surveyed, it seems a large proportion of investors are yet to adjust their private equity investment plans in light of recent regulatory changes.

Fig. 2.13 shows the range of challenges private equity investors grapple with in today's market. Valuations have come under much scrutiny from investors, ranking as the top concern of the private equity investor community in H2 2015. There have been concerns about the surge in global liquidity and low interest rates driving up asset valuations, which in turn could negatively affect returns. Deal flow, the exit environment and performance are also factors that have emerged as significant challenges perceived by LPs.

The proportion of investors that have indicated regulation is a key issue has grown from 21% in June 2014 to 34% in June 2015. However, with several delays and much uncertainty surrounding the implementation of various reforms including the AIFMD, Solvency II, Dodd Frank and Basel III in recent years, the impact on private equity allocations is yet to be seen. While these regulations place restrictions on particular investor types, only 5% of LPs surveyed have had to reduce their allocations to private equity

**Fig. 2.13: Biggest Challenges Facing Investors Seeking to Operate an Effective Private Equity Program at Present**



Source: Preqin Investor Interviews, June 2015

as a result, with only 4% contemplating a possible reduction in their allocation in the future (Fig. 2.14).

As of June 2015, just under half of institutional investors (49%) are unsure as to whether the European AIFMD regulation is beneficial for the private equity industry, compared with 23% that believe it is detrimental to the industry (Fig. 2.15). Reasons for the perceived negative impact include the belief that it is an unnecessary protection for investors and that it will lead to reduced choice.

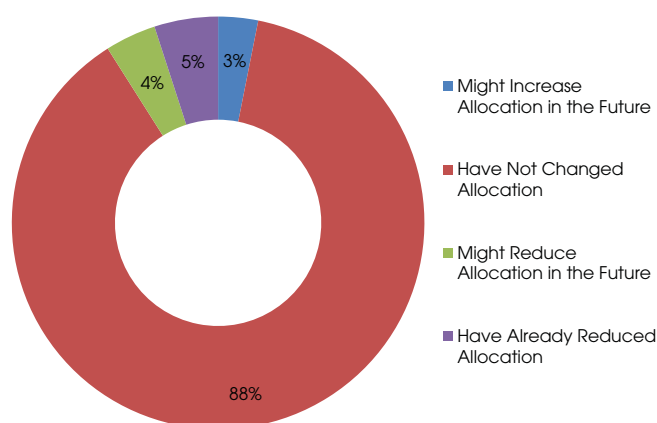
## Research Center Premium

**Research Center Premium** is a free online service providing access to up-to-date charts and league tables, research reports, benchmarking tools and slide decks from recent Preqin conference presentations.

To register for **free** please visit:

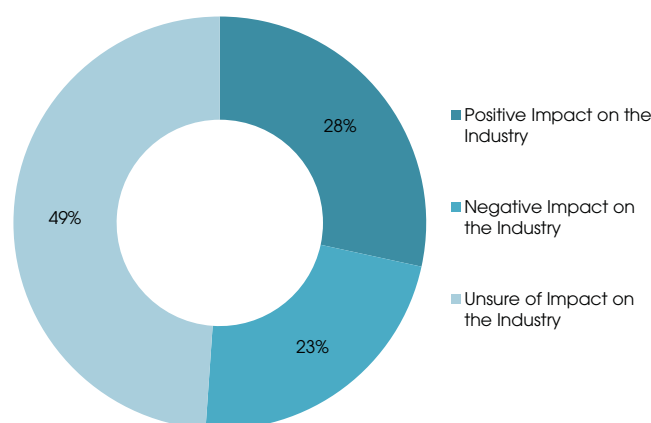
[www.preqin.com/rcp](http://www.preqin.com/rcp)

**Fig. 2.14: Impact of Recent Regulatory Changes and Proposals on Investors' Private Equity Allocations**



Source: Preqin Investor Interviews, June 2015

**Fig. 2.15: Investors' Attitudes towards the Impact of the AIFMD Regulation on the Alternative Assets Industry**



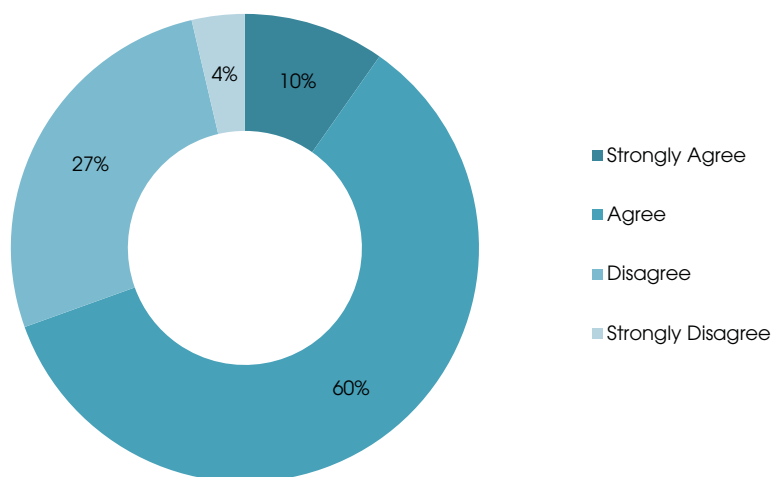
Source: Preqin Investor Interviews, June 2015

# Fees and Alignment of Interests

The latest investor interviews carried out by Preqin reveal that the majority (70%) of investors in private equity believe that LP and GP interests are properly aligned (Fig. 2.16). While this strong level of investor satisfaction is positive in itself, it is even more encouraging when compared with Preqin's survey results last year. In June 2014, 63% of investors were satisfied with their relationship with GPs and 37% did not believe interests were properly aligned. The competitive fundraising market, with over 2,200 private equity funds on the road seeking LP commitments, has led to increased efforts from GPs in nurturing a healthy relationship with their investors, in order to secure more re-ups in the future.

Fig. 2.17 shows the fund terms and conditions where investors believe GP-LP relations could be improved. Management fees are cited by the largest proportion of investors surveyed (40%), though this is a reduction on the corresponding 54% of respondents in Preqin's June 2014 survey. This may account for the overall improvement in LP satisfaction with LP-GP relationships. Other areas where investors displayed a desire for improvement include the amount of performance fees charged

**Fig. 2.16:** Proportion of Investors that Believe LP and GP Interests Are Properly Aligned

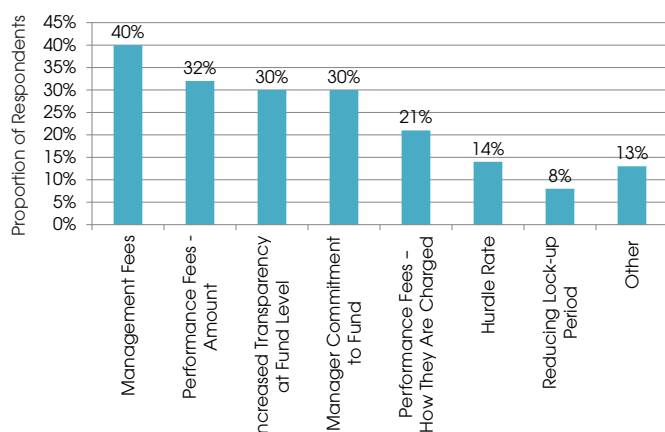


Source: Preqin Investor Interviews, June 2015

(32%) and increased transparency at fund level (30%). The amount of capital committed by GPs (also cited by 30% of respondents) seems to be a growing concern among the investor community; in June 2014, 24% of investors cited a lack of 'skin in the game' by managers as an area of concern.

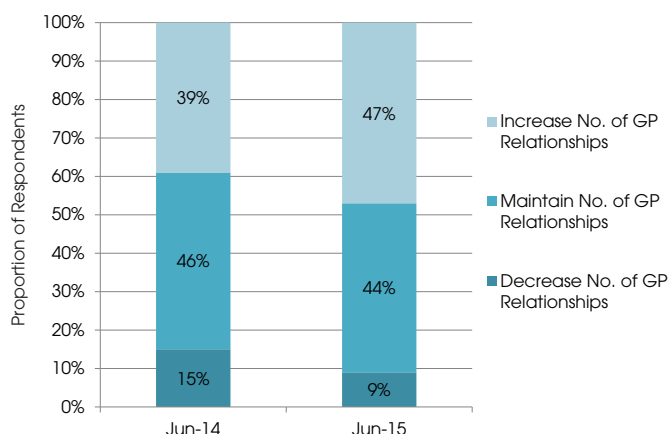
Fig. 2.18 shows a reduction in the proportion of LPs looking to decrease their number of GP relationships over the next two years, from 15% in June 2014 to 9% in June 2015. A corresponding increase from 39% to 47% was seen in the proportion of LPs looking to increase their number of relationships with GPs.

**Fig. 2.17:** Investors' Views on Areas of Fund Terms and Conditions Where Alignment of Interests Can Be Improved



Source: Preqin Investor Interviews, June 2015

**Fig. 2.18:** Investors' Intentions for GP Relationships over the Next Two Years, June 2014 - June 2015



Source: Preqin Investor Interviews, June 2014 - June 2015

## Data Source:

Use the Terms Calculator tool on Preqin's **Private Equity Online** to calculate fund term benchmarks for funds of different types, geographic foci, fund sizes and commitment sizes. View individual fund terms information on an anonymous basis.

For more information, please visit: [www.preqin.com/privateequity](http://www.preqin.com/privateequity)



# Hedge Funds

## Investors Seek Improved Performance with More Favourable Fees in H2 2015

Following a difficult 2014, a poor year in terms of performance and a year that saw the departure of some high-profile investors from investment in the asset class, Preqin predicted, in our 2015 Global Hedge Fund Report, that 2015 would need to be a year in which hedge funds showed what they are worth. The triple threat of generating **better performance**, gaining investment in a **competitive fundraising environment** and navigating the **regulatory environment** were the key issues that fund managers identified as challenges for the year. The results of our institutional investor survey, conducted in June 2015 and in which over 190 institutions participated, have revealed that many of the concerns of fund managers are proving to be true.

### The Difficulties in H1 2015

Investor disappointment with the 12-month performance of hedge funds has reached its highest level since Preqin started tracking this data in 2008

(see page 20). Investors are also wary of putting more money to work in hedge funds; a third of investors plan to invest less capital in the next 12 months than the previous year and just 19% intend to invest more (see page 21). In addition, investors have identified performance and fees as the key issues in the year ahead, suggesting that the value of hedge funds is something that many investors are actively scrutinizing.

### The Opportunities for H2 2015

Although the hedge fund sector faces many challenges, our survey does reveal some bright spots. When evaluating hedge fund performance over the first half of 2015, investors show greater levels of satisfaction with returns than over the 12-month period to June 2015. Seventy-nine percent of investors stated that return expectations had been met or exceeded in the first half of 2015, compared to 57% that stated the same for the 12-month period to June 2015. This indicates that there is improved

sentiment about hedge fund performance in 2015, a period in which hedge funds have made gains of 5.65% compared with the 3.37% logged by the S&P 500. Some strategies have particularly impressed institutional investors; multi-strategy and equities strategies were highlighted by 90% and 80% of investors in these strategies as having satisfied performance expectations respectively.

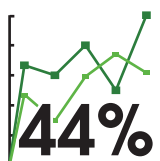
Investor concerns expressed in our June 2015 investor interviews reflect that fundraising is likely to be even more challenging in the year ahead. However, in our H2 2015 Preqin Investor Outlook, Preqin aims to help navigate the difficult environment of 2015 with insight into institutional investment in hedge funds. Our special feature 'How Investors Source and Select Hedge Funds' (page 24) takes a closer look at how investors find and filter the hedge funds that meet their needs from the 15,000+ open for investment today.

### Key Facts

43%



Proportion of investors that believe hedge fund returns have not met expectations over the previous 12 months.



44%

Proportion of investors that believe that performance is the key issue for hedge funds in 2015, the most commonly cited issue.

47%



Proportion of investors that source new fund opportunities from consultant recommendations, the most commonly utilized method of finding new funds.

156

The average number of hedge fund proposals received each year by institutional investors.



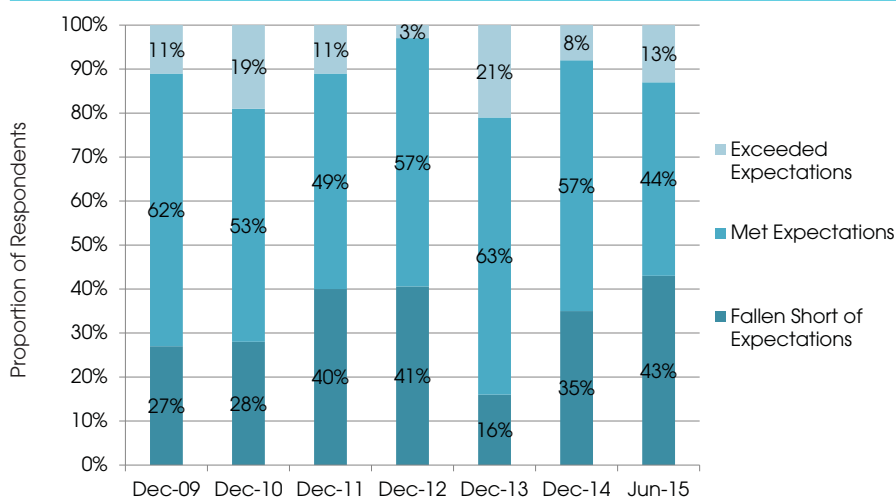
# Satisfaction with Returns

Fig. 3.1 shows how institutional investors rank the performance of hedge funds over the preceding 12 months. There has been a notable increase in the proportion of investors interviewed by Prequin that indicated that their hedge fund portfolio returns over the past 12 months, to June 2015, had fallen short of their expectations, up from 35% at the end of 2014 to 43% in H1 2015. This is the highest level of dissatisfaction with 12-month returns recorded by Prequin.

However, following a five-month streak of positive returns from the start of 2015 until May, there appears to be some degree of positivity returning to the investor outlook on hedge funds. When specifically asked about the performance in H1 2015, the solid returns produced by hedge funds in the first half of the year has led to a larger proportion of investors (79%) stating their returns expectations had been either met or exceeded in this timeframe (Fig. 3.2), compared to the longer 12-month period (57% in Fig. 3.1). Therefore, it is likely the poor performance in the second half of 2014, when the Prequin All-Strategies Hedge Fund benchmark added just 0.30% in the final six months of the year, that has led to such high levels of investor dissatisfaction.

Prequin asked investors to rate the strategies that they currently invest in by whether they had performed well or underperformed in the first half of 2015. Ninety-six percent of the investors that participated in the Prequin study have a current investment in an equities strategy fund and 80% have been satisfied with

**Fig. 3.1: Hedge Fund Portfolio Performance Relative to Expectations of Institutional Investors, December 2009 - June 2015**



Source: Prequin Investor Interviews, December 2009 - June 2015

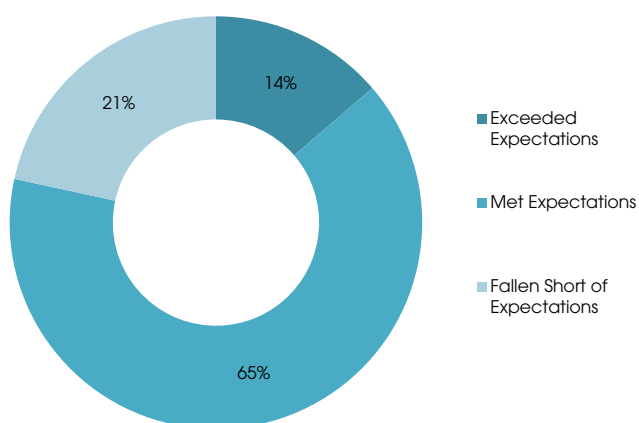
the performance of the strategy over the first half of 2015 (Fig. 3.3). Despite a difficult June, the Prequin All-Equities Strategies benchmark had recorded gains of 4.33% in H1 2015, higher than the 3.37% logged by the S&P 500 in the same timeframe.

Ninety percent of investors with an investment in a multi-strategy fund ranked the strategy as performing well in the first half of 2015. Multi-strategy funds enjoyed a seven-month streak of positive monthly returns between November 2014 and May 2015. Activist funds have also been rated as good performers by the investors in these funds, having

delivered the highest year-to-date net return (7.60% as of 30 June 2015) of all the hedge fund strategies.

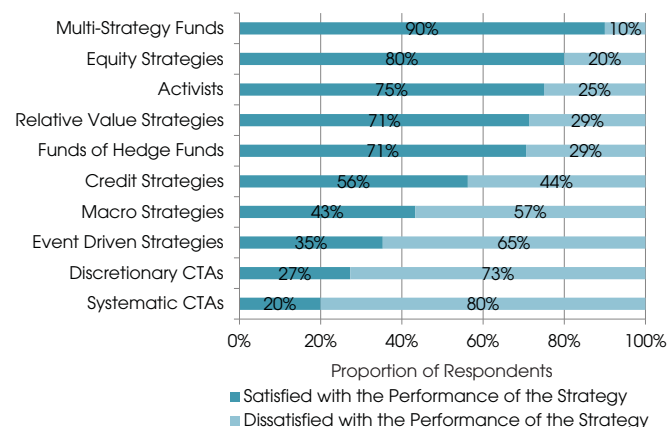
In contrast, 80% and 73% of investors in systematic and discretionary CTA strategies respectively feel that these funds had not performed well in the first half of 2015. Systematic CTAs started the year strongly, adding 5.27% in Q1 2015; however, a difficult Q2 led the strategy to lose all of the first quarter gains, and record net losses year to date, as of June 2015, of -0.83%. This volatile and poor performance has not gone unnoticed by investors in the strategy.

**Fig. 3.2: Investor Satisfaction with Hedge Fund Performance in H1 2015**



Source: Prequin Investor Interviews, June 2015

**Fig. 3.3: Investor Satisfaction with Hedge Fund Performance in H1 2015 by Strategy**



Source: Prequin Investor Interviews, June 2015

# Investor Activity in the Next 12 Months

A larger proportion of investors plan to invest less capital in hedge funds over the next year than are planning to invest more capital in the asset class (Fig. 3.4). The failure of hedge funds to meet investors' expectations, in terms of performance, over the past 12 months (page 20) may have contributed to the reluctance of many investors to put more money to work in the asset class in the year to come, as they put portfolios on ice or re-evaluate the weighting of hedge funds in their portfolios.

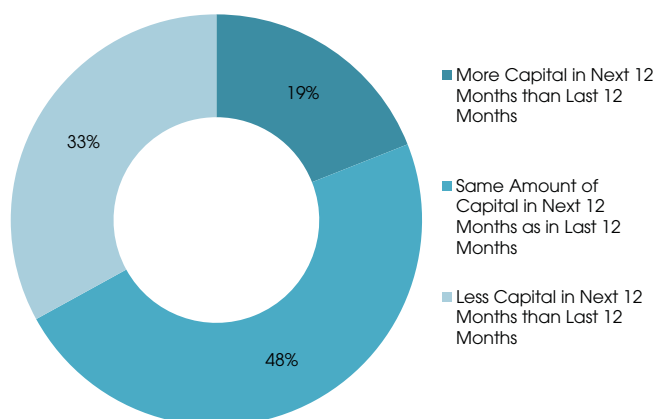
Of those investors that are actively looking to make new investments in the year ahead, the majority (59%) will be seeking to make investments of \$49mn or less

or less, whereas just 12% of these investors are planning to put \$250mn or more to work in the asset class in the next 12 months (Fig. 3.5). However, while most investors will be deploying relatively small amounts of capital in hedge funds, this will be distributed across multiple funds. Two-thirds of the active institutional investors on Preqin's Hedge Fund Investor Profiles service are planning to invest in at least three funds in the next 12 months (Fig. 3.6)

Long/short equity and macro funds are the most commonly sought-after strategies by those investors looking to make new investments; 55% and 30% of current fund searches respectively

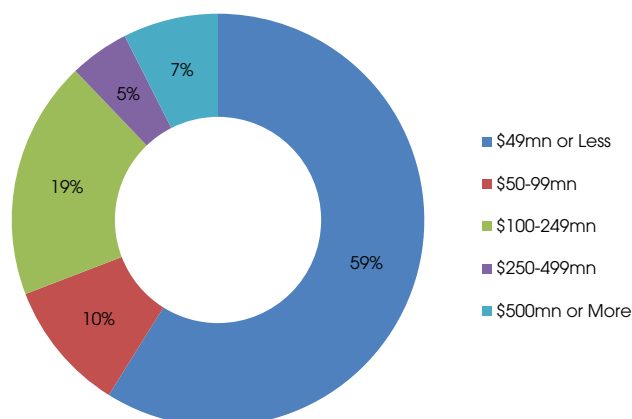
include these strategies as a preference (Fig. 3.7). At the other end of the liquidity spectrum, event driven funds, with their longer investment horizons and potential for return premiums, are also commonly sought by institutional investors. Twenty-three percent of investors currently searching for new funds in the year to come include event driven funds as part of their search, potentially for the strategy's ability to generate higher returns over the longer term, something that many investors have found hedge funds have not managed to do in the past year.

**Fig. 3.4:** Investors' Plans for their Hedge Fund Investments over the Next 12 Months Compared with the Last 12 Months



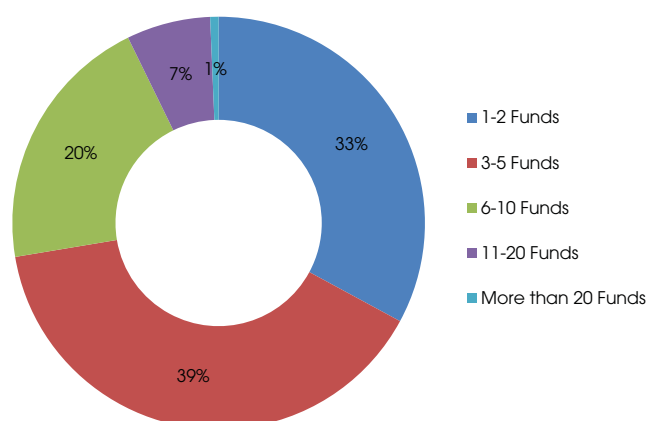
Source: Preqin Investor Interviews, June 2015

**Fig. 3.5:** Amount of Fresh Capital Institutional Investors Expect to Invest in Hedge Funds over the Next 12 Months



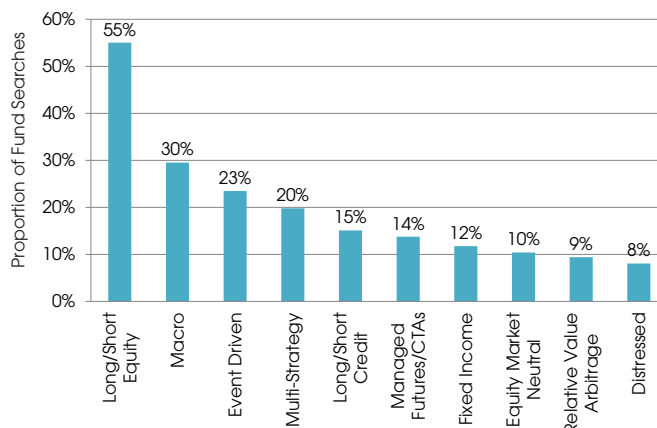
Source: Preqin Hedge Fund Investor Profiles

**Fig. 3.6:** Number of Hedge Funds Institutional Investors Expect to Add to Their Portfolios over the Next 12 Months



Source: Preqin Hedge Fund Investor Profiles

**Fig. 3.7:** Breakdown of Hedge Fund Strategies Sought by Institutional Investors over the Next 12 Months



Source: Preqin Hedge Fund Investor Profiles

# Key Issues and Regulation

Investor dissatisfaction with the 12-month returns of hedge funds is at its highest level since Preqin started tracking this information (page 20). With such high levels of investors disappointed with the performance of the sector over the past year, it is perhaps unsurprising that hedge fund performance is the foremost concern among hedge fund investors for the rest of 2015 (Fig. 3.8). Since the last Preqin study of institutional investors in December 2014, we have seen an increase in the proportion of investors stating that performance is the key issue in the industry, up from 33% at the end of 2014 to 44% as of June 2015.

We have also seen continued growth in the number of investors stating that fees will be a key issue; 35% of investors cited this as an important issue in the hedge fund sector in June 2015, compared with the 21% that stated the same at the end of 2014. With hedge funds failing to meet the expectations of many investors, more institutions are questioning the value of the asset class. The higher costs involved when investing in hedge funds compared to other assets is a key consideration for investors in the current returns environment and something that is becoming an increasing concern.

The hedge fund industry has become increasingly regulated over recent years and investors, as participants in the sector, continue to be impacted by its effects. Fifteen percent of the survey participants noted it as a key issue facing the industry over the rest of the year, an increase from the 6% that echoed this view when interviewed by Preqin in December 2014. The Alternative Investment Fund Managers Directive (AIFMD) has been one of the more prominent pieces of legislation introduced to the hedge fund industry. Despite the regulation passing its two-year anniversary of implementation in July, there is still a great deal of uncertainty surrounding the effect of the AIFMD on the industry by institutional investors. Nearly half (49%) of the surveyed institutions are unsure of the impact of the AIFMD on the hedge fund sector (Fig. 3.9).

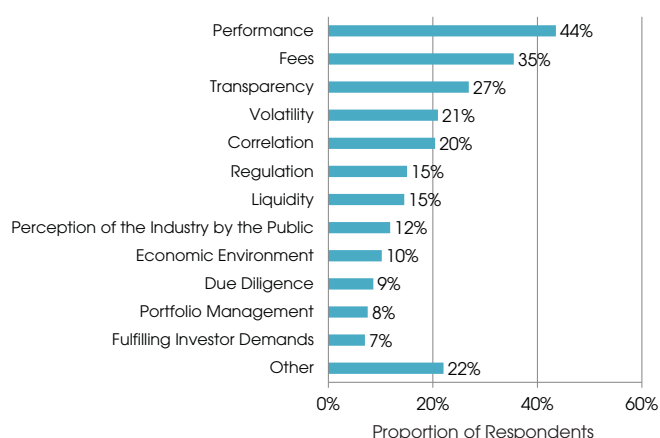
Written into national law in July 2013, the AIFMD is still in its infancy and many investors may not yet have felt the effects of the new regulations upon their choice of fund manager. As we pass the two-year landmark of the implementation of the AIFMD, it still appears as though a large proportion of hedge fund investors are yet to determine whether the directive

is beneficial to the industry or will disrupt their investment objectives.

Twenty-eight percent of investors believe the AIFMD will be good for the industry and half of these investors argued that the directive will provide greater transparency on hedge funds. Thirty-five percent of these investors believe that the AIFMD provides additional levels of protection for the investor, while 12% suggested it produces a better quality of alternative fund.

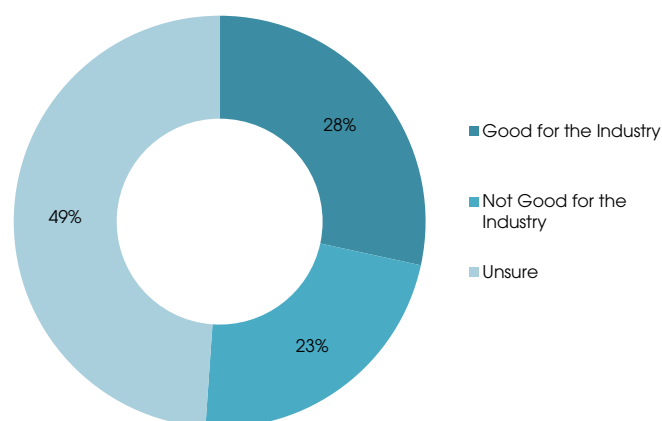
Europe-based hedge funds have been expected to become fully compliant with the new regulation brought about in the wake of the financial crisis, but there still remains negativity surrounding its impact on the hedge fund industry; 23% of hedge fund investors feel the AIFMD is not good for the industry. Among this group of investors, a significant proportion (57%) believe that the AIFMD is an unnecessary regulation to protect qualified investors, while a further 24% stated that the directive has led to reduced choice as an investor.

**Fig. 3.8: Key Issues Facing the Hedge Fund Industry in H2 2015 According to Institutional Investors**



Source: Preqin Investor Interviews, June 2015

**Fig. 3.9: Institutional Investors' Views on Whether the AIFMD Regulation is Good for the Hedge Fund Industry**



Source: Preqin Investor Interviews, June 2015

**Fig. 3.10: Institutional Outlook on the Benefits and Disadvantages of the AIFMD**

Why the AIFMD is Positive for the Industry	Why the AIFMD is Negative for the Industry
Will lead to more transparency (50%)	It is unnecessary regulation (57%)
It provides extra levels of protection for investors (35%)	Will lead to less choice for investors (24%)
Will lead to better quality of funds (12%)	Will lead to higher fees (14%)

Source: Preqin Investor Interviews, June 2015

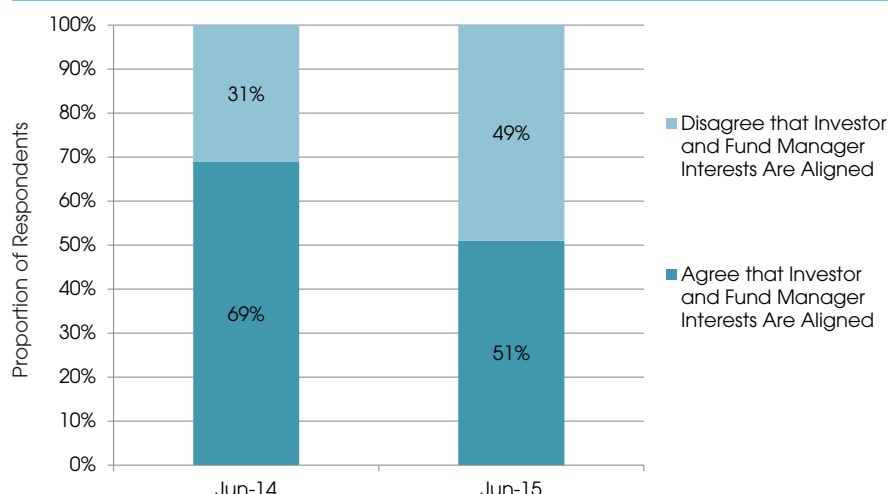
# Fees and Alignment of Interests

Thirty-five percent of investors believe that fees form one of the key topics affecting the hedge fund industry today (see page 22). This represents an increase from the 21% that stated the same in our survey conducted in December 2014. There has, in conjunction with this increase in investor awareness of fees, been an increase in the proportion of investors that believe that fund manager and investor interests are not aligned from a similar study conducted in June 2014 (Fig. 3.11). Today, investors are almost evenly split between agreeing that interests are aligned and disagreeing.

Despite more investors being dissatisfied with the alignment of interests between their institutions and their hedge fund managers, there has been a shift towards more investors seeing an improvement in fees in favour of the investor. In June 2014, a third of the investors that participated in the Preqin survey had seen a shift in fund terms in favour of the investor; in our June 2015 study this increased to 40% (Fig. 3.12).

With almost half of all investors believing that their interests are not aligned with those of the funds they invest in, how important is it for fund managers to reconsider their fee structures? Ninety percent of investors have rejected a fund because of the fees charged, 36% do so on a regular basis (Fig. 3.13). It

**Fig. 3.11:** Proportion of Investors that Believe Investor and Fund Manager Interests Are Properly Aligned, June 2014 - June 2015



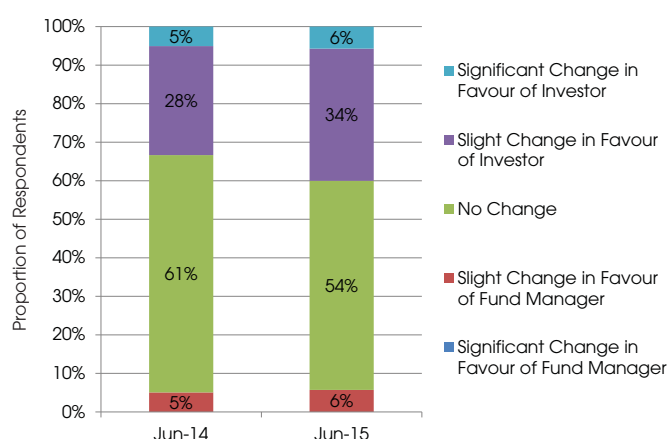
Source: Preqin Investor Interviews, 2014 - 2015

is clear that having inappropriate fees, or fees that investors deem too high or incorrectly structured, can affect fund managers' abilities to gain investment from institutions.

With investor dissatisfaction with the performance of hedge funds at high levels, the question of fees and the value that hedge funds represent has become more important to investors over the past year. Significant numbers of investors are dissatisfied with the alignment of

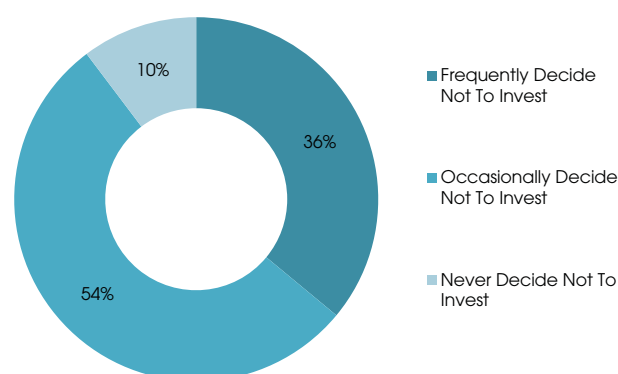
interests in the hedge fund industry and also reject funds on the basis of inappropriate fees. Therefore, it seems the fee debate does not appear to be abating; in the competitive fundraising environment of 2015, it is more important than ever for fund managers to pay close attention to investor demands in regard to fund terms and conditions and tailor products accordingly in order to attract institutional capital.

**Fig. 3.12:** Proportion of Investors that Have Seen a Change in Fund Terms over the Last 12 Months, June 2014 - June 2015



Source: Preqin Investor Interviews, 2014 - 2015

**Fig. 3.13:** Frequency with Which Investors Have Decided Not to Invest in a Fund Due to Its Fees



Source: Preqin Investor Interviews, June 2015

# How Investors Source and Select Hedge Funds

Fundraising remains a key challenge for hedge fund managers. With more investors looking at investing less capital in the year to come than are planning to invest more, it is more important than ever to understand how investors source and select new investment opportunities in order to be in with a greater chance of gaining some of the capital earmarked for new investment.

As Fig. 3.14 shows, 51% of the institutional investors that participated in the Preqin survey typically make one or two investments each year. Some institutions make significantly larger numbers of investments, for instance, 20% of the surveyed investors add five or

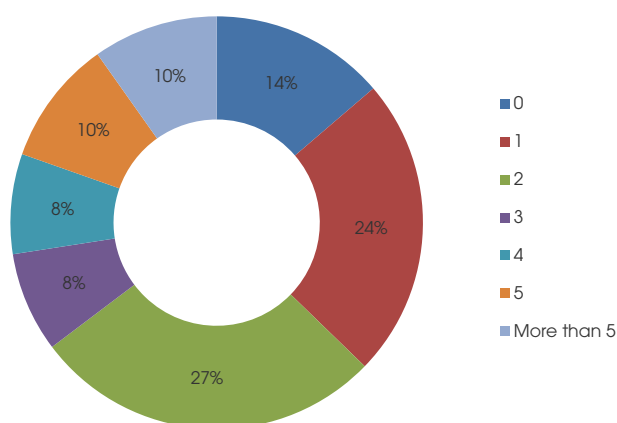
more new hedge funds to their portfolio on an annual basis.

With the greatest number of institutions making just a modest number of investments each year, fund managers need to find out how to gain their attention in the first place in order to have a chance at winning a mandate. Getting on the radar of investment consultants is a good step to being noticed by institutional investors; nearly half (47%) of investors source new investment opportunities through recommendations made by their consultants (Fig. 3.15). Investors are also proactively searching for hedge funds, with 36% of the participants in the Preqin study sourcing new funds through their

investment teams reaching out to the industry. In addition, 25% of institutions find funds through peer networks and the recommendations of other investors, and 21% use industry databases, such as Preqin's Hedge Fund Analyst, to find and review new funds.

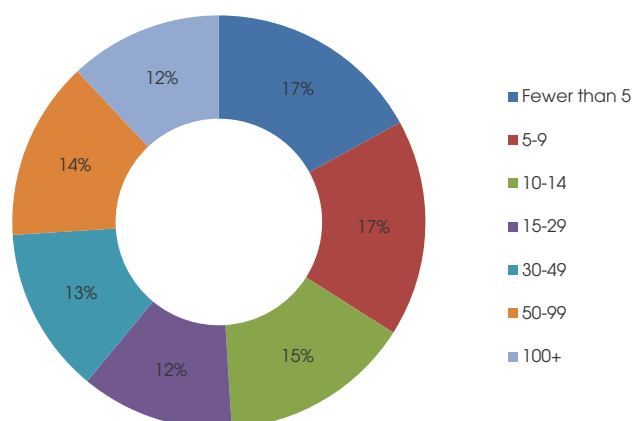
There are currently over 15,000 hedge funds open to investment globally. With such a large number of funds in the marketplace, investors face a challenging job to find the best and most suitable investment opportunities. As shown in Fig. 3.16, investors are receiving varied amounts of proposals each month. Just over a third (34%) of institutional investors receive fewer than 10 fund proposals on a

**Fig. 3.14:** Typical Number of New Hedge Fund Investments Made by Institutional Investors Each Year



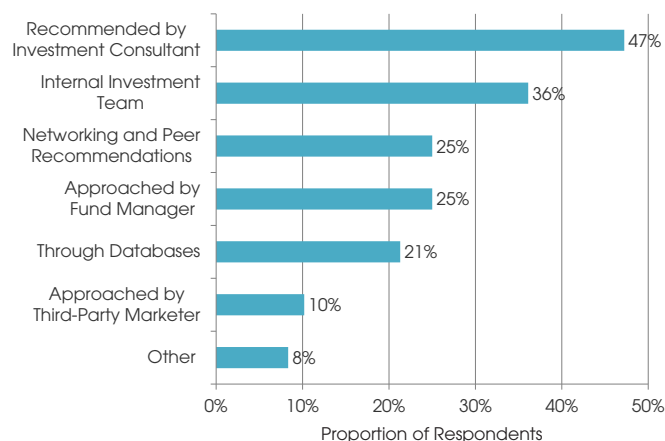
Source: Preqin Investor Interviews, June 2015

**Fig. 3.16:** Number of Hedge Fund Marketing Proposals Received by Institutional Investors Each Month



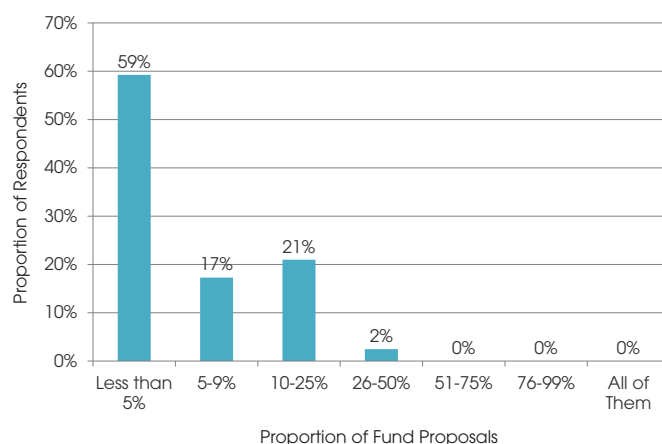
Source: Preqin Investor Interviews, June 2015

**Fig. 3.15:** Methods Used by Institutional Investors to Source New Hedge Fund Opportunities



Source: Preqin Investor Interviews, June 2015

**Fig. 3.17:** Proportion of Hedge Fund Proposals Received by Institutional Investors Which Get Through the First Round of Screening



Source: Preqin Investor Interviews, June 2015

monthly basis. However, over half (51%) receive 15 or more hedge fund proposals. A notable proportion (12%) receive 100 or more fund proposals each month.

Investors certainly face a difficult task in sorting through the large number of proposals they receive to select funds that they might want to investigate further. Fifty-nine percent of investors reject 95% or more of the fund proposals they receive in the first round of screening (Fig. 3.17). Ninety-eight percent of investors reject at least three-quarters of the fund proposals they receive when they initially screen the opportunities. Most commonly, investors reject funds because the strategy is not of interest to them, with 36% of investors stating this as a reason why a fund is rejected in the first stages of screening (Fig. 3.18). The results also highlight the continued challenge that emerging fund managers face in terms of raising capital; the next leading two reasons why funds are rejected are that the fund is either too

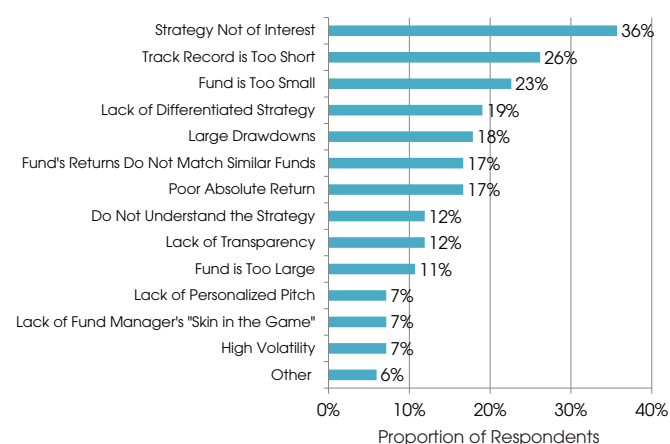
small or the track record too short. Other reasons investors highlighted included the fund strategy not being different enough from others in the market, and various factors related to the fund's performance, notably large drawdowns, poor performance relative to its peers and poor absolute returns.

Preqin's survey reveals that across all of the investors interviewed, institutions receive, on average, 13 hedge fund proposals each month. This equates to more than 150 funds on an annual basis. With most of these proposals being rejected at the first stage, the majority of investors (57%) are only monitoring 10 hedge funds or fewer on a pre-investment basis (Fig. 3.19). The institutions surveyed by Preqin vary in the amount of time it takes to evaluate each new fund opportunity and to make an investment decision. A third of investors take up to three months to make a decision to invest in a fund from the day the initial proposal

was received (Fig. 3.20). Other investors take more time in evaluating a potential new fund investment; 38% of investors spend at least six months evaluating a fund before they make an investment.

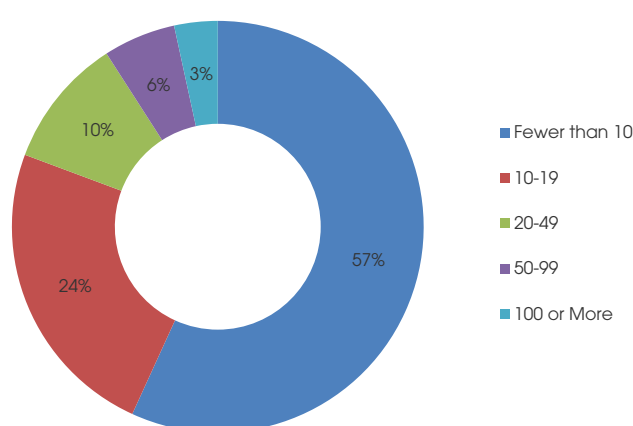
Sourcing and selecting new hedge funds for investment is a resource-intensive activity for institutional investors and therefore, once they have decided to commit to a new fund, that capital is likely to stay invested for several years. In fact, two-thirds of institutions will remain invested in a fund for at least three years (Fig. 3.21). Therefore, although gaining the attention of institutional investors is difficult, the efforts involved in providing the right information and meeting the requirements of institutions can have a significant effect on the success of a hedge fund. Not only do institutional investors invest significant sums, but their capital is 'sticky' and remains invested for long periods of time.

**Fig. 3.18: Reasons Why Institutional Investors Reject Proposals During Initial Screening**



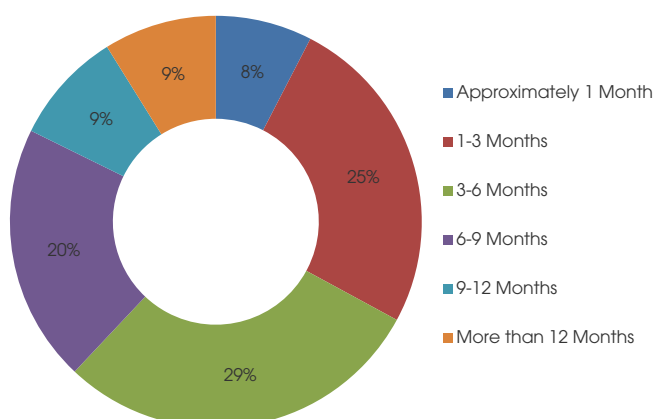
Source: Preqin Investor Interviews, June 2015

**Fig. 3.19: Number of Hedge Funds Institutional Investors Are Currently Monitoring Pre-Investment**



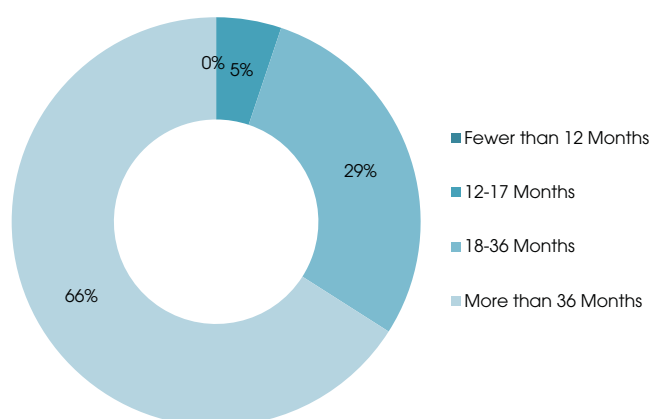
Source: Preqin Investor Interviews, June 2015

**Fig. 3.20: Typical Time Taken for an Institutional Investor to Decide to Invest in a Hedge Fund from the Date of Fund Proposal**



Source: Preqin Investor Interviews, June 2015

**Fig. 3.21: Typical Length of Time Institutional Investors Remain Invested in a Hedge Fund**

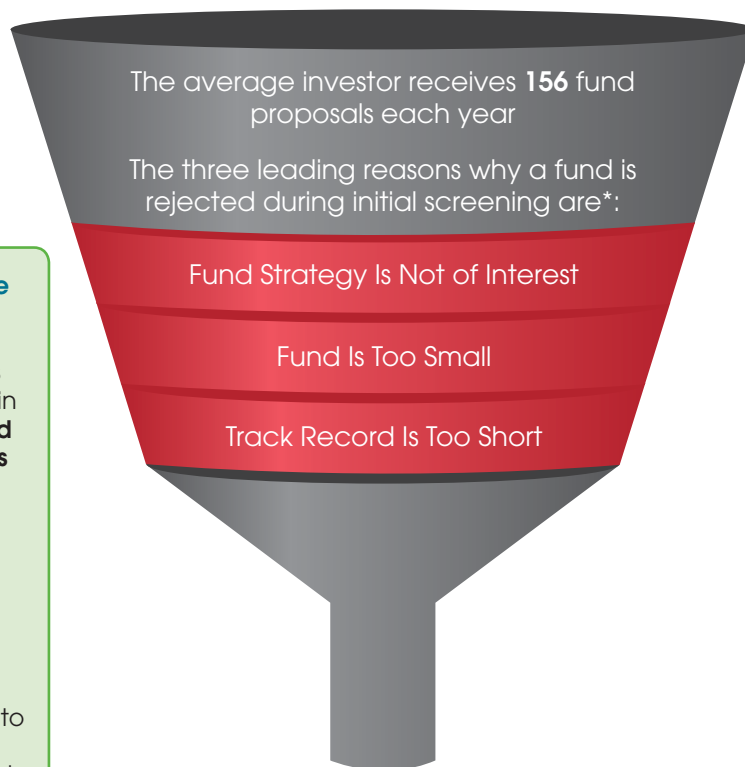
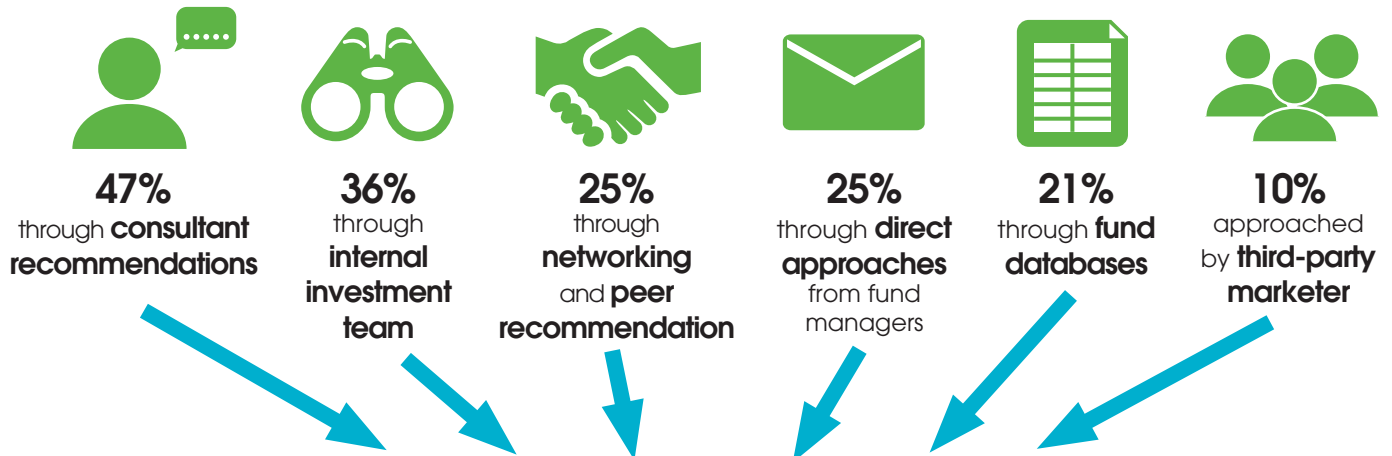


Source: Preqin Investor Interviews, June 2015



# How Investors Source and Select Hedge Funds: In Brief

## How Investors Source Funds\*:



### How Can Preqin Help Raise Funds?

- > Find out what strategies investors are interested in with our dedicated **Fund Searches and Mandates** portal
- > Find out which consultants work with which investors and the key contacts at each group
- > Gain detailed insights into over **5,500** institutional investors to build tailored pitches to those investors looking for your fund
- > Over **7,000** investors are looking at funds on **Preqin Investor Network**, ensure your details are accurate and up-to-date so investors can find you!

[www.preqin.com/sharedata](http://www.preqin.com/sharedata)

The average investor is pre-screening **seven** funds at any one time\*



The average investor makes **three** investments each year\*

Average Time Taken to Make an Investment Decision: **5 Months\***



**Two-thirds** of investors remain invested in a fund for **36 months or more\***

\*Source: Preqin Investor Interviews, June 2015

# Real Estate

## Attractive for Investors Despite Pricing Concerns

There is a general sense of satisfaction among real estate investors, with the majority of investors holding a positive perception of the asset class and 91% believing that their private real estate investments have met or exceeded their expectations in the previous year.

Positive sentiment is driving further investment in the asset class; 78% of surveyed real estate investors expect to invest the same amount of capital, or more, in real estate compared to the previous year, and further growth in the asset class is expected over the long term as more

investors are planning to increase their allocations than reduce them. Additionally, investors are planning to commit significant amounts of capital to real estate; 23% are planning to invest more than \$300mn, and 8% are targeting \$600mn or more.

Also contributing to investor satisfaction is the alignment of interests between investors and fund managers; 80% of surveyed investors agree that fund manager and investor interests are properly aligned, six percentage points up from December 2014. However, 85% of investors have decided not to invest in a fund due to the

proposed terms and conditions, indicating fund managers need to be sure they are aligned with market rates or can effectively justify the fees they charge if they want to ensure these issues are not an obstruction in gaining commitments from investors.

However, investors are still concerned about a range of interrelated issues including valuations, deal flow and performance. How fund managers address and mitigate these concerns could be the differentiator in a successful fundraising within the highly competitive fundraising environment.

### Data Source:

Preqin's **Real Estate Online** is the leading source of intelligence on the private real estate fund industry. This constantly updated resource includes details for all aspects of the asset class, including net-to-investor fund performance, fundraising information, institutional investor profiles, fund manager profiles and more.

For more information, please visit:

[www.preqin.com/reo](http://www.preqin.com/reo)

### Key Facts



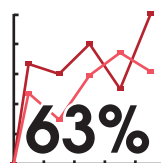
Proportion of investors that believe fund manager and investor interests are properly aligned.



Proportion of surveyed real estate investors targeting absolute returns of 8-9% from their real estate investments.



Proportion of investors that utilize recommendations by their investment consultant as their primary method for sourcing private real estate fund opportunities.



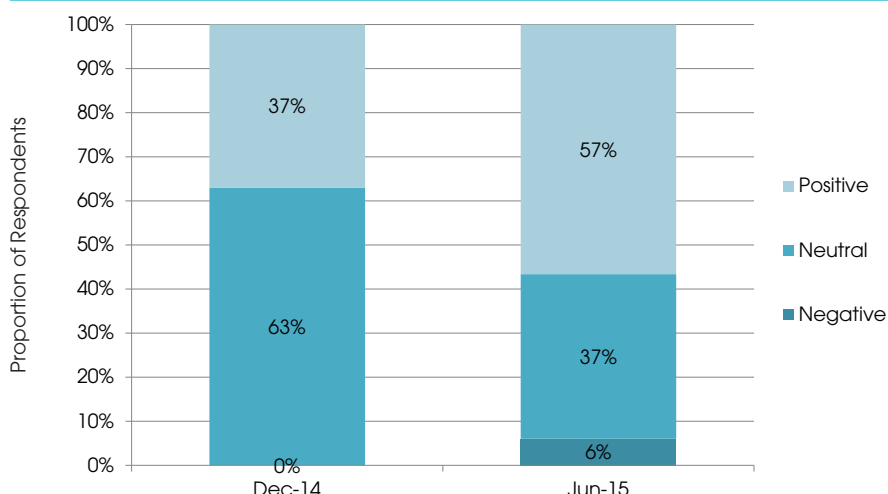
Proportion of surveyed investors that believe rising valuations is the key issue for the private real estate market in 2015.

# Satisfaction with Returns

Encouragingly, the majority (57%) of surveyed investors have a positive perception of the real estate asset class at present, a large change in sentiment from the 37% that felt this way in December 2014 (Fig. 4.1). However, 6% have a negative perception of the industry at present, while none stated this at the end of 2014.

Investor satisfaction with the asset class has continued to grow; 39% of investors surveyed in June felt that the performance of their real estate portfolios exceeded their expectations, up from 33% in December 2014 and 3% in December 2012 (Fig. 4.2). Furthermore, investors' confidence in real estate's ability to achieve portfolio objectives over the last 12 months has remained stable; over three-quarters (77%) of investors have seen no change in the last year, while 10% have gained confidence in the asset class. This continued satisfaction in the real estate asset class has led to over a quarter (26%) of investors expecting to invest more capital in private real estate over the next year compared with the previous 12 months, while 52% expect to maintain the same level of capital commitments.

**Fig. 4.1:** Investors' General Perception of the Real Estate Industry at Present, December 2014 - June 2015

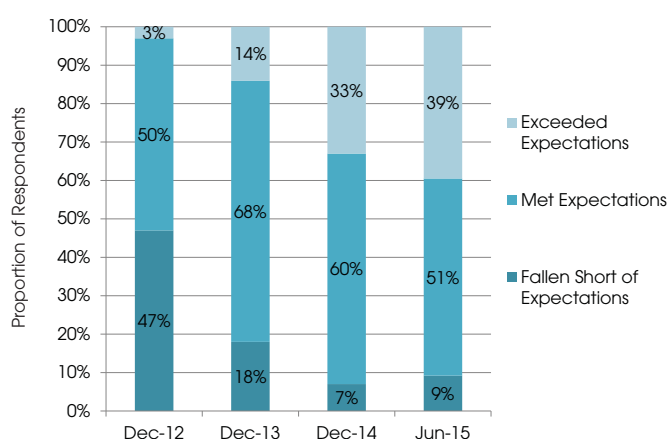


Source: Preqin Investor Interviews, December 2014 - June 2015

Interrelated issues are the key concerns of investors at the beginning of H2; inflated asset prices, a highly competitive deal environment and concerns over the eventual performance of real estate vehicles were chosen by 63%, 37% and 30% of surveyed real estate investors

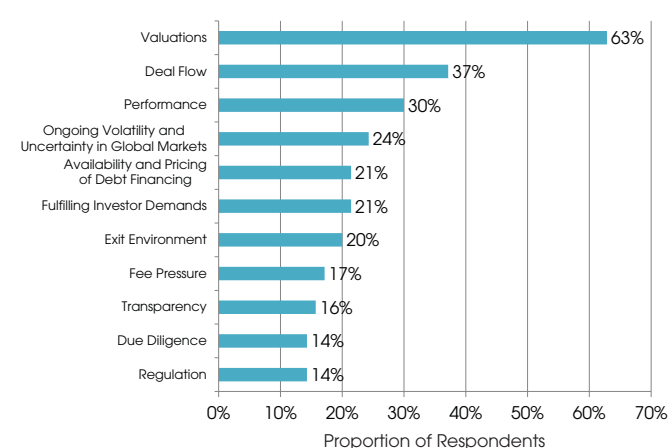
respectively (Fig. 4.3). Macroeconomic uncertainty and volatility in global markets are also on the minds of investors, with 24% indicating this as a key issue for private real estate in 2015.

**Fig. 4.2:** Proportion of Investors that Feel Their Private Real Estate Investments Have Lived up to Expectations over the Past 12 Months, December 2012 - June 2015



Source: Preqin Investor Interviews, December 2012 - June 2015

**Fig. 4.3:** Investors' Views on the Key Issues for the Private Real Estate Market over the Next 12 Months



Source: Preqin Investor Interviews, June 2015

## Download the Data Pack

View all the charts and tables featured in this report in our handy Excel data pack. It includes ready-made charts that can be used for presentations, marketing materials and company reports.

To download the data pack for **free**, please visit: [www.preqin.com/investoroutlook](http://www.preqin.com/investoroutlook)



# Investor Activity in the Next 12 Months and the Longer Term

## Exposure to Real Estate

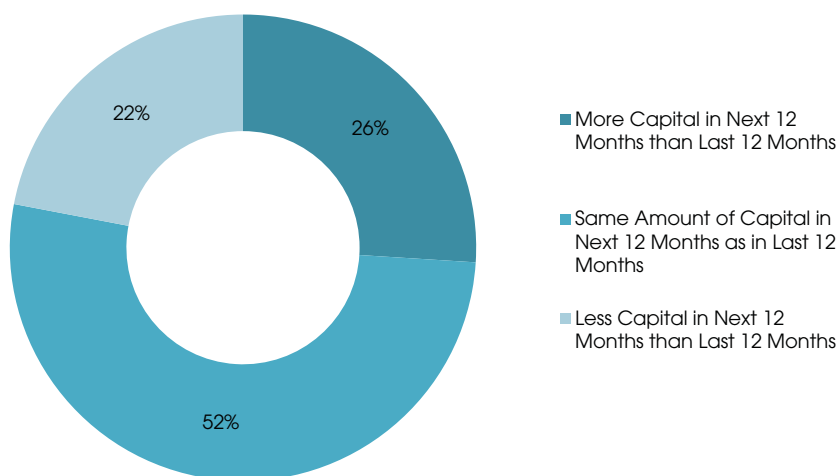
Many investors will increase their exposure to the real estate asset class over the next 12 months; 78% of surveyed investors expect to commit the same amount of capital, or more, to real estate in the next 12 months compared with the previous year (Fig. 4.4). In the longer term, over half (55%) of respondents will look to maintain their allocations to real estate (Fig. 4.5). However, further growth in the asset class is expected over the long term as more investors are planning to increase their allocations than reduce them.

Larger institutions are more likely to be active in the next year, with 54% of respondents that have \$10bn or more in assets under management (AUM) expecting to make, or are considering making, new fund commitments in the next year, compared to 46% that have less than \$10bn in AUM. However, the gap between large and small institutions participating in the asset class has dropped since the end of 2014, indicating a wider scope of institutions willing to participate in the asset class.

## Capital Commitments and Number of Funds Targeted

Many investors will be committing a significant amount of capital over the next year; just under half (49%) of active

**Fig. 4.4:** Investors' Expected Capital Commitment to Private Real Estate Funds in the Next 12 Months Compared to the Last 12 Months

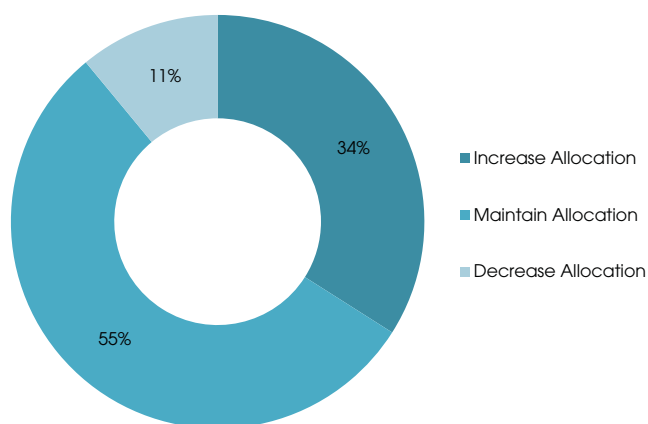


Source: Preqin Investor Interviews, June 2015

investors are planning to commit \$100mn or more to private real estate in the next 12 months (Fig. 4.6). Notably, 23% are planning to invest \$300mn or more, with 8% targeting \$600mn or more. The majority of active institutions will be looking to commit to two or more funds, with over a third expecting to make four or more commitments. Thirteen percent of investors planning to make commitments in the next year are looking to invest in just one fund, with 16% expecting to commit to two vehicles.

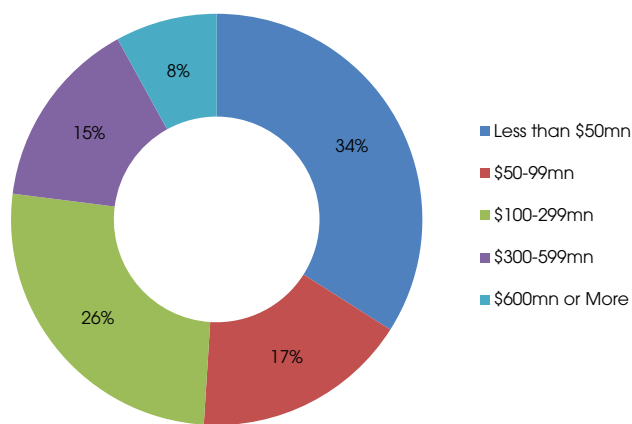
While California Public Employees' Retirement System (CalPERS) has made headlines with moves to reduce the number of managers in its portfolio, this does not appear to reflect a widespread trend. The majority (60%) of investors are looking to maintain the number of fund manager relationships they currently have (Fig. 4.7), while a greater proportion of investors (29%) are looking to increase the number of fund manager relationships they hold in comparison to those looking to reduce them (11%).

**Fig. 4.5:** Investors' Intentions for Their Private Real Estate Allocations over the Longer Term



Source: Preqin Investor Interviews, June 2015

**Fig. 4.6:** Amount of Fresh Capital Investors Plan to Invest in Private Real Estate over the Next 12 Months



Source: Preqin Real Estate Online

## Strategies and Regions Targeted

Value added, core and opportunistic remain the most favoured strategies in the next year, with core funds being targeted by the same proportion of investors (54%) as value added strategies (Fig. 4.8). There has been a noticeable decline in investors' preference for distressed funds, suggesting that the strategy type is not as appealing as in previous years, possibly due to a more stable macroeconomic environment and the deleveraging process undertaken by banks reducing the number of viable distressed opportunities in comparison to a few years ago.

As expected, the majority of investors looking to make commitments in the next 12 months have a strong domestic bias, with investors much more likely to deploy capital to opportunities in the region in which they are based (Fig. 4.9). However, investors in all regions are looking to expand their exposure to non-domestic markets in the next 12 months. North America-based investors favour greater geographic diversification, demonstrating the greatest preference for targeting global opportunities.

### Data Source:

**Real Estate Online** features in-depth profiles of over 4,700 institutional investors actively investing in real estate.

Prequin's dedicated team of research analysts is in regular direct contact with all active investors.

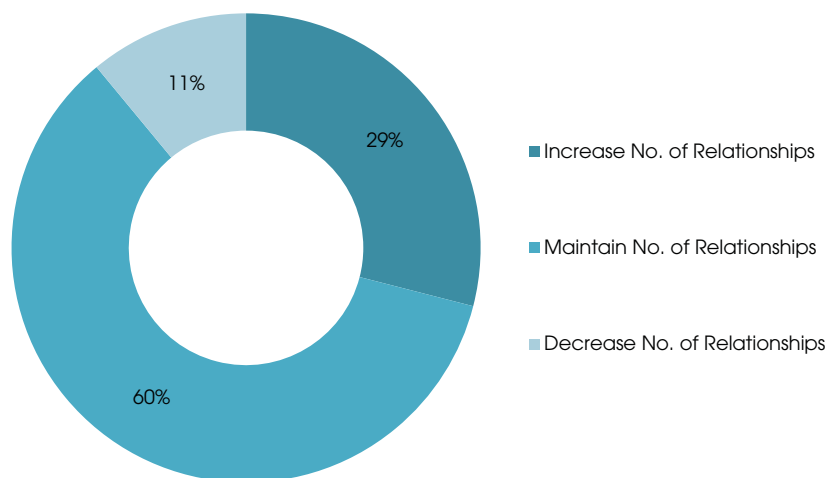
Detailed information includes:

- Allocations to real estate
- Assets under management
- Current fund searches and open mandates
- Direct contact details for key decision makers and much more.

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

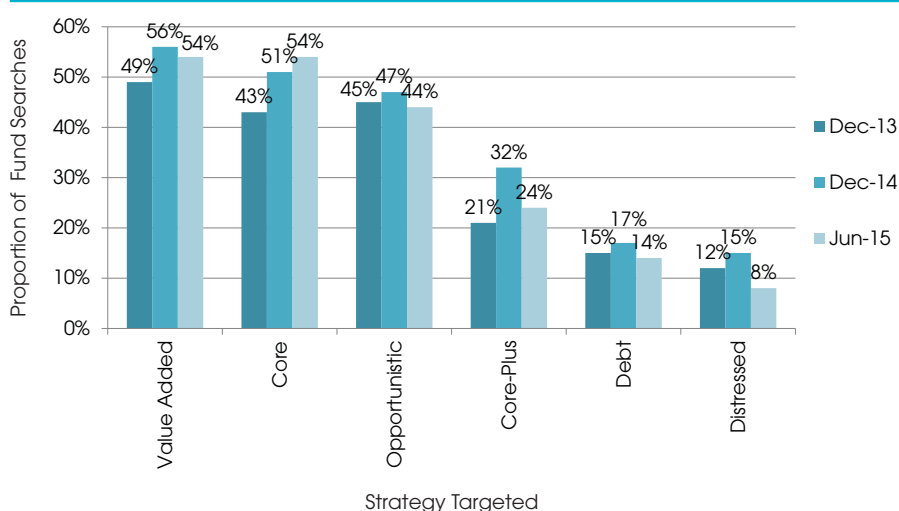
[www.prequin.com/reo](http://www.prequin.com/reo)

**Fig. 4.7:** Investors' Intentions for Fund Manager Relationships over the Next 12 Months



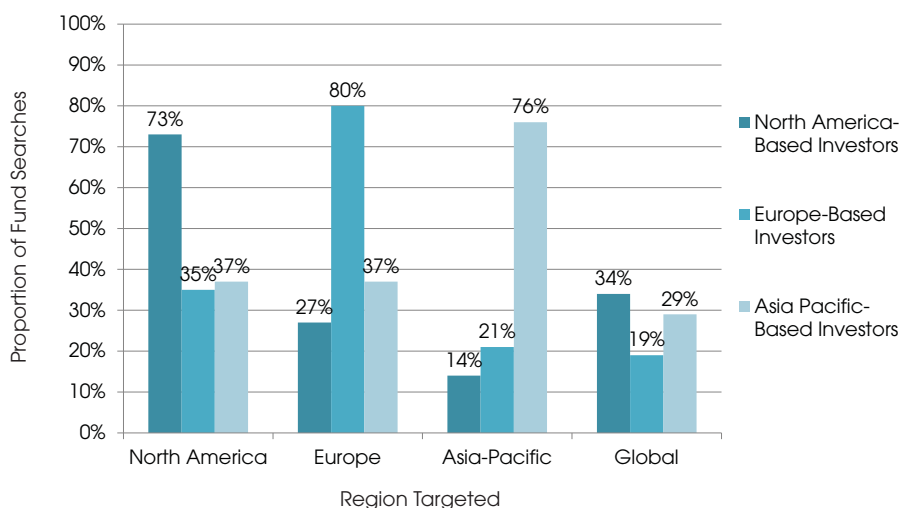
Source: Prequin Investor Interviews, June 2015

**Fig. 4.8:** Strategies Targeted in the Next 12 Months by Private Real Estate Investors, December 2013 - June 2015



Source: Prequin Real Estate Online

**Fig. 4.9:** Regions Targeted in the Next 12 Months by Private Real Estate Investors by Location



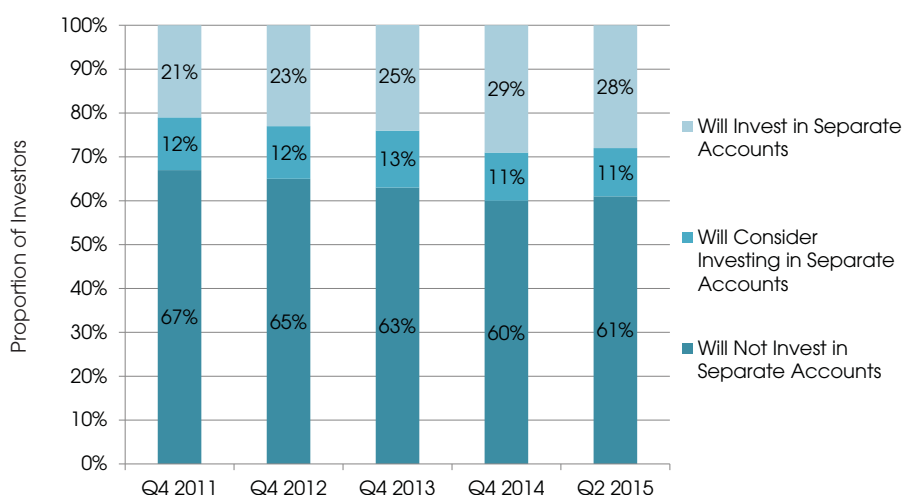
Source: Prequin Real Estate Online

# Alternative Methods of Accessing the Asset Class

Recent years have seen an increase in investor appetite for alternative structures, which offer the investor a variety of benefits over the traditional commingled fund model, including greater control over their real estate portfolio, lower fees and a greater level of exposure to attractive assets. Fig. 4.10 illustrates that the proportion of investors that will invest through separate accounts has steadily increased since 2011, with 39% of all institutional investors in real estate investing, or considering investing, in separate account mandates as of Q2 2015.

Appetite for separate account structures differs significantly across investor types; 53% of asset managers are investing, or considering investing, in separate accounts, the largest proportion of any investor type (Fig. 4.11). Public pension funds and family offices are also likely to invest through these structures, with 42% and 45% of both investor types investing or considering doing so respectively. Investors with significant assets under management hold sufficient resources to benefit from the economies of scale presented by separate accounts, benefitting from the

**Fig. 4.10: Investor Appetite for Real Estate Separate Accounts, Q4 2011 - Q2 2015**



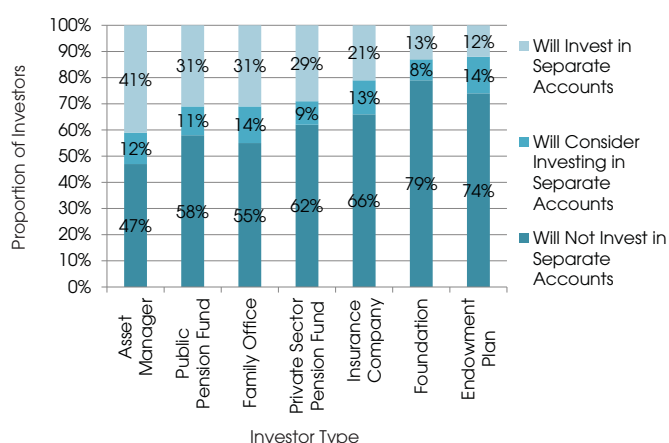
Source: Preqin Real Estate Online

likely more favourable terms and greater control and are therefore more likely to follow this route.

While the proportion of investors that will invest through separate accounts has grown in recent years, it is interesting

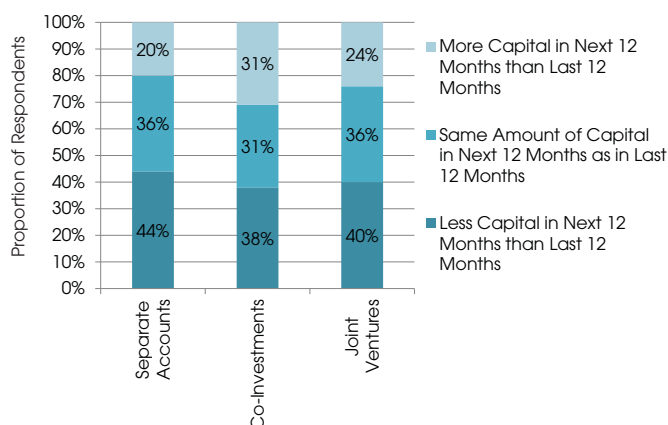
to note that many investors appear to be scaling back their outlay to separate accounts and other alternative structures. A greater proportion plan to reduce the amount of capital they invest through these structures in the coming year than plan to increase it (Fig. 4.12).

**Fig. 4.11: Investor Appetite for Real Estate Separate Accounts by Investor Type**



Source: Preqin Real Estate Online

**Fig. 4.12: Investors' Intentions for Their Co-Investments, Joint Ventures and Separate Accounts in the Next 12 Months**



Source: Preqin Investor Interviews, June 2015

## Data Source:

The **Future Fund Searches and Mandates** feature on **Real Estate Online** is the perfect tool to pinpoint those institutions that are targeting new funds or separate accounts. Search for potential investors by their preferred fund structure, fund strategy and regional preferences.

For more information, please visit: [www.preqin.com/reo](http://www.preqin.com/reo)



# Investor Objectives for Real Estate

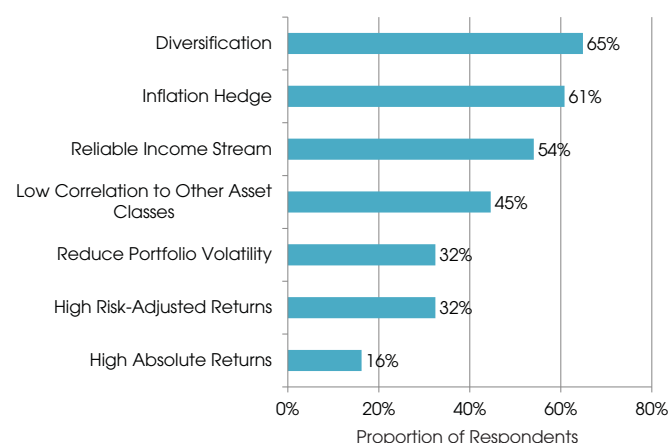
A diverse range of institutional investors choose to invest in the real estate asset class, each with their own set of objectives. Fig. 4.13 shows that there are a multitude of reasons that surveyed investors place above returns as their main motivation. The diversification benefits of real estate were cited by the largest proportion of respondents, most likely due to the asset class's relatively low correlation to traditional asset classes and the diversity of property

types, strategies and locations available on the market. Large proportions of surveyed investors also choose to invest in real estate because of its inflation-hedging properties and the asset class's ability to generate a predictable and reliable income stream.

With only 16% of respondents choosing high absolute returns as their main reason for investment, it is unsurprising that the majority of surveyed investors

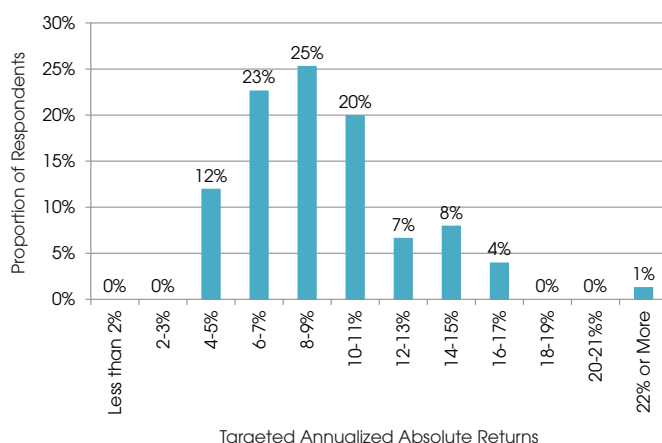
(60%) target absolute returns of less than 10%, with this proportion rising to 80% for investors targeting less than 12% (Fig. 4.14). While investor attitudes towards risk differ based on the tolerance of the distinct institution, real estate does offer opportunities for investment across the risk spectrum, with 13% of respondents seeking high absolute returns of 14% or more.

**Fig. 4.13:** Investors' Main Reasons for Investing in Real Estate



Source: Preqin Investor Interviews, June 2015

**Fig. 4.14:** Investors' Targeted Annualized Absolute Returns for Real Estate



Source: Preqin Investor Interviews, June 2015



**Source** new investors for funds and separate accounts

**Identify** new investment opportunities

**Conduct** competitor and market analysis

**Compare** fund performance against industry benchmarks

**Develop** new business

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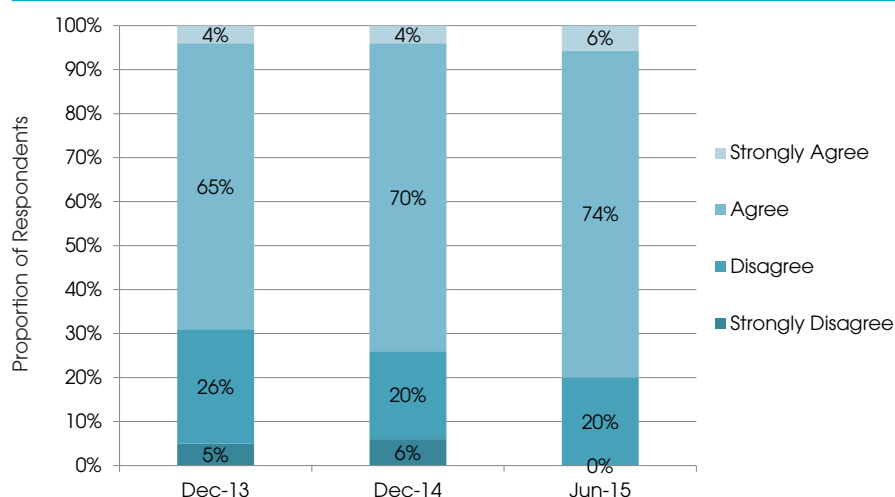
# Fees and Alignment of Interests

The alignment of interests between fund managers and investors is the result of appropriately structured fund terms and conditions. Investor satisfaction with fund terms is high, with 80% of surveyed investors agreeing that fund manager and investor interests are properly aligned, six percentage points up from December 2014 (Fig. 4.15).

Greater investor satisfaction with the alignment of interests may be correlated with more favourable fund terms for the investor; 35% of investors have seen changes in favour of the investor in the past year, an increase on the 14% that stated the same in December 2014 (Fig. 4.16).

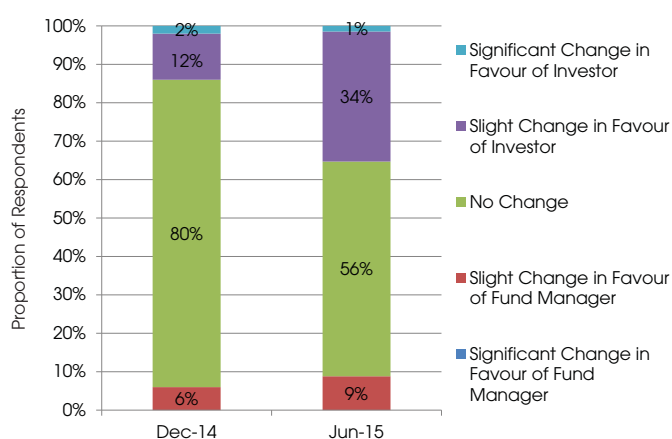
Eighty-five percent of investors have decided not to invest in a fund due to the proposed terms and conditions, with 23% frequently deciding against investing (Fig. 4.17). Despite the alignment of interests clearly improving, fund managers need to be sure they are aligned with market rates or can effectively justify the fees they charge if they want to ensure these issues are not an obstruction in gaining commitments from investors.

**Fig. 4.15:** Proportion of Investors that Feel Fund Manager and Investor Interests Are Properly Aligned, December 2013 - June 2015



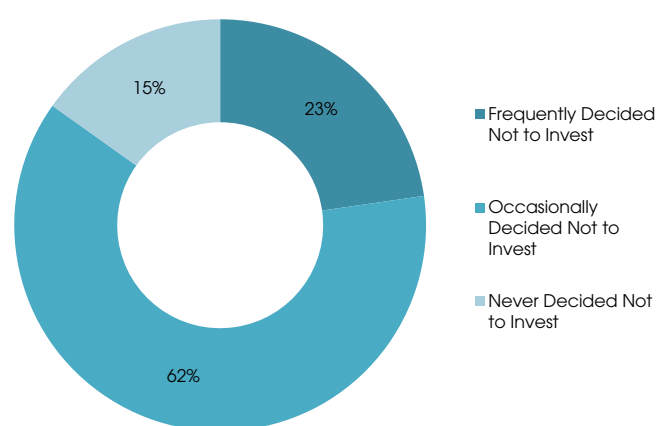
Source: Preqin Investor Interviews, December 2013 - June 2015

**Fig. 4.16:** Proportion of Investors that Have Seen a Change in Private Real Estate Fund Terms and Conditions over the Last 12 Months, December 2014 - June 2015



Source: Preqin Investor Interviews, December 2014 - June 2015

**Fig. 4.17:** Frequency with Which Investors Have Decided Not to Invest in a Fund Due to the Proposed Terms and Conditions



Source: Preqin Investor Interviews, June 2015

## Data Source:

Use the Terms Calculator tool on Preqin's **Real Estate Online** to calculate fund term benchmarks for funds of different types, geographic foci, fund sizes and commitment sizes. View individual fund terms information on an anonymous basis.

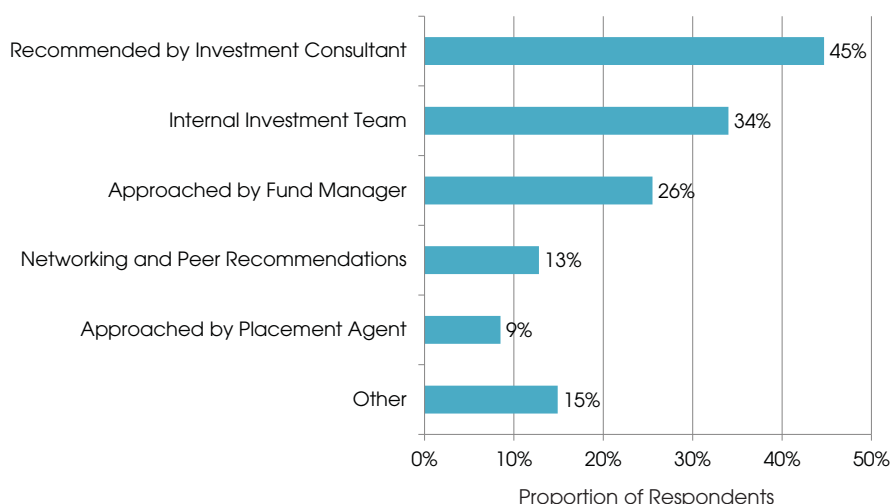
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# How Investors Source and Select Real Estate Funds

When raising capital, it is important for private real estate fund managers to understand how investors search for new fund opportunities in order to successfully market their vehicle in the most effective way. With many institutional investors mandated to employ investment consultants to either run or advise on their real estate program, it is unsurprising that nearly half (45%) of surveyed investors were recommended new opportunities through consultants (Fig. 4.18). Thirty-four percent of investors utilize an internal investment team, although this is generally the larger, more experienced institutions. Direct marketing to institutions could still play a part in reaching a successful fundraise; over a quarter (26%) of respondents suggested this was one of their main methods in sourcing fund investments.

While these are the most likely routes to get the attention of the investor, Fig. 4.19 shows that past performance and strategy are the most important factors investors look for in a real estate fund manager. Respondents also stated they took into account a combination of some, or all, of these factors when seeking funds.

**Fig. 4.18: Methods Used by Institutional Investors to Source New Real Estate Fund Opportunities**

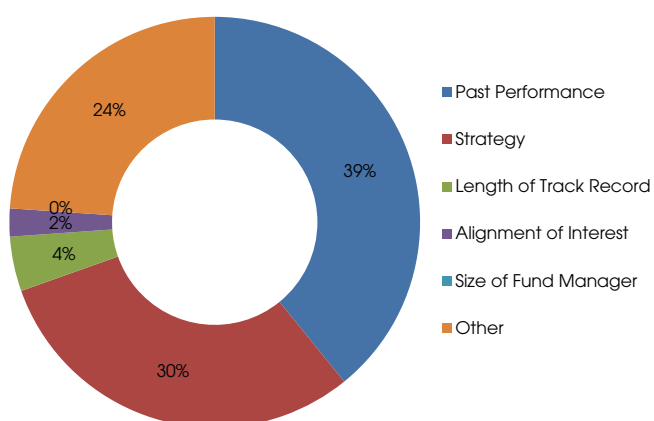


Source: Preqin Investor Interviews, June 2015

While the majority of surveyed institutional investors do not look specifically for local, environmentally or socially responsible real estate funds, or for female- or minority-owned firms, there are some that do. Local investments are the most likely to be taken into account (16%), as shown

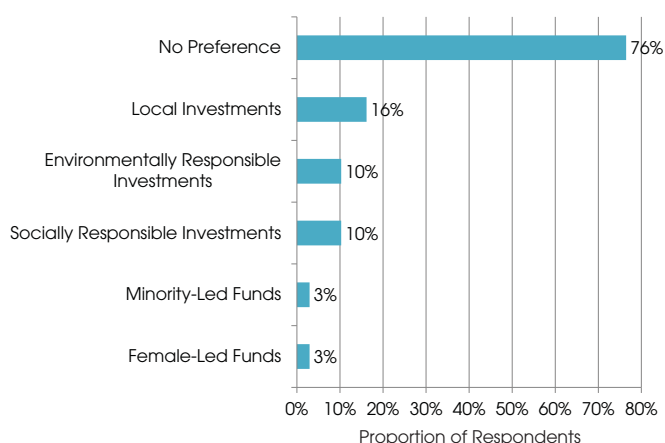
in Fig. 4.20. Very few investors have a mandate to specifically target female- or minority-owned firms, with just 3% stating each as a preference.

**Fig. 4.19: Investors' Views on the Most Important Factor to Consider when Looking for a Real Estate Fund Manager**



Source: Preqin Investor Interviews, June 2015

**Fig. 4.20: Investors' Preferences for Different Types of Real Estate Investments and Funds**



Source: Preqin Investor Interviews, June 2015

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# Infrastructure

## Institutional Investors Satisfied Despite Pricing Concerns

Infrastructure represents an asset class of growing importance to institutional investors' portfolios; average target allocations have increased each year since 2011 and now stand at 6.3% of total assets under management for the 36% of institutions that allocate to the asset class. Furthermore, 79% of surveyed infrastructure investors expect to commit either the same amount, or more capital, in the coming 12 months than in the previous year, and over the long term, 88% stated they will maintain or increase their current level of exposure to the asset class.

New investor commitments are likely to become further concentrated among a smaller selection of experienced managers with a proven track record; 42% of respondents stated that they will invest in first-time infrastructure funds, down from 56% in December 2011. However, growing

investor sophistication and size have led to continued growth in alternative structures to pooled funds; 50% of investors seek to invest, or are considering investing, in separate accounts, and 61% actively target or consider co-investment opportunities alongside fund managers.

There has been a growing move among fund managers to adopt fund terms to better meet investor needs; 86% of surveyed investors feel that investor and fund manager interests are properly aligned, or do not have a strong opinion either way. Despite this, fund terms do present a sticking point in some negotiations between investors and fund managers; 84% of respondents claim they occasionally or frequently decide not to invest in a particular opportunity due to the proposed fund terms and conditions.

Institutional investors choose investment in

the infrastructure asset class for a variety of reasons, although diversification and predictable cash flows were chosen as the main reasons for investing by the majority of surveyed investors. However, a number of issues are impacting institutional investor appetite for infrastructure opportunities. Concerns over pricing and the parallel effects on deal flow and performance of unlisted infrastructure vehicles are concerns for a large proportion of surveyed institutional infrastructure investors. Encouragingly for the asset class, further commitments from investors are expected; 20% of investors with plans for next year will invest more than \$500mn in infrastructure and 48% will make three or more investments in the same period.

### Data Source:

**Infrastructure Online** is Preqin's flagship online infrastructure information resource. Constantly updated by our team of dedicated researchers, it represents the most comprehensive source of industry intelligence available today, with global coverage of institutional investors, fund managers, fundraising, performance, deal activity and more.

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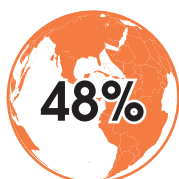
### Key Facts



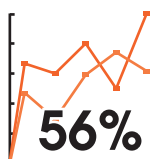
Proportion of surveyed investors that felt their infrastructure investments had met or exceeded their expectations.



Proportion of surveyed infrastructure investors that are targeting absolute annualized returns of 8-9% from their infrastructure investments.



Proportion of infrastructure investors investing in global opportunities in the next 12 months, the highest of any region.



Proportion of surveyed infrastructure investors that feel valuations are the key issue in the infrastructure market.

# Satisfaction with Returns and Allocations to Infrastructure

While the majority of surveyed institutional investors are generally satisfied with their infrastructure fund investments over the last 12 months, more than one-in-five feel infrastructure has fallen short of expectations, up from 14% in December 2014 and 13% in December 2013. More encouragingly, 15% of respondents feel infrastructure has exceeded their expectations over the last year, up from 3% in December 2014.

In line with views on their fund investments, 43% of surveyed infrastructure investors have a positive perception of the industry, with a further 42% maintaining a neutral opinion (Fig. 5.2). Less encouraging is the fact that the proportion of institutions with a negative view of infrastructure has increased from 0% at the end of 2014 to 15% now. Concerns over pricing may have contributed to increased negativity towards the asset class from investors.

## Allocations to Infrastructure

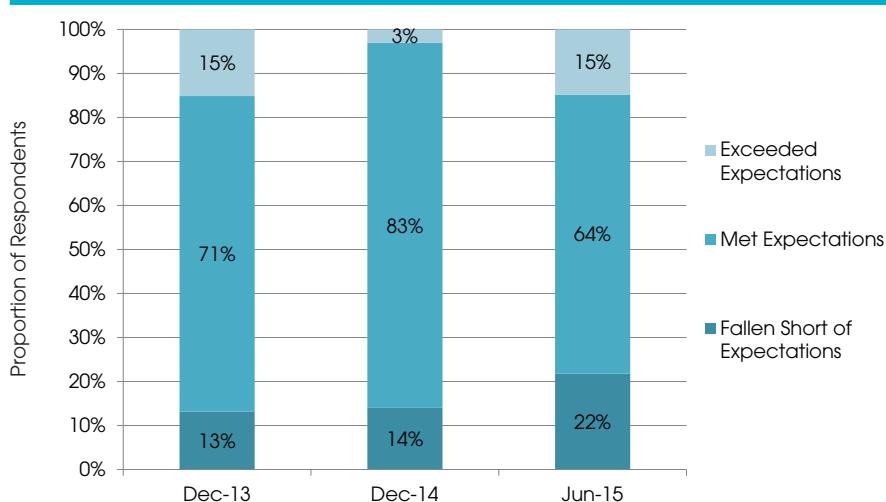
Due to the relative youth of infrastructure as a distinct asset class, institutional investors will typically allocate a smaller proportion of their total assets under management (AUM) to infrastructure, when compared with other alternative asset classes. The majority (64%) of investors are below their strategic target allocation to the asset class, which is encouraging for the industry's longer term growth.

As seen in Fig. 5.3, over time, investors are growing their allocations to infrastructure. The average current allocation to infrastructure for investors has increased from 3.5% of AUM in 2011 to 4.3% in 2014 and 2015. Target allocations to the asset class have continued to grow in 2015 and now stand at 6.3% of AUM for those investors allocating to the asset class. Allocations are likely to continue to grow over the coming years, with 44% of investors planning to increase the amount of capital they invest in infrastructure.

## Source of Allocation

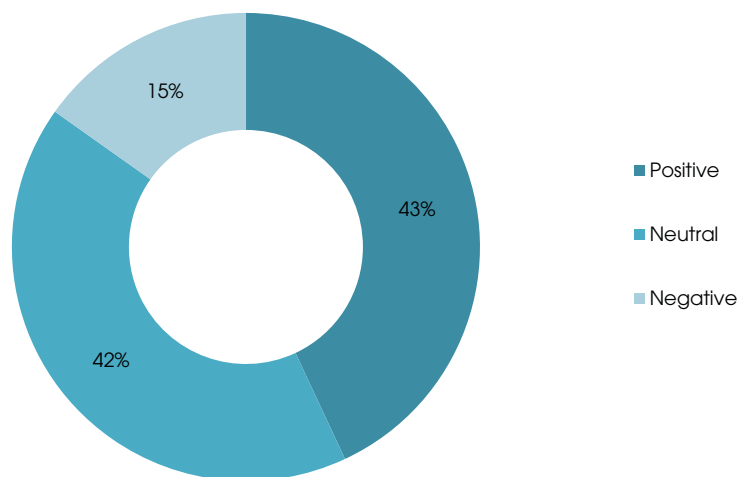
Institutions invest in infrastructure in a variety of ways, with the largest proportion of investors (39%) having a

**Fig. 5.1:** Proportion of Investors that Feel Their Infrastructure Fund Investments Have Lived up to Expectations over the Past 12 Months, December 2013 - June 2015



Source: Preqin Investor Interviews, December 2013 - June 2015

**Fig. 5.2:** Investors' General Perception of the Infrastructure Industry at Present



Source: Preqin Investor Interviews, June 2015

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distinct infrastructure allocation (Fig. 5.4). The number of investors with a separate infrastructure allocation has increased over the years; however, with the additional influx of newer entrants to the market, the proportion has declined from 2011.

#### Key Issues Facing the Infrastructure Fund Market in 2015

A number of issues will impact institutional investor appetite for infrastructure opportunities over the coming 12 months and the general growth of the industry in the longer term (Fig. 5.5). A more competitive deal environment is pushing prices for infrastructure assets higher, and as a result, the majority (56%) of investors feel this is a key challenge for the industry over the next year. This has a knock-on effect on both deal flow and the performance of unlisted vehicles, which are also pressing issues according to surveyed infrastructure investors, with 43% and 30% of respondents respectively stating these as key challenges. Other issues include volatility and uncertainty in global markets, fundraising, due diligence and transparency.

#### Data Source:

Preqin's **Infrastructure Online** contains detailed profiles for over 2,400 active infrastructure investors worldwide.

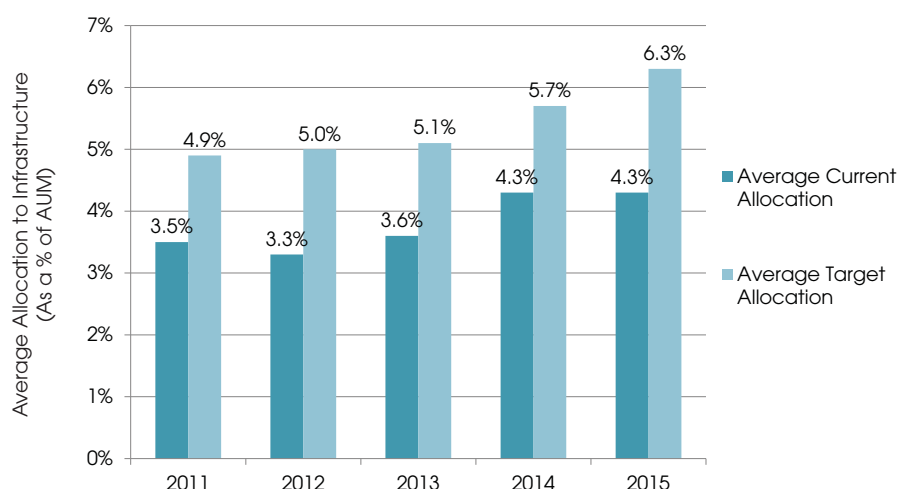
Preqin's dedicated team of research analysts is in regular direct contact with all active investors, allowing us to provide detailed information on:

- Current and target allocations
- Fund type and geographic preferences
- Future investment plans
- Direct contact information for key decision makers and much more

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

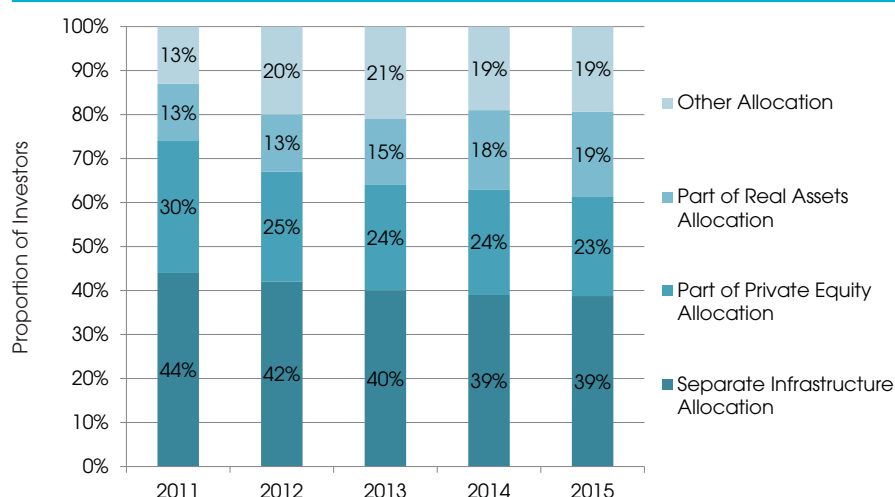
[www.preqin.com/infrastructure](http://www.preqin.com/infrastructure)

**Fig. 5.3: Average Current and Target Allocations to Infrastructure over Time, 2011 - 2015**



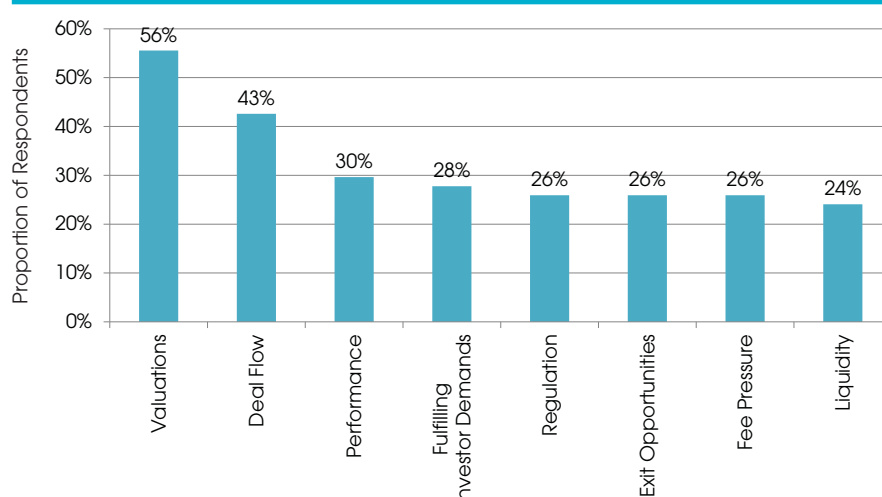
Source: Preqin Infrastructure Online

**Fig. 5.4: Breakdown of Infrastructure Investors by Source of Allocation, 2011 - 2015**



Source: Preqin Infrastructure Online

**Fig. 5.5: Investors' Views on the Key Issues for the Infrastructure Market over the Next 12 Months**



Source: Preqin Investor Interviews, June 2015

# Investor Activity in the Next 12 Months and the Longer Term

The infrastructure fund market is relatively smaller than those for other alternative asset classes, and while there are some very experienced investors that have been active for some time, there are also many newer entrants that are relatively inexperienced. As these investors evolve and gain further expertise, they will explore new ways to gain exposure to infrastructure. As a result, it is vital that fund managers are aware of and adjust to changing investor attitudes in order to secure capital in a competitive fundraising environment.

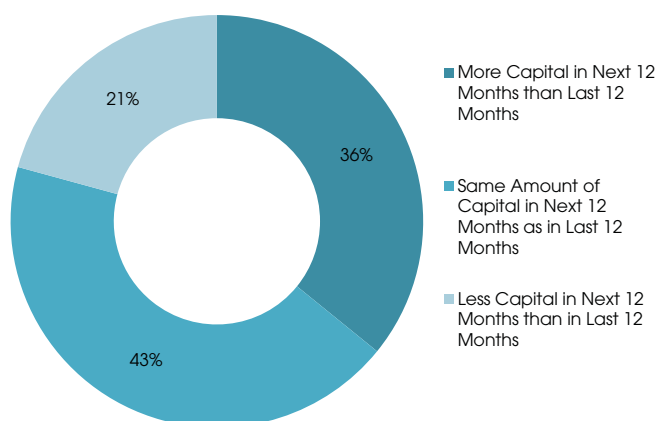
## Investors' Infrastructure Commitments in the Next 12 Months

As can be seen in Fig. 5.6, 79% of surveyed infrastructure investors expect to commit at least the same amount of capital as in the previous year. In comparison to results from December 2014, when 45% of investors indicated that they expected to commit less capital to the asset class; these results are encouraging and demonstrate the continued importance of infrastructure in institutional investors' portfolios.

## Investors' Infrastructure Allocations over the Longer Term

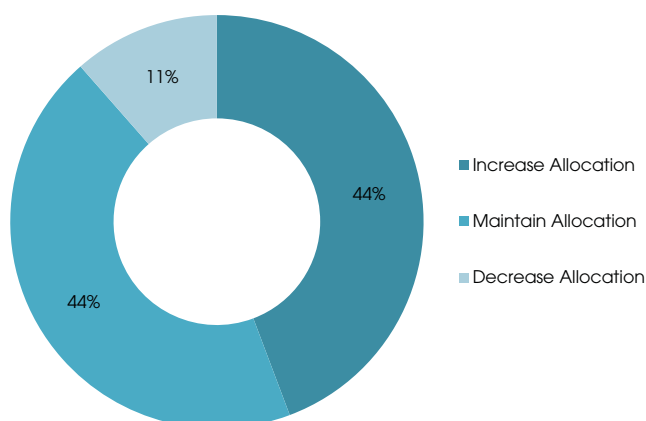
Over the longer term, the prospects for the continued growth of the asset class are positive. The average current allocation to infrastructure across the entire infrastructure investor population has remained steady in 2014 and 2015 at 4.3% of AUM. The average target allocation, however, has reached its highest level yet, at 6.3% of total assets. Forty-four percent of survey respondents stated they will increase their allocation to infrastructure over the longer term,

**Fig. 5.6:** Investors' Expected Capital Commitments to Infrastructure Funds in the Next 12 Months Compared to the Last 12 Months



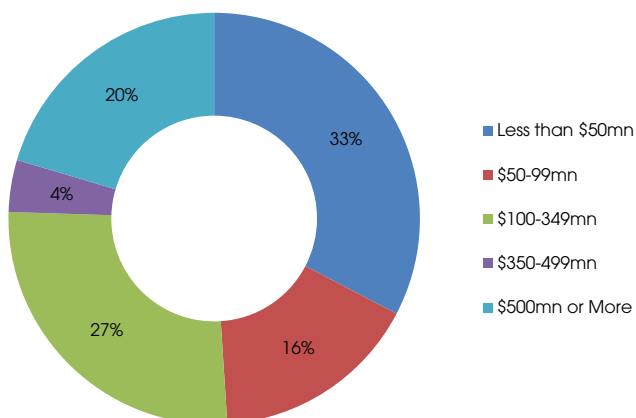
Source: Preqin Investor Interviews, June 2015

**Fig. 5.7:** Investors' Intentions for Their Infrastructure Allocations over the Longer Term



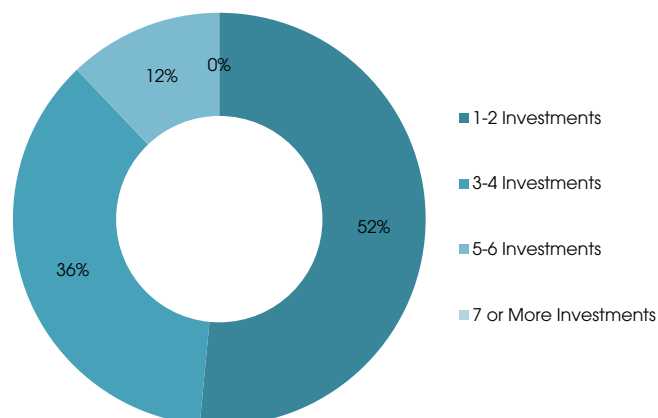
Source: Preqin Investor Interviews, June 2015

**Fig. 5.8:** Amount of Fresh Capital Investors Plan to Invest in Infrastructure over the Next 12 Months



Source: Preqin Infrastructure Online

**Fig. 5.9:** Number of Infrastructure Investments Investors Plan to Make over the Next 12 Months



Source: Preqin Infrastructure Online

with a further 44% maintaining their current level of exposure (Fig. 5.7). Eleven percent of respondents state they will reduce their allocation in the longer term, representing a notable shift in attitude from the results at the end of 2014 when no investors stated they planned to reduce their allocation.

### Capital Outlay and Investment Plans

Preqin's **Infrastructure Online** service tracks the activity and plans for future investment of over 2,400 active investors in the infrastructure asset class. Over half (51%) of investors with plans to make further investment in the next year will invest more than \$100mn in infrastructure opportunities, with 20% of investors planning to invest over \$500mn (Fig. 5.8).

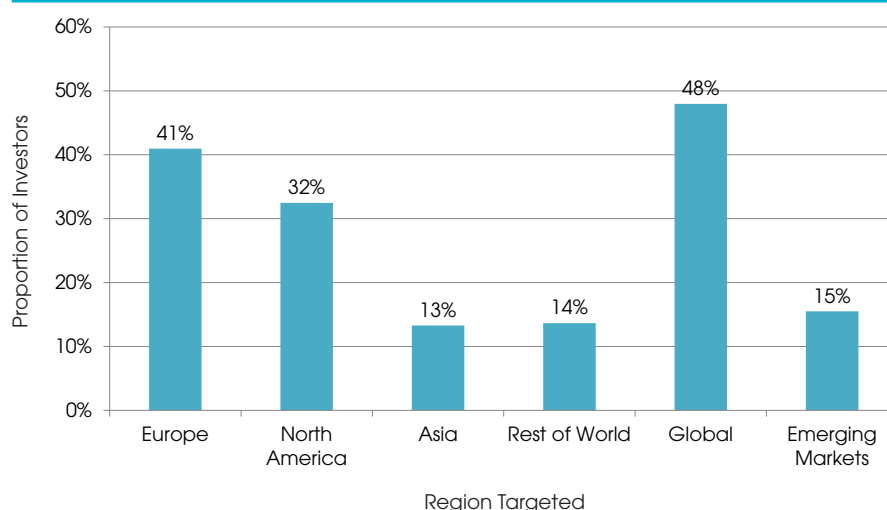
With some investors planning to put considerable amounts of capital to work over the next year, it is positive that 48% plan to invest in more than three new infrastructure vehicles, with 12% planning to make at least five investments in the coming year (Fig. 5.9).

The benefits of geographic diversification have led nearly half (48%) of investors with plans to place additional capital in the asset class to target global opportunities (Fig. 5.10). European and North American infrastructure assets are targeted by 41% and 32% of investors respectively. Despite the inception of the Asian Infrastructure Investment Bank by China and further plans for infrastructure funding from the Japan-led Asia Development Bank, Asian infrastructure assets are targeted by only 13% of investors planning new investments.

### Route to Market

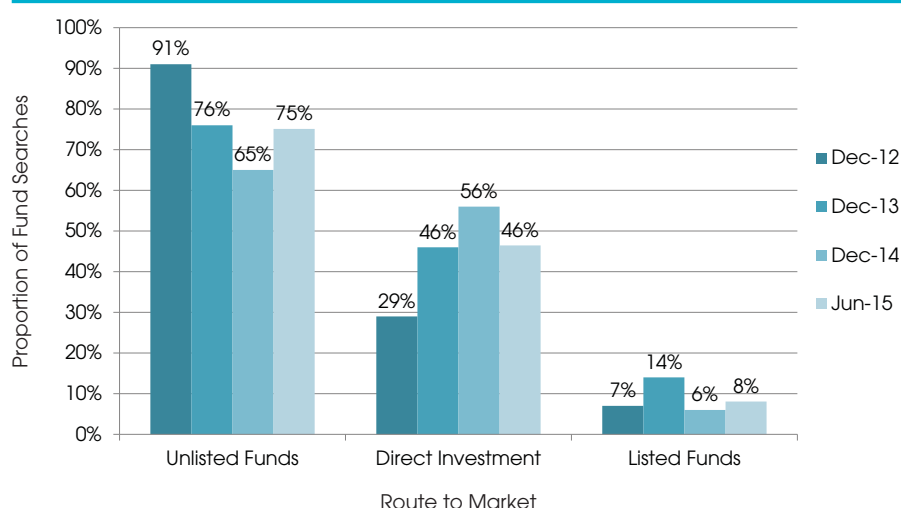
While appetite for listed infrastructure vehicles has remained low since 2013, interest in direct investment and unlisted funds has fluctuated over time (Fig. 5.11). At the beginning of H2 2015, unlisted vehicles are targeted by the largest proportion of investors planning further capital outlay; three-quarters of investors choose this route to market, representing an increase from the 65% at the end of 2014. Correspondingly, the proportion of investors targeting direct investment has fallen from 56% in December 2014 to 46% in June 2015.

**Fig. 5.10: Regions Targeted by Infrastructure Investors in the Next 12 Months**



Source: Preqin Infrastructure Online

**Fig. 5.11: Preferred Route to Market of Infrastructure Investors Searching for New Investments in the Next 12 Months, December 2012 - June 2015**



Source: Preqin Infrastructure Online

Looking back further in time shows the growth of the asset class and the growing expertise of investors active in the market. In December 2012, 91% of investors were targeting unlisted vehicles and 29% were targeting infrastructure assets directly. As investors grow their AUM and build up distinct investment teams, it is expected more investors will target direct infrastructure investment.

### Outlook

With the majority of investors operating below their strategic target to infrastructure and expectations of further growth in allocations in both the short and long term, the outlook for the asset class appears positive. A multitude of economic, social and geopolitical

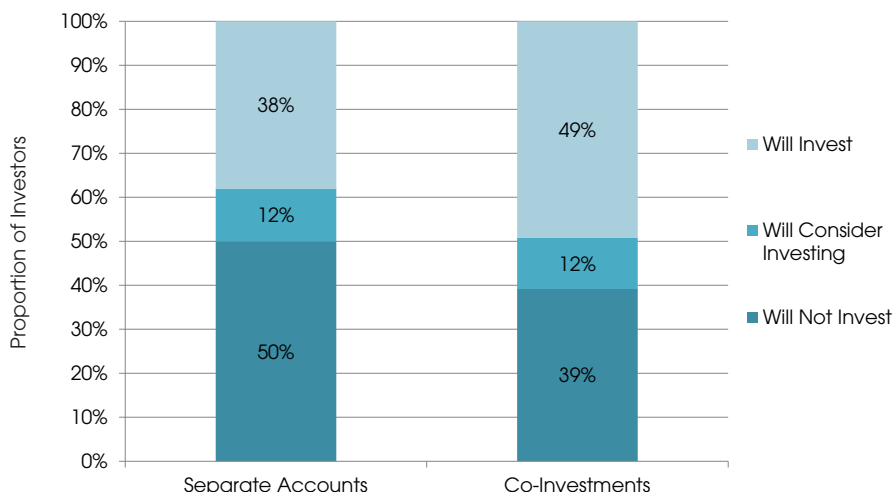
factors will ensure further investment in infrastructure assets over the longer term, although in the short to mid-term, pricing concerns have affected infrastructure fundraising and made investors more cautious over where they commit further capital. In order to buck the quarter-on-quarter drop in fundraising, fund managers looking to raise capital over the next year will need to be able to effectively communicate how they can find value in the current market in order to successfully secure investor commitments.

# Alternative Methods of Accessing the Asset Class

## Alternative Structures: Co-Investments and Separate Accounts

As institutional investors' expertise in the infrastructure market develops, they start to look for alternative structures and routes to market as opposed to just investing in pooled infrastructure funds. The benefits include greater control over the direction of their capital, more access to attractive assets and a greater ability to negotiate fees and other fund terms. Fig. 5.12 shows that 38% of investors will seek to invest in separate accounts and 49% will target co-investment opportunities alongside fund managers. However, due to the high barriers for entry, these structures are typically only suitable for larger institutions. Often, this form of investment requires large capital commitments and substantial human resource to carry out the due diligence and portfolio monitoring that accompanies this type of investment. As Fig. 5.13 demonstrates, as assets under management (AUM) increase, investors are more likely to target both types of alternative structure; 57% of investors with AUM of \$10bn or more will invest in separate accounts, while 73% of the same pool of investors will invest in co-investment opportunities. Comparatively, only 9% and 36% of smaller institutions (less than \$1bn in AUM) will target separate accounts and co-investment opportunities respectively.

**Fig. 5.12: Infrastructure Investor Appetite for Separate Accounts and Co-Investments**



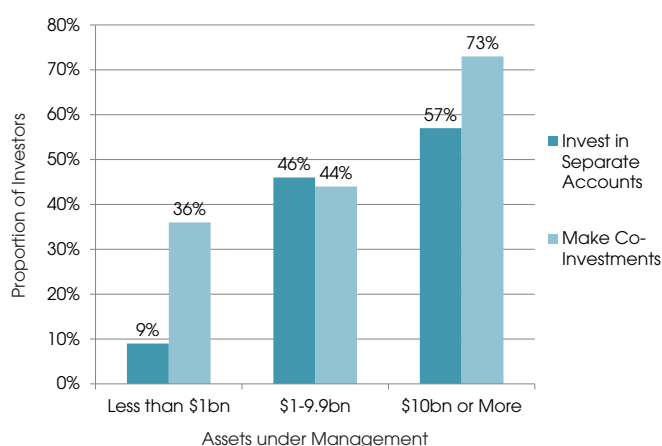
Source: Prequin Infrastructure Online

## First-Time Funds

Investor appetite for first-time funds has continued to decline since 2011. As it stands, 42% of investors will invest in first-time infrastructure funds, a slight reduction on 43% in December 2014 and 56% in December 2011 (Fig. 5.14). Many institutional investors are increasingly keen to invest with managers that have a proven track record, and with 50% of funds in market being raised by managers that have raised two or

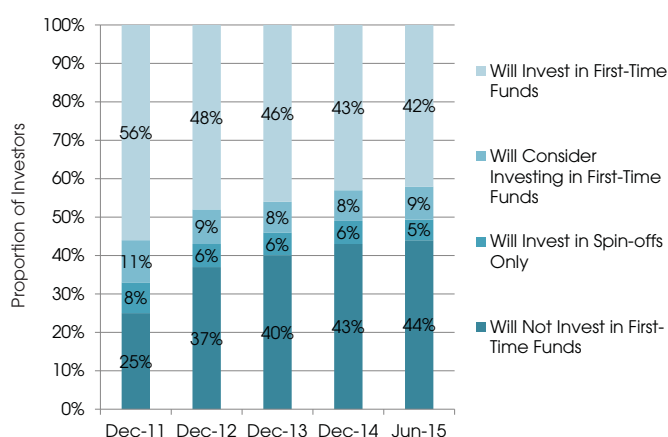
more infrastructure funds previously, investors are less likely to target first-time fund managers and capital is likely to become further concentrated among the leading managers with established track records.

**Fig. 5.13: Infrastructure Investor Appetite for Separate Accounts and Co-Investments by Assets under Management**



Source: Prequin Infrastructure Online

**Fig. 5.14: Infrastructure Investor Appetite for First-Time Funds, December 2011 - June 2015**



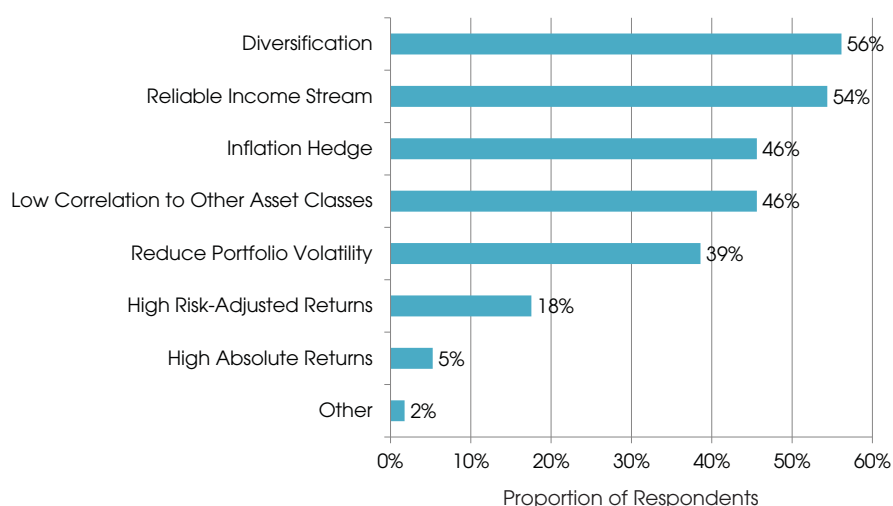
Source: Prequin Infrastructure Online

# Investor Objectives for Infrastructure

Investment in infrastructure can play an important role in an institutional investor's portfolio, delivering many positive benefits. Infrastructure assets hold generally dominant market positions, providing the ability to generate long-term, stable cash flows, with inflation-linked contracts that are able to protect investors from the effects of inflation on those cash flows. Additionally, due to its low correlation to other asset classes, infrastructure investment is a viable way to gain diversification within a portfolio. As can be seen from Fig. 5.15, the largest proportion (56%) of surveyed investors stated diversification as one of the main reasons they invest in the asset class, followed by 54% of respondents choosing the predictable cash flows.

With high risk-adjusted returns and high absolute returns mentioned by only 18% and 5% of surveyed institutional investors respectively, it is unsurprising that the absolute returns targeted by infrastructure investors are towards the lower end of the return spectrum; three-quarters of investors seek absolute returns of less than 10%, with the largest

**Fig. 5.15: Investors' Main Reasons for Investing in Infrastructure**

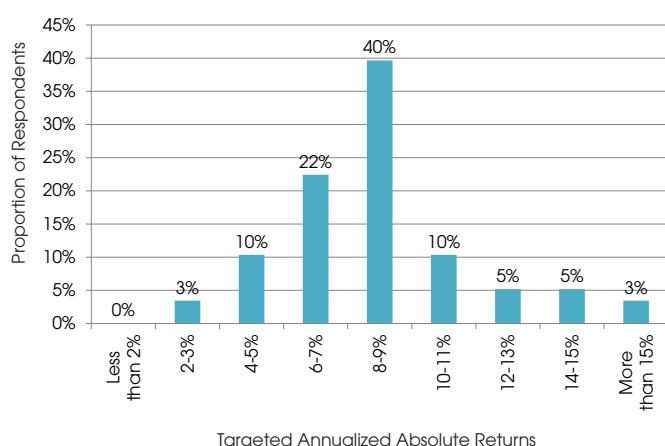


Source: Preqin Investor Interviews, June 2015

proportion (40%) targeting returns of 8-9% (Fig. 5.16). Two-thirds of hedge fund investors target absolute returns of less than 10% from their hedge fund investments and 60% of real estate investors do.

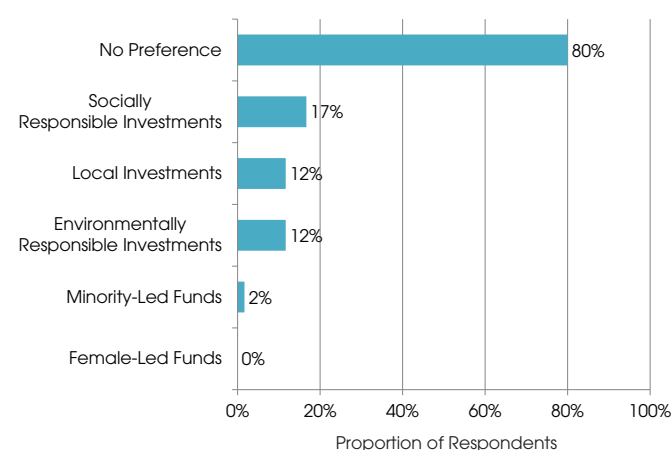
A significant 80% of investors do not look specifically for environmentally or socially responsible funds, or for female- or minority-owned firms (Fig. 5.17).

**Fig. 5.16: Investors' Targeted Annualized Absolute Returns for Infrastructure**



Source: Preqin Investor Interviews, June 2015

**Fig. 5.17: Investors' Preferences for Different Types of Infrastructure Investments and Funds**



Source: Preqin Investor Interviews, June 2015

## Data Source:

The **Fund Searches and Mandates** feature on **Infrastructure Online** is the perfect tool to pinpoint those institutions that are seeking new infrastructure funds for investment now. Search for potential investors by their preferred fund structure, fund strategy and regional preferences.

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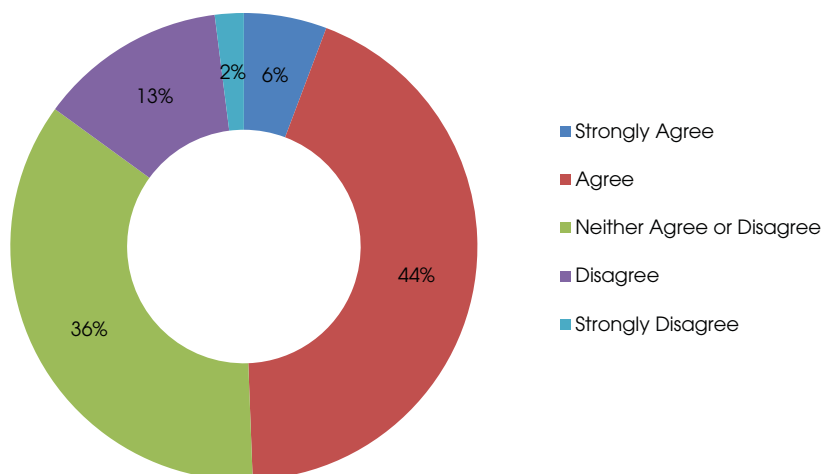
# Fees and Alignment of Interests

As shown in Fig. 5.18, a substantial 86% of surveyed investors feel that investor and fund manager interests are properly aligned, or do not have a strong opinion either way. This compares to the 51% of surveyed investors which stated the same in June 2013, suggesting that fund managers have largely listened to the concerns regarding fees and the growing requirement to adopt terms that better meet investors' needs. Positively for the industry, 6% of respondents strongly agreed that there is an alignment of interests between investors and fund managers, compared with no respondents suggesting this was the case in December 2014. Furthermore, just 15% of respondents disagreed that investor and fund manager interests are properly aligned, compared with 28% in December 2014.

The majority of respondents (63%) have not seen a change in fund terms and conditions over the last year (Fig. 5.19). However, more surveyed investors have seen changes to fund terms in favour of the investor than have seen changes in favour of the fund manager.

With fund terms and conditions being such an important factor for investors, it is not surprising that many investors surveyed stated that they have previously decided against investing in a particular infrastructure fund opportunity due to the proposed terms and conditions. In fact, 84% of respondents claim they occasionally or frequently decide not to

**Fig. 5.18:** Proportion of Investors that Feel Fund Manager and Investor Interests Are Properly Aligned



Source: Preqin Investor Interviews, June 2015

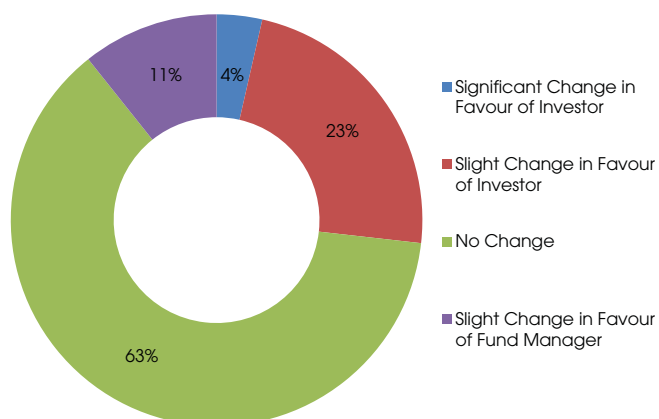
invest in a particular opportunity due to the fund terms and conditions, indicating that although the alignment of interests between investors and fund managers has clearly improved, work still needs to be done in some cases.

## Outlook

The fundraising environment is driven by the relationship between fund managers and investors. Key issues of fund terms and conditions and the alignment of interests between the two parties are

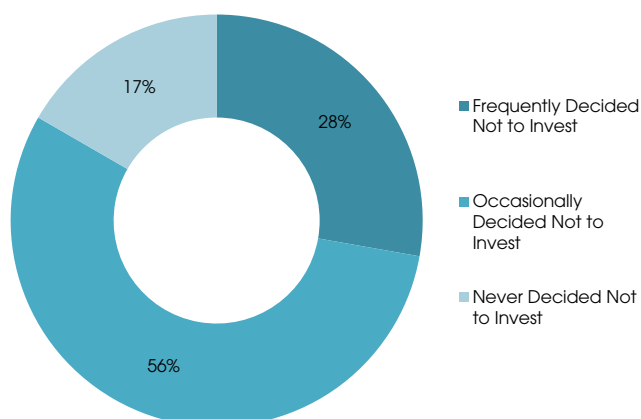
central to creating a positive relationship and drive further capital commitments from the investor. Generally speaking, fund terms and conditions have become more favourable for investors over the last few years, and according to Preqin's latest investor survey, a growing number of institutional investors are confident that fund manager and investor interests are firmly aligned, although there are a number of investors that feel that more work still needs to be done.

**Fig. 5.19:** Proportion of Investors that Have Seen a Change in Fund Terms over the Last 12 Months



Source: Preqin Investor Interviews, June 2015

**Fig. 5.20:** Frequency with Which Investors Have Decided Not to Invest in a Fund Due to the Proposed Terms and Conditions



Source: Preqin Investor Interviews, June 2015

# Private Debt

## Investor Confidence in Private Debt Continues into H2 2015

Driven by strong investor interest in 2014, the first half of 2015 has seen appetite for the private debt asset class remain healthy across the already robust North American and growing European markets. Competition among managers, specifically within the direct lending segment, has continued to heat up, both in terms of securing investor commitments and deal sourcing. These trends are likely to persist as more resources become focused on initiating and maintaining private lending outfits globally. Both experienced and first-time managers alike have seen successful closes during an expansionary period, which has brought the question of private debt allocations into the conversation for most, if not all, global institutional investors. As such, investors are systematically carving out separate private debt allocations, as opposed to participation in the form of opportunistic or private equity buckets from which investors previously dabbled with lending strategies.

As of July 2015, there were 259 private debt funds in market seeking an

aggregate \$140bn. Healthy fundraising totals are expected to continue, as the responses to the most recent Preqin Investor Outlook survey suggest that more institutional investors than ever before are now looking at lower risk private debt strategies as a fixed income alternative and to provide strong risk-adjusted returns. Private Debt Online has details of more than 1,600 institutional investors globally, including information on allocations, preferences and future investment plans.

Thirty-eight percent of investors are likely to deploy more capital in private debt in the coming year than the last, and positive sentiment towards the asset class has remained consistent during the growth phase of private debt as a standalone asset class, even with mounting concern across the investment industry over a potential credit event. More than half (56%) of investors surveyed believe that private debt overall will outperform relative to corresponding public debt given a shock to credit markets. It will undoubtedly be interesting to track private debt strategies through a complete credit

cycle, as the most substantial growth in the asset class has been realized post-2008 and it has not yet had to weather a full downturn.

Investors widely favour direct lending strategies, with 63% planning to commit capital to the strategy in the next 12 months. Mezzanine and distressed opportunities will also be broadly targeted by investors, as all three strategies present differing risk/return profiles. Twenty-nine percent of respondents noted past performance as the most important criterion in choosing a fund and those managers with strong track records are likely to secure capital commitments more quickly than their newly formed counterparts, though key person experience would seem more likely to be an indicator of return potential in a given fund. While the outlook for private debt in 2015 remains strong, managers must remain flexible to the growing investor presence and sophistication in the marketplace in order to sustain the momentum gathered so far.

### Key Facts



Proportion of investors that feel fund manager and investor interests are properly aligned.



Proportion of investors that target absolute annualized returns of more than 5% from their private debt investments.



Proportion of investors that expect to commit more capital to private debt funds in the year ahead than in the last 12 months.



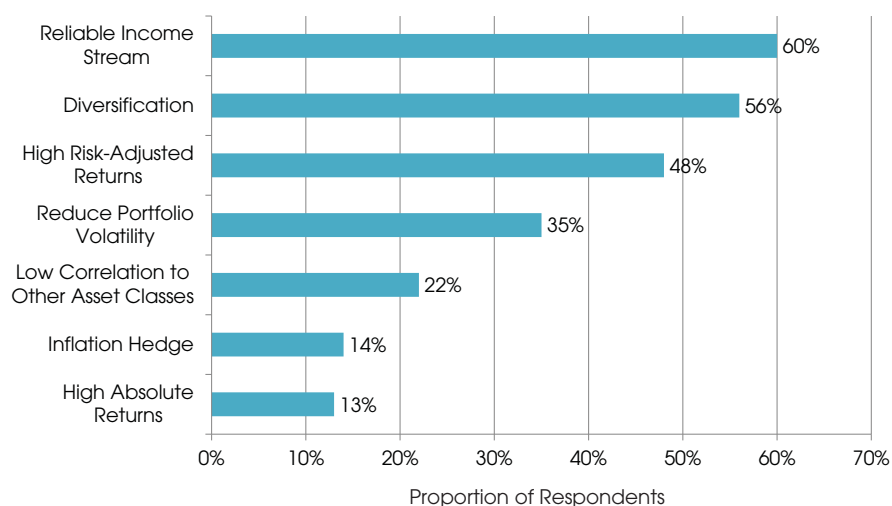
Proportion of investors that expect to target direct lending funds in the year ahead.

# General Perception of the Private Debt Market

Investors commit to private debt funds for a wide variety of reasons, with 60% of investors surveyed by Preqin stating that they invest in private debt because it provides a reliable stream of income (Fig. 6.1). This may well be related to the structural similarities between traditional fixed income vehicles and many private debt strategies. Additionally, diversification was provided as a reason by over half of investors surveyed (56%). This suggests a substantial proportion of investors view private debt as an attractive way to mitigate risk. Forty-eight percent of investors surveyed stated high risk-adjusted returns as a reason for investing in private debt.

These motives provide important insight into investors' views on the future of private debt and, significantly, 46% of investors surveyed viewed this growth of private debt as signalling a fundamental change in credit markets that will persist in the longer term (Fig. 6.2). In comparison, 22% view this growth as just a cyclical change. Almost a third (32%) are unsure whether the growth of private debt is expected to continue; this uncertainty could signify a preference to wait and see what impact increased regulation of the private debt industry has on performance

**Fig. 6.1: Investors' Main Reasons for Investing in Private Debt**

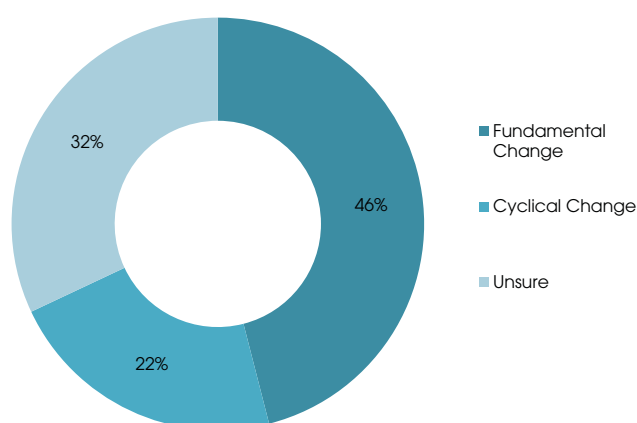


Source: Preqin Investor Interviews, June 2015

and fundraising momentum. Even though forms of private debt have existed for decades, the asset class has taken a more prominent role within the alternative assets industry since the credit crisis, and has therefore come under heightened regulatory scrutiny. It would seem that a large proportion of investors are waiting to see the long-term impact of this regulation.

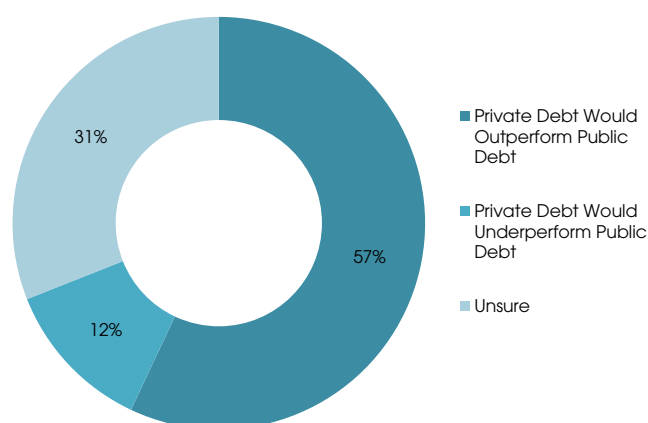
Over half (57%) of respondents believe that if there were to be another credit event, private debt would outperform public debt (Fig. 6.3). Only 12% of investors believe private debt would underperform, which demonstrates significant confidence in the asset class.

**Fig. 6.2: Investors' Perception of the Growth of Private Debt as a Fundamental or Cyclical Change in Credit Markets**



Source: Preqin Investor Interviews, June 2015

**Fig. 6.3: Investors' Views on How Private Debt Would Perform Relative to Public Debt in a Credit Event**



Source: Preqin Investor Interviews, June 2015

## Data Source:

The **Fund Searches and Mandates** feature on Preqin's **Private Debt Online** is the perfect tool to pinpoint those institutions that are seeking new private debt investments now. Search for potential new investors by type and location, as well as their current fund type and geographic preferences.

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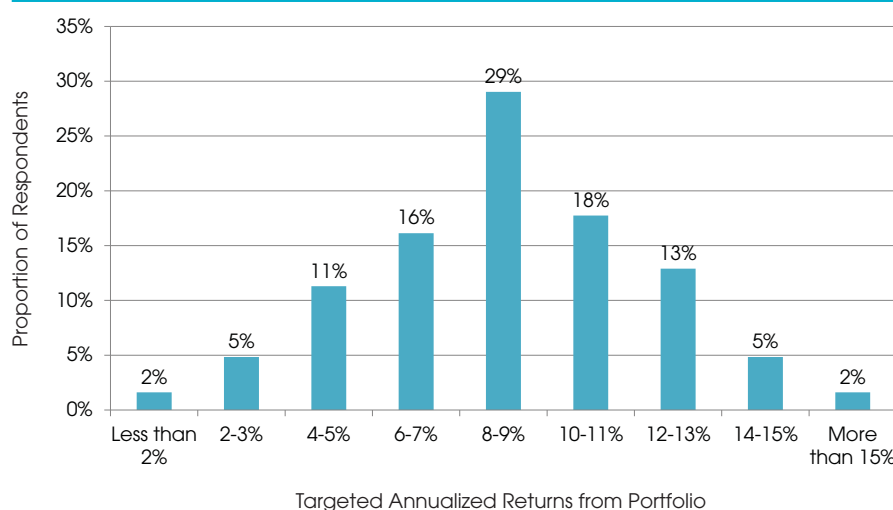
# Satisfaction with Returns

Investors surveyed by Preqin continue to gain exposure to private debt as an alternative to public debt equivalents. The asset class has been viewed as a potential solution to the current low-yield environment, as investors are seeking to cover currently relatively weak fixed income returns. Almost two-thirds of investors (67%) are targeting absolute annualized returns of 8% or more (Fig. 6.4).

Investors are generally satisfied with their private debt investments, with 82% stating that their investments have either met or exceeded their expectations (Fig. 6.5). This can be partly attributed to the boosted interest rates secured in private lending agreements relative to public, ultimately generating higher returns for the end investor.

In order for fund managers to continue to raise capital, a sound understanding of investors' views on the key issues within the industry is needed. Fig. 6.6 shows that 51% believe that finding suitable investment opportunities is a key issue.

**Fig. 6.4: Investors' Targeted Annualized Absolute Returns for Private Debt**

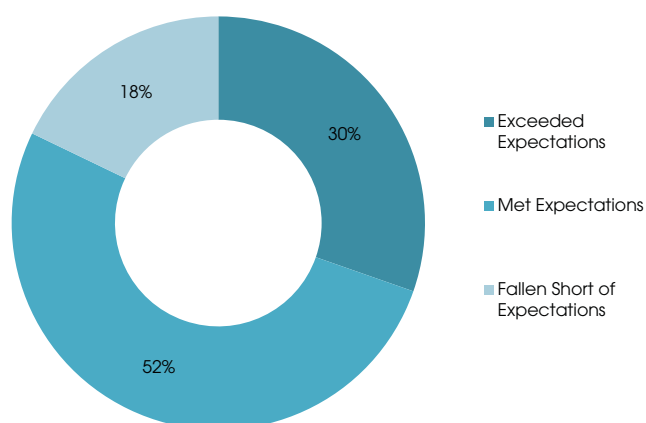


Source: Preqin Investor Interviews, June 2015

High levels of dry powder have resulted in heightened competition among fund managers, and finding attractive opportunities to put this capital to work will be a challenge for fund managers.

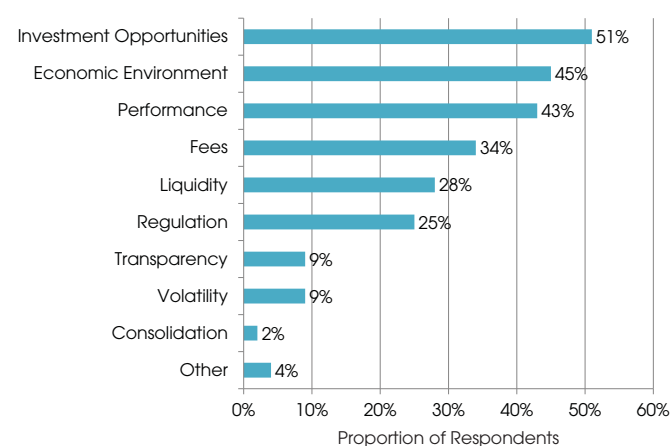
Other key issues include the economic environment (45%), performance (43%) and fees (34%).

**Fig. 6.5: Proportion of Investors that Feel Their Private Debt Fund Investments Have Lived up to Expectations over the Past 12 Months**



Source: Preqin Investor Interviews, June 2015

**Fig. 6.6: Investors' Views on the Key Issues for the Private Debt Market over the Next 12 Months**



Source: Preqin Investor Interviews, June 2015

## Download the Data Pack

View all the charts and tables featured in this report in our handy Excel data pack. It includes ready-made charts that can be used for presentations, marketing materials and company reports.

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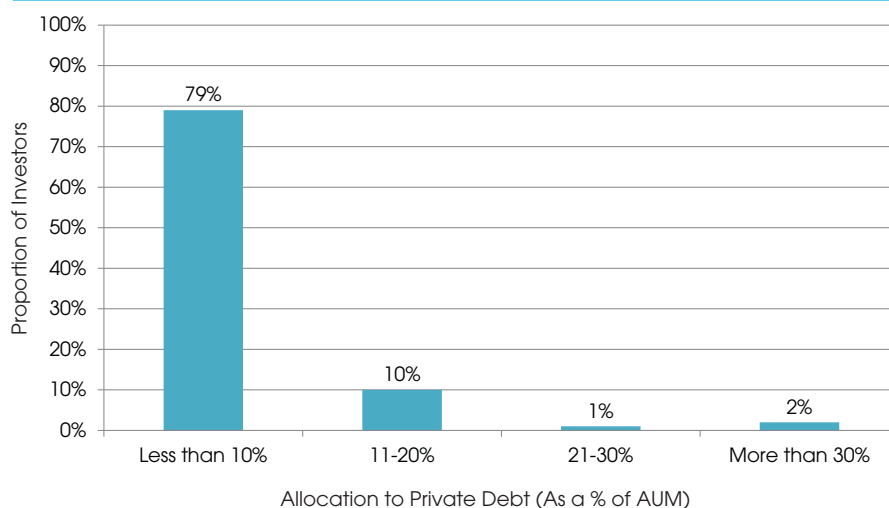
# Investor Activity in the Next 12 Months and the Longer Term

As shown in Fig. 6.7, the majority (79%) of investors tracked by Preqin's Private Debt Online allocate up to 10% of total assets to private debt strategies. The private debt market is perceived to be in a strong position and is expected to grow over the longer term. Regulation changes in the form of Basel I, II and III certainly have the potential to create more opportunities, with small- and medium-sized businesses increasingly turning to alternative funding methods.

Over three-quarters (78%) of investors surveyed expect to actively invest in private debt funds over the next 12 months. Furthermore, 38% of investors surveyed that are already active in the debt market expect to invest more capital in the asset class over the next 12 months, as shown in Fig. 6.8, while the same proportion expect to invest the same amount of capital in the year ahead as they did in the last 12 months, suggesting a positive outlook for managers of private debt funds.

Preqin's interviews with investors also revealed a positive outlook for the asset class over the longer term. As shown in Fig. 6.9, almost half of investors (48%) plan to maintain their current allocation to private debt, with only 14% looking to decrease their exposure. More importantly for the future, 38% of investors said they would be looking to increase their exposure to private debt

**Fig. 6.7:** Investors' Allocations to Private Debt as a Proportion of Assets under Management



Source: Preqin Private Debt Online

over the longer term, suggesting more capital is set to flow into the asset class.

The outlook for the private debt industry is positive; not only will many investors be looking to increase their allocation to private debt over the next 12 months, but they are also likely to increase their allocation over the longer term, which bodes well for the future of the asset class.

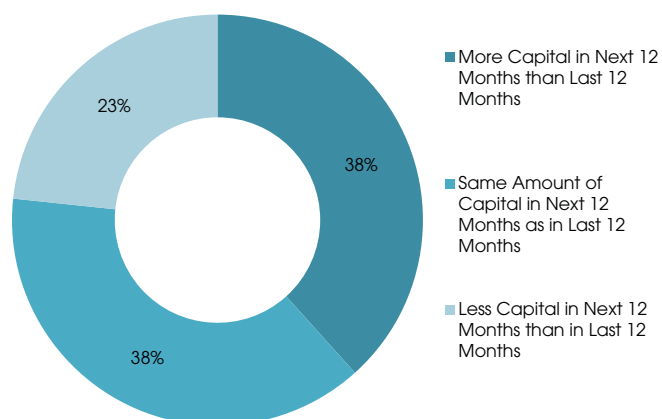
#### Data Source:

Pinpoint the institutions that are seeking new private debt investments now with the **Fund Searches and Mandates** feature on Preqin's **Private Debt Online**.

For more information, please visit:

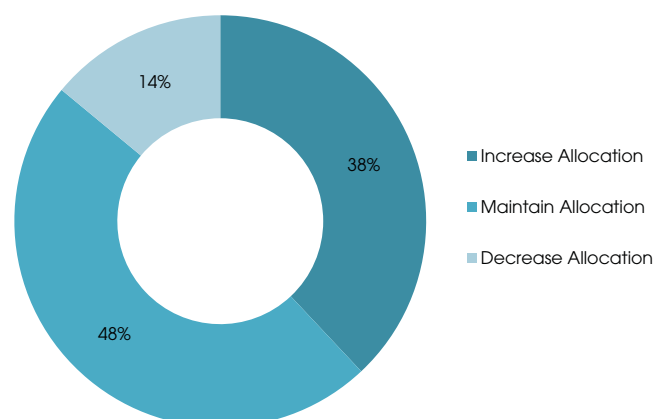
[www.preqin.com/privatedebt](http://www.preqin.com/privatedebt)

**Fig. 6.8:** Investors Expectations for the Amount of Capital They Will Commit to Private Debt in the Next 12 Months Compared to the Last 12 Months



Source: Preqin Investor Interviews, June 2015

**Fig. 6.9:** Investors' Intentions for Their Private Debt Allocations over the Longer Term



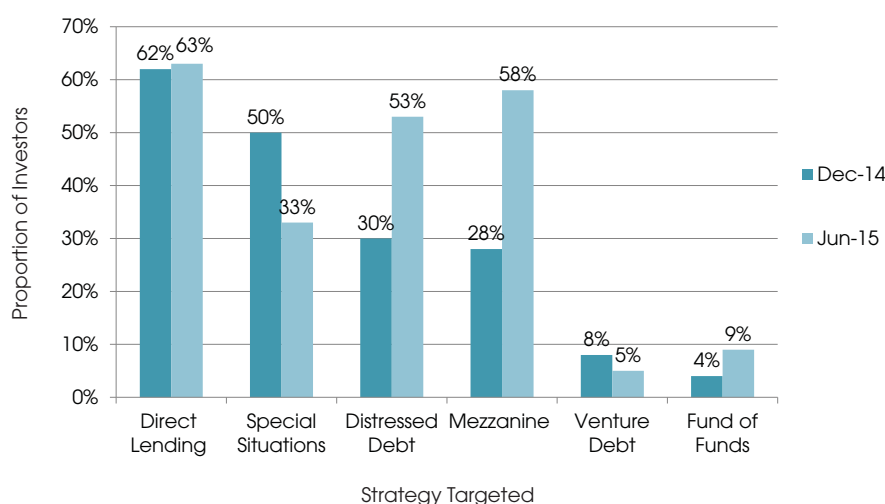
Source: Preqin Investor Interviews, June 2015

# Strategies and Geographies Targeted

## Fund Type Preferences

According to Preqin's Private Debt Online, 63% of investors are seeking to make direct lending commitments within the next 12 months (Fig. 6.10), which is encouraging for fund managers on the road as direct lending vehicles account for both the highest number of funds seeking commitments and the largest amount of capital targeted. Interestingly, over half of investors will likely commit to mezzanine (58%) and distressed debt funds (53%) in the coming year. This is a considerable increase in interest when compared with December 2014. Investor appetite for special situations funds has dropped, with 33% of investors naming the fund types as a viable investment strategy in the next 12 months compared with 50% in December 2014.

**Fig 6.10: Strategies Targeted in the Next 12 Months by Private Debt Investors, December 2014 - June 2015**



Source: Preqin Private Debt Online

## Geographic Preferences

North America and Europe are generally viewed as the top two regions for private debt investment, with 65% of investors citing the two regions as presenting the best investment opportunities in the near term (Fig. 6.11). The growth of interest in Europe relative to the previously dominant North American market could be due to perceived opportunities for alternative lenders following banking industry regulatory change. Nonetheless, these figures still present a slight increase in investor appetite for North America since December 2014, which could indicate

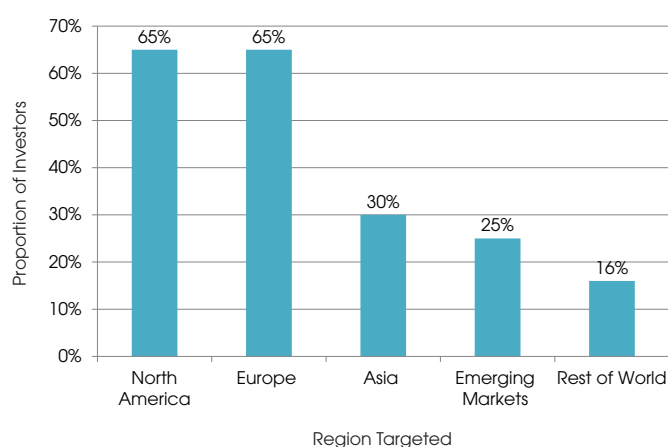
investors are still seeking investment in the relatively more mature and stable market. Asian markets are viewed favourably by 30% of investors, followed by emerging markets (25%).

## ESG Framework within Private Debt

Gradual awareness of environmental, social and governance policies have led to these factors being considered within investors' decision making processes, although only by a minority of investors at present. The vast majority (83%) of

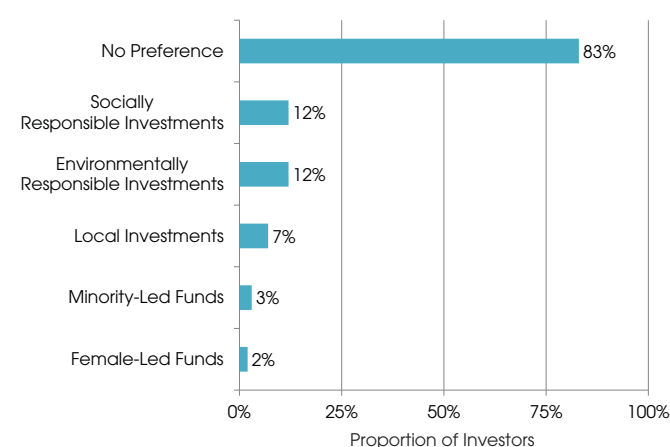
investors hold no preference for these factors when considering investments (Fig. 6.12). A smaller proportion of investors have a specific preference for environmentally responsible and socially responsible investments (12% each). Seven percent of investors have a preference for local investments, 3% for minority-led investments and 2% for female-led funds. These figures would suggest that this remains a niche area of concern for investors within the private debt asset class.

**Fig. 6.11: Regions Targeted in the Next 12 Months by Private Debt Investors**



Source: Preqin Private Debt Online

**Fig. 6.12: Investors' Preferences for Different Types of Private Debt Investments and Funds**



Source: Preqin Investor Interviews, June 2015



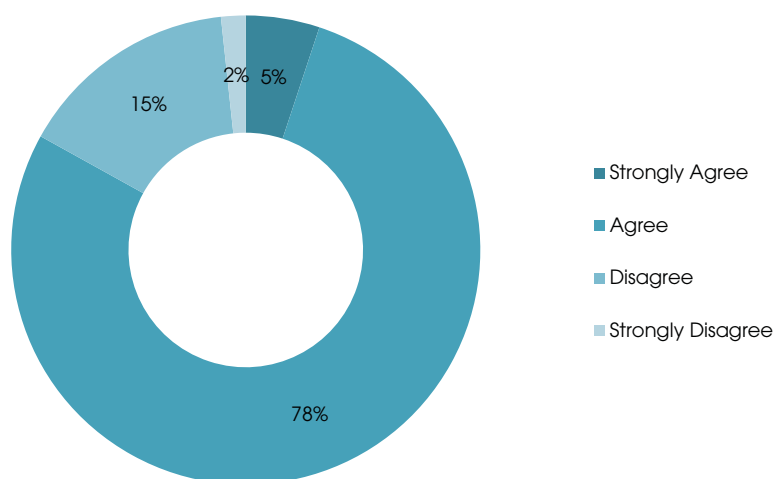
# Fees and Alignment of Interests

The vast majority of private debt investors (83%) believe that fund manager and investor interests are properly aligned (Fig. 6.13). This is a notable improvement since December 2014, when 65% of investors stated that fund manager and investor interests were properly aligned.

Over the past 12 months, 37% of investors have seen fund terms and conditions change in their favour, while just 9% believe fund terms have become more favourable for fund managers (Fig. 6.14). This may go some way in explaining why more investors are now satisfied with the alignment of interests between fund managers and investors.

In order to secure further capital commitments in the future, it is important for fund managers to understand the key factors investors assess when selecting which private debt fund managers with which to place their capital. As shown in Fig. 6.15, the largest proportion (29%) of investors named past performance as the most important factor they consider when making new private

**Fig. 6.13:** Proportion of Investors that Believe Fund Manager and Investor Interests Are Properly Aligned

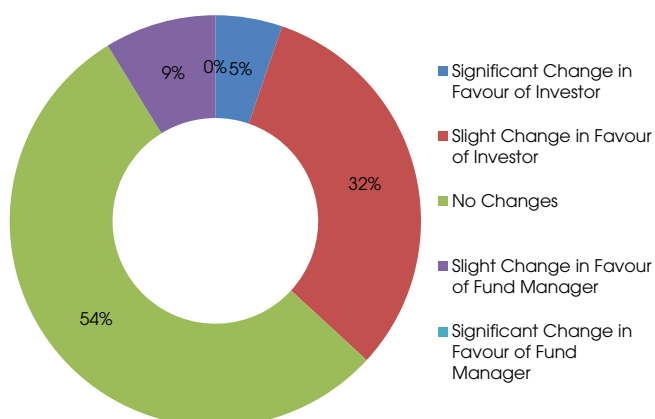


Source: Preqin Investor Interviews, June 2015

debt fund commitments, suggesting that established fund managers with a proven track record are likely to receive the majority of investor capital. Strategy

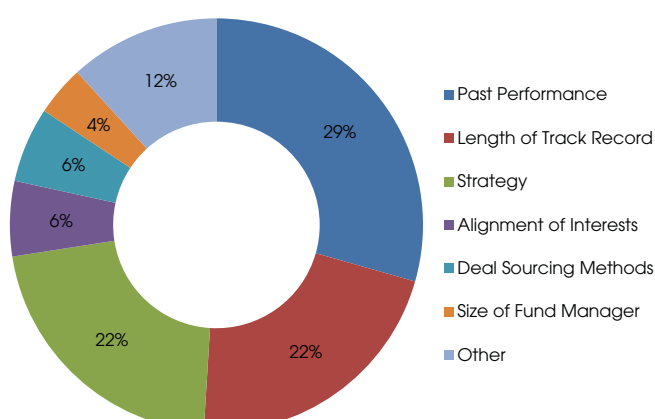
(22%) and length of track record (21%) account for notable proportions as well.

**Fig. 6.14:** Proportion of Investors that Have Seen a Change in Fund Terms over the Last 12 Months



Source: Preqin Investor Interviews, June 2015

**Fig. 6.15:** Investors' Views on the Most Important Factor to Consider when Looking for a Private Debt Fund Manager



Source: Preqin Investor Interviews, June 2015

## Data Source:

Preqin's **Private Debt Online** contains net-to-investor performance data, with full metrics for over 664 named vehicles.

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68 Upper Thames Street  
London  
EC4V 3BJ

Tel: +44 (0)20 3207 0200

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One Finlayson Green, #11-02  
Singapore 049246

Tel: +65 6305 2200

Fax: +65 6491 5365

#### San Francisco:

1700 Montgomery Street  
Suite 134, San Francisco  
CA 94111

Tel: +1 415 835 9455

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