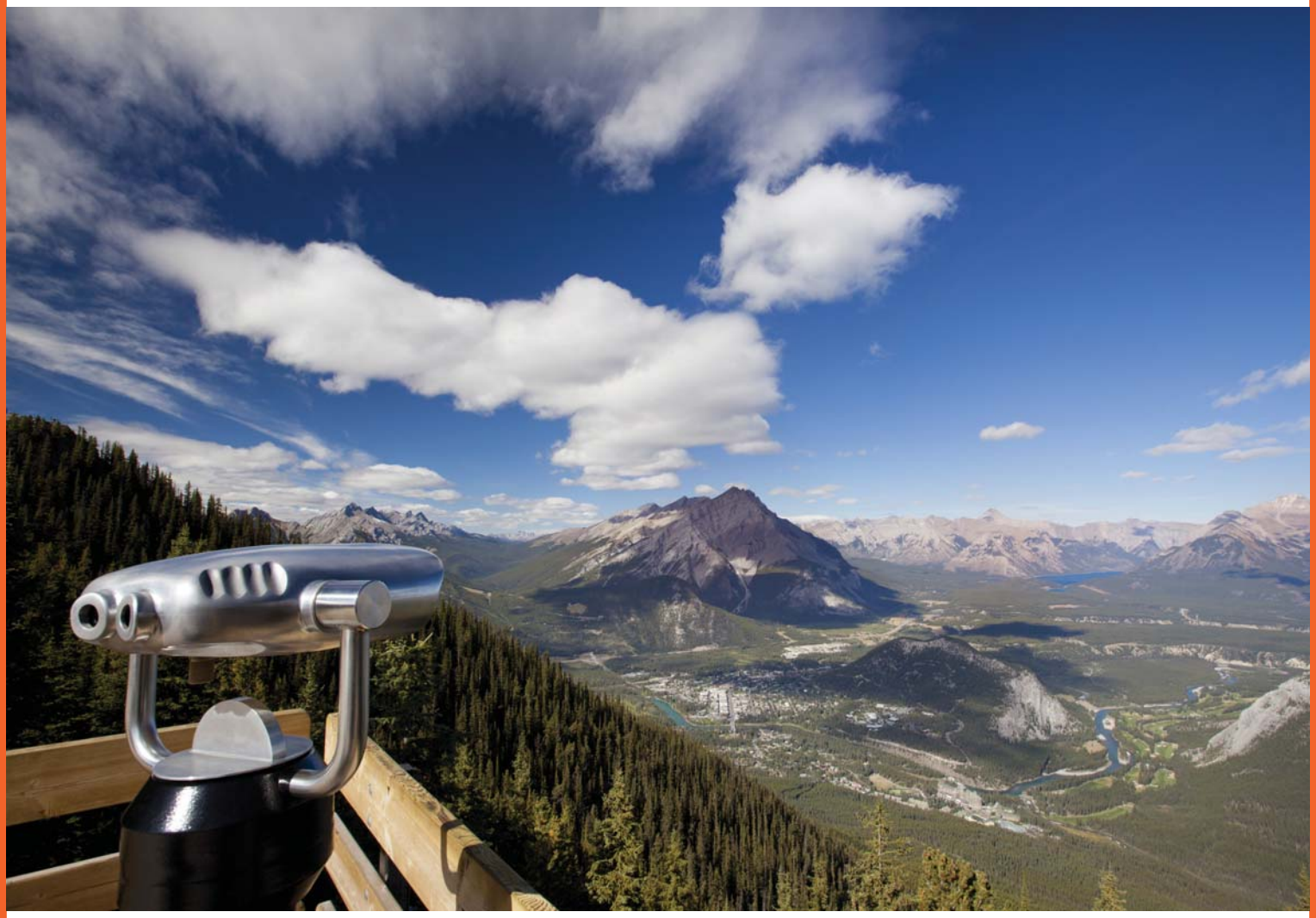
Preqin Investor Outlook: Infrastructure H1 2015



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Infrastructure

Concerns in the Short Term, but Continued Growth in the Long Term

Infrastructure is a growing part of many institutional investors' portfolios, with target allocations to the asset class rising to an average of 5.7% in 2014, compared to 5.1% in 2013. Additionally, the majority (57%) of investors view the infrastructure industry positively, and a considerable 67% plan to increase their allocation to infrastructure over the longer term, reflecting the growing importance investors are placing on infrastructure as a part of their overall portfolios.

Investors are increasingly seeking alternative structures to pooled funds, with 45% seeking to invest in separate accounts, and 50% targeting co-investments alongside fund managers. Additionally, investors' favoured route to market is changing, with unlisted funds now targeted by just 65% of investors planning to invest in the year ahead, compared to 91% in December 2012, and direct infrastructure investment sought by 56% of investors compared to 29% in 2012.

Concerns over pricing and the availability of attractive assets, however, have left investors divided on their plans for infrastructure in 2015, with a considerable 45% stating that they will commit less capital than they did in 2014, while 39% stated that they will invest more capital. Encouragingly, 53% of institutions planning to make further investments in 2015 expect to invest at least $100mn, with a sizeable 19% expecting to invest at least $500mn. As a result, those investors that are planning to invest in the year ahead are likely to commit sizeable amounts of capital. Nonetheless, with investors increasingly drawn to fund managers with a proven track record, and appetite for emerging managers continuing to decline, infrastructure fund managers seeking institutional capital are likely to continue to find fundraising challenging in 2015.

Data Source:

Preqin's **Infrastructure Online** contains detailed information on the entire infrastructure industry.

Constantly updated by our team of dedicated research analysts, the service features in-depth data on fundraising, fund managers, institutional investors, deals, net-to-LP fund performance and much more.

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

www.preqin.com/infrastructure

Key Facts

Fifty-seven percent of investors view the infrastructure industry positively.

5.7%

Investors' average target allocation to infrastructure, up from 5.1% in 2013.

67%

Proportion of investors that plan to increase their allocations to infrastructure over the long term.

Fifty-six percent of active investors are targeting direct investments in the next 12 months, compared to 29% in December 2012.

Satisfaction with Returns and Allocations to Infrastructure

Satisfaction with Returns and Confidence in the Asset Class

The vast majority of institutional investors surveyed appear satisfied with the performance of their infrastructure investments over the last 12 months, with 86% feeling that their infrastructure investments have either met or exceeded expectations in the past year, as shown in Fig. 5.1. This suggests that infrastructure assets have continued to provide investors with positive performance in the last 12 months, despite 14% of surveyed investors stating that their infrastructure investments have fallen short of expectations.

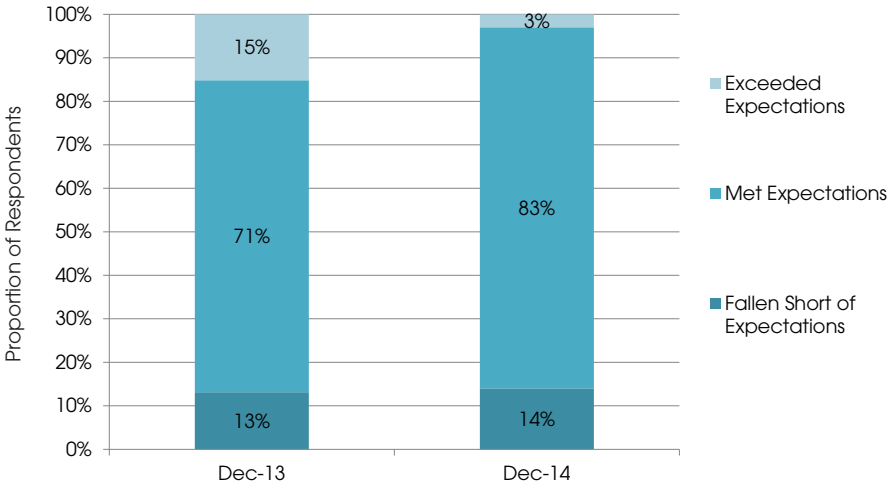
Institutional investors' general perception of the infrastructure industry is also positive. As illustrated in Fig. 5.2, a significant 57% of surveyed investors have a positive opinion of the infrastructure market, while 43% have a neutral attitude. None of the investors surveyed have a negative view of the infrastructure space, which is extremely encouraging for the asset class, suggesting that institutional investor demand for exposure to infrastructure opportunities will continue to grow in future years.

Allocations to Infrastructure

Due to the relative youth of the asset class, institutional investors will typically allocate a relatively small proportion of their assets under management (AUM) to infrastructure, when compared with other alternative asset classes. The majority (62%) of investors are below their target allocations to infrastructure. This is encouraging for the long-term growth of the asset class, as investors will look to put more capital to work in the coming years as they move towards their long-term strategic targets.

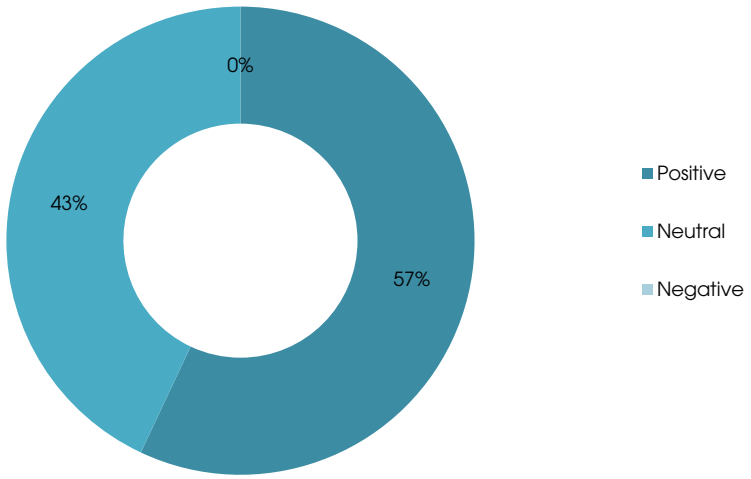
Investors' growing allocations to the asset class are revealed in Fig. 5.3; the average current allocation of investors to infrastructure has increased from 3.5% in 2011 to 4.3% in 2014, with the average target allocation increasing from 4.9% to 5.7% over this time period. Allocations to infrastructure are likely to continue to grow in the coming years, with 67% of investors planning to increase their allocation to infrastructure over the longer term.

Fig. 5.1: Proportion of Investors that Feel Their Infrastructure Fund Investments Have Lived up to Expectations over the Past 12 Months, 2013 - 2014



Source: Preqin Investor Interviews, December 2013 - December 2014

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



Source: Preqin Infrastructure Online

Source of Allocation

Investors in infrastructure allocate to the asset class in a variety of ways, with Fig. 5.4 revealing that the largest proportion of investors (39%) have carved out separate infrastructure allocations. The proportion of investors with a dedicated allocation has fallen slightly in recent years; this is a reflection of newer entrants to the market being less likely to have a dedicated allocation. The absolute number of investors with an infrastructure allocation has grown in the past few years. Accessing infrastructure through real assets allocations is becoming more common; while just under a quarter invest through a private equity allocation, although the proportion investing from a private equity bucket has fallen in recent years.

Key Issues Facing the Infrastructure Fund Market in 2015

A number of key issues will continue to impact institutional investor appetite for infrastructure opportunities over

the coming 12 months and the general growth of the industry in the longer term. As shown in Fig. 5.5, 49% of surveyed investors suggest that the number of viable investment opportunities will be a key issue in the 2015 infrastructure market. With more investors looking to invest in the infrastructure asset class than ever before, investors are concerned about pricing and whether there are enough attractive opportunities available at present. Other key issues highlighted by investors include liquidity (33%), performance (26%) and fees (23%).

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
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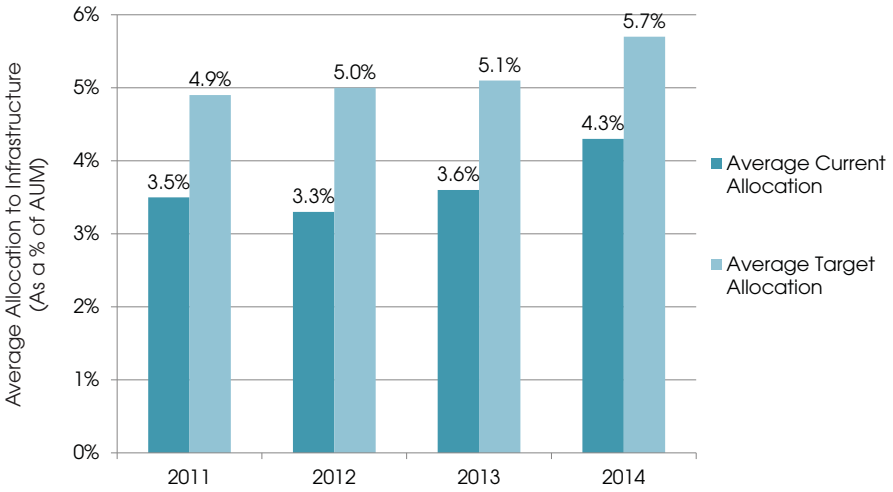
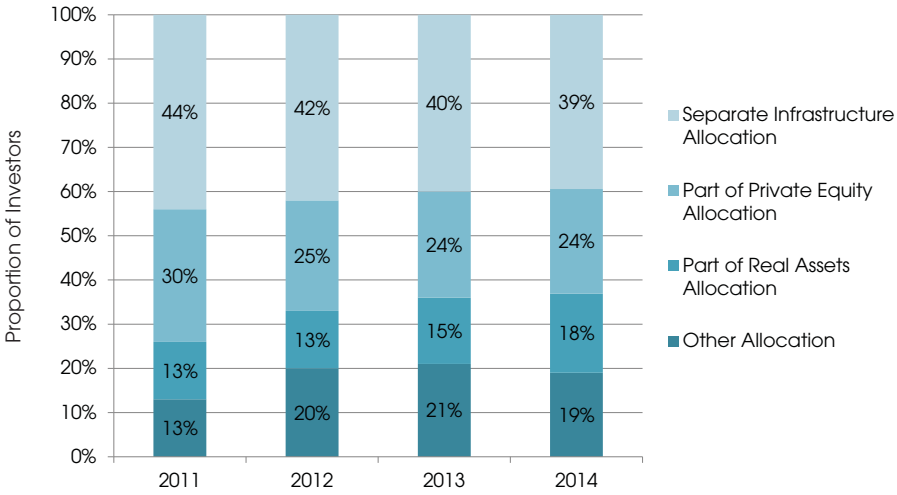
Fig. 5.3: Average Current and Target Allocations to Infrastructure over Time, 2011 - 2014



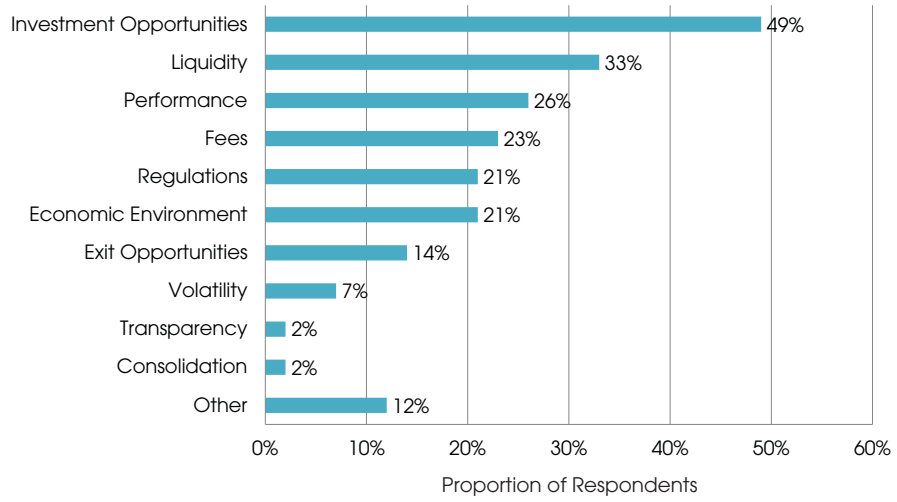
Source: Preqin Infrastructure Online

Fig. 5.4: Breakdown of Infrastructure Investors by Source of Allocation, 2011 - 2014



Source: Preqin Infrastructure Online

Fig. 5.5: Investors' Views on the Key Issues for the Infrastructure Market in 2015



Source: Preqin Investor Interviews, December 2014

Investor Activity in 2015 and the Longer Term

Infrastructure continues to grow as an independent alternative asset class, but the market remains relatively small when compared to other alternatives. This means that many of the institutional investors currently active in the space are either new to the market or relatively inexperienced, and their preferences are continuing to evolve as they explore the best ways to gain exposure to the asset class. As a result, it is vital for infrastructure fund managers to be aware of and adjust to changing investor attitudes in order to ensure their offerings are meeting the needs of institutional investors.

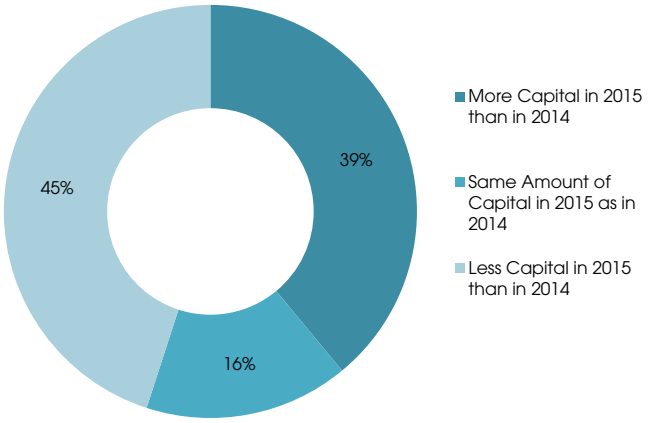
Investors' Infrastructure Commitments in 2015

There is a mixed view from investors as to whether they will be upping or reducing their capital outlay to infrastructure in 2015. While the majority of respondents expect to commit more capital in 2015 than they did in 2014, or to maintain their level of outlay to infrastructure, a notable proportion expect to put less capital to work (Fig. 5.6). This may be a reflection of high valuations for infrastructure assets and the impact on the availability of attractive investment opportunities, with investors electing to delay making fresh commitments in 2015 as a result.

Investors' Infrastructure Allocations over the Long Term

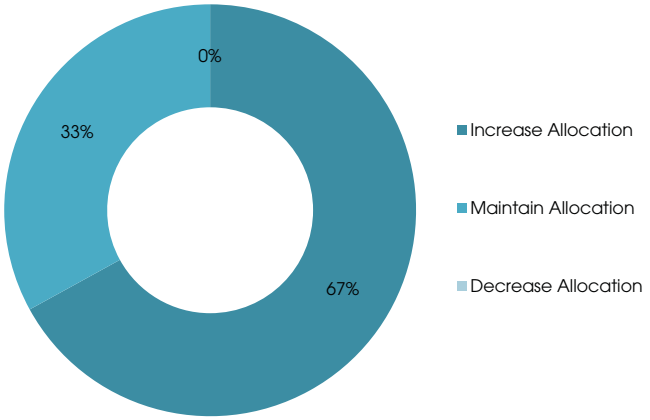
In the longer term, the prospects for the continued growth of the asset class remain very positive. The average current allocation to infrastructure across the entire infrastructure investor universe is 4.3% of total assets under management. However, as these investors become more experienced in infrastructure, build up investment teams and become more comfortable with the risks associated

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



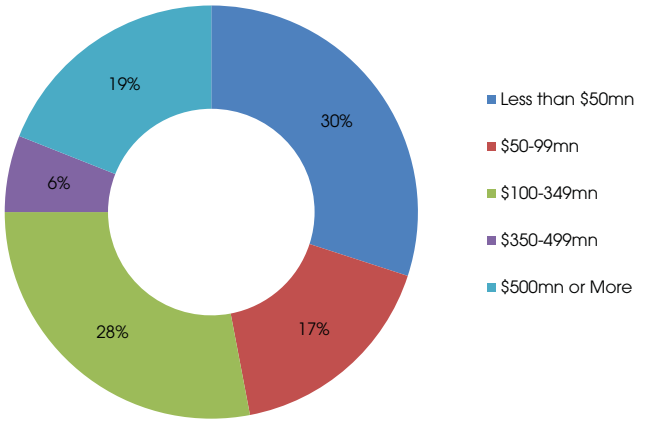
Source: Preqin Investor Interviews, December 2014

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



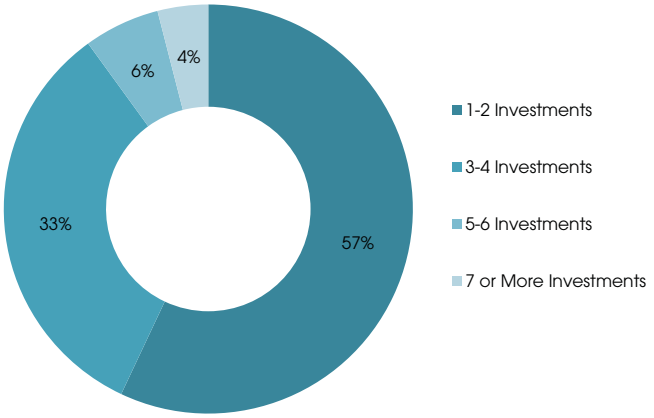
Source: Preqin Investor Interviews, December 2014

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



Source: Preqin Investor Interviews, December 2014

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



Source: Preqin Investor Interviews, December 2014

with investing in the space, it is likely that allocations will increase. Two-thirds of surveyed investors intend to increase their infrastructure allocations over the long term, as shown in Fig. 5.7. An additional 33% plan to maintain their current level of exposure, while none of the investors surveyed suggested plans to reduce their allocations.

Future Searches and Capital Outlay

Preqin's Infrastructure Online service tracks the activity of over 2,400 active investors in the infrastructure asset class, through which we are able to monitor the changing investment strategies of these institutions as well as their plans for future investment. As shown in Fig. 5.8, 53% of investors with plans to make further investments in 2015 expect to invest at least $100mn in fresh capital. This includes a considerable 19% that expect to invest at least $500mn over the course of the year.

This shows that many institutional investors are planning to make sizeable investments in infrastructure opportunities throughout 2015. Fig. 5.9 further demonstrates this, showing that 43% of active investors expect to make at least three investments over the next 12 months. This includes 10% which plan to make at least five investments in the coming year.

In terms of investors' regional preferences for 2015, the largest proportion of investors (49%) will be targeting investments in Europe, as shown in Fig. 5.10. North American infrastructure assets will be sought by 35% of institutions, with Asia and countries outside these three core regions each targeted by just 15% of investors. Many infrastructure investors prefer geographical diversification when investing in infrastructure, and as such a considerable 36% of investors target global infrastructure investments.

Route to Market

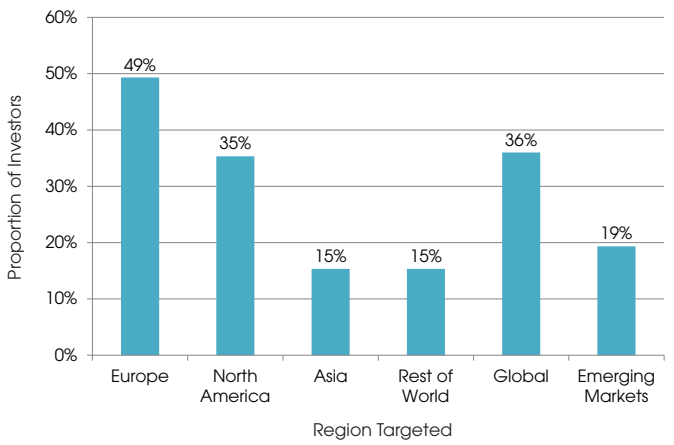
The route via which investors invest in infrastructure has undergone considerable change over the last three years, with a greater number of investors now seeking to invest directly in infrastructure assets, as shown in Fig. 5.11. As of December 2014, 56% of investors were targeting direct infrastructure investment in the next 12 months, compared to just 29% in December 2012. Correspondingly, the proportion of investors targeting infrastructure investment via unlisted funds has declined from 91% in 2012 to 65% in 2014, with appetite for listed funds remaining low: just 6% of active investors are targeting listed funds in 2015.

Institutional investors making direct investments were involved in 28% of transactions completed in 2014, and seem likely to be even more active in the coming year. The investors that can put capital to work directly are typically larger institutions, with an established allocation to the asset class and the resources to build sizeable investment teams. While the proportion of investors targeting pooled fund commitments has fallen in recent years, it remains the most common approach, and for many smaller investors, the best way to gain infrastructure exposure.

Outlook

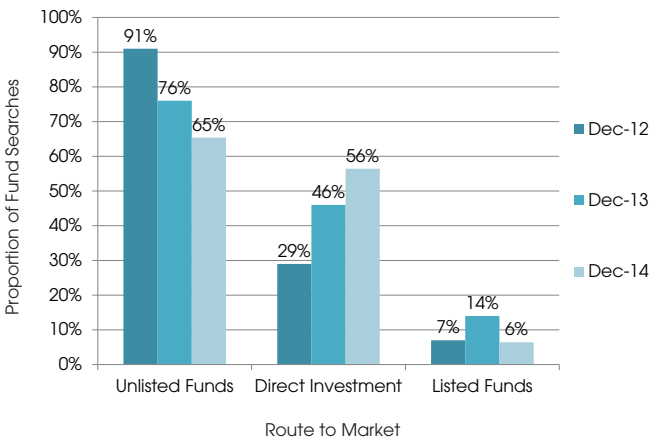
The long-term outlook for the infrastructure asset class appears positive. The demand for private investment capital in the infrastructure space will only grow in future, and the vast majority of institutional investors are planning to increase or maintain their current allocations over the longer term. While many investors are looking to commit substantial amounts of capital to infrastructure opportunities in 2015, a sizeable proportion are reducing the amount of capital they intend to put to work, and there are concerns among investors about the pricing of assets, the availability of attractive brownfield opportunities and the performance of the asset class. Fund managers looking to raise capital in 2015 will need to be able to effectively communicate how they can find value in the current market in order to successfully secure investor commitments.

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, 2012 - 2014



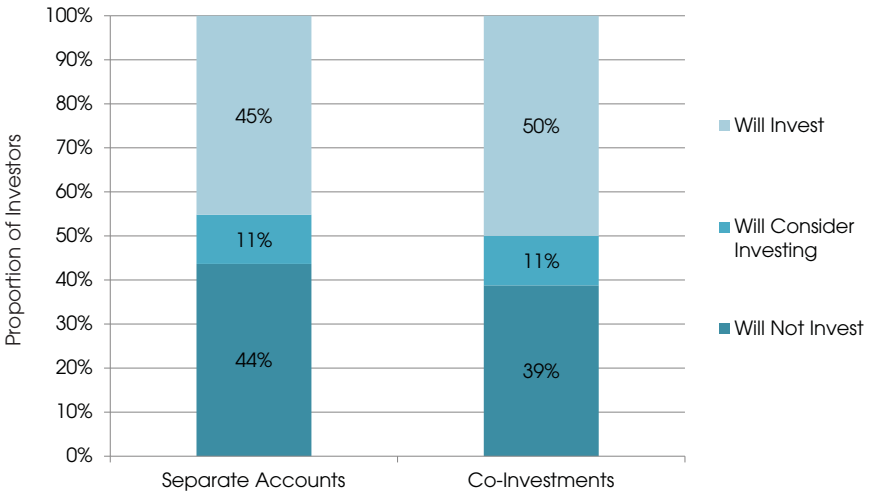
Source: Preqin Infrastructure Online

Appetite for First-Time Funds, Separate Accounts and Co-Investments

Alternative Structures: Co-Investments and Separate Accounts

Increasingly, investors in infrastructure are seeking alternative structures to pooled infrastructure funds, which may allow them greater control over the direction of their capital, more access to attractive assets and the chance to negotiate more attractive fees. Fig. 5.12 demonstrates that 45% of investors will seek to invest in separate accounts, and 50% will target co-investments alongside fund managers. However, these alternative methods of investing in infrastructure are often only suitable for larger institutions which have a large enough ticket size, the resources to conduct the necessary due diligence for these types of investment, and the ability to monitor their portfolios on an ongoing basis. Fig. 5.13 demonstrates that investors with $10bn or more in AUM are considerably more likely to invest in separate accounts and make co-investments, with 55% and 67% doing so respectively. In comparison, just 10% and 32% of investors with less than $1bn in AUM will invest via these methods respectively.

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



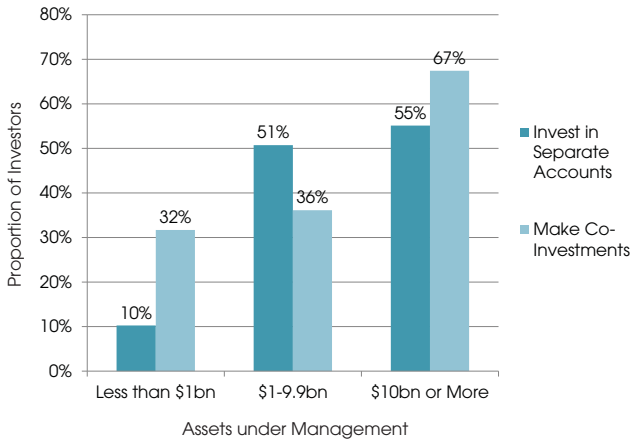
Source: Preqin Infrastructure Online

Appetite for First-Time Funds

Investor appetite for first-time funds has continued to decline over the past 12 months, as shown in Fig. 5.14, with just 43% of investors stating that they will invest in first-time infrastructure funds as of December 2014, compared to 56% which stated so in December 2011. Many institutional investors are increasingly looking at investing with managers with a proven track record; as just 28% of funds in market are being raised by managers which have raised more than two infrastructure funds previously, capital is likely to become further concentrated among a smaller selection of managers in 2015.

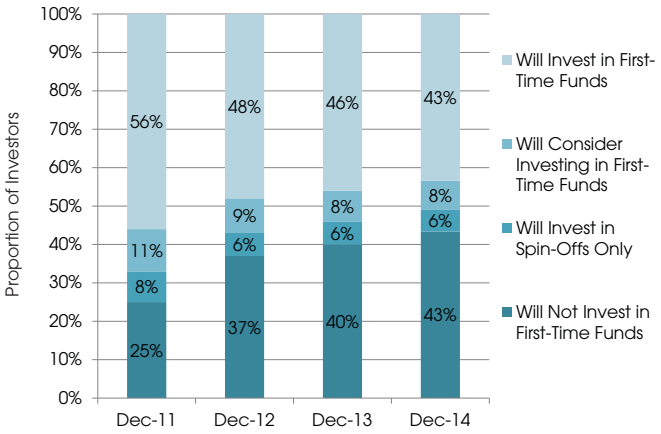
There are variations depending on investor size, with those investors with greater assets under management more likely to invest in first-time funds, as they are more likely to be able to undertake the necessary due diligence on new fund managers. Forty-eight percent of investors with $10bn or more in AUM will invest in first-time funds, compared to just 30% of investors with less than $1bn.

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



Source: Preqin Infrastructure Online

Fig. 5.14: Infrastructure Investor Appetite for First-Time Funds, 2011 - 2014



Source: Preqin Infrastructure Online

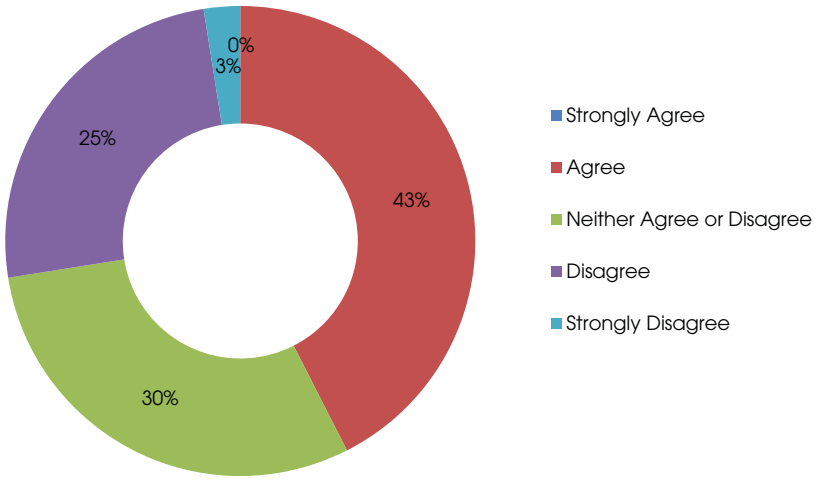
Fees and Alignment of Interests

Fund terms and conditions have generally become more investor friendly in recent years, while the alignment of interests between infrastructure fund managers and investors continues to be a very important issue in the infrastructure fund market. Based on the results of Preqin's December 2014 investor survey, a healthy proportion of institutional investors are confident that fund manager and investor interests are properly aligned, but there are still LPs that feel more needs to be done to improve fund terms.

Alignment of Interests

As shown in Fig. 5.15, a significant 73% 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 65% of surveyed investors which stated the same in December 2013, and just 27% that felt this when surveyed in 2010, and points to a growing willingness from fund managers to listen to the concerns of investors. It may also reflect an acceptance among limited partners that there is a need to pay for the deal sourcing and asset management abilities of the best investment managers. Just 28% of respondents disagree that investor and fund manager interests are properly aligned, compared to 35% in December 2013. Despite the positive steps taken in recent years, some fund managers may need to make further concessions to LPs. Only those fund managers dedicated to improving the alignment of interests with investors can hope to attract capital in a very competitive fundraising market.

Fig. 5.15: Investors' Views on Whether There is an Alignment of Interests with Fund Managers

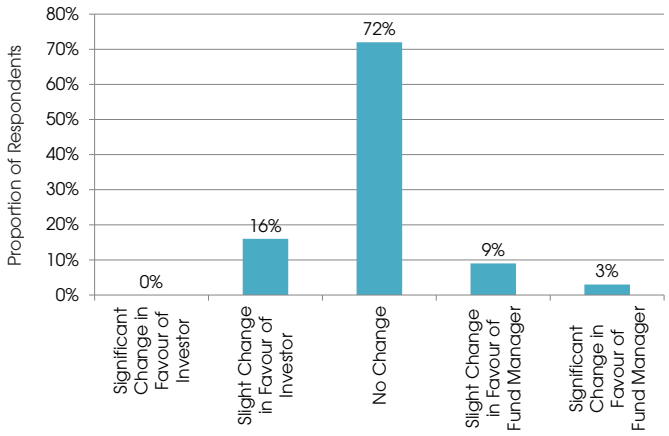


Source: Preqin Investor Interviews, December 2014

There appear to have been relatively limited changes in typical fund terms in the past year, with a considerable 72% of surveyed investors having not seen a change in the structure of fund terms and conditions in the last 12 months (Fig. 5.16). While 16% had seen a move towards more LP-friendly terms, this was only slightly more than the proportion that had seen a movement in favour of the fund manager (12%).

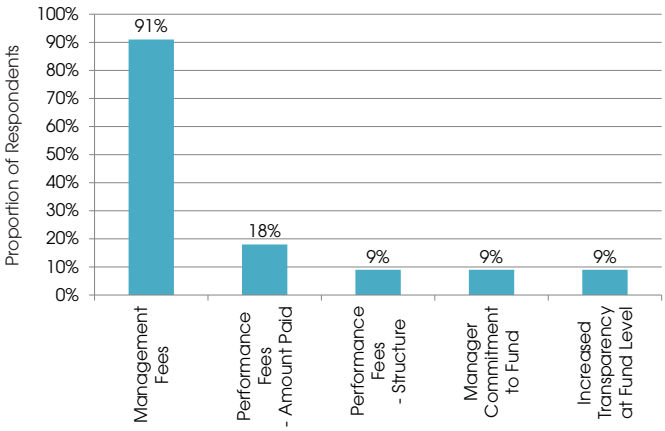
The key area where investors feel alignment could be improved is management fees, with 91% of surveyed investors stating so (Fig. 5.17). This is higher than the 61% of surveyed investors that highlighted the same issue in December 2013. Eighteen percent of investors surveyed feel that the level of performance fee charged by fund managers needs addressing, while other key issues in need of improvement include the structure of performance fees, as cited by 9% of respondents, the level of manager commitment to their own funds (9%) and the need for increased transparency at fund level (9%).

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



Source: Preqin Investor Interviews, December 2014

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



Source: Preqin Investor Interviews, December 2014

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

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

London:

Vintners' Place
68 Upper Thames Street
London
EC4V 3BJ

Tel: +44 (0)20 3207 0200
Fax: +44 (0)87 0330 5892

Singapore:

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
Fax: +1 440 445 9595

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