2014 Preqin Global Infrastructure Report

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The 2014 Preqin Global Infrastructure Report Contents

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2013 – A Gradual Improvement in the Global Project Finance Market

- Geoff Haley, Global Executive Chairman, IPFA

The global financial crisis has had a profound effect on project finance for infrastructure around the world. We have suffered from economic recessions and country crises over many years, but not such a global crisis which has affected so many countries, all at the same time.

For a period, people in the project finance industry had the view that if we held on, things would return to normal, the cost of debt would return once more to a reasonable level and the project deal flow would increase. The global financial crisis has reduced the availability of private capital by increasing its cost and restricting its availability. At the same time, economic policies adopted by many countries concentrated on austerity and reduction in public expenditure as opposed to growth.

During this period of uncertainty, the demand for infrastructure development across the world has continued to increase even though we are seeing reduced economic growth in many countries. Demand for clean water, electricity, improved transport systems, education and healthcare improvements increase, as the global population expands. 2013 has been the turning point for a new certainty in infrastructure development and governments recognize that investment in infrastructure (whether public or private) creates jobs, which creates growth.

In 2013, we have seen more and more countries using project finance to develop infrastructure and adopting the PPP concept. Canada, with a strong and successful PPP history, probably holds the record for speed of procurement; however, new markets across South and Central America are developing quickly.

Brazil has a dynamic approach to PPP, with a PPP law in place since 2004 and a PPP guarantee fund (whose assets are separate from those of the federal government) which protects private parties against the contracting authority default risk for each PPP contract. The federal structure of the country allows for PPP projects to be tendered by both the federal government (which has the exclusive right to grant PPP projects in energy and transport) and by the state and municipal government (responsible for water sanitation and regional roads). Other countries in the region with exciting PPP programs are Columbia, Peru, Mexico and Panama.

California is developing the PPP concept. In 2012 the Bay Area Council Economic Institute in San Francisco published a report on job creation using PPP, and cites findings by the Federal Highway Administration that each additional $1bn of government infrastructure spending creates between 4,000 to 18,000 jobs. Moodys, the ratings agency has demonstrated that in California, for every $1 invested in infrastructure this produces $1.59 of gross domestic product and infrastructure investment is seen as a key pillar of growth. In an economic downturn, it is especially important to job creation and economic recovery.

Australia was another successful country for PPP in 2013. The Australian experience illustrates potential life-cycle cost savings from the effective implementation of PPP methods. In addition to improving time and delivery of projects plus accelerated job creation, Australia has demonstrated on-budget delivery i.e. built on time and at cost.

The Netherlands has been extremely successful in the implementation of PPP. The government sees private finance as a means to gain value for money for the Dutch taxpayer and provides discipline and enhances risk management in projects. The government's role is to provide a clear framework and to remove undesirable barriers in contract documents and tender documents. If private finance becomes too difficult, too complex or too expensive, the government would finance the projects themselves.

African countries are having increasing difficulties in putting PPP projects together on both a country basis and on a project-by-project basis; the issues here are the same for many emerging markets. The issues are:

- Private sector investors' return requirements are too high.
- Lenders are trying to conserve capital and rebuild their balance sheets.
- Basel III is imposing additional capital requirements for project finance lending, as well as requirements for lenders to match the duration of loans and funding.
- The service provided by the PPP is often unaffordable to the end user without substantial grant subsidy.

In Africa, and other emerging markets, the consensus is a new model is required that is simpler, quicker to deliver and more attractive to foreign investors (mainly commercial banks). Initiatives, like the EIB Bond and Pebble development in 2013, will continue to be developed in 2014.

We expect the market in project finance to continue to grow in 2014. Infrastructure funds and pension funds are expected to have an increasing involvement in infrastructure investment, whether Basel III Rules continue to reduce the banks' appetite for project finance remains to be seen. Developing global best practice and designing optimal solutions through transfer of knowledge and expertise are the key objectives of IPFA.

The International Project Finance Association (IPFA)

The International Project Finance Association (IPFA) is a not-for-profit, networking, trade association dedicated to promoting and representing the interests of both public and private sector organisations involved in project finance worldwide. It has, as its members, key financial institutions and project sponsors, law firms, construction companies and operators active in the PPP and project finance market globally.

For further information on IPFA and their activities around the world, visit their website:

www.ipfa.org

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The 2013 Fundraising Market

The level of institutional investor capital secured by private infrastructure funds that closed in 2013 was the highest the industry has seen since 2008. As illustrated in Fig. 4.1, 47 unlisted infrastructure funds reached a final close in 2013 raising a significant $38bn. This represents 31% more capital than was raised by infrastructure funds that closed in 2012 and 58% more than was achieved in 2011. It also surpasses the $32bn raised by infrastructure GPs in 2010. In addition, a further $11bn was secured by infrastructure funds holding an interim close in 2013.

Although extremely positive for the infrastructure industry, there are signs that the capital being raised is increasingly concentrated among a handful of the largest players. Thirty-four percent of the $38bn raised in 2013 was secured by just two funds that are managed by two of the most experienced infrastructure firms. These were the $7bn Brookfield Infrastructure Fund II, managed by Brookfield Asset Management, and the $6bn EIG Energy Fund XVI, managed by EIG Global Energy Partners.

Fund Sizes

As a result of the increased level of capital raised during the year, the average size of an infrastructure fund closed in 2013 was a sizeable $872mn, significantly higher than the $647mn average in 2012. Even when excluding the combined $13bn raised by Brookfield Infrastructure Fund II and EIG Energy Fund XVI, the average fund size for 2013 is $604mn, above the average size of funds closed in 2011.

The strong fundraising market for infrastructure funds is further demonstrated in Fig. 4.2, which provides a breakdown of unlisted infrastructure funds closed between 2010 and 2013 by the proportion of target size achieved. Encouragingly, 53% of funds closed in 2013 did so either on, or above, their initial fundraising target, compared to 39% of funds that achieved the same in 2012. Almost a quarter of unlisted infrastructure funds closed in 2013 achieved 120% or more of their initial fundraising target.

Geographic Focus

Of the capital raised in 2013, those vehicles primarily focused on North American infrastructure were the most prominent, securing commitments of $17.2bn across 11 funds. It is important to note that this includes several global funds which, although primarily focused on North America, will invest in a broad range of geographic locations. As shown in Fig. 4.3, 19 Europe-focused infrastructure funds closed in 2013 raising an aggregate $12.8bn, meaning that 78% of total capital raised during the year will be put to work in the developed European or North American markets. Nine funds with a primary focus on Asia reached a final close in 2013 securing $3.2bn, while $5.2bn was raised by eight vehicles focused outside of these core regions.

Time Spent on the Road

Although a higher proportion of infrastructure fund managers are meeting or exceeding their fundraising targets, Fig. 4.4 reveals that fundraising for infrastructure funds is still a long process for most firms. Firms that closed funds in 2012 spent an average of 23 months in market, considerably longer than the 16-month average for funds closed in 2008. The average length of time spent in market for funds closed in 2013 fell slightly to 22 months, suggesting some improvement, but confirming that fundraising is still challenging for many firms.

Target Net IRRs

The diverse range of risk/return profiles available to investors in the infrastructure asset class is illustrated in Fig. 4.5. As would be expected, with many infrastructure funds targeting stable, income-producing assets, 41% of funds

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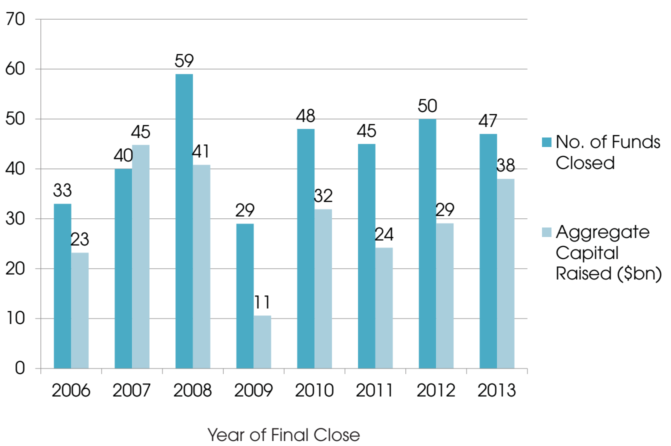
Fig. 4.1: Annual Unlisted Infrastructure Fundraising, 2006 - 2013



Source: Preqin Infrastructure Online

Fig. 4.2: Breakdown of Unlisted Infrastructure Funds Closed by Proportion of Target Size Achieved, 2010 - 2013

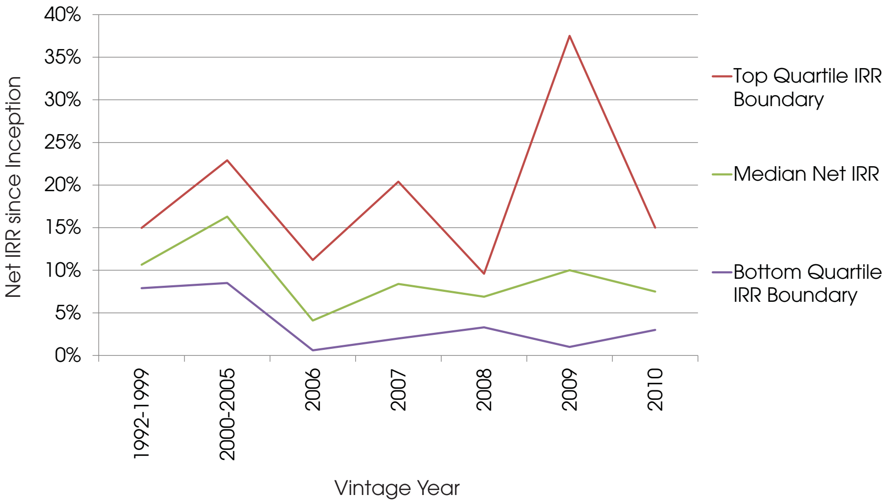
Source: Preqin Infrastructure Online

Infrastructure Fund Performance

The benefits to investors of investing in infrastructure funds are often cited as the potential for stable, predictable returns, that are uncorrelated to other asset classes. With the emergence of infrastructure as a distinct asset class occurring only in recent years, performance data for the industry is limited, with most data available for funds of more recent vintages, many of which are yet to put much of their capital to work.

Preqin's Infrastructure Online features net-to-LP performance data for more than 140 unlisted infrastructure funds. While the majority of these were launched post-2004, analysis of funds of older vintages provides a useful insight into prospective returns of the asset class when more recent funds mature.

Fig. 6.1: Median Net IRRs and Quartile Boundaries of Unlisted Infrastructure Funds by Vintage Year



Source: Preqin Infrastructure Online

Median Net IRRs by Vintage Year

By examining the median net IRRs and quartile boundaries of unlisted infrastructure funds by vintage year, Fig. 6.1 reveals a varied picture, with the median IRR of more recent vintages below that of older offerings. While the performance of more recent vintage funds is mixed, with the median IRRs for these vintage years ranging between 4.1% and 10.0%, many of the more mature funds do seem to be generating solid returns for their investors. In particular, many funds of 2000-2005 vintage years have been strong performers, with a quarter of funds generating IRRs of 22.9% or more.

Despite infrastructure fund managers typically targeting lower returns than managers of private equity and private real estate funds, infrastructure funds of older vintages perform on a comparable level to these other strategies, as shown in Fig. 6.2. In fact, for vintage 2000-2005 funds, infrastructure outperforms other strategies, with a median net IRR of 16.3%, compared to 15.3% for buyout funds and a much lower 4.8% for private real estate funds and 1.3% for venture capital funds.

Looking for the Performance of a Specific Infrastructure Fund?

Preqin's **Infrastructure Online** contains individual fund returns for over 140 separate named funds, including percentage called and distributed, net IRR and much more.

For more information, or to register for a demonstration, please visit:

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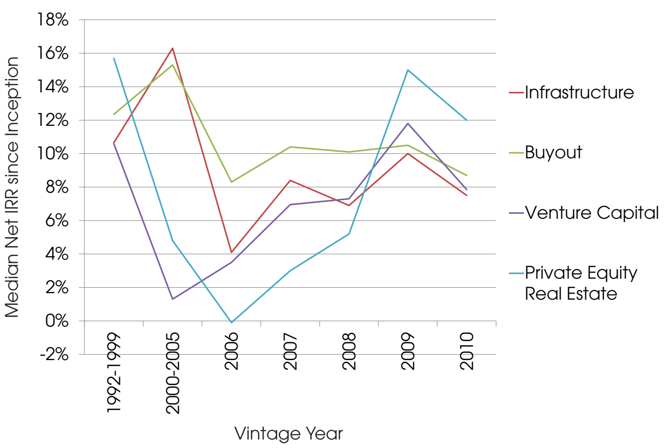
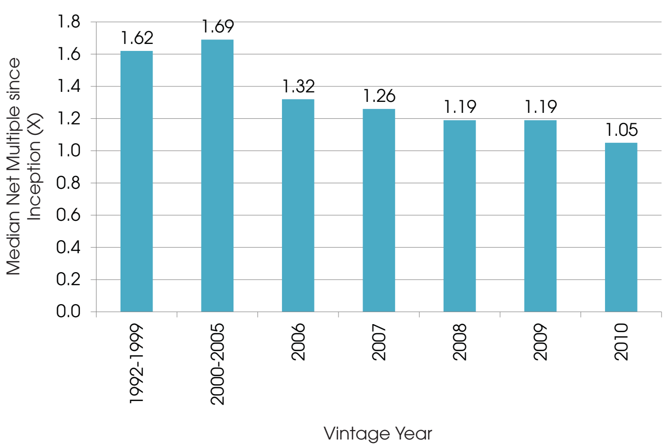
Fig. 6.2: Infrastructure vs. Other Private Equity Strategies - Median Net IRR by Vintage Year



Source: Preqin Infrastructure Online

Fig. 6.3: Median Net Multiples of Unlisted Infrastructure Funds by Vintage Year



Source: Preqin Infrastructure Online

Investors' Infrastructure Allocations over the Long Term

Infrastructure is still a new asset class for many investors and 72% of active investors in infrastructure have less than 5% of their total assets allocated to the asset class (page 30). As institutions become more comfortable and familiar with the risk/return potential of infrastructure funds, allocations to the space are likely to rise. The outlook for infrastructure is very positive, with a significant 46% of surveyed investors planning to increase their allocation to infrastructure over the long term, while 38% plan to maintain their current level of exposure, as illustrated in Fig. 7.12. Just 16% of surveyed investors expect to decrease their infrastructure allocation in future.

Future Searches and Capital Outlay

Through direct contact with over 2,100 active investors featured on Preqin's Infrastructure Online, we are able to build a clear picture of the investment strategies and plans for future investment of these institutions. Fig. 7.13 shows that many active investors expect to allocate substantial amounts of capital to the asset class in the coming year. Twenty-seven percent of investors with plans to make further investments in 2014 have reserved less than $50mn for such opportunities. In contrast, 43% of investors expect to invest at least $100mn over the course of the next year, with 11% planning to invest $500mn or more. Further demonstrating this is Fig. 7.14, which shows that the majority (56%) of active investors expect to make at least three commitments in the coming 12 months.

Although the vast majority (76%) of investors planning on allocating capital to infrastructure in 2014 intend to do

Data Source:

Preqin's **Infrastructure Online** features detailed profiles for over 2,100 infrastructure investors worldwide. The **Future Fund Searches and Mandates** feature on **Infrastructure Online** is the perfect tool to pinpoint those institutions that are seeking to make new infrastructure investments. Search for potential investors by their current investment searches and mandates, including, fund strategy and geographic preferences.

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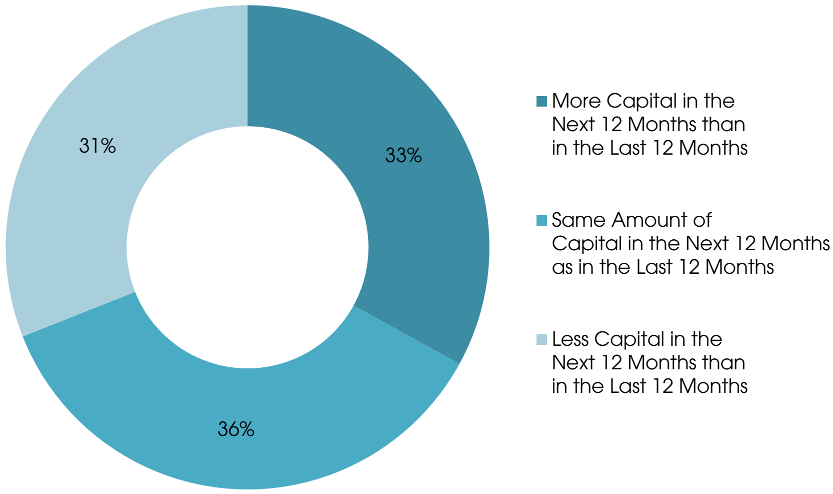
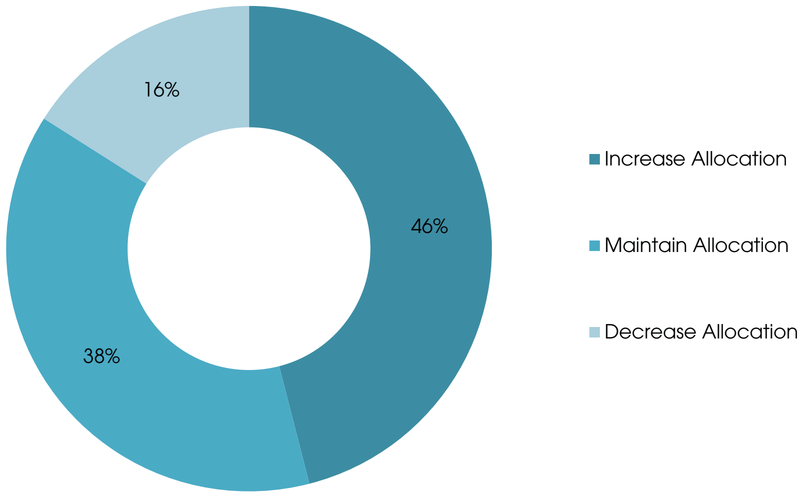
Fig. 7.11: Investors' Expected Capital Commitments to Infrastructure Funds in the Next 12 Months Compared to the Last 12 Months



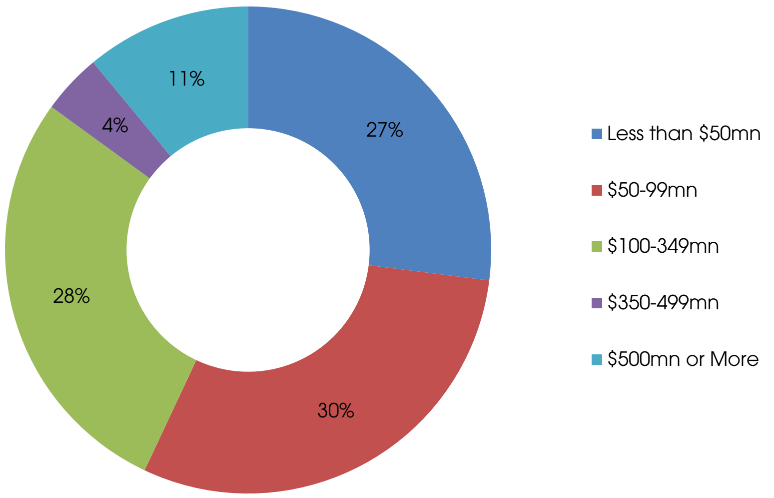
Source: Preqin Investor Interviews, December 2013

Fig. 7.12: Investors' Intentions for Their Infrastructure Allocations over the Long Term



Source: Preqin Investor Interviews, December 2013

Fig. 7.13: Amount of Fresh Capital Investors Plan to Invest in Infrastructure over the Next 12 Months



Source: Preqin Infrastructure Online

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The Infrastructure Debt Fund Market

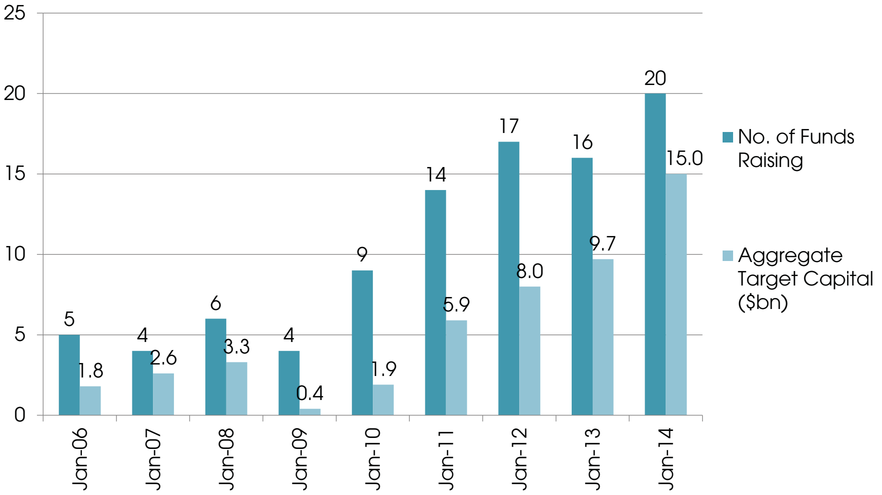
Infrastructure debt funds are an increasingly prominent part of the unlisted infrastructure fund market. New and impending banking regulations on liquidity and capital adequacy have placed tighter restrictions on the lending capabilities of banks, creating more opportunities for the private debt market to grow and increasing the appetite of both fund managers and institutional investors for infrastructure debt. As such, a growing number of unlisted infrastructure debt funds have been launched over the last 12 months, with the number of funds in market now at a record level.

Preqin's Infrastructure Online tracks a total of 96 infrastructure debt funds, including those providing mezzanine financing, of which 74 are traditional unlisted closed-end vehicles. Of the remainder, 12 debt funds maintain an open-ended structure, while five are mutual funds, four are listed funds and one an evergreen vehicle.

Debt Funds in Market

The dramatic growth of the unlisted infrastructure debt fund market since 2009 is demonstrated in Fig. 11.1. As of January 2014, there are a record number of unlisted infrastructure debt funds on the road, with the aggregate capital sought increasing by 55% compared to the previous year, with 20 funds seeking an aggregate $15.0bn, compared to 16 funds targeting $9.7bn in January 2013.

Fig. 11.1: Unlisted Infrastructure Debt Funds in Market over Time, January 2006 - January 2014



Source: Preqin Infrastructure Online

The largest infrastructure debt fund in market in January 2014 is IL&FS India Infrastructure Debt Fund, which will finance infrastructure projects in India. Another notable vehicle on the road is Allianz UK Infrastructure Debt Fund, which is seeking to raise £1bn.

Of the 20 infrastructure debt funds on the road, eight vehicles have already held at least one interim close, raising a combined $1.5bn towards their overall fundraising targets. Five infrastructure debt funds held an interim close in 2013, including AMP Capital Infrastructure

Data Source:

Preqin's **Infrastructure Online** has detailed profiles for over 420 active investors that have a preference for investing in debt/ mezzanine infrastructure funds, including investment preferences, information about allocations, known investments, and more.

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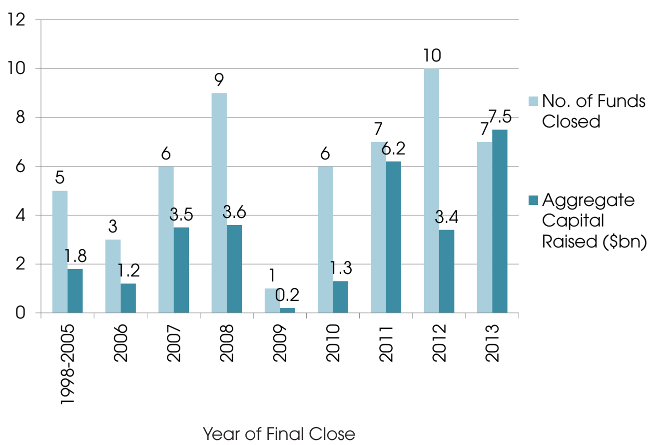
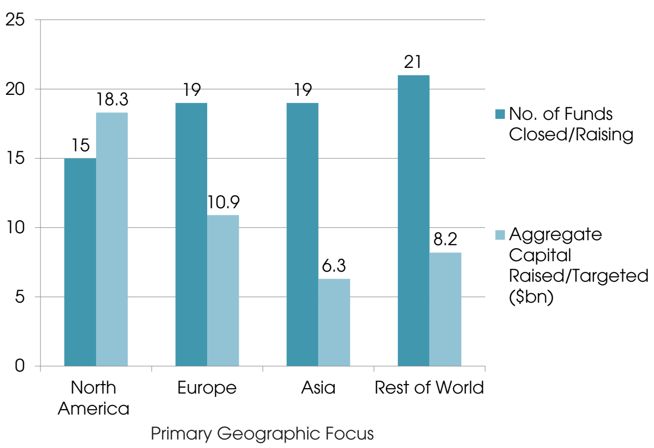
Fig. 11.2: Annual Infrastructure Debt Fund Fundraising, All Time



Source: Preqin Infrastructure Online

Fig. 11.3: Breakdown of Unlisted Infrastructure Debt Fund Universe by Primary Geographic Focus



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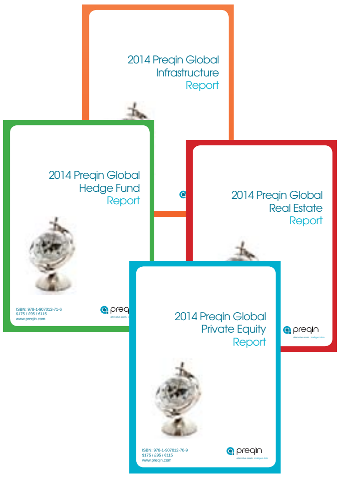

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