# 2014 Preqin Global Infrastructure Report

## Sample Pages


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# The 2014 Preqin Global Infrastructure Report
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# The Infrastructure Industry in North America

## - Chris Leslie, CEO, Macquarie Infrastructure Partners, Inc.

**What are the main changes you have seen in the infrastructure industry in North America over the past two years?**

There has obviously been a lot of activity in the energy sector. While these transactions generally involve infrastructure in the common sense of the word, many investors seem willing to accept a higher degree of commodity, pricing, credit and re-contracting risk than we have traditionally seen from infrastructure LPs. This leads to a question as to whether energy should be a separate class, or simply a higher-risk category within a broad infrastructure allocation. In itself, this distinction is of little consequence, provided that investors understand the strategy and the risks are appropriately priced.

We have also seen the maturing of the infrastructure "industry," if we can call it that. Infrastructure is now firmly established as its own investable asset class, either in its own right or as part of a real assets strategy. Numerous state, local and city governments now have the necessary legislation, understanding and support to actively capture private capital. Wall Street, legislators, politicians, their staff and a wide array of professional organizations are now well informed about the asset class, creating a self-sustaining set of opportunities which is expected to endure and grow. Basically the same evolution as was seen in real estate and buyouts when those asset classes were relatively new.

**What is the attraction for investors of North American infrastructure?**

There are a couple of factors that make North America attractive both for LPs (and GPs). First, the North American market is unparalleled in sheer scale and breadth. The population of the US and Canada is approaching 350mn, and the magnitude of opportunities for private infrastructure development and rehabilitation is tremendously compelling. The infrastructure needed to support the continued growth of these economies is significant. A lot of existing infrastructure is reaching the end of its design life.

There is also a confidence in government regulation and legal systems. Investors know that contracts and concession agreements are enforceable, and there are a number of recent examples of the courts upholding the rights of private investors in infrastructure, which is not the case in all markets.

Finally, the cultural dimensions of North America are incredibly attractive. North Americans have a long tradition of innovation and recovery in the face of adversity. Despite all the political wrangling in Washington, DC and some of the dysfunction in Congress, people in North America will not sit by and watch their infrastructure collapse. The idea that North America's roads and airports are going to continue to deteriorate is implausible. There will be renewal. People will demand it. But there is no way that the public sector can, or even should, fund it all.

Back in 2007, LA City Council approved \$1.2bn of public funding to rebuild Tom Bradley International Terminal at LAX. That approval did not happen until after a number of airlines started diverting to more modern terminals. Today, Tom Bradley is absolutely world class, but the cost of renovations is expected to top \$4bn. It is the largest public works project in Los Angeles history. Not every city or municipality has the capacity to make that kind of investment, and that's where the private sector can play an incredibly valuable role.

At times, there seems to be an unwarranted pessimism about the outlook for private infrastructure in North America, which we do not share. The fact that Central Terminal Building, the main terminal at New York's La Guardia Airport, is using a private procurement model for its \$2.4bn rebuild project is emblematic of just how far the industry has come.

**What do you see as the most attractive sectors for infrastructure investment in 2014?**

We tend not think about infrastructure opportunities as being "most attractive" within any given twelve month period. Infrastructure is not as cyclical as other asset classes, and it often involves long lead times to bring transactions to market, let alone execute. We are just as much focused on 2014 as we are on 2015 and 2016. If you cannot have some confidence about an asset's economic characteristics in ten or twenty years, then it's probably not infrastructure in the first place.

Having said that, the utility sector at the moment is a good example where one needs to be mindful of exercising pricing discipline. The transport sector is offering numerous opportunities, but only a subset has the characteristics that we find attractive.

Vintage risk in infrastructure is more tied to the availability of leverage than to economic cycles generally (although GDP-correlated assets such as traffic-risk toll roads, airports and ports do display inevitable correlations). If anything, as US GDP continues to recover, GDP-correlated assets should be a good place to be, especially as many such assets also provide a degree of inflation protection.

**What is deal flow like at the moment? Do you see a good pipeline of assets?**

While it was expected that there would be a flood of cheap or distressed deals in 2009 and 2010, many deals actually came off of the market. There was a rush to get in and buy cheaply, but many sellers opted to wait. Deal supply has now normalized, and deal flow has resumed a steady pace.

In terms of opportunities in the pipeline, we are very optimistic. By volume, utilities, energy, and transportation make up the bulk of activity. But some of the most interesting and successful deals we've seen have come to us through smaller or less-typical sources.

We are also mindful not to be distracted by "shiny objects". We always ask ourselves whether opportunities truly meet our definition of "infrastructure". What risk profile are we taking on to get the required returns? We are constantly screening assets, and that gives us insight into the relative value of different sectors at different points in time when we find something that meets all of our criteria.

**Is asset pricing an issue?**

Once again, this is a question of discipline. There are certainly examples of assets being mispriced, but this tends to be the exception rather than the rule. The market is not frothy. It is certainly expensive in some sectors, but not overheated. We maintain discipline by always having a number of near-term investable opportunities for our funds so we are not drawn into the heat of a single deal. The rising interest rate environment is causing publically-listed utilities to underperform the market, and we expect that utility pricing may moderate in the medium term.

**How is the PPP model developing in the US?**

We have seen positive developments in the PPP model in recent years. The increase in sophistication that we are seeing from procuring agencies is very encouraging. They are moving to a model that tailors the structure of a PPP to match the risk profile of their specific asset.

The other consideration is the procurement process. In the US, this happens at a state and local level. While the analogy of the US being "50 different countries" is well known, it is actually even more complex than that. States and agencies that have a realistic and programmatic approach are the most successful. We have seen steady deal flow from the populous areas – New York, California, Texas, Colorado, and coastal states such as Florida and Virginia – and certainly an uptick in the number of states considering PPP legislation. PPPs succeed when they have local champions, hence the proliferation of localized procurement models best suited to the local situation.

PPPs are becoming a powerful, self-sustaining industry. From the service providers, banks, politicians and lobbyists, down to the investors, owners, designers and local construction businesses, PPPs are gaining critical mass. When major US pension funds are making 4-6% allocations to infrastructure, and Canadian pensions continuing to lead the investment space with some of highest infrastructure allocations in the world, that is a lot of money that can be productively invested. PPP activity will only continue to grow.

**How easy is it to secure debt financing in the current market?**

Debt market conditions have improved substantially in the last 12 months across all markets, including project finance and capital markets. Japanese and Canadian lenders continue to be very active, but we are also seeing a return of the more traditional European lenders, which is resulting in more competitive terms and better availability of debt capital.

Compared to where the markets have been in previous years, conditions are certainly easier, but we are also cautious, because when debt financing is cheaper and more readily available, leverage and asset prices tend to increase.

**How is the fundraising market at the moment? Are you seeing growing investor appetite for infrastructure exposure?**

We are seeing appetite across the board right now. Traditionally, the major infrastructure investors have been pension funds. Over 80% of MIRA investors historically have been public and corporate pension funds. Now we are seeing that interest expand to include more involvement from insurance companies, foundations and endowments. Sovereign wealth funds are also increasingly active in funds in addition to their direct investment programs. The present interest rate environment is driving demand from two directions: as a hedge against inflation and (similarly) as a redeployment of fixed income allocations. So, the prospect of rising interest rates is driving particularly high demand for the asset class right now.

**Is it mainly domestic institutional investors targeting North American Infrastructure, or do you see appetite from international investors?**

There has always been interest in North American infrastructure from international investors. International investors have a longer history of investing in the asset class, and they remain very interested in North American opportunities.

That being said, we think it is good social policy to have a nation's earnings invested in the revitalization of its national infrastructure. This has the potential to solve the dual problems of underfunded pensions and the need for renewal of infrastructure to grow the local economy. In some ways, it remains surprising that American institutions have been relatively slow to embrace the asset class domestically. Interest is certainly strong and increasing, but it remains relatively low given the size of the American market compared to (say) Canada and Australia, where domestic institutions play a critical role in ownership of domestic infrastructure.

**Do you find investors now want more co-investment opportunities?**

Without a doubt. Historically, many investors sought co-investment, but very few had the in-house capability, resources and flexibility to execute within the required timeframes. Today, there are more investors with capable in-house teams who are seeking to structure bespoke co-investment programs alongside GPs. In some cases, LPs that were seeking to go direct have returned to the fund model to supplement their teams in far-flung or unfamiliar markets. In all cases, the deal flow and expertise that a GP can bring are central to co-investment decisions and allocations.

**Thank you for your time.**

### Macquarie Infrastructure and Real Assets

Macquarie Infrastructure and Real Assets (MIRA) is one of the largest, most experienced alternative asset managers in the world, with an 18-year history specializing in infrastructure, real estate, agriculture and other real assets via public and private funds, co-investments, partnerships and separately managed accounts. MIRA has over $45bn in assets under management, including a global portfolio of over 100 infrastructure investments in 23 countries. With 400+ professionals around the globe, MIRA is organized into regional investment teams of professionals who invest in and manage local investments in real assets. MIRA's regional focus aids deal flow and execution and is fundamental to its philosophy of long-term asset management in the real assets sector

www.MIRAfunds.com

# 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

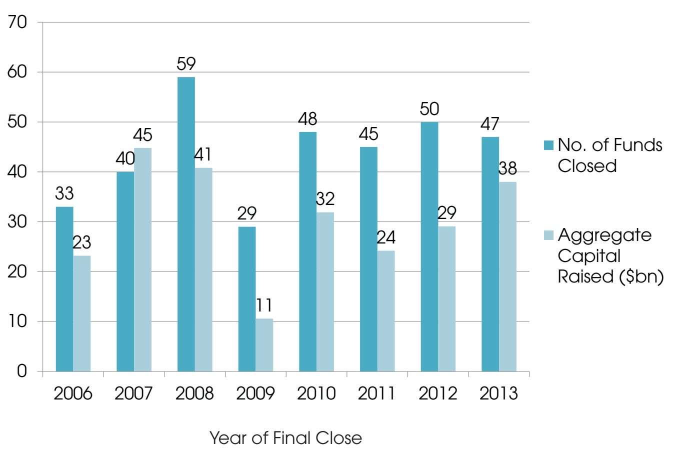
Although a higher proportion of infrastructure fund managers are meeting or exceeding their fundraising targets, Fig. 4.4 reveals that fundraising for infrastructure funds is still a long process for most firms. Firms that closed funds in 2012 spent an average of 23 months in market, considerably longer 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

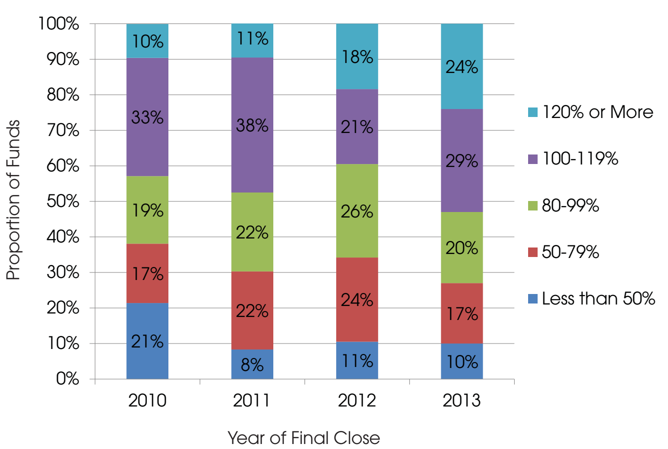


**Fig. 4.1:** Annual Unlisted Infrastructure Fundraising, 2006 - 2013




*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*

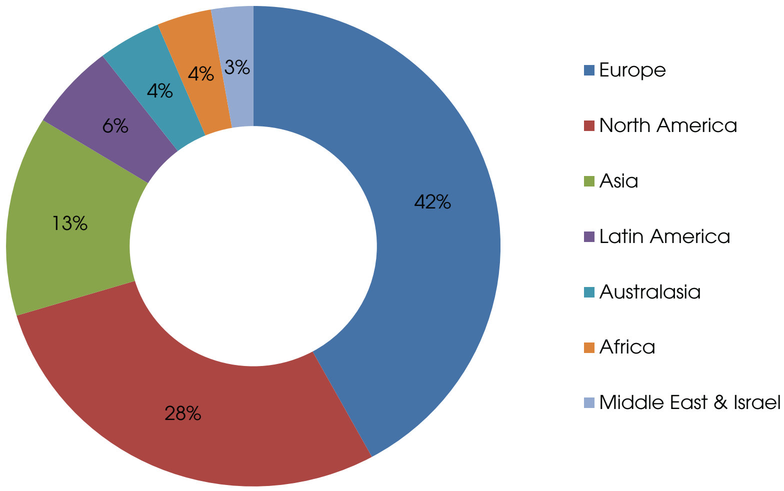
# Fund Manager Universe

With infrastructure becoming a more established asset class, the number of fund managers active in the space continues to grow. Preqin's Infrastructure Online features detailed profiles for more than 400 infrastructure fund managers worldwide that have collectively raised over $275bn in investor capital in the last 10 years. With almost half of all infrastructure transactions to take place in the last five years involving European assets, it is unsurprising that 42% of fund managers are based in the region, as shown in Fig. 5.1. Twenty-eight percent of infrastructure fund managers are based in North America, and 13% in Asia.

The relative youth of the infrastructure asset class means that many fund managers do not have long track records, with the majority (61%) managing only one fund or in the process of raising their first fund, as shown in Fig. 5.2. With institutional investors generally seeking more experienced fund managers to invest with, the capital raised for infrastructure funds is becoming increasingly concentrated among the handful of more experienced infrastructure managers. For example, Macquarie Infrastructure and Real Assets has raised 19 unlisted infrastructure funds, garnering $26bn in aggregate capital commitments. However, some managers raising their first fund are still able to attract considerable levels of investor capital, with first-time fund managers raising a significant $5.6bn in 2013. One such fund is Suzhou International Development Venture Capital Holding's China-focused Urban Construction Fund. The fund closed in April 2013 having raised CNY 10bn ($1.6bn) in commitments.

Corresponding with the relative inexperience of many infrastructure fund managers, the spread of total capital raised by infrastructure firms over the last 10 years is weighted towards the lower end of the scale, with 64% of firms having raised less than $500mn, as demonstrated in Fig. 5.3.

**Fig. 5.1:** Breakdown of Unlisted Infrastructure Fund Managers by Location of Headquarters




*Source: Preqin Infrastructure Online*

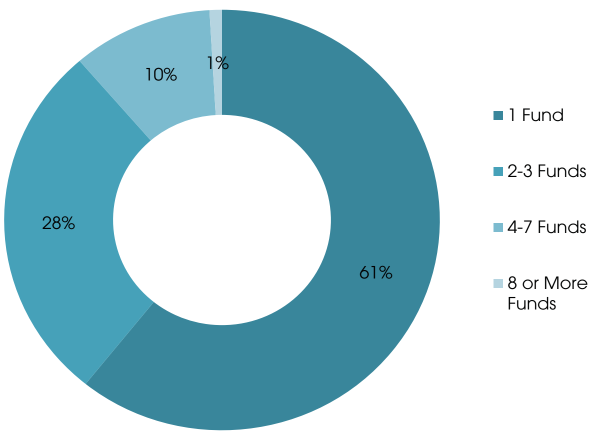
### Data Source:

Preqin's **Infrastructure Online** features detailed profiles of over 400 active infrastructure fund managers, including key contact details, individual fund performance, and more.

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

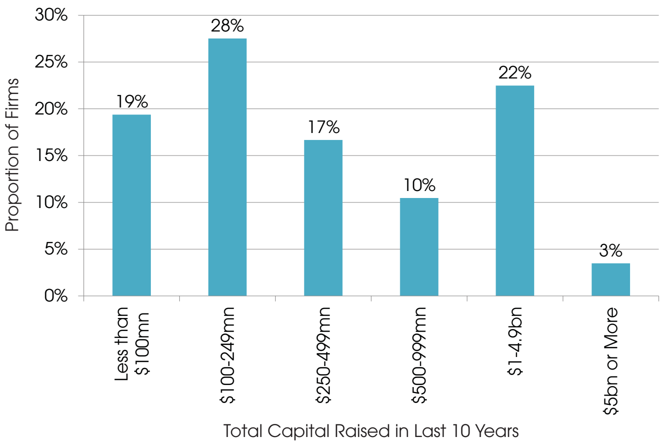
www.preqin.com/infrastructure

**Fig. 5.2:** Breakdown of Unlisted Infrastructure Fund Managers by Number of Funds Managed




*Source: Preqin Infrastructure Online*

**Fig. 5.3:** Breakdown of Unlisted Infrastructure Fund Managers by Total Capital Raised in the Last 10 Years



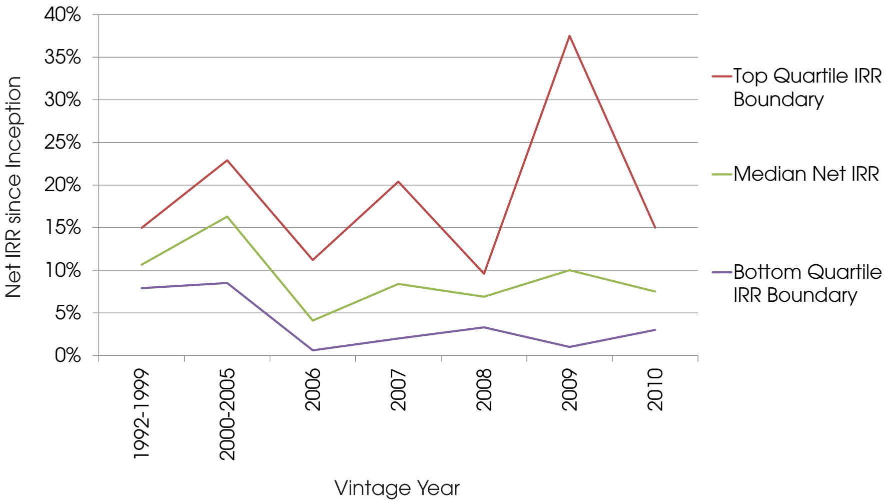

*Source: Preqin Infrastructure Online*

# 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*

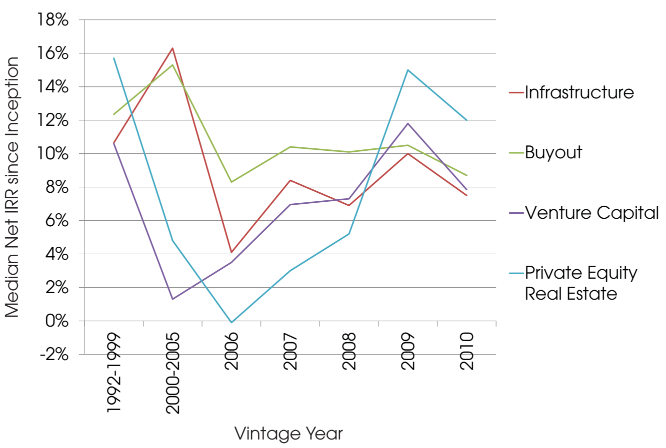
## Median Net IRRs by Vintage Year

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.

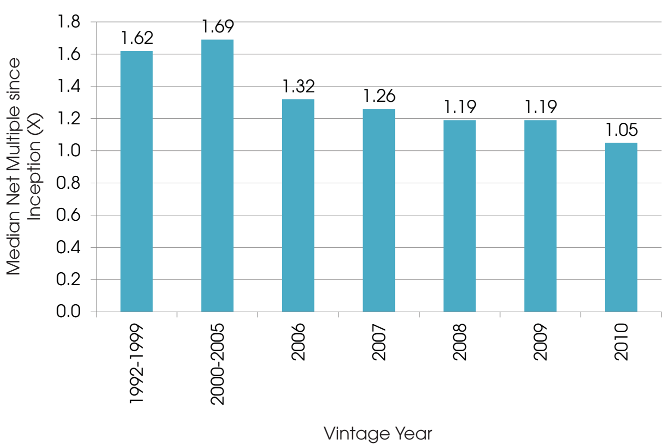


**Fig. 6.2:** Infrastructure vs. Other Private Equity Strategies - Median Net IRR by Vintage Year




*Source: Preqin Infrastructure Online*

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




*Source: Preqin Infrastructure Online*

# Investor Appetite for Infrastructure in 2014

The infrastructure investor universe is still relatively small when compared to other alternative asset classes, and many investors remain relatively inexperienced in, or new to, the space. With a large number of funds on the road, there is a great deal of competition among fund managers to secure commitments from an investor base that, while growing, remains smaller than that of many other alternative asset classes. Fund managers must therefore continue to pay close attention to investor attitudes and their changing demands in order to correctly position their fund to stand out from the crowd. In December 2013, Preqin conducted a series of interviews with 50 institutional investors actively investing in the infrastructure asset class, in order gauge their thoughts on the market and future appetite for infrastructure opportunities.

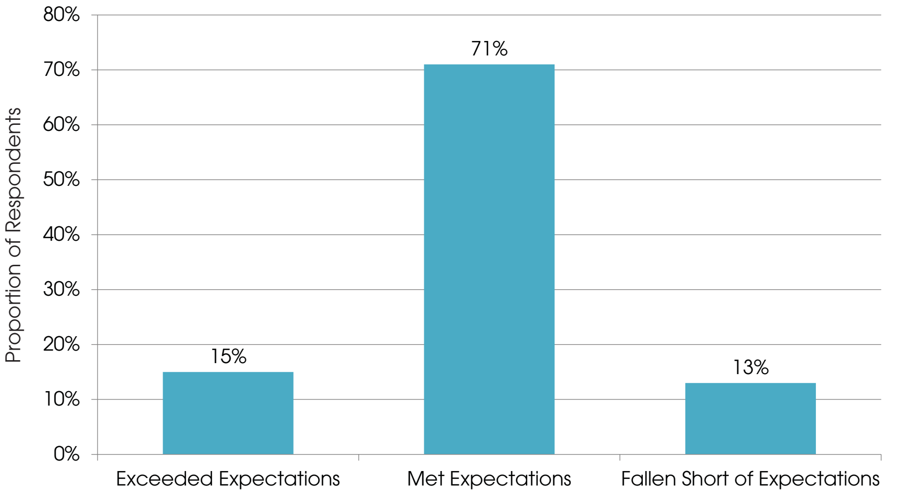
## Satisfaction with Returns and Confidence in the Asset Class

Overall, infrastructure investors appear satisfied with the returns received from their fund investments over the last 12 months, with a significant 86% of investors surveyed feeling that their infrastructure investments have either met or exceeded expectations over the past 12 months. This suggests that infrastructure investments have largely performed positively and most investors believe they have contributed well to the overall goals of their portfolios.

The risk/return profile of the infrastructure asset class is quite diverse depending on the type of fund and chosen strategy. Some investors commit to infrastructure funds as an extension of their return-seeking private equity portfolio, while others are looking for lower longer-term yields. We asked investors whether their confidence in infrastructure to achieve portfolio objectives had changed over the past 12 months; a significant 68% of investors surveyed reported no change and remained largely positive towards the infrastructure space, as shown in Fig. 7.10.

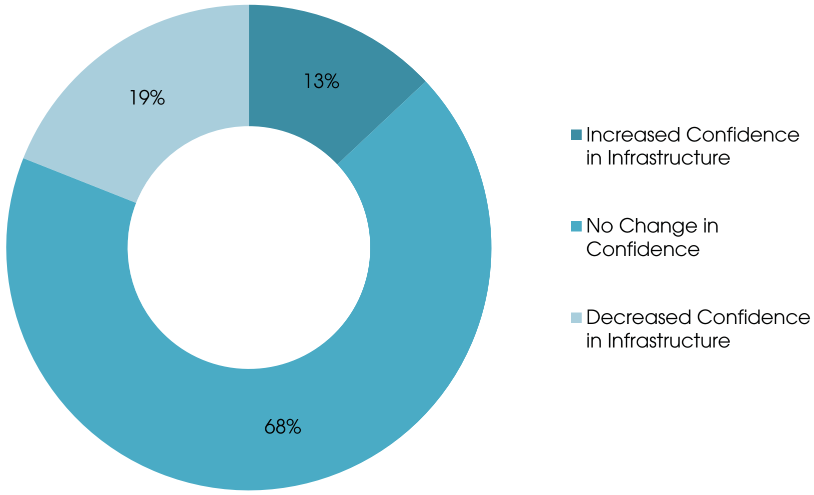
In terms of investors' general perception of the infrastructure industry, 34% of surveyed investors are positive, while a further 52% have a neutral outlook. Despite general positivity towards infrastructure, 14% of investors surveyed

**Fig. 7.9:** Proportion of Investors that Feel Their Infrastructure Fund Investments Have Lived up to Expectations over the Past 12 Months




*Source: Preqin Investor Interviews, December 2013*

**Fig. 7.10:** Investors' Confidence in Infrastructure to Achieve Portfolio Objectives




*Source: Preqin Investor Interviews, December 2013*

### Data Source:

Preqin's **Infrastructure Online** details investors' plans over the next 12 months, including investment preferences, number of planned commitments and more.

The **Future 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 current investment searches and mandates, including fund structure, fund strategy and regional preferences.

For more information, please visit: www.preqin.com/infrastructure

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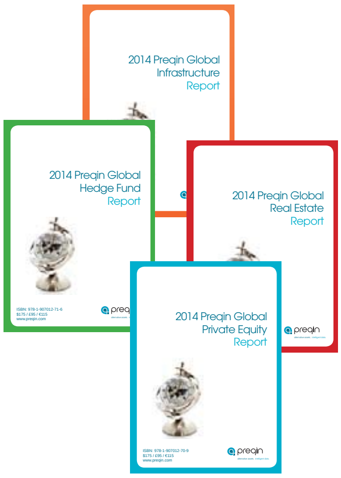


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