Deloitte.

A positive horizon on the road ahead?
European Infrastructure Investors Survey 2016

Contents

Foreword

Welcome to the fourth edition of our analysis of the infrastructure investors market.

As with our previous editions, we have interviewed a wide cross-section of infrastructure investors throughout Europe, and our thanks go to the investors that have contributed to our survey.

When we last conducted our survey in 2013, the sector had successfully weathered the economic storm, and investors had a clear focus on core infrastructure assets in the most established jurisdictions for infrastructure investment – particularly in Western Europe. We also saw a shift in the competitive landscape in this marketplace, with direct investors increasingly focusing on these same core assets.

Today, the results of our survey show this trend continuing, with direct investors now bedded in to the core infrastructure market in Western Europe. Infrastructure funds are having to become increasingly innovative in both their deal sourcing and their investment theses to be in a position to acquire assets that will produce their target returns.

Because of the increasing impact of direct investors in the market, investors have scaled back their target returns, but continue to perform well against these targets. In our 2013 survey, some thought that this might lead to departures from the market, however it appears that infrastructure funds have adapted well to these challenges.

One clear message coming from the survey is that renewables are becoming increasingly popular with investors as an asset class, although there have been some significant regulatory changes in this sector that have impacted returns. Investors are keen to see the regulatory environment stabilise for renewables assets and more broadly across the infrastructure market.

The debt markets remain buoyant, with good access to debt capital at competitive prices and terms. We have also seen infrastructure funds move into the debt market, with a number having raised specific infrastructure debt funds primarily focused on junior/mezzanine lending.

Exits have become more prevalent, and we expect this trend to continue, with first generation funds coming towards maturity and market conditions seen as positive for exits by infrastructure funds with high quality assets currently demanding high prices.

Overall, we are happy to say that the infrastructure asset class continues to perform strongly and provide stable secure returns. We expect this to continue through a period of more steady evolution in the infrastructure investors market over the years to come.

So in conclusion, a positive horizon on the road ahead.

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Executive summary

Observations on the state of the infrastructure market

The following have emerged from our interviews as the key trends in the infrastructure investors landscape today:

1

Infrastructure has proven to be very resilient

The infrastructure sector has performed well over the last five years. This has particularly been the case for traditional infrastructure assets such as airports, pipelines and water. The renewables sub-sector has seen the most erratic performance, principally because of the evolving regulatory frameworks as this asset sub-class has developed.

2

Renewables have become a well-established and popular asset class

Infrastructure investors have embraced the renewables asset class, despite the recent regulatory changes. As the regulatory environment stabilises, and an increasing number of these assets become available, infrastructure investors see this asset class as one of the most attractive.

3

Iberia and Italy are back

After a number of years of being viewed as 'closed markets', Iberia and Italy have bounced back with infrastructure investors now once again looking to invest in these jurisdictions.

4

Increasing competition in traditional infrastructure markets

Infrastructure investors continue to prefer assets in the more traditional infrastructure markets in Western Europe, North America and Australasia. However increased competition in these markets, in particular from direct investors, is forcing the infrastructure funds to make a choice between the lower returns now available in these markets and the higher returns available in other less well-established markets.

5

A reduction in target Internal Rate of Returns (IRRs)

Target IRRs for infrastructure funds have moved towards a 10%-12% range, a decrease from the 12%-14% we have seen previously. This noticeable decrease in target returns is primarily driven by the increasing competition in the market.

6

Corporate governance has significantly improved

Investors believe that the corporate governance structures in place in their investments have seen a significant improvement over the last three years. Investors are expecting a continued focus from regulators on corporate governance, and this will increasingly be a key issue.

7 A focus on investee company management teams

Infrastructure investors see asset management as one of the key areas in which they are able to add value during the life of the investment. Having the right management in place is critical, and as such this is one of the areas infrastructure investors are most active in to make sure the best possible management team is in place. Finding and retaining good quality management teams continues to be a challenge, and infrastructure investors see the development of the right management incentive plans as key.

8 Regulatory risk continues to increase

Driven by several regulatory regime changes in Scandinavia, Spain and Italy, investors still see regulatory risk as their key concern. Regulatory risk is particularly high in Western Europe, with investors identifying the UK (for the first time), Iberia and Italy as jurisdictions where regulation is considered to be both excessive and lacking stability and consistency.

9 Limited Partner (LP) due diligence – a focus on deal teams

LP investors' focus on due diligence has continued to increase, with the most critical factor in LPs' investment decisions being on assessing deal teams, alongside current performance of existing infrastructure funds. Co-investment rights and refined fee structures remain the preferred incentives to attract cornerstone investors.

10 More exits

We have seen an increase in the number of exits by funds over the last couple of years, and expect this trend to continue, with infrastructure investors indicating that around a third of assets currently under management are expected to be disposed of in the next five years – primarily through secondary sales to direct investors or to infrastructure funds.

11 Debt markets remain favourable for infrastructure investors

Across the board, appetite for infrastructure lending is very strong, with lenders often offering more leverage than investors are looking to take, and offering favourable pricing terms – with low spreads and fees and reasonable covenants.

12 Infrastructure debt funds have become more prevalent

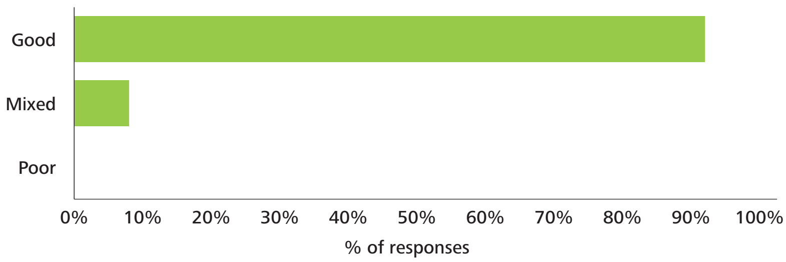
There has been a significant increase in the number of infrastructure funds with a dedicated infrastructure debt fund, with over 45% of investors having raised such a fund. Investors still feel now is a good time to launch a debt fund, albeit only a minority of those interviewed are actually considering doing so.

Performance

Infrastructure as an asset class continues to weather the challenges in the wider economy very well. Over 90% of investors that we interviewed rated the resilience of their investments as good, with none characterising performance as poor.

Figure 1

How resilient have your existing infrastructure investments been to the challenges of the last 5 years?



Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Returns

Internal Rate of Return (IRR) and cash yield remain the key indicators Limited Partners (LPs) look to when assessing the performance of infrastructure funds. The weighting given to each of these differs by the type of LP investor, with:

- pension fund LPs focusing more on cash yield to service long-dated liabilities with a steady cash return; and
- insurance company LPs placing more emphasis on IRR as they are generally required to market their investments.

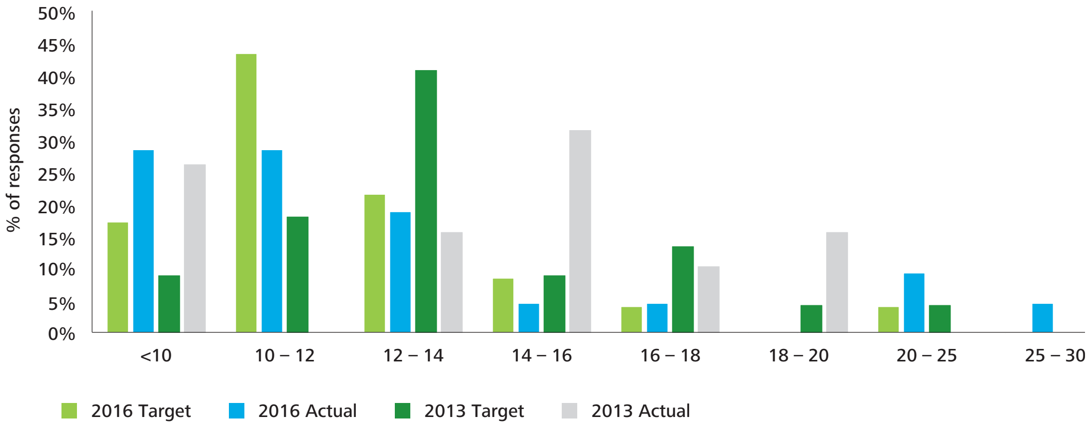
Both target and actual IRR are now most commonly 10%-12%, which is a decrease when compared to 2013 when we saw more target IRRs in the 12%-14% range. This reduction has primarily been driven by the increase in the price of new assets as a result of the greater competition in the bidding process created by the increasing number of direct investors in the market.

Actual IRRs achieved for most infrastructure funds are broadly consistent with their targets; if anything they are slightly higher. However, these are still predominantly driven by asset valuations and, to a limited extent, refinancing proceeds. Looking forward, it will be interesting to see how final IRRs compare to these targets, particularly as first generation funds come towards maturity.

IRR and cash yield remain the key indicators LPs look to when assessing the performance of infrastructure funds.

Figure 2

Please state your fund's target and actual internal rates of return (IRR)



Source: Deloitte Infrastructure Investors Survey 2016 and 2013, Deloitte Analysis

The majority of infrastructure funds are still targeting annual cash yields in the 5% to 9% range, which is consistent with the targets identified in our 2013 survey. Actual cash yields have tended to be towards the lower end of this range, most typically 5%-7%.

Figure 3

What is your target cash yield?

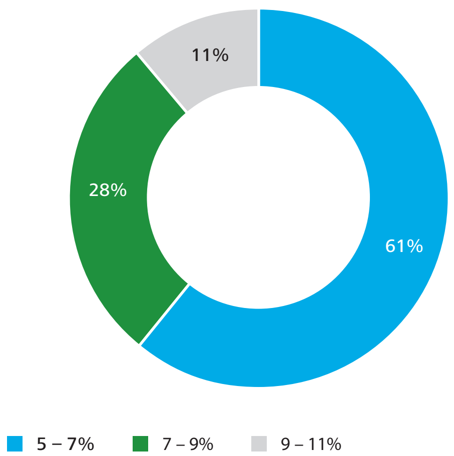
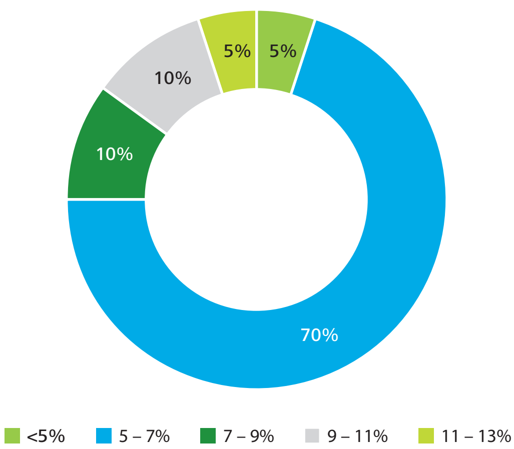


Figure 4

What is your actual cash yield to date?



Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Portfolio performance

Within existing portfolio groups, investors continue to protect performance or accelerate growth primarily through cost base efficiencies and de-leveraging, which is consistent with our previous survey in 2013.

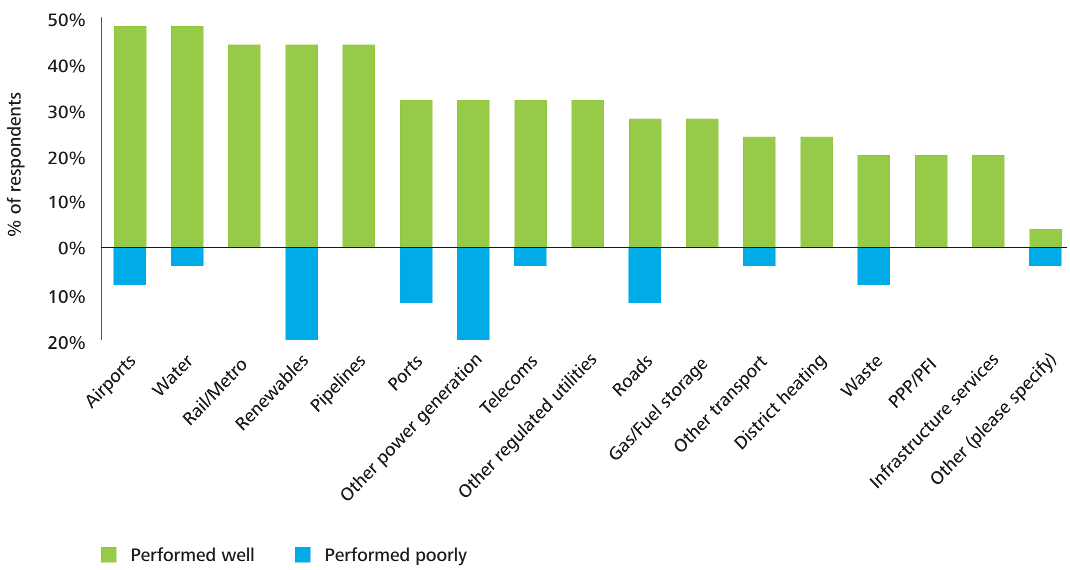
Fewer infrastructure assets have experienced covenant compliance problems over the last two years than when we conducted our last survey in 2013. This could be due to a combination of factors, including:

- the **improving market conditions** resulting in better performance of assets;
- **less onerous covenants** in the terms of infrastructure debt; and
- infrastructure investors being **less aggressive on leveraging** assets.

Performance in the more traditional infrastructure asset sub-classes such as airports, pipelines and water has been the most positive, with in excess of 50% of investors that we interviewed indicating these sectors have performed particularly well. No asset sub-classes have been identified as performing particularly poorly, however the performance of renewables seems to have been erratic with over 40% of those interviewed indicating that this sector has performed particularly well and over 20% indicating a poor performance. This erratic picture of the performance of renewables might be driven by the relatively short lifespan of the asset class and the continuing changes in renewables regulatory frameworks that has severely impacted returns in some jurisdictions.

Figure 5

Sectors that have performed particularly well or poorly



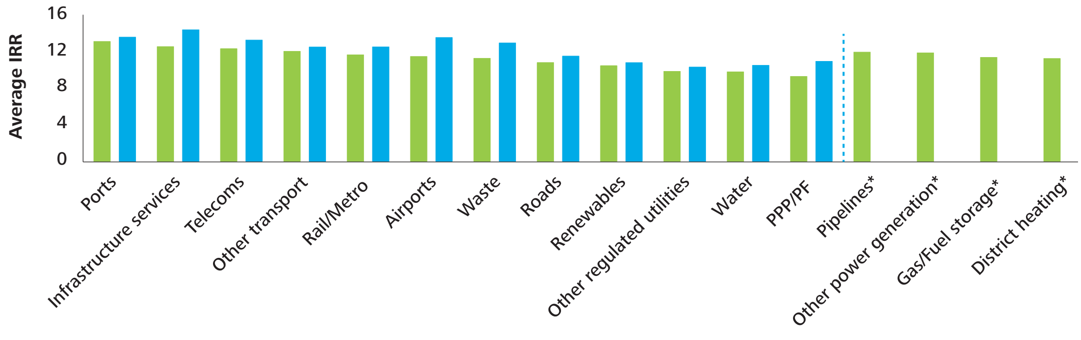
Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

IRR performance for asset sub-classes were similar between the funds. Consistent with the findings of our last survey in 2013, the highest sub-sector IRR's were in the demand risk transport sub-sectors (e.g. ports, airports, rail and metro and other transport), pipelines, telecoms and other infrastructure services. Sub-sectors with the lowest target IRRs are Public Private Partnerships (PPP)/Private Finance Initiative (PFI), water and other regulated assets.

The asset class IRRs mirror the trend seen with fund IRRs with all asset classes lower than when we conducted our survey in 2013.

Figure 6

How does IRR compare between sub-classes?



*No comparative data available

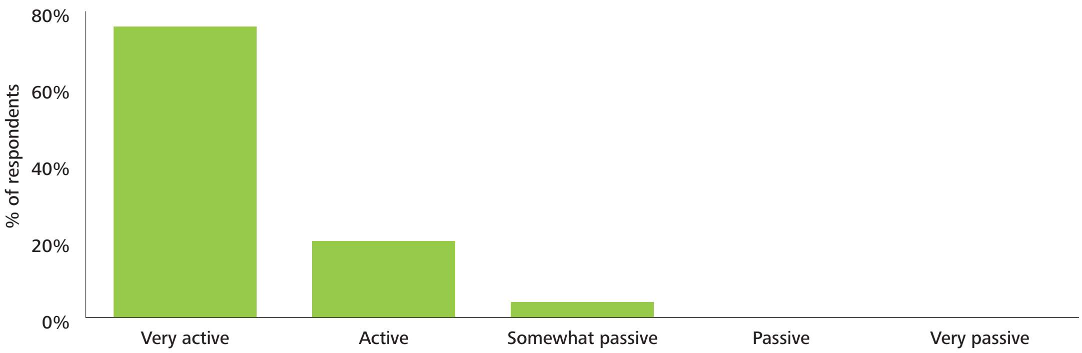
Source: Deloitte Infrastructure Investors Survey 2016 and 2013, Deloitte Analysis

Role with investee companies

The involvement of infrastructure fund investors in their investee companies continues to increase with over 95% of investors indicating they are actively or very actively involved in their investee companies.

Figure 7

How do you categorise your involvement with your investee companies?



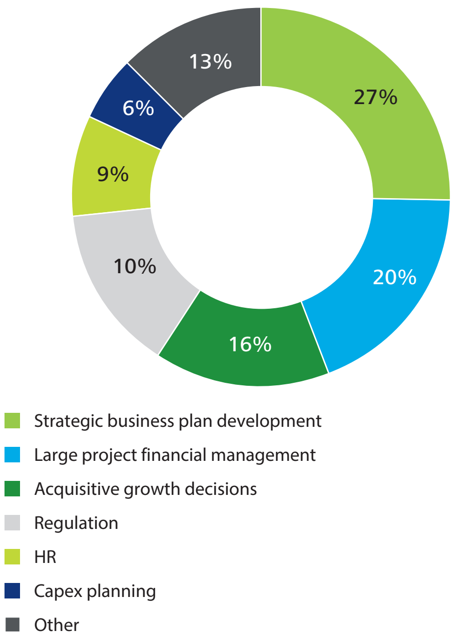
Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Investors' involvement in infrastructure companies covers many areas. The three most often quoted were:

- Strategic business plan development: The business plan is considered to be the single largest value lever, and so investors are very involved in both its initial development, as well as reviewing, refining and refreshing the business plan.
- Finance: Investors typically work closely with management teams on the debt financing, including modelling to satisfy lender requirements and assisting with large project finance.
- Acquisitive growth decisions: Where significant M&A investments are made, investors are generally more closely involved in these decisions.

Figure 8

Which areas of management do your team become most closely involved with in your portfolio investments?



Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Over 50% of the infrastructure investors we interviewed identified getting the best management teams in place as the key internal challenge for their portfolio companies.

Infrastructure investors clearly see asset management as one of the core areas in which they can add value during the lifecycle of their investment.

In this context, infrastructure investors are increasingly influencing change in their investee companies' senior management teams, with 92% having done so during their ownerships (2013: 77%).

Infrastructure investors tell us that in order to recruit and retain the best management teams it has become increasingly important to develop the right management incentive plans to both incentivise management and ensure that managements' objectives are aligned with their (often long-term) investors.

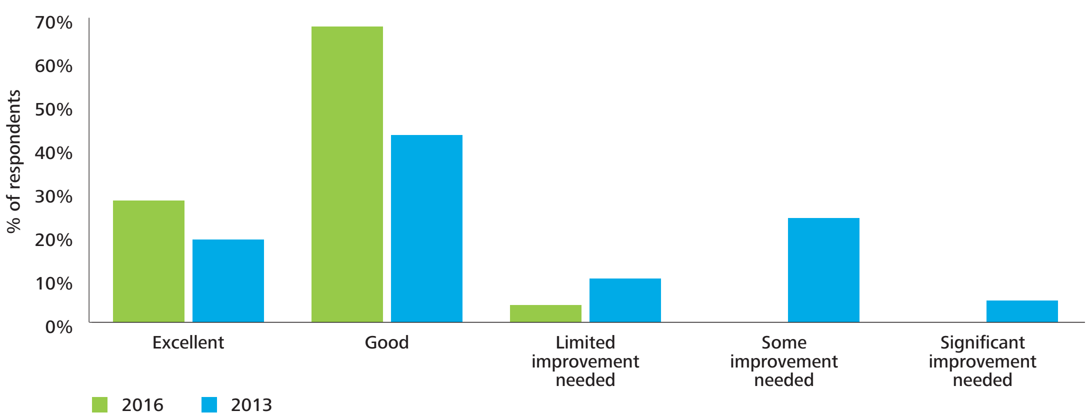
Governance

There appears to be an increasing focus on the corporate governance structures for infrastructure assets, particularly regulated assets where decision making processes are coming under more scrutiny.

In response to this, corporate governance structures in assets held by infrastructure investors have improved significantly since we last conducted our survey in 2013, with over 95% of the investors we interviewed indicating that their governance structures are good or excellent, compared to around 60% in 2013.

Figure 9

How do you rate the corporate governance structure of your portfolio investments?



Source: Deloitte Infrastructure Investors Survey 2016 and 2013, Deloitte Analysis

When direct investors began to enter the infrastructure market, corporate governance structures and the oversight of portfolio investments was an area that was perceived to be a key challenge for these investors given their historically more passive roles in investment. In response to this, we have seen a clear shift in capabilities of direct investors, with many taking on dedicated portfolio management teams to improve their asset management capabilities.

Market and asset focus – looking forward

Investment thesis

Almost all of the infrastructure investors we interviewed still have a preference for core infrastructure assets, with the three most critical factors sought being the provision of an essential service to society, high barriers to entry and their asset-backed nature. Yield generation is seen by investors as slightly less important, which may be reflective of some infrastructure funds' move away from a 'traditional' infrastructure long-term buy and hold model towards a more quasi private equity model with a view to sale as an alternative investment thesis.

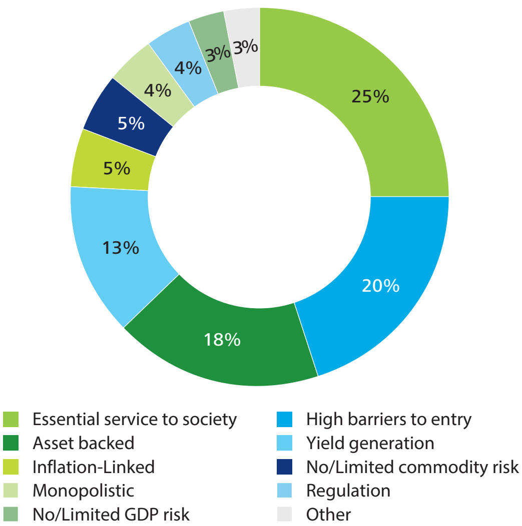
Assets

Core infrastructure assets remain the asset classes that are most attractive to infrastructure investors, with the most popular asset classes mentioned being pipelines, renewables and rail/metro assets.

Appetite for waste assets and infrastructure services remains low, as does the popularity of PFI/PPP – which, given the lower returns available, tends to be a class focused on by dedicated funds rather than the more general infrastructure funds.

Figure 10

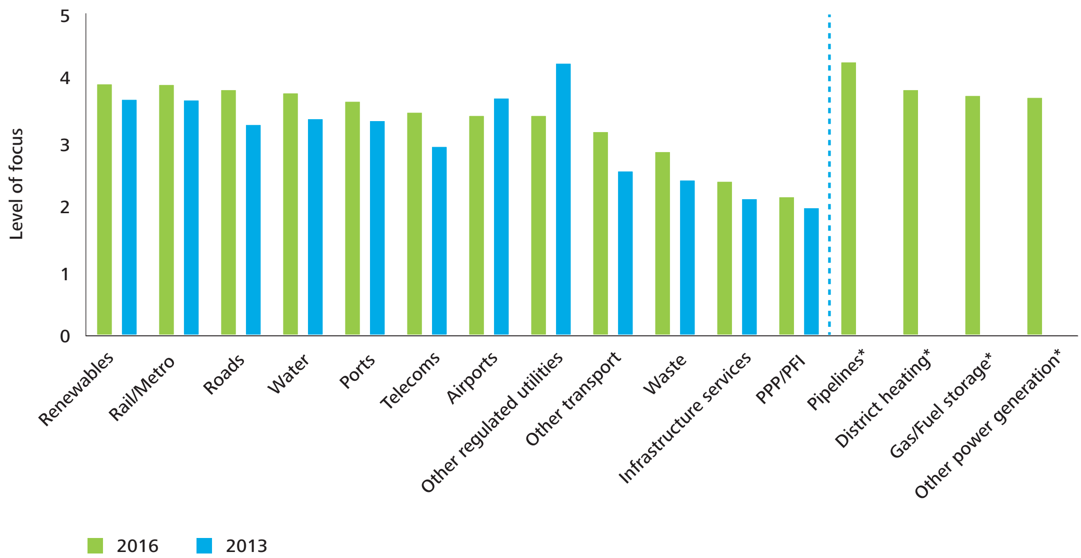
Which factors do you see as most critical in defining what constitutes an infrastructure asset now?



Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Figure 11

From an investment perspective, please indicate the level of focus your fund has on the following infastructure sub-classes (5 being a significant focus and 1 being not under consideration)



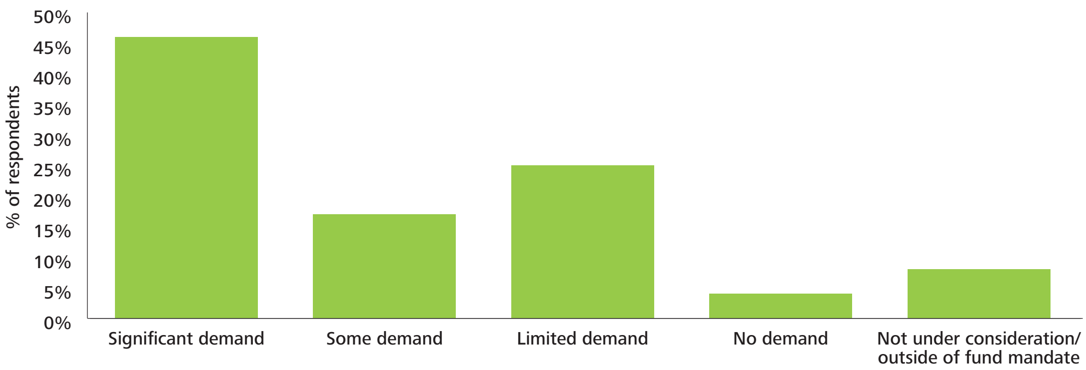
*No comparative data available

Source: Deloitte Infrastructure Investors Survey 2016 and 2013, Deloitte Analysis. Scores are based on the mean average of responses

As discussed in our 2013 survey, regulated assets continue to be highly attractive investments and are expected to continue to be so over the next five years. However the infrastructure investors we interviewed remain concerned about the regulatory environments for these assets, and these concerns appear to have driven the biggest change in Figure 11, where "other regulated utilities" has moved from the most popular category in 2013 to the middle of the pack in 2016, albeit the categorisation changes may also have had an impact. Notwithstanding this the chart below shows investors still have significant demand for regulated assets.

Figure 12

From an investment perspective, please rate the level of demand your fund has/will have for regulated assets



Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Whilst focus on the asset sub-classes themselves are expected to remain broadly consistent over the coming years, infrastructure funds are expecting a number of shifts in their approaches to the asset classes driven by the increased competition for proven core infrastructure assets. This includes:

- a shift from core to core+ and peripheral assets;
- a willingness to engage in deals structured in a more complex way – including hybrid deals; and
- more greenfield investments – driven by the increased competition for proven core infrastructure assets by direct investors.

Markets

The most attractive regions for infrastructure investors, and where they continue to focus the majority of their resources, remains the more traditional infrastructure markets in Western Europe, North America and Australasia.

Within Western Europe, Germany, Scandinavia and the UK remain the most attractive countries for investments – principally due to the stability of the jurisdictions, the quantum of deal flow and the investors' knowledge of these areas. Unsurprisingly these three countries also have the lowest IRRs.

Having seen a significant fall in attractiveness in our 2013 survey when the 'peripheral area' EU economies were struggling, both Iberia and Italy have seen a resurgence in attractiveness and are very much seen as markets that are 'open for business' again, with the expectation that the worst is over for these areas and the hope that a more stable future lies ahead.

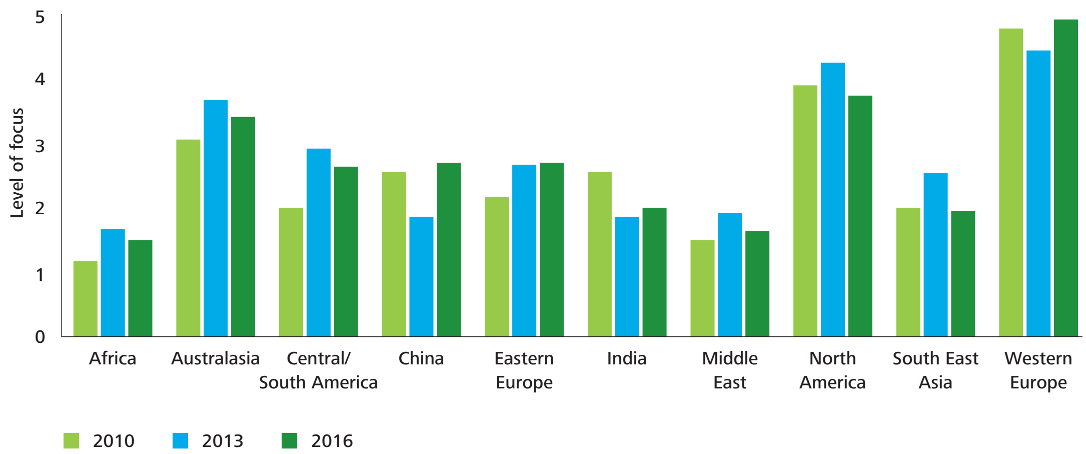
Infrastructure funds are expecting a number of shifts in their approach to investing, driven by the increased competition for proven core infrastructure assets.

However, with the increasing focus of direct investors in these established markets, the European infrastructure funds we interviewed are now considering other regions for investment. Along with Central/Eastern Europe, those investors surveyed are looking further afield for assets, with Central/South America and China increasingly being considered as alternatives.

The Indian market has not seen the same resurgence as the Chinese market, and infrastructure funds focus here remains low, as it does in the Middle East and Africa.

Figure 13

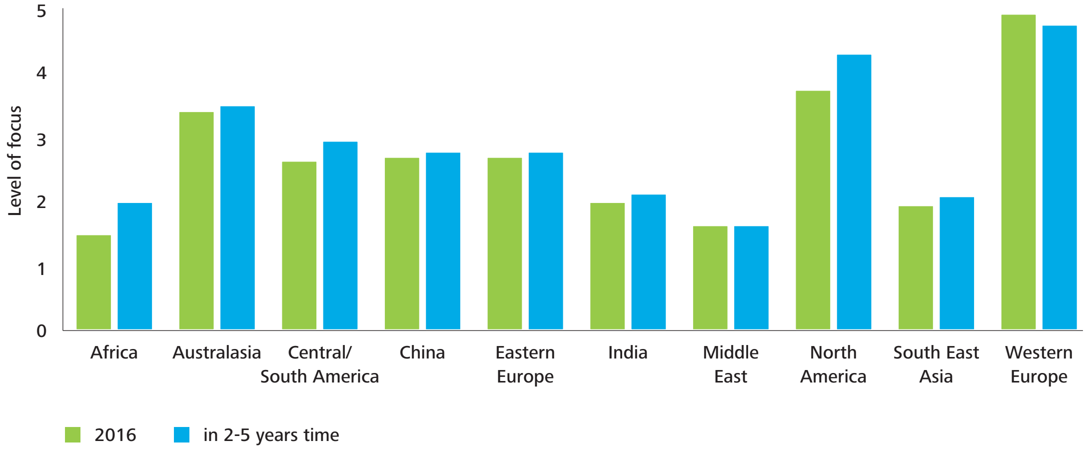
From an investment perspective, please indicate the level of focus your fund has on the following markets (5 being a significant focus and 1 being not under consideration)



Source: Deloitte Infrastructure Investors Survey 2016, 2013 and 2010, Deloitte Analysis.
Scores are based on the mean average of responses

Figure 14

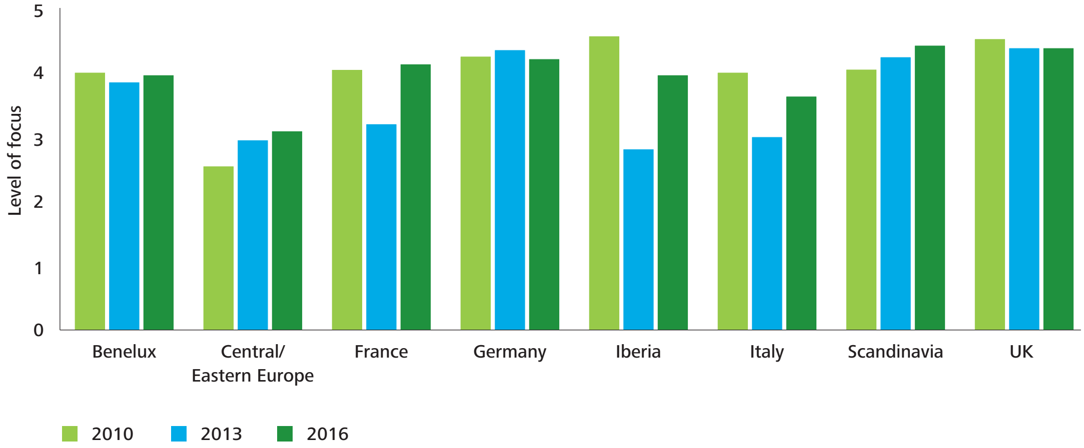
From an investment perspective, please indicate the current and anticipated level of focus your fund has/will have on the following markets (5 being a significant focus and 1 being not under consideration)



Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis.
Scores are based on the mean average of responses.

Figure 15

From an investment perspective, please indicate the level of focus your fund has on the following markets (5 being a significant focus and 1 being not under consideration)



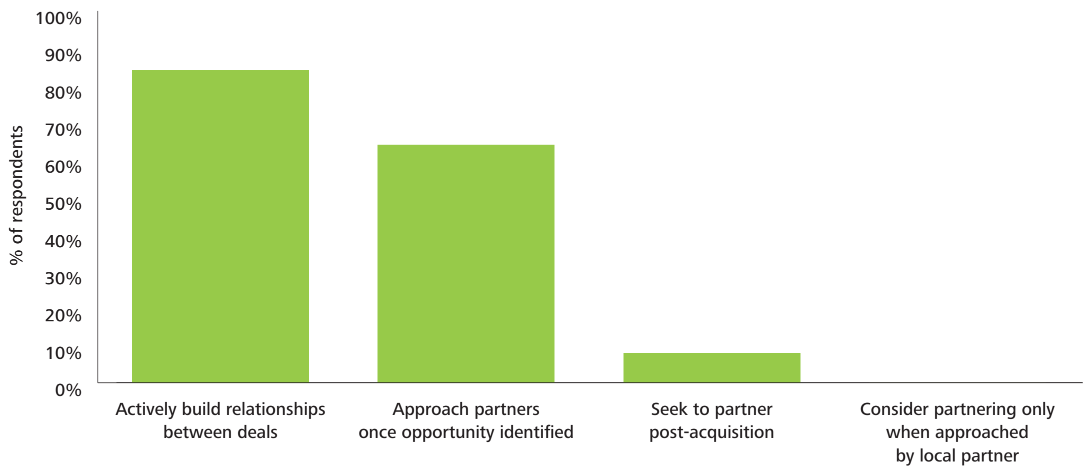
Source: Deloitte Infrastructure Investors Survey 2016, 2013 and 2010, Deloitte Analysis.
Scores are based on the mean average of responses

Partnering

Investors still view building relationships with local partners as a core part of their strategy, and all of the investors interviewed indicated that they actively seek to partner. Whilst the approaches can differ by asset type and geography, the majority of infrastructure investors look to build relationships between deals. This helps to strengthen operational expertise and local market regulatory environment knowledge, and can also drive the early identification of deals.

Figure 16

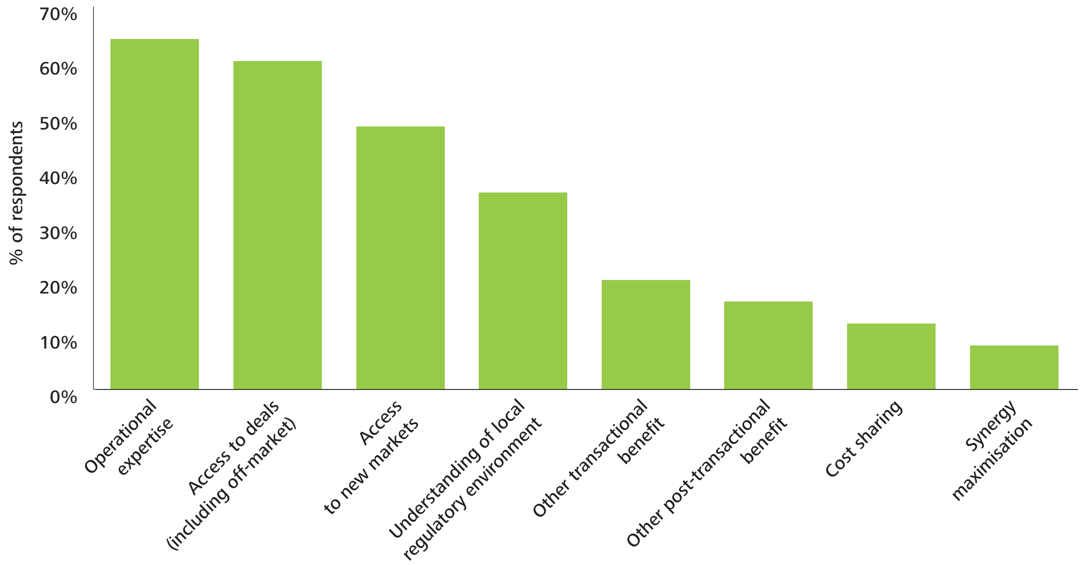
How do you seek to build relationships with potential partners? (select all that apply)



Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Figure 17

What do you see as the key benefits to partnering?



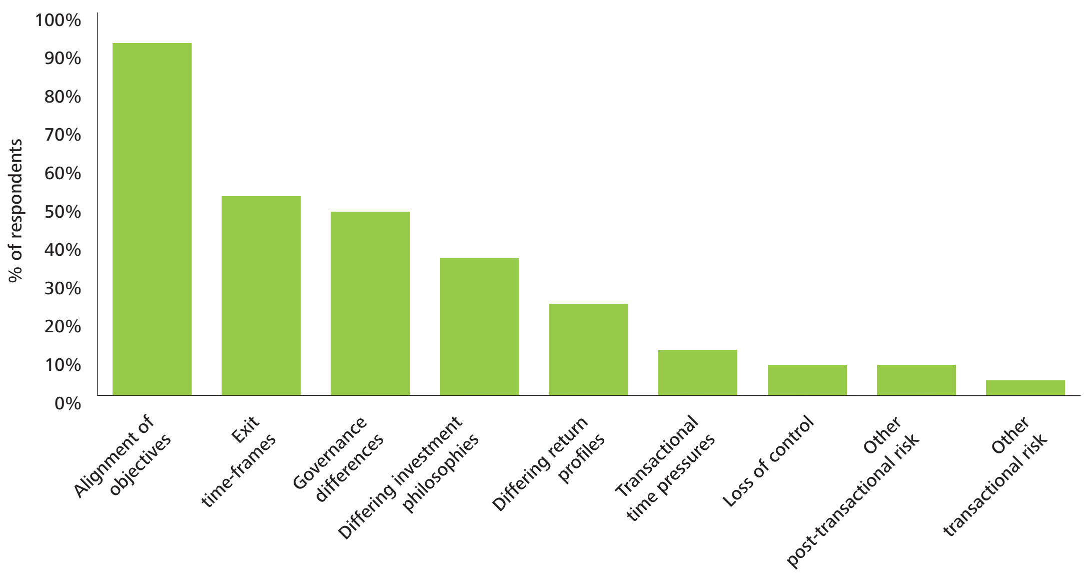
Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

There are particular markets and geographies where partnering is seen as crucial, particularly in geographies where local relationships are culturally important, such as France, Eastern Europe and Asia.

Whilst partnering is important, and often critical, to a successful transaction, it comes with risks attached, principally the alignment of objectives between the fund and the partner. Outside of this, differing views on exit time-frames, and governance structures can cause infrastructure investors concern.

Figure 18

What do you see as the key risks in partnering with corporates?



Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Competitive landscape

In 2013 we noted a marked shift in the competitive landscape, with an emergence of three distinct market segments:

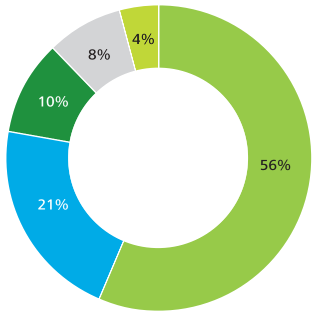
- **large US and European funds:** These are multi-billion Euro or USD funds that typically have a mandate to invest globally and will seek out deals requiring £500m+ equity cheques;
- **mid-market funds:** These are smaller funds, often with a more specific mandate towards certain asset classes and/or geographies, which are looking to invest in deals ranging between £100m-£500m; and
- **direct investors:** These are large institutional investors such as pension, insurance and sovereign wealth funds investing in assets directly rather than through infrastructure funds as LPs. These investors focus on larger core assets in the more traditional jurisdictions given the larger capital at their disposal and the need to service their liabilities, hence focussing more on cash yield.

In our last survey we noted direct investors had significantly increased their investment and operational capabilities which, together with their available capital, enabled them to directly compete with the larger infrastructure funds. This trend has continued over the last three years, and the increasing competition in the marketplace has driven up asset prices. Notwithstanding the competition from direct investors, the funds see other funds as their biggest competitors. The influence of the direct investors is felt more in the larger market where they were the clear second largest competitor.

The influence of the direct investors is felt more in the larger market where they were the clear second largest competitor.

Figure 19

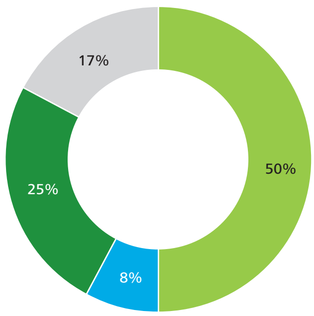
Large funds – Who do large investors see as their biggest competitors?



Other infrastructure funds | Direct investors | Private equity | Trade buyers | Other

Figure 20

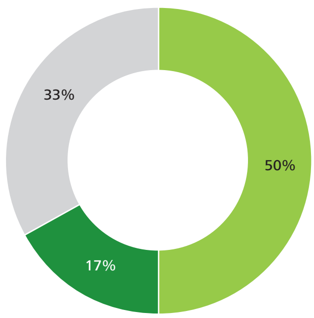
Mid-market funds – Who do mid-market investors see as their biggest competitors?



Other infrastructure funds | Direct investors | Private equity | Trade buyers

Figure 21

Direct investors – Who do direct investors see as their biggest competitors?



Other infrastructure funds | Private equity | Trade buyers

Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

The changing competitive landscape

To counteract the changing competitive landscape, infrastructure fund investors are increasingly seeking alternative and innovative strategies through which they can differentiate themselves. These infrastructure fund investors expect to see the following trends over the next 2-5 years:

- **deal sourcing for traditional infrastructure assets will continue to become more competitive** with the continued influence of direct investors in the market;
- funds expect to be **more innovative in deal souring, seeking bilateral processes** where possible to avoid auctions where prices are more influenced by direct investors;
- as direct investors move up the risk chain, infrastructure funds will be forced to look at assets outside of the core infrastructure assets – increasingly looking at core+, peripheral and greenfield assets – with **the definition of infrastructure assets widening**;
- infrastructure funds are expecting to be pushed towards **the less traditional geographies** as direct investors strengthen their foothold in the more established infrastructure markets.

To counteract the changing competitive landscape, infrastructure fund investors are increasingly seeking alternative and innovative strategies through which they can differentiate themselves.

Risks

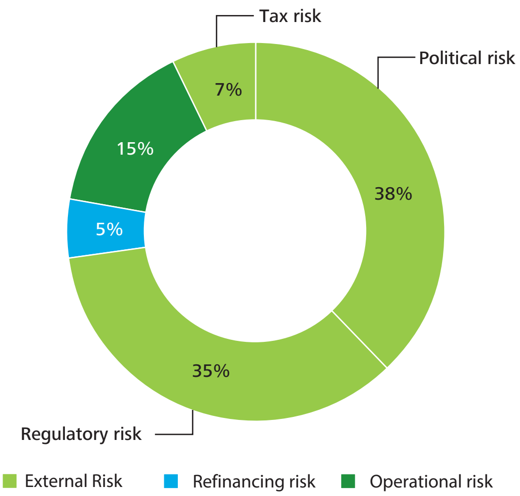
The key risks that concern infrastructure investors are external risks. When considering whether to invest or not, almost all of the infrastructure investors we interviewed identified macro-economic risk as the most important factor. On the face of it, this might seem unexpected as infrastructure asset investments are often insulated from direct GDP risk; however, infrastructure investors appear to see the macroeconomic picture as critical in influencing the other external risks that they face.

Outside of the macro-economic environment, political and regulatory risks were the key areas of focus highlighted by investors. Investors expect these key areas of risk focus to remain unchanged going forward.

Whilst tax risk is one of the lower areas of focus, the message we've received from investors is that tax risk is intrinsically linked with political and regulatory risk. With a global tax reset underway, being driven by international initiatives such as the OECD/G20 Base Erosion and Profit Shifting ("BEPS") project, infrastructure investors are closely monitoring how these fundamental changes in the tax landscape will impact their investments.

Figure 22

When considering whether to invest, which risks most concern you?



Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Whilst some infrastructure investors have mentioned technological risk, this area does not currently seem high on the agenda for infrastructure investors. Given the increasing reliance on technology it may be that technological risk becomes more of a focus for infrastructure investors going forward and an area that regulators may look to address.

Regulatory risk has increased dramatically over the last five years, with over 90% of infrastructure investors interviewed indicating that the regulatory risk environment has increased over this period. Investors expect this trend to continue, with over 65% of those interviewed expecting stricter regulation over the next five years.

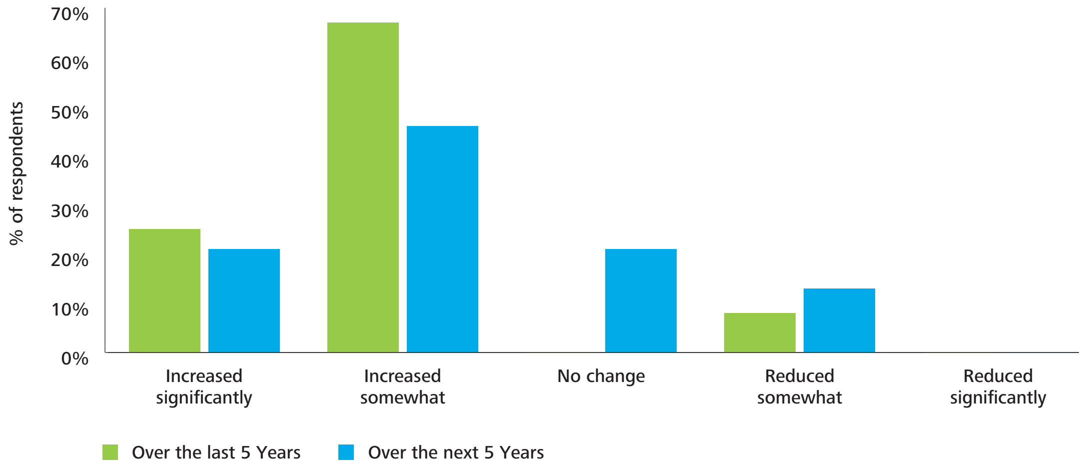
We were not surprised by these responses given the high-profile regulatory changes that we have seen over the last few years, with a number of European jurisdictions making regulatory changes that have significantly impacted returns for infrastructure investors. These include the regulatory changes to the Gassled system tariffs from 2016, the lowering of the solar feed-in tariffs in Spain, and the retroactive changes in the Italian solar feed-in tariffs.

Infrastructure investors increasingly see regulatory and political risk as linked, with a perception that regulators are more and more influenced by the political landscape and that politicians are seeking to influence regulators to achieve their political goals. Given this trend, we expect regulatory risk to remain very much front-of-mind for most investors.

Almost all of the infrastructure investors we interviewed identified macro-economic risk as the most important risk factor in their investment decisions.

Figure 23

How would you characterise the evolution of the regulatory risk environment?

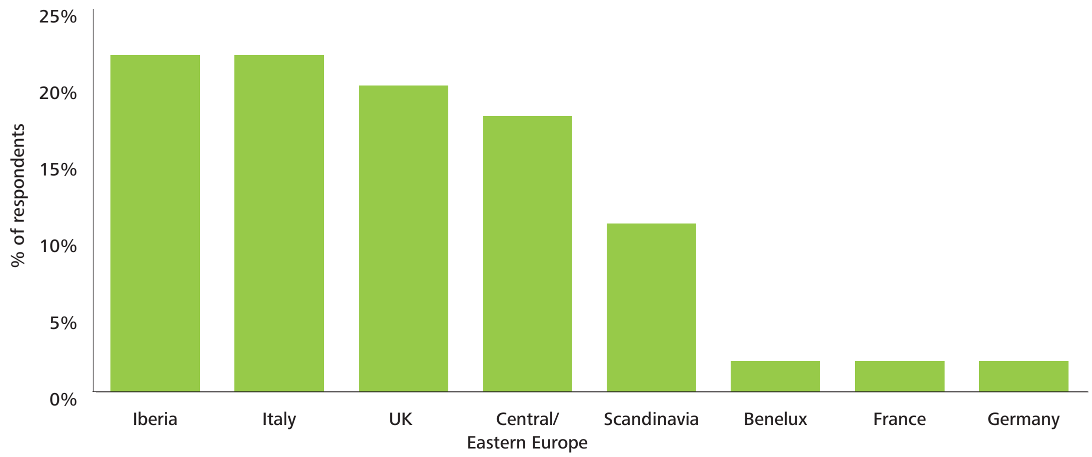


Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Within Europe, the infrastructure investors that we interviewed see regulatory risk as particularly high in the UK, Iberia and Italy. The investors that we interviewed identified the key reasons for this as the lack of stability and consistency in the regulatory regimes in these jurisdictions (e.g. regulatory changes in both Spain and Italy in respect of renewables assets) and that in some instances regulation is considered to be onerous.

Figure 24

European regions of greatest regulatory risk



Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

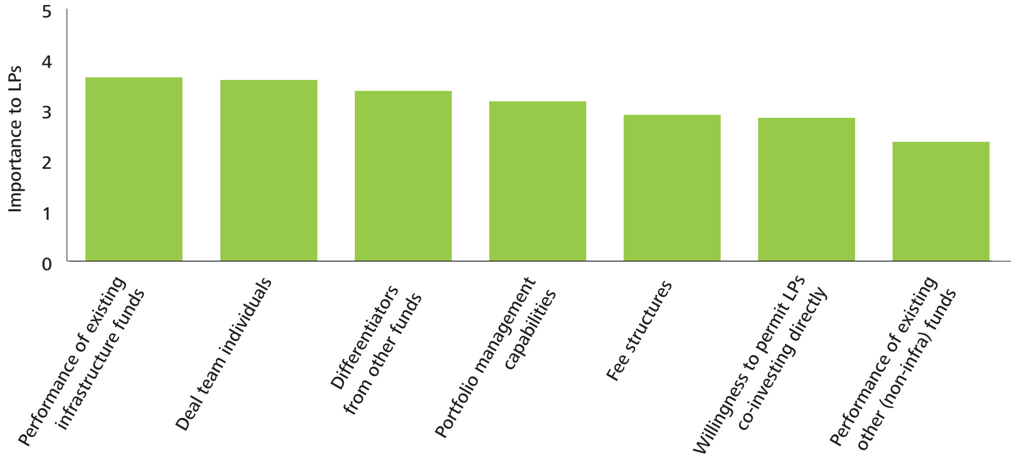
There is a clear desire from infrastructure investors for more stable regulatory regimes, and for regulators to be more independent and less susceptible to the influence of changes in the political landscape.

Fundraising and LP due diligence

The factors that LPs see as critical in determining whether to invest in infrastructure funds are broadly consistent with those that we have seen historically; however, individuals on the deal team within the fund are now clearly seen as one of the most critically important areas of focus for LPs, alongside the performance of existing infrastructure funds.

Figure 25

Please indicate on a scale of 1 to 5, the importance of the following characteristics to LPs in the fund raising process (5 being of critical importance and 1 being not applicable).



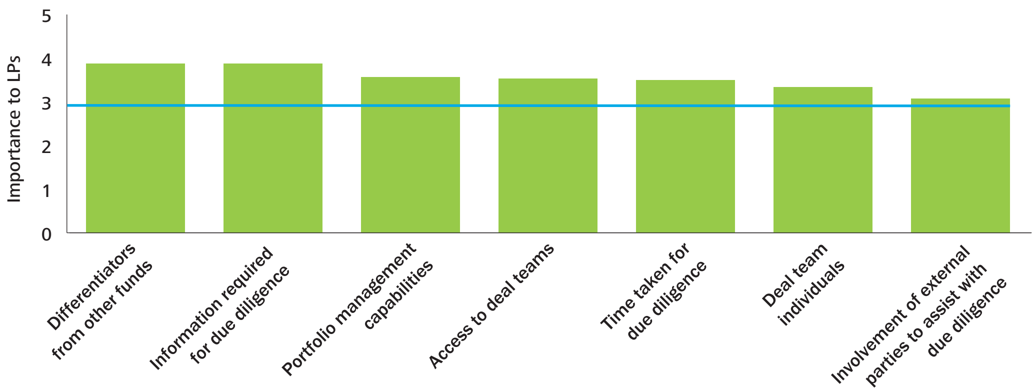
Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis. Scores are based on the mean average of responses

In our 2013 report we noted LPs had increased the amount of due diligence performed when investing, and this has continued to be the case. Our 2016 survey clearly shows LP due diligence has increased even further over the last two years across all areas, and is expected to continue to increase over the next two to five years.

This has been particularly noticeable by the increasing amount of information requested by LPs to undertake their due diligence.

Figure 26

On a scale of 1 to 5, how has LP due diligence evolved over the last two years (5 being a signficant increase and 3 being no change)?



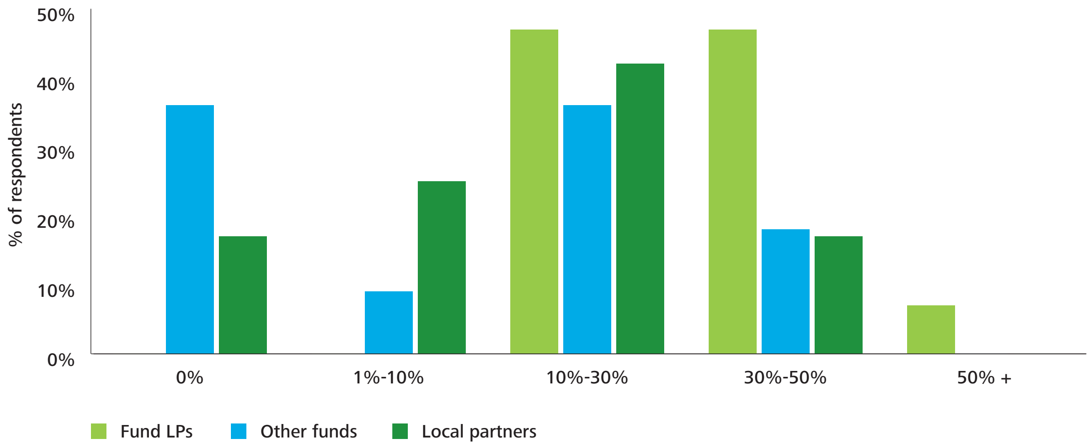
Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis. Scores are based on the mean average of responses

Funds' strategies for attracting cornerstone investors have remained consistent, with co-investment rights and refined fee structures still the key incentives offered – with no appetite to offer LPs board representation.

LPs are also the preferred co-investors, with access to larger stakes than other co-investors.

Figure 27

How much equity in target investments are you prepared to offer to fund LPs, other funds and local partners as co-investors?



Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Debt financing

Continued strong appetite

As predicted in our 2013 report, the availability and terms of infrastructure debt financing have stabilised over the last three years.

In general, the infrastructure investors we interviewed felt that the level of debt available in the market was often in excess of the leverage multiples that they are looking to take, and so we don't see an appetite in the market for further leverage to be made available. The investors we interviewed feel that debt availability will continue to remain steady over the next five years.

There may be a further increase in competition in the debt markets in the coming years, with Solvency II paving the way for institutional investors to become involved in the markets.

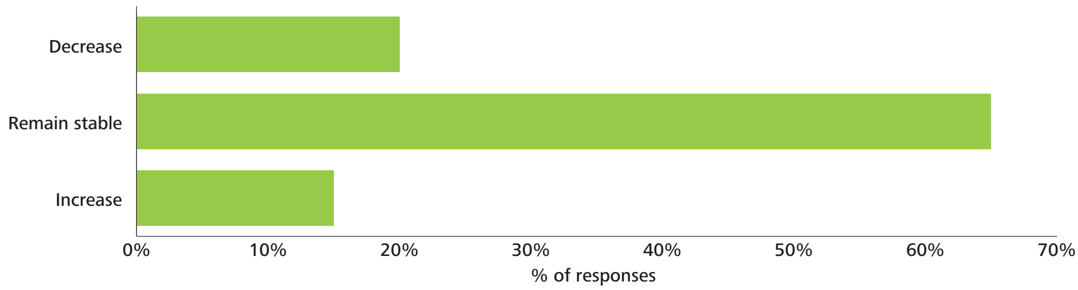
Pricing has continued to become more competitive, with margins as low as 150bps, compared to around 200bps in 2013 and 250-300bps following the financial crisis. This seems to be driven by the very strong appetite from lenders to lend to infrastructure assets. With little desire from borrowers for additional quantum of lending, pricing has become the key differentiator for lenders.

Fees are currently fairly low and are expected to remain stable in the 2%-2.5% range, and debt covenants have also stabilised at a fairly light level, although not reaching the covenant-light levels we saw prior to the financial crisis.

In general, the infrastructure investors we interviewed felt that the level of debt available in the market was often in excess of the leverage multiples that they are looking to take.

Figure 28

How will the availability of debt change over the next five years?



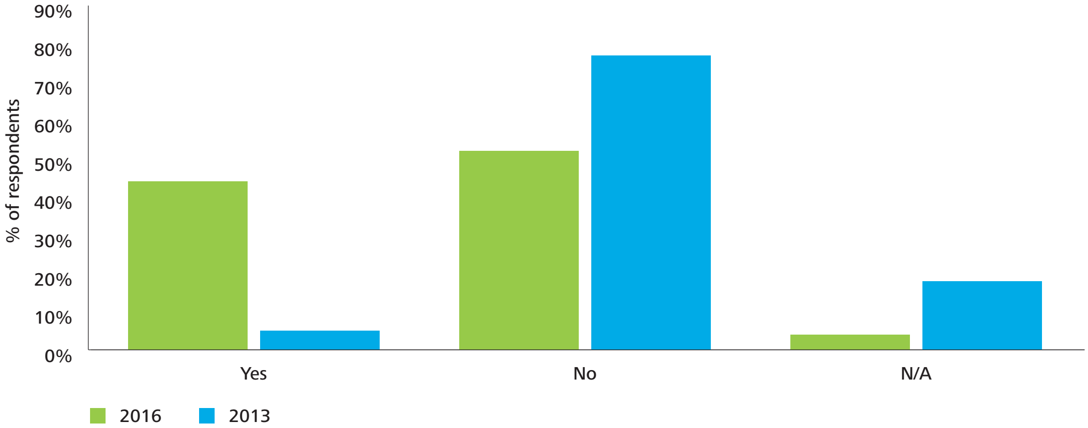
Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Infrastructure debt funds

In our 2013 survey we discussed the potential emergence of specialist infrastructure debt funds as a new phenomenon in the market. At the time of our survey in 2013, only one of the infrastructure investors we interviewed had a specialist debt fund, and very few were considering launching one. We concluded there to be only a modest appetite amongst infrastructure funds to establish their own debt funds – however three years on, the picture appears to have changed significantly, with over 45% of those infrastructure investors interviewed now either managing a debt fund or alternatively managing a segregated account focussing on debt investments.

Figure 29

Do you already have a debt fund/platform?



Source: Deloitte Infrastructure Investors Survey 2016 and 2013, Deloitte Analysis

When asked whether now was the time to launch a debt fund or platform, about 40% of investors indicated that now would be a good time. Investors already managing a debt fund were much more positive, with 64% believing that now was the right time compared to only 17% of those without an existing debt platform.

As was the case in 2013, it seems the appetite to actually launch a debt fund is limited, with only 13% of those interviewed indicating that they were considering doing so – and all of these investors already have a debt platform.

Figure 30

Investors without a debt fund/platform

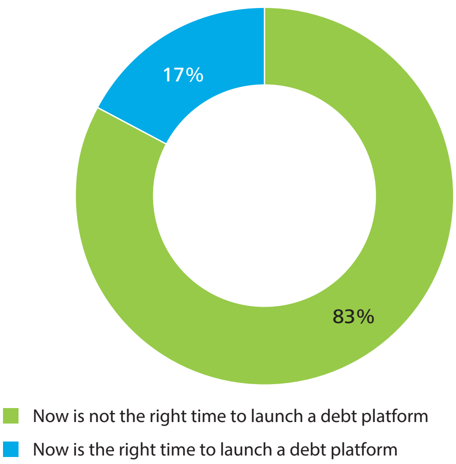
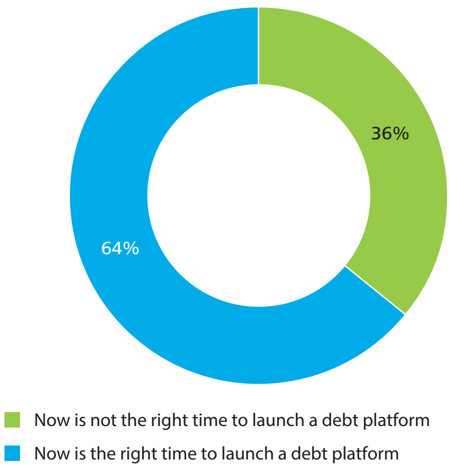


Figure 31

Investors with a debt fund/platform



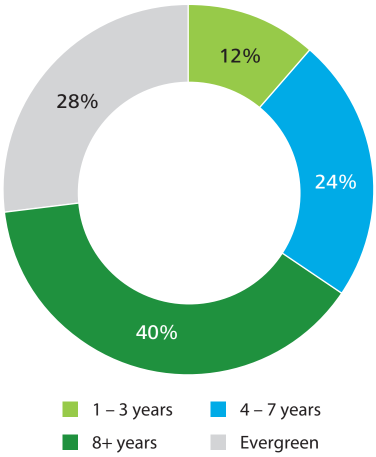
Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Exit strategy

Given the current environment of high asset prices driven by the direct investors in the market, and with a number of first generation funds moving towards maturity, we are expecting the number of secondary disposals by infrastructure funds to accelerate over the next few years.

Figure 32

How many years does your current fund have until maturity?

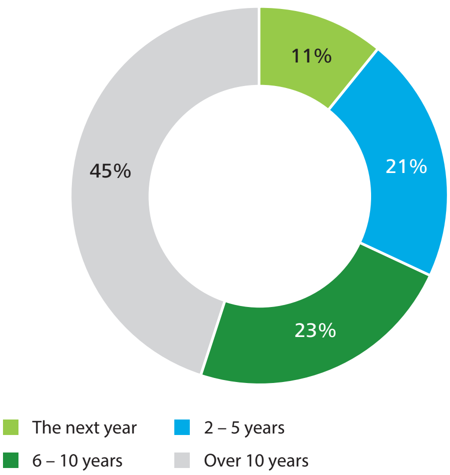


Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

The investors that we interviewed identified c.120 assets that they currently hold that they expect to exit from over the next five years, an average of about a third of their portfolios.

Figure 33

When are you expecting to exit your current assets under management?



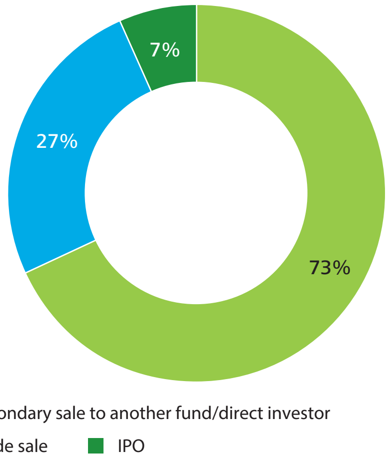
Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

In our 2013 survey we discussed the prevalence of exits through IPOs in the wider investment market, and predicted that this trend would translate into the infrastructure market. In reality, we have seen very few investors even considering IPOs as an exit route for their assets, and no significant IPO exits.

As the IPO market has settled down over the last two or three years, listing as a potential exit route now seems less attractive, and for infrastructure investors an IPO is the preferred exit route for only 6% of asset exits over the next five years.

Figure 34

What exit routes do you think are best suited to your assets?



Source: Deloitte Infrastructure Investors Survey 2016, Deloitte Analysis

Unsurprisingly, investors almost unanimously indicated they would prefer a bilateral process over a formal auction process when acquiring an investment, with those selling still preferring an organised sale process as a route to maximise coverage and control of the sale, and therefore price.

Encouraging private investment in infrastructure

What should governments do?

We asked infrastructure investors what key things governments should be doing to promote private investment in the infrastructure industry. A number of overarching themes emerged from the responses we received:

1. **Stabilising regulatory environments**

   An unstable or unclear regulatory environment has a significant impact on investors' appetite to make investments. Investors have identified Italy, Iberia and the UK as jurisdictions where they presently have most concerns in this respect.

   Given this, the key step to continue to encourage private investment in infrastructure will be to ensure the independence of regulatory bodies and a stable, consistent regulatory framework.

2. **Cleverly packaging and structuring deals**

   Private infrastructure investors have a strong appetite for investments that deliver yields as soon as possible. Historically, this has been through a focus on secondary acquisitions, however we have seen an increasing appetite for private investment into primary deals that are cleverly structured to deliver returns earlier in the lifecycle. The Thames Tideway transaction is a good example of such a deal, and the delivery model for this project is seen by private infrastructure investors as a positive blueprint for other major infrastructure projects that governments could seek to replicate going forward.

3. **A willingness to underwrite contracted risks**

   Another key barrier to private infrastructure investors seeking to invest in primary projects is the contractual uncertainty early in the asset life. Governments hoping to encourage private investment into greenfield infrastructure should consider providing some form of support/risk reduction during an infrastructure project's early development stages. This would reduce the development risk and would increase competitive bids.

4. **Tax stability**

   As with the regulatory environment, the stability of the tax system is crucial for infrastructure investors returns, and a stable and predictable taxation environment enables private investors to appropriately price infrastructure investments. Where jurisdictions are seen as having particularly volatile tax environments (including significant changes to the tax system, or retrospective taxation if returns are perceived to be high), private infrastructure investors become significantly less willing to invest.

5. **Providing more opportunities and projects**

   Investors have successfully raised funds and are ready to invest in infrastructure assets, however there is a current lack of pipeline in high quality infrastructure assets. In order to encourage private investment, governments should seek to bring more opportunities to market to take advantage of the capital currently available.

6. **'Unblocking' planning approval processes**

   Unwieldy and lengthy planning approval processes are often quoted by investors as being both a barrier to spending expansionary capex in current investments, and in making new investments.

   Given the number of times this came up in our conversations, this is clearly an area that governments should look into if they want to promote and accelerate private investment in infrastructure.

7. **Educating the public about private investment in infrastructure**

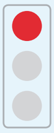
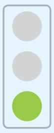
   Infrastructure investors are more aware of the public perception of their role than ever before, and PR is becoming an increasingly critical issue facing these investors.

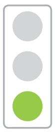
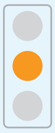
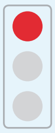
   Governments seeking to promote private investment into infrastructure should seek to educate the public to the benefits of private infrastructure investment, both explaining the necessity for private capital, the risks taken by private investors, and by publicly backing private infrastructure investment through the life of the investment.

Our previous predictions

How did we do?

In our 2013 report we made a number of predictions about how we envisaged that the infrastructure market would evolve over the next few years. How did we do?

2013 predictions		Where are we now?
	**Exits ahead** – We predicted that we would see an increasing number of exits, many of which would be positive for funds.	We have seen an increasing number of exits by infrastructure funds, and expect to continue to see this as first generation funds move towards maturity. The majority of exits have been very positive for funds, with infrastructure assets currently attracting high prices.
	**IPOs** – We expected to see the infrastructure market mirror the considerable activity in the broader IPO market, and predicted that we would see at least one exit of a transport or renewables asset to IPO.	This prediction has not materialised, with the broader IPO market cooling and with high prices being available through secondary sales, this is still the preferred exit route.
	**Secondary sales** – We expected to see an increasing bubble of secondary sales to direct investors where infrastructure funds had proved the stability of returns over the course of their ownership.	We have seen this pattern clearly develop in the market, with direct investors increasingly looking to invest in secondary sales of assets. One of the more recent examples of this was the sale of London City Airport by GIP and Oaktree to a consortium predominantly consisting of direct investors.
	**An imperative to innovate** – We predicted that the rise of direct investors would push funds to pursue more innovative strategies to differentiate themselves.	We are starting to see this happen with infrastructure funds moving into core+ assets, widening the definition of what constitutes an infrastructure asset, and changing investment thesis to a less traditional infrastructure model. Infrastructure investors expect to continue having to innovate to move outside of the core infrastructure market that they see increasingly dominated by direct investors.

2013 predictions	Where are we now?
 **Asset Management** – We expected to see an increased focus on asset management, and predicted that we would see infrastructure funds recruit dedicated asset management teams.	We have seen infrastructure funds focus more on asset management. Some have recruited more dedicated asset management teams, whilst others use their teams to both complete transactions and manage the assets afterwards.
 **New entrants** – We thought two new groups of infrastructure investors would emerge: • Asian directs; and • European insurance companies and other principal financial institutions.	We are starting to see Asian direct investors enter the market, albeit not yet at the scale anticipated in 2013. We have also started to see European insurance companies increasing their focus on the market, partially driven by Solvency II, albeit the influx has not been as strong as anticipated in 2013.
 **Implications for pricing** – We predicted that despite an increased supply of assets coming to market, there would continue to be an excess of capital chasing core infrastructure assets, and so prices will remain high.	This has clearly been the case. With debt remaining more affordable than expected over the last few years and the increasing presence of direct investors, we have seen high price levels, perhaps even in excess of what we expected in 2013.
 **Departures** – We expected to see some departures from the infrastructure funds market – primarily those who failed to differentiate themselves in an increasingly competitive market.	We have not really seen this happen to a great extent and as the infrastructure investors market continues to stabilise and investors adapt to the new competitive landscape, we do not now expect significant departures from the traditional infrastructure fund market. In fact, many infrastructure funds seem to be successfully raising new funds at the moment.

2016 predictions

We have seen the infrastructure investors market begin to stabilise over the last few years, with an increasingly coherent market picture emerging in the industry. So, in the medium term, what do we think is on the horizon for the road ahead?

1. **Steady as she goes** – We expect the infrastructure investor market to enter a relatively stable phase, with no significant market shifts over the next few years. Where change does happen, we expect a gradual evolution, rather than fast-paced change.

2. **An increasing number of exits** – A significant portion of assets under management will be exited over the next five years, and we're expecting an uptick in transaction volume. However, we're expecting the majority of these exits to be to infrastructure funds and direct investors, and so do not expect these exits to cause a contraction in the infrastructure investor market.

3. **Direct investors** – Direct investors are expected to remain the key competitors for the established infrastructure funds, with direct investors willing to accept lower returns and as a result willing to pay more for assets. We're expecting to see a lot of secondary sales of assets in the more established infrastructure markets to direct investors where infrastructure funds have shown a track record of stable returns. We expect to see more direct investors focusing on core infrastructure, pushing infrastructure funds towards "core+" infrastructure and also into less traditional jurisdictions.

4. **Increased focus on deal sourcing** – As the core infrastructure landscape in the established jurisdictions becomes more competitive, we expect infrastructure funds to spend an increasing amount of time looking for off-market or proprietary deals to avoid competitive auction processes.

5. **More differentiation by infrastructure funds** – We also expect infrastructure funds to become more differentiated – again, driven by the competition from direct investors in the core infrastructure market. We expect the infrastructure funds to begin to focus more on non-core and core+ assets, as well as into geographies that might be less attractive to direct investors. We also expect a shift towards more complex and bespoke transactions (particularly for greenfield assets) that are less likely to be favoured (at least initially) by direct investors.

6. **Debt markets remaining buoyant** – Infrastructure debt has been readily available in the market and whilst we expect to see this tighten slightly, it is unlikely to put pressure on infrastructure funds. We are also expecting to see debt pricing spreads and terms become less generous, although these are not expected to deteriorate significantly. We also anticipate a much broader source of debt capital for infrastructure deals and projects to emerge.

7. **Regulatory risk** – We expect regulatory risk to remain the overriding key external concern for infrastructure investors. Whilst infrastructure investors would like to see increased stability in the regulatory environment, we expect to see a continued trend of uncertainty, particularly in Europe given the continuing political uncertainty in some jurisdictions.

Notes

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