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Infrastructure Managers Feeling the Heat.

Infrastructure managers are under pressure to increase their investment in the U.S. as American investors boost infrastructure exposure and the investment climate in Europe — the top region for infrastructure deals — becomes less hospitable.

Managers are in a tough spot. They have more capital than viable deals. At the end of the first quarter, infrastructure managers were sitting on a record \$124 billion in unspent capital commitments, according to London-based alternative investment research firm Preqin.

At the same time, the U.K.'s vote to leave the European Union, combined with the upcoming referendum on the Italian government and elections in Germany and France, are starting to cause some infrastructure managers and investors to steer clear of Europe.

This makes the U.S.'s infrastructure need — estimated by the American Society of Civil Engineers to total \$3.6 trillion by 2020 — a tempting target. But the much lower cost of municipal bond financing and the high political cost of privatizing publicly funded infrastructure has put the bulk of these potential projects beyond managers' reach.

However, there are signs of change.

Both U.S. presidential candidates have plans to boost infrastructure investment. Democratic nominee Hillary Clinton's proposal is to spend \$275 billion over five years for infrastructure that would be funded through business tax reform. Some \$250 billion would be direct public investment with the remainder going to fund a national infrastructure bank that would offer loans, loan guarantees and other forms of credit. The bank would expand the Build America Bonds program.

Republican nominee Donald J. Trump has proposed \$800 million to \$1 billion in infrastructure spending, which would be financed with government bonds.

What's more, U.S. state and local governments are beginning to increase their use of public-private partnerships for everything from roads to courthouses.

And a new IRS regulation released in August makes it easier for infrastructure to be financed with a combination of municipal bonds and private investment.

Geopolitical uncertainty

Outside of public-private partnerships, infrastructure managers increasingly are investing in renewable energy as the U.S. moves away from coal and traditional energy sources. Regulatory changes are making renewable energy investments more attractive to investors.

"A lot of institutional investors today, because of uncertainty in Europe, don't want to take the geopolitical risk that is happening there," said Timothy C. Ng, chief investment officer of outsourced CIO firm Clearbrook Global Advisors LLC, New York. "If anything goes sideways, it will affect your projects and they won't get done."

So a lot of capital is flowing to the U.S. for infrastructure, as well as for real estate and private equity investment, Mr. Ng explained.

"There's huge money here now," Mr. Ng said.

And that is putting more pressure on managers to seek out deals in North America.

Europe is the top region for infrastructure investment. There were 266 deals in Europe in the first half of this year compared with 178 in North America, according to Preqin. The U.S. accounted for 140 of the North American transactions.

Investors typically like to invest their money at home first, said John Sweeney, vice president of New York-based placement agency Park Madison Partners LLC.

Institutional investors globally have an increased appetite for infrastructure, Mr. Sweeney said, because of its low volatility and risk profile.

"This creates a problem for infrastructure funds and infrastructure investors because as more capital is flowing into the sector, pricing is becoming more competitive," Mr. Sweeney said. "And the deal flow was already not as robust as it should be considering there's a lot of need in the U.S."

For investors, the too-much-capital-for-too-few investments is a classic recipe for lower returns, increasing the burden on managers to find viable deal sources.

This overabundance of capital is a concern for officials at longtime infrastructure investor New Mexico Educational Retirement Board, Santa Fe, said Bob Jacksha, CIO of the \$11.4 billion pension fund.

"We were one of the first, perhaps the first, U.S. public pension plans to have an active infrastructure program," Mr. Jacksha said. New Mexico ERB has invested in infrastructure since 2008.

"We have seen the demand increase as other funds have joined us and as they have allocated more and more capital to the space," he said.

A lot of that demand is for core assets, because of the perceived safety of that category, Mr. Jacksha said. So New Mexico ERB officials have been investing in projects that involve construction.

"We are now often investing in something other than core, as that has become expensive," and in core greenfield projects, Mr. Jacksha said. "Some other investors may not classify these as core."

The ERB also has invested in build-to-core projects — projects sold to core buyers after they're built.

ERB has about 73% of its \$413 million in infrastructure exposure — fair value plus unfunded commitments — in the U.S.

Move to U.S.

Infrastructure manager IFM Investors Pty. Ltd. plans to invest as equally as possible in the U.S. and Europe to maintain the diversification of its open-end fund, said Julio Garcia, head of infrastructure, North America, in the New York office. Some 55% of IFM's global open-end fund portfolio is invested in the U.S., Mr. Garcia said.

In the past 18 months, IFM invested a combined \$4 billion in two toll roads: the Indiana Toll Road

and the Circuito Exterior Mexiquense in Mexico City. In May, IFM sold a stake in the Indiana Toll Road to the \$307.2 billion California Public Employees' Retirement System, Sacramento, and Allstate Corp.

Mr. Garcia sees a lot of opportunity in the U.S. in energy infrastructure — especially in the midstream space, the pipes that transport oil from source to refinery to market.

Wilson Magee, New York-based director of global real estate and infrastructure securities at Franklin Templeton (BEN) Institutional LLC, said he is seeing “interesting capital investment opportunities” in water and wastewater projects as municipalities need to upgrade their systems.

Franklin Templeton's global infrastructure funds have 30% to 35% invested in the U.S.

Over time, Mr. Magee said he expects that airports, which are mostly publicly owned in the U.S., will switch to a model that includes private ownership. “The model elsewhere around the world is long-term concession contracts,” he said.

The first big airport project in the U.S. is a public-private partnership that includes finance, design, construction, operation and maintenance of New York City's LaGuardia Airport Central Terminal B, with a lease term through 2050.

There are other airport public-private partnerships on the drawing board. Los Angeles World Airports, the city agency that operates the City of Los Angeles' three airports, is considering a public-private partnership to finance a modernization program for Los Angeles International Airport that would include a 2.25-mile automated people mover.

In August, the Denver City Council approved continued negotiations with a consortium led by Ferrovial, a Spanish firm that runs London's Heathrow Airport, for a partnership to upgrade one of its terminals.

“There is increased interest in P3 in the U.S. recently,” said Justine Kastan, an attorney in law firm Rutan & Tucker LLP's Palo Alto, Calif., office who specializes in public-private partnership infrastructure investments.

In August, the IRS made regulatory changes that increase the length and flexibility of public-private partnerships, Ms. Kastan said.

But even before the IRS rule change, governmental interest in P3s had increased, she said.

“I think there is a growing national awareness that we have infrastructure needs that aren't being met,” Ms. Kastan said.

PENSIONS & INVESTMENTS

BY ARLEEN JACOBIOUS | SEPTEMBER 5, 2016

This article originally appeared in the September 5, 2016 print issue as, “Infrastructure managers feeling the heat”.

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