Bond Case Briefs

Municipal Finance Law Since 1971

Early Views On The US Energy And Infrastructure Sectors Under A Trump Administration: Sherman & Sterling

Energy and infrastructure policy was as at the forefront of the presidential election discussion and has continued to be highlighted as a focus for the Trump administration. Here, we take an early look at how a Trump administration could affect the US energy and infrastructure sectors.

Renewables

- The current renewable energy industry continues to rely on tax credits for growth. The Production Tax Credit (PTC) is primarily utilized by the wind energy industry, while the Investment Tax Credit (ITC) is utilized by investors in both wind and solar. Predictability for these tax credits has been critical for future investment – for example, investment in wind has historically significantly slowed in past periods leading up to an expiration date.
- The FY16 Omnibus Appropriations Bill passed in December 2015 included the extension, step-down and, ultimately, phase-out of both the ITC and the PTC. Despite the phase-out, the renewal of the ITC and PTC programs is expected to spur new investment into the 2020s.
- The advent of the new administration, at a minimum, plays a role in creating a degree of uncertainty around the previously assumed stability of the tax credits. While Congress has the power to repeal the credits, including as part of a comprehensive tax reform which has been discussed by Trump, there are many factors that make major changes to the tax credits unlikely.
- Over the past eight years, wind turbines and solar panels have begun moving into states held by GOP politicians, lending renewable energy increasing bipartisan support in key geographic areas of the country.
- In 2008, just 12 US House Republicans represented districts where utility-scale solar facilities are located; in 2016, the number has risen to 89.1 In that same time span, the number of House Republicans with utility-level wind power facilities in their districts increased from 34 to 67.2
- In terms of the production capacity of wind power, the top states in 2015 were Texas, Iowa, California and Oklahoma.3 The states opening the greatest number of wind power facilities between 2008 and December 2015 were Texas and Iowa (opening 74 and 60 wind facilities, respectively).4 Since 2008, North Carolina has opened 281 solar-power facilities, second only to California.5 In terms of state-by-state representation, Republican senators now represent approximately half of the top wind energy states and half of the top solar energy states.6
- There are, of course, Republicans and Republican organizations that oppose credits as an unfair subsidy. And while Trump himself has been a vocal opponent of President Obama's executive actions on climate, Trump did not openly oppose the tax credits and even supported the wind credit, as phased out over the next years.
- On balance, the changeover of agency control at the IRS and Treasury could be more likely to have an effect on the ITC and PTC. Treasury and IRS have the ability to affect the implementation of the credits, by issuing guidance on their use. However, these changes in guidance cannot alone repeal the credits.
- Another potentially powerful factor to consider is the effect of Trump slashing corporate tax rates from 35% to 15%. If corporations have a drastically lower overall tax liability, there could be less need for corporations to engage in tax-equity investments to round up offsetting credits. While, in

the past, demand for tax-equity outpaced supply, the tax-equity investment market in renewable energy could lose momentum at a time when wind and solar projects are expected to require approximately $56.2 billion over the next four years.7 Those in the industry expect that demand will not fall so much that tax-equity will run dry, but investors should keep an eye on this space.

Oil, Gas and Coal – Outlook

- Throughout his campaign, Trump has promised to "unleash America's $50 trillion in untapped shale, oil and natural gas reserves."8 However, Trump's energy plan by itself may not have the ability to achieve this goal. In the current economic climate, many oil and gas companies have slowed down on new drilling activity because there is already a glut of supply brought on by the shale revolution. Last year, the US produced its highest average of oil per day since 1972, doubling the 2008 average.9 Crude prices hit a low of $26.21 a barrel in New York in early February.10 Continued increases in production resulting from a Trump plan to further lift regulations on the oil and gas industries could have the effect of driving prices down. Additionally, any changes in US policy will need to be viewed in light of macroeconomic forces such as the recent OPEC decision to reduce production.
- It also has not necessarily been clear that production activity was significantly affected by environmental regulations. Oil and gas companies have in many cases scrapped significant projects because of the low price of oil rather than burdensome regulation. Investment is expected to increase only as it becomes commercially attractive again, whether or not environmental rules and regulations have been nullified.
- One part of the oil and gas market that may grow under a Trump administration is the midstream pipeline market. Trump has pledged to approve certain pipelines currently blocked by the Obama administration on the grounds of environmental concerns. Trump-led agencies are also expected to be an asset to midstream players, incentivizing investors to lower the risk premium currently imposed on companies seeking to build out this type of infrastructure. In turn, the enhanced infrastructure and transportation for petroleum products would also improve economics for major upstream operators.
- The coal industry has celebrated Trump's victory, following his promise to put miners back to work. As natural gas has become a cheaper alternative fuel source, however, utility companies have naturally reduced their reliance on coal as an energy source. Since 2008, over 300 coal-fired power plants across the nation have closed.11 While many countries still import American coal, coal exports fell 23% overall in 2015 and fell another 32% in the first six months of 2016.12 Any help given to the natural gas industry by a Trump administration may further affect the opportunities for a bounceback in the coal industry. It appears unlikely that investors would seek out new coal opportunities in great numbers, especially considering that any regulations removed or blocked from implementation under a Trump presidency (such as the Clean Power Plan), could be imposed by a successor administration.
- In summary, the mix of power generation may very well stay similar to what it is today – market forces could have more impact than a Trump administration, though Trump-led agencies may nudge up the production of oil and gas and the expansion of the coal industry.

Infrastructure

General

- The first policy statement that President-Elect Trump made in his acceptance speech in the early hours of November 9 was his desire to create jobs by rebuilding the country's infrastructure so that it would be "second to none." This statement was consistent with the Trump-Pence campaign's message during the run-up to the election.
- Although he has not yet proposed specific policy programs, Trump's "Contract with the American

Voter," which sets forth his agenda for his first 100 days in office, makes reference to a proposed American Energy and Infrastructure Act that would involve the investment of $1 trillion in infrastructure over 10 years.
- Trump's initial statements on infrastructure, and the prevalent bipartisan view in favor of infrastructure improvement to spur job growth, could result in a significant increase in private investment opportunities in the sector.

Private Investment and P3s

- Trump's infrastructure plan could provide significant opportunities for investments in public-private partnerships (or P3s) in particular, specifically major projects with ample revenue streams.
- Trump has spoken favorably regarding P3s and other innovative procurement methods to stimulate investments in major projects and to complete them on time and on budget, which governments frequently struggle to do. During the campaign, Trump pledged to eliminate regulatory red tape that would enable projects to be completed faster and at lower cost. As set forth in his Contract with the American Voter, the central tenets of Trump's infrastructure plan include "leveraging public-private partnerships" and the creation of tax incentives to fuel equity investment. Given his real estate development background, where tax incentives are often key investment drivers, these views are not surprising.
- Some details regarding Trump's plan were outlined toward the end of the campaign by two of his senior policy advisors, Wilbur Ross, a private equity investor (who has been tapped as the proposed Secretary of Commerce), and Peter Navarro, a UC-Irvine business professor, in a paper contrasting Trump's and Clinton's proposals on infrastructure.13 The paper has attracted significant commentary, both positive and negative, from lawmakers and other stakeholders on both sides of the political aisle.
- Under the plan outlined in the paper, Trump envisions the private sector contributing $167 billion of the contemplated $1 trillion investment in the sector. In return, investors would receive an 82% tax credit, which would be repaid to the government from the incremental tax revenues resulting from project construction (realized primarily through wage income growth and contractor profits). The overall equity return on these investments would be roughly 9-10%.
- This investment plan dovetails with Trump's plan to incentivize the repatriation of corporate income held overseas by offering a reduced tax rate on profits of 10 percent, instead of the 15 percent that would apply under Trump's tax plan (or 35 percent under current tax law). The paper suggests that these firms could, in turn, recoup their tax payments through the infrastructure tax credit described above.
- The paper also suggests that Build America Bonds (BABs) or similar instruments could provide a viable, low-cost source of debt financing. BABs, notably, have historically had significant bipartisan support. They are less expensive to the Treasury than traditional tax-exempt bonds and provide tax credits to issuers for a portion of the interest payments on the notes. Trump has suggested since the election that such bonds could be issued by a dedicated infrastructure fund.
- In addition, the paper focuses on projects with revenue streams sufficient to attract significant private sector investment. It does not discuss potential sources of financial support for projects, P3s or otherwise, which either have no dedicated revenue stream (or a limited one) and/or would not qualify for debt financing through BABs or other instruments.
- It is important to bear in mind that the US infrastructure is driven by policies and facts and circumstances affecting states and localities. Thus, even with a push by Trump, the sector will still need considerable cooperation by states and local authorities, and the existence and form of investment opportunities will be shaped in large part by policy makers at those levels of government.

Sales of Brownfield Infrastructure Assets

- Over the last few years, the US market has seen a significant uptick in investment opportunities in mature infrastructure assets, in particular in the toll road space, marked by the multi-billion dollar sales of the Indiana Toll Road and neighboring Chicago Skyway in 2015 and early 2016, respectively, and the recently agreed sale of the Pocahontas Parkway. Other road and parking assets are currently on the block and attracting investor attention.
- Trump's plan points to a continuation of such trend. In addition to the tax incentives inherent in the plan, increased investment opportunities in greenfield projects could result in further opportunities in mature assets, as the funds that own these assets approach the end of their investment period or developers look to create dry powder for new investments.

Legislation

- In December 2015, Congress passed the Fixing America's Surface Transportation (FAST) Act, a five-year bill that reauthorized, at then-current levels, the core programs providing federal transportation funding to the states. Notably, the FAST Act was the first long-term transportation bill passed in 10 years.
- The FAST Act also continued key programs within the US Department of Transportation (USDOT) that have provided support to P3s, including the Transportation Infrastructure Financing and Innovation Act (TIFIA) loan program and the use of Private Activity Bonds (PABs) to finance the construction of surface transportation projects and water projects.
- Given their positive track record, and the projected funding need, it would seem likely for these programs to continue to play a significant role in infrastructure financing under the Trump Administration. Trump's selection for Secretary of Transportation, Elaine Chao, is well-versed on federal transportation policy matters and should be familiar with these programs and given her former role as deputy secretary of USDOT. However, given Trump's focus on privately-led investment solutions, it seems less likely that any new transportation legislation would increase the budget authority of these programs, or create a National Infrastructure Bank, which had been suggested by President Obama and Hillary Clinton, among others.
- In the water sector, the houses of Congress have been discussing their respective proposals for the Water Resources Development Act (WRDA), which would authorize numerous Army Corps of Engineers projects and provide funds to support communities like Flint, Michigan that have suffered due to contamination. The Senate's version of the bill also includes additional funding for the state revolving funds (SRFs) – under which states provide loans and grants to municipalities for water projects and appropriations for the Water Infrastructure Finance and Innovation Act (WIFIA) program, which would make low-cost loans to public and private entities for water infrastructure improvements. There is optimism for passage of the WRDA during the current lame duck session, which is currently scheduled to run until December 16.
- During the campaign, Trump pledged to make clean water a high priority and in particular to triple funding to the SRFs in order to upgrade critical drinking water and wastewater infrastructure. Even if no WRDA is passed this year, it seems likely that Congress will take up a new version of the bill in its next session.
- Once Trump is sworn into office, investors will be waiting to see the extent to which new legislation on infrastructure takes shape that could create new programs such as those referred to above or otherwise incentivize private investment in the sector.

Footnotes

1 Jack Fitzpatrick, Wind and Solar Energy Subsidies Aren't Just for Democrats Anymore, Morning Consult (March 7, 2016).

2 Id.

3 US Wind Energy State Facts, American Wind Energy Association, http://www.awea.org/resources/statefactsheets.aspx?itemnumber=890 (last visited Dec. 2, 2016).

4 Fitzpatrick, supra note 1.

5 Id.

6 Id.

7 Joe Ryan & Brian Eckhouse, Trump's Tax Proposals Would Threaten Wind and Solar Investment, Bloomberg (Nov. 7, 2016).

8 Donald J. Trump, An America First Energy Plan, https://www.donaldjtrump.com/policies/energy (last visited Dec. 2, 2016).

9 Matt Egan, Does Donald Trump's Plan to Drill More Oil Make Sense?, CNNMoney (May 31, 2016).

10 Clifford Krauss, Oil Prices: What's Behind the Volatility? Simple Economics, N.Y. Times (Nov. 2, 2016).

11 Sheryl Gay Stolberg, Trump's Promises Will Be Hard to Keep, but Coal Country Has Faith, N.Y. Times (Nov. 28, 2016).

12 US Energy Information Administration.

13 Wilbur Ross & Peter Navarro, Trump Versus Clinton on Infrastructure, http://peternavarro.com/sitebuildercontent/sitebuilderfiles/infrastructurereport.pdf (last visited Dec. 2, 2016).

Last Updated: December 9 2016

Article by Robert N. Freedman, Paul J. Epstein and Alyssa Cowley

Shearman & Sterling LLP