A PE Windfall from Infrastructure Package is No Sure Thing.

The US Senate this week passed a sweeping $1.2 trillion infrastructure bill, marking President Biden's biggest legislative victory to date. But it remains unclear if the bill will be a win for a US private equity industry that has raised hundreds of billions over the past decade to rebuild the country's roads, bridges, utilities and more.

Public-private partnerships, also known as P3s, have struggled to gain traction in the US, even as the country's infrastructure has slowly crumbled. The Senate bill, which totals some 2,700 pages, attempts to change that by directing states and municipalities to consider instituting public-private agreements. Part of the infrastructure bill requires local governments seeking federal funding for a project of over $750 million to run a cost analysis on a private partnership.

But the bill reportedly doesn't require local governments to actually create public-private partnerships. That means investors that have raised billions for infrastructure deals could be in the precarious position of having ample dry powder but few opportunities to spend.

And the bill still needs to pass a divided House of Representatives before being signed into law.

Investment is needed. The American Society of Civil Engineers gave the country's infrastructure a "C-" grade in a 2021 report card, reportedly estimating that it would cost almost $2.6 trillion to implement the necessary repairs and earn a "B" grade.

Some within the private equity industry have sounded an optimistic tone about the legislation. Adam Bernstein, a managing director at infrastructure and impact investor North Sky Capital, said the bill could open the door for more investment in electrical vehicle infrastructure, renewables and the electrical grid. And that could open the door for mega-deals.

"You're going to have to take some big swings," Bernstein explained. "And you would just have to think that a larger infrastructure fund would be able to participate in that."

Over the past decade, infrastructure fundraising has climbed, albeit in fits and starts, with the total raised peaking at more than $46 billion in 2018, according to PitchBook data.

Private equity firms have turned to infrastructure deals in part because they are often immune to the level of volatility seen by fixed income or equities, for instance. And the contracts can often last decades, providing steady returns regardless of broader market trends.

In 2017, Blackstone announced it would raise $40 billion for an infrastructure fund, with $20 billion coming from the Public Investment Fund of Saudi Arabia. But the vehicle has struggled to get off the ground. In Blackstone's fourth quarter earnings call, president Jonathan Gray said the vehicle had raised around $14 billion, well short of its original target.

Over the past few years, there's been growing angst about allowing private equity firms to dip their beaks into public works projects. In Bayonne, N.J., water bills spiked 28% after KKR invested in the city's public water systems, according to an analysis by The New York Times. Other cities including

Missoula, Mont. have actually sued to buy back their water systems.

Private equity investments in public utilities haven't always gone well for the firms, either. In 2014, electricity company Energy Future Holdings filed for Chapter 11 bankruptcy protection, bogged down by more than $40 billion in debt after TPG, KKR and the private equity arm of Goldman Sachs took the company private in 2007 in a $45 billion deal.

At the time, The Wall Street Journal reported it was the eighth largest bankruptcy in the history of the US. And it's one of the most high-profile LBOs to ever fail, with the firms reportedly losing a combined $8 billion of their invested capital.

"Overall, a lot of money has been raised, and that's commensurate with the capital needs of the amount of infrastructure spending," Bernstein said. "That, of course, doesn't guarantee it'll end up being a good investment."

For local and state governments, it's not always easy to know whether or not to partner with PE. Governments often tap the $4 trillion municipal bond market for financing. This allows them to keep more of the profits from massive infrastructure projects to themselves, but they are then responsible for any cost overruns.

For North Sky, Bernstein sees an opportunity to pour more capital into lower-middle-market infrastructure projects, with investments ranging between $15 million and $20 million and on a shorter timeline than the typical private equity holding period, which can extend up to seven years.

"Where we see the opportunity is to really partner with those smaller counties [and] cities that may not necessarily need 100 MW solar or wind farms or electricity, but may need to refurbish a recycling facility, or a water treatment plant, or a smaller, renewable electricity facility," he said. "And those are the kinds of transactions that aren't going to get attention from some of the larger players."

Yahoo Finance

August 14, 2021