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Rebuilding Infrastructure in America

The Impact of U.S. Government Infrastructure Spending on the Private Funds Industry

As part of our ongoing series on the Trump administration's infrastructure proposal, Building A Stronger America (the "Plan"), we continue to provide insight on how various sectors of the financial industry may be impacted by one of the largest pro-growth government spending campaigns of the past few decades. In March 2018, we provided an update on administrative and legislative reactions to the proposal along with an analysis of relevant tax planning aspects of investing in U.S. infrastructure projects more generally. In this segment, we explore the potential impact of the Plan on private funds.

OVERVIEW OF THE PLAN

On February 12, 2018, the Trump administration released a proposal that would increase U.S. federal infrastructure funding and incentives, provide state and local authorities greater discretion over infrastructure investments and encourage cooperation between state and local governments and the private sector in developing and operating infrastructure projects. If enacted, the Plan would, according to the current administration, result in $1.5 trillion in new infrastructure investment by leveraging $200 billion over 10 years in federal spending. The remainder of the funding would come from a combination of state and local government funds and private capital through public-private partnerships ("P3 Projects").

IMPACT OF THE PLAN ON THE PRIVATE FUNDS INDUSTRY

The sort of co-investment opportunities contemplated by the Plan would allow for an atypical marriage between first rate private sector expertise and robust government funding. In particular, infrastructure, real estate and certain credit funds would stand to benefit in a number of ways.

THE STATE OF THE PRIVATE FUNDS INDUSTRY

Since 2009, the private funds industry has been, by many accounts, an unwitting victim of its own success. The desire among investors to seek high-yielding investment products in the wake of the financial crisis has resulted in immensely successful capital-raising campaigns for private funds, which campaigns reached record heights in 2017. By some estimates, private investment firms now sit on nearly $1 trillion of capital ready for deployment (often referred to in the industry as “dry powder”), but suffer from a dearth of investment opportunities to which they can commit such capital. If the Plan were indeed put into action, a number of attractive co-investment opportunities alongside governmental entities could open the door to new exits, allowing private funds to deploy the abundance of dry powder they have accumulated over the past few years.

INFRASTRUCTURE FUNDS

It naturally follows that infrastructure funds could experience a boon, particularly as details surrounding the Plan become more certain. According to Preqin’s projections for 2018, infrastructure and private debt will be the top priorities for limited partner investors courting private equity firms. The validity of such an assertion may in some sense be supported by Blackstone Infrastructure Partners’ (“BIP”) launch of a $40 billion capital fundraising effort, which effort was advanced by the Saudi Public Investment Fund’s commitment of $20 billion to BIP in 2017. While BIP has since had trouble meeting fundraising deadlines— BIP has temporarily scaled back its fundraising goal to $15 billion— there is still a lot of potential in this area. If the Plan were implemented, new opportunities for the deployment of capital in the infrastructure sector would be created, including co-investment opportunities with U.S.-based governmental entities, which could stimulate more investment activity in this space. Given the foregoing, fund managers would be remiss not to take note of the potential opportunities for infrastructure investment in the coming quarters, and we will continue to monitor developments as they may arise.

REAL ESTATE FUNDS

There are a number of changes proposed under the Plan that could benefit private funds invested in real property. The Trump proposal would allow the federal government to take real property assets that are no longer needed by any federal agency directly to market, enabling third parties, including private funds, to purchase such assets without facing some of the hurdles common to such public-private transactions such as burdensome preference arrangements or rights of first refusal. The Plan would additionally give more federal agencies greater authority to retain disposition proceeds generated from real property sales provided they re-invest such proceeds into other mission-critical facilities. The foregoing policy changes would incentivize federal agencies to dispose of real property assets in a more timely manner, creating new investment opportunities for private funds. And according to recent estimates, capital-raising in this space is not headed for a slowdown anytime soon. On April 5, 2018, Preqin announced it believes that during the first quarter of 2018, investor commitments to private closed-end real estate funds reached approximately $36 billion. If so, that would be a record not broken since 2008.

FUNDS WITH EXPOSURE TO CERTAIN CREDIT-ORIENTED STRATEGIES

A key selling point of the Plan is that it would give state/local governments the authority to issue more Private Activity Bonds (“PABs”), or tax-exempt bonds issued by or on behalf of such governmental entities for development projects. The proposal would broaden the eligibility criteria concerning which entities may qualify to issue or purchase PABs, and in certain circumstances, exempt the interest derived from such PABs from the Alternative Minimum Tax. These policy changes could provide interesting opportunities for private funds engaged in municipal credit and other credit-oriented strategies to help finance the infrastructure initiative and help stimulate additional P3 Projects.

CONCLUSION

If enacted, the Plan could lead to a more integrated partnership between private investment funds and the U.S. government, encouraging fund managers to pool assets together in an effort to take advantage of a more investor-friendly regulatory environment. In so doing, the Plan could open the door to an array of co-investment and other opportunities for private investment funds seeking investment opportunities.

We stand ready to address any specific questions or issues you may have regarding the Plan and how you can restructure your investment strategies to take advantage of some of the benefits it may provide.