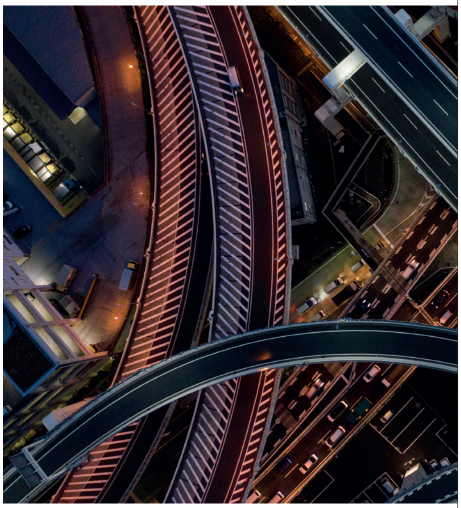
Infrastructure Investor

Analysis

New deal structures emerge, regulatory scrutiny increases

These are two separate themes Latham & Watkins' Timothy Hia and Ravi Purohit have seen emerge this year, as LPs' appetite for exposure to the asset class grows



The past two years have been the busiest ever for the global infrastructure investment market, which is a testament to the resilience of the asset class and its appeal as a non-cyclical, or even counter-cyclical, proposition. An increased appetite for infrastructure exposure among institutional investors is driving the advent of more novel financing structures in the space, with sponsors seeking to bring together elements of project finance and corporate finance to explore new models and sources of financing.

Mobilising institutional capital

A case in point of a novel financing structure is last year's infrastructure asset-backed securities issuance by Bayfront Infrastructure Management. This transaction built on the success of its earlier IABS issuance in 2018, which represented the first-ever securitisation of project and infrastructure loans in Asia. Bayfront's IABS tranched out the credit risk of a portfolio of infrastructure projects but added a first-of-its-kind sustainability tranche to broaden the appeal of the structure to institutional investors and drive down funding costs. The success of the Bayfront deal has since been replicated in the US market, with sponsors seeking to use similar structures to mobilise private institutional capital into the infrastructure financing market.

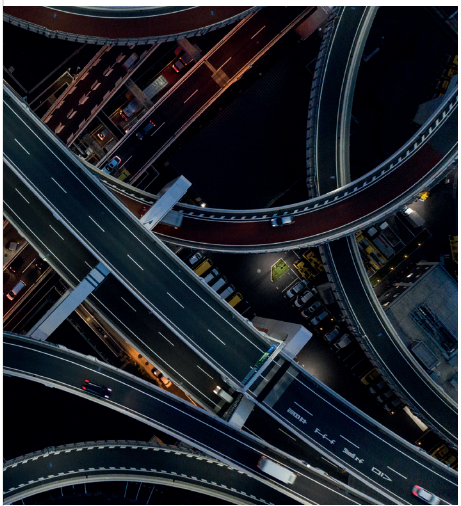
Elements of US-style structures have also gained traction in the Asian market. One key example is last year's platform infrastructure financing framework for India's largest private sector power transmission and retail distribution company, Adani Transmission, which raised $700 million from eight leading international banks to finance a series of green infrastructure developments. The revolving senior debt facility is the first of its kind in Asia, incorporating elements of a US-style construction revolver facility to replace a typical project finance approach with a platform structure to finance four transmission projects that Adani is developing in India, for a total cost of $1.5 billion.

The revolving loan facility's structure allows staged drawdowns and repayments to support construction on different timelines. The first three projects will be refinanced on the capital markets after completion, with the amounts raised from the refinancing being "recycled" to fund completion payments for the construction of a fourth project.

The platform approach allows the banks to evaluate all the projects together and benefit from the pooled revenue streams of all the projects on the platform, thereby marrying the capex programme of Adani with the capital recycling needs of the banks to fund both ongoing and future projects.

Both IABS transactions and the platform infrastructure financing frameworks aim to bring alternative financing structures and sources of capital into regional markets to improve the visibility of the initial financing banks into the ultimate refinancing of new loans that they extend.

Having commercial banks evaluate and fund greenfield risk, but then transfer that risk onto other investors, allows traditional project financing lenders to deploy their technical capabilities without necessarily committing to long-term funding arrangements, while also permitting institutional investors to move capital into transactions that have been proven to be bankable. We expect to see more of these transactions as investors seek greater exposure to infrastructure assets globally.



> *"Regulators [will increasingly] treat private capital investors in a manner more closely aligned with their treatment of strategics"*

A seller's market

With investor sentiment favouring green assets and high-tech innovations, the definition of infrastructure as an asset class will keep expanding in 2022. While infrastructure assets continue to share the central characteristics of essential services – predictable cashflows and the ability to hedge against inflation – private capital providers are expanding their infrastructure investment remits to include non-traditional assets such as radiology clinics, amusement parks, nursing homes, education services providers, water heaters and air-conditioning systems.

Allocations to infrastructure funds will continue to be strong throughout this year as returns from equity markets remain depressed. Moreover, given the increased scope of investable infrastructure assets, infrastructure investors are competing with traditional private equity investors and family offices driving intense competition for deals. Those bringing solid infrastructure assets to this sellers' market can expect a lot of bids and high valuations this year, forcing buyers to be strategic about the opportunities they pursue.

Bilateral discussions have become few and far between as formal processes serve to drive higher prices, which, from a legal perspective, results in limited negotiation on purchase agreements and an enhanced ability for sellers to walk away from a closing without any lingering liabilities. Investors need to be prepared to move quickly, take commercial positions and accept a little more risk than they might have previously.

Enhanced regulatory focus

Meanwhile, the regulatory regime in the US will likely drive more scrutiny of infrastructure investments under the Biden administration. Strategic investors are increasingly mindful of antitrust legislation and can expect more information requests from the Federal Trade Commission than were common in the past. We are seeing premerger notifications taking longer than they have in previous years, with much more focus on market power and consolidation risks in certain industries, most notably in energy generation.

That same level of scrutiny will be a growing issue for private capital moving forward, as regulators around the world look deeper into the source or origination of the private capital as well as a fund manager's exposure to a sector across the portfolio as a coordinated move to treat private capital investors in a manner more closely aligned with their treatment of strategics.

Such an approach has significant implications for transaction timelines and can materially impact financing arrangements and deal economics. Buyers should therefore be cognisant of these risks upfront and willing to proactively offer solutions, which, for example, in an antitrust context, might involve agreed-upon divestment of specific assets in certain geographies.

Democratic administrations in the US also have a history of intensifying oversight of foreign investment on national security grounds, and the practices of the Committee on Foreign Investment in the United States are proving a useful template for other governments.

Fuelled by a desire to control investments by companies from hostile states in key sectors, we have seen the introduction of greater levels of foreign investment screening introduced across the EU in recent years. The UK's National Security and Investment Bill came into force in January, bringing in a screening regime similar in scope to CFIUS and a new mandatory notification obligation for certain transactions.

For private funds, such moves to protect sensitive assets from unwelcome overseas investment will result in longer lead times on deals, more risk exposure between signing and closing that will need to be factored into valuations and transaction documentation, and a heightened focus on the role of foreign LPs in investment fund dynamics.

Again, the onus is on fund managers to get ahead of issues by ensuring investors from problematic jurisdictions are explicitly passive, lacking any governance rights, and kept away from investment committee seats or positions on underlying operating company boards. If regulators can be convinced that limited partners are receiving only high-level financial information, in line with that available to retail investors, these issues should not be insurmountable. ■

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