

INFRASTRUCTURE INVESTMENT: Bridging the Gap Between Public and Investor Needs

NOVEMBER 2015

“Investment, particularly in infrastructure... is important for economic growth, job creation and improving productivity... The G20’s challenge is to reduce the barriers preventing productive investments, so more of this capital can be connected with investment and infrastructure needs.”

— G20 statement, 2014¹

Introduction

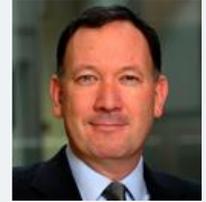
There is a compelling global need for greater infrastructure investment. Well-functioning infrastructure is critical to driving sustainable long-term economic growth. In many countries, it is becoming more challenging to meet funding requirements from traditional sources, such as public authorities and banks. The OECD estimates that \$70 trillion in infrastructure investment is needed by 2030 to simply maintain the current levels of global GDP growth.² Private capital can help bridge the shortfall in infrastructure funding, and institutional investors, such as insurance companies and pension funds, could potentially increase their allocation to infrastructure over the long term.³

To promote a greater role for private capital in infrastructure projects, policy makers need to craft a policy framework for infrastructure investing tailored to investors’ needs. In this *ViewPoint*, we describe the current environment for infrastructure investing and propose a set of principles to develop a holistic policy framework that recognizes investors’ needs. Despite their long-term strategic interest in infrastructure as an asset class, private investors express concerns about regulatory uncertainty, which increases both the risk profile of infrastructure investments and the cost of providing private capital to help fund

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PRINCIPLES OF A HOLISTIC POLICY FRAMEWORK FOR GREATER PRIVATE CAPITAL MARKETS INVESTMENT IN INFRASTRUCTURE

1. Provide certainty to investors

- Minimize political and regulatory risk, especially retroactive changes to policy
- Facilitate the development of projects that meet investors’ financial targets
- Increase contractual and structural certainty through consistent legal enforceability

2. Focus on transparency

- Develop deep sources of project data
- Maintain up-to-date project pipelines
- Follow best practices for procurement and commissioning processes

3. Determine funding structures that align the interests of investors and public authorities

- Target public financial support where it is needed to attract, not crowd out, private capital

4. Develop a stable and consistent regulatory environment for infrastructure investment

- Build a long-term decision-making process for governments
- Increase the potential for greater investment through pooled funds
- Avoid unnecessary barriers through regulatory capital charges and obstructive tax regimes (e.g., the impact of Base Erosion and Profit Shifting on funds investing in real assets – see discussion on page 10)

public infrastructure.⁴ In this *ViewPoint*, we also discuss a number of existing regulatory barriers to infrastructure investment and provide suggestions to address them.

Understanding Infrastructure Investments

Infrastructure is not just about roads and bridges. In defining infrastructure, we must take care to avoid channeling infrastructure capital into a limited range, which would exclude key projects. **We recommend a broad, characteristics-based approach to defining infrastructure, which includes the basic physical systems of a business or nation.** Such systems include power (including low-carbon systems), energy, transportation and social systems, as well as related infrastructure such as water, schools, and hospitals. These tend to be long-term, capital intensive investments that are vital to economic development and prosperity. Given that infrastructure is a critical part of society, infrastructure investments tend to be less cyclical in nature and have lower correlation to the public markets than other investments, such as corporate equity or debt.

The financing of infrastructure assets can be structured in different ways with varying risk and return parameters based on the specific characteristics of each underlying opportunity (for more details, see Appendix).⁵ The distinction between infrastructure equity and debt is key, given the very different risk return profiles of each. Traditionally, infrastructure debt has been provided solely by project finance lenders and infrastructure equity from the balance sheets of participants involved in infrastructure development. The financial crisis constrained these sources of capital and resulted in the entry of additional capital markets investors seeking yield by investing in either debt or equity through direct investments or commingled funds.

Infrastructure investors are mostly pension investors and insurance companies who can accept relatively moderate returns and are increasingly favoring less liquid long-term investments – if they can achieve comfort with the long-term policy framework underpinning their investments. Typically these investors are seeking long-term predictable yield to duration to match their future liabilities and payments. Certainty is critical for these long-term investors. More certainty means less risk, which decreases investor return requirements and therefore reduces the cost of private capital in public infrastructure. Conversely, less certainty means more risk, which increases investor return requirements and increases the cost of private capital in public infrastructure. In other words, low counterparty risk and high certainty of periodic cash flow are primary considerations for investors, and potential asset appreciation is often a secondary concern (in the case of equity investments).

Exhibit 1: INFRASTRUCTURE INVESTMENT AT BLACKROCK



Source: BlackRock. Illustrative example only.

Infrastructure equity investments typically offer lower correlation to markets and the broader economy while increasing portfolio diversification. Infrastructure debt can offer stable cash flows and long duration at attractive fixed yields. Infrastructure debt investments have historically experienced lower default rates and higher recoveries than comparable core fixed income.⁶ A study by Moody's over 30 years provides strong evidence that infrastructure deals are typically not pro-cyclical and have low default correlations to the broad market and other infrastructure investments.⁷ We note that infrastructure debt is often long-term, illiquid and has enhanced recovery rates when compared to corporate debt.

It is critical for any policy framework for infrastructure investment to recognize the different means of structuring infrastructure investments and the different risk-return profiles of the assets to ensure the proper alignment of interests.

The Current Environment

There are three primary pillars of infrastructure funding: (i) governments and other public authorities, (ii) bank lending, and (iii) the capital markets. In recent years, the first two, more traditional pillars of funding have reduced the amount of capital available to commit to infrastructure investments, though they remain important players. Looking ahead, we envisage that the three pillars will complement each other as sources of capital for infrastructure.

Infrastructure projects readily lend themselves to government and other public funding sources as they often provide a public good and are able to access the tax-exempt debt markets in some jurisdictions. However, public deficits, increased debt-to-GDP ratios, and increasing pressures on public pension funds have constrained government budgets in spite of record low borrowing costs.⁸ Further, the public sector faces challenges in making efficient investment choices as a result of the short-time horizons of political decision makers.⁹

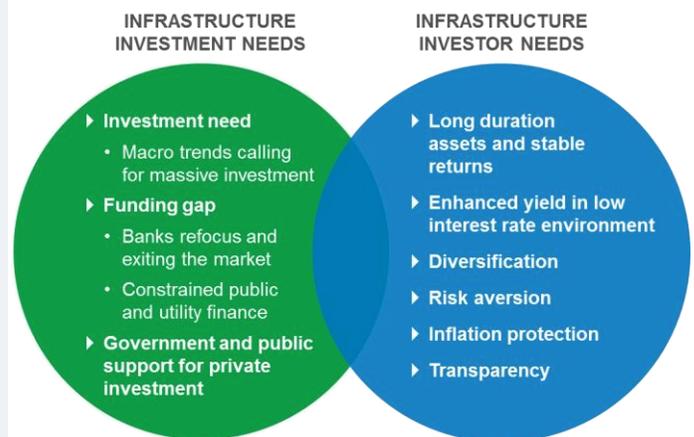
Bank lending remains important. Following the 2008 financial crisis, many banks were compelled to restructure their balance sheets due to capital requirements and other banking reforms. Banks have short-term liabilities and are not ideally positioned to hold long-term assets on their balance sheets. As a result, bank finance for infrastructure projects had become constrained, although the picture has somewhat shifted in 2015.¹⁰ As interest rates normalize, the cost of public and bank funding is likely to increase, and it will become more important that the cost of capital for institutional investors remains attractive.

Institutional investors, such as insurance companies and pension funds, have shown increased interest in infrastructure as the prolonged low interest rate environment and large and growing long-term liabilities encourage them to seek alternative sources of return. Institutional investors choose to invest in infrastructure to include diversification and long-term, stable cash flows in their portfolios. Institutional investors tend to have long-term investment horizons and long-dated liabilities and are, therefore, well-placed to invest in infrastructure, as their long-term time horizon works well with the multi-year or even multi-decade time horizon of most infrastructure projects. Infrastructure investments are also a way to hedge against inflation. In addition, investors are increasingly seeking investments that advance both social and financial goals – impact investing.¹¹ Infrastructure investments may be well suited to these objectives.

Capital raised by infrastructure funds reached a record \$48.3 billion in 2014, and we estimate that an additional \$9 to \$10 billion was allocated for direct investments or co-investments by institutions with the internal resources to execute on those investments.¹² Aggregate capital in infrastructure funds under management has increased from \$127.7 billion in 2008 to \$317.5 billion at the end of 2014.¹³

Although individual investors may not have savings horizons as long as institutional investors and may not have the same capacity or willingness to hold illiquid assets to maturity, we are seeing increasing interest from retail investors in local infrastructure projects (such as schools or hospitals) and clean energy infrastructure. Individual investors have not been historically well-equipped to invest in these types of projects. Looking forward, new pooled investment vehicles such as the European Long Term Investment Fund (ELTIF) may increasingly enable them to do so.

Exhibit 2: MEETING THE NEEDS OF INFRASTRUCTURE INVESTMENT AND INVESTORS



Source: BlackRock. Illustrative example only.

Principles of a Holistic Policy Framework for Greater Capital Markets Investment in Infrastructure

Governments and supranational bodies around the world (e.g., G20, OECD, and EU) are promoting infrastructure investment in an effort to foster long-term growth and jobs.¹⁴ This has resulted in a proliferation of initiatives and legislation calling for greater funding of infrastructure projects. These initiatives will be more successful if they acknowledge the needs of private capital and build the appropriate environment to encourage infrastructure investment. We have outlined a holistic framework – consisting of four key principles – to help achieve these objectives.

1. Provide Certainty to Investors

Investors require a comprehensive view of infrastructure investment opportunities. An investor's risk analysis is heavily influenced by their assessment of the certainty of whether a given infrastructure project will be able to deliver expected returns. The level of certainty drives both the decision to invest and the level of risk premium required. Given the critical nature of the public sector in driving certainty and reducing risk, public entities can take a number of specific actions to increase certainty and attract investor demand.

Political and Regulatory Certainty

Sovereign political risk, particularly the risk of short-term political decision-making, can severely undermine the certainty that infrastructure investors require. Infrastructure projects often need financing for up to 30 years.

As such, investors need to reconcile this long-time horizon with the potential for short-term decision-making from governments elected for 4 to 5 years. Institutional investors require certainty that the policy framework underpinning infrastructure projects is durable. Greater certainty leads to lower risk and lower cost of capital. Investors, rating agencies, and regulatory authorities look to jurisdictions where past experience shows that there is a favorable and stable regulatory environment over the long term and where political risk is limited. Reducing political risk that a government, municipality, or other commissioning body will change the terms of a project subsequent to its funding is critical to fostering an environment of certainty.

The risks of project tariff revenues declining as a result of action by public authorities is another area of continuing concern for investors. While we recognize that public finances are still under strain post-crisis, some short-term budgetary decisions may have unintended consequences for infrastructure investment. This is especially the case where efforts to cut subsidies for emerging technologies, such as in the renewables sector, put planning and construction at risk.

CASE STUDIES HIGHLIGHT THE NEED FOR INCREASED REGULATORY CERTAINTY

- ▶ Investor confidence in the UK was recently undermined by the unexpected removal of Levy Exemption Certificates (LECs) for renewable energy in the Summer Budget 2015. Renewable projects have historically been exempt from the Climate Change Levy (CCL) and have received LECs, which are issued to generators for each unit of electricity produced. The LECs are sold to suppliers (through power purchase agreements) who use them in accounting for their CCL obligation. The changes to the LECs will reduce the revenues of operating renewables projects. The level of impact on project returns depends on the technology, power purchase agreement terms and LEC forecasts used.
- ▶ In June 2013, the Norwegian government authorized cuts to the tariffs for the gas transport pipeline, Gassled. In certain areas, the tariffs would be cut by as much as 90% from 2016. This was a surprise to investors and left them facing a potential 40% reduction in return expectations, harming the perception of Norway as a stable regulatory environment for infrastructure investment.
- ▶ A large number of investors deployed capital in Spain based on a favorable 25-year Feed in Tariff (FiT). In December 2010, these investors were heavily hit by retroactive FiT cuts implemented by the government. Spanish solar PV plants suffered an average 30-40% reduction in income. Over half of Spain's solar PV companies have gone bankrupt since 2008.

Transparency and consistency of public authorities in setting and maintaining subsidies, tariffs, fees, and regulatory controls after the closure of a transaction mitigates investor concerns over the regulatory risk associated with the projected revenues of projects. **An increased use of cost-benefit analyses and disclosure of the underlying data and assumptions used by commissioning bodies can help reduce future political risk.**

The European Insurance and Occupational Pensions Authority (EIOPA) has recommended a number of criteria defining what constitutes low political risk:

1. *The infrastructure assets and infrastructure project entity shall be located in countries which are members of the European Economic Area or the Organisation for Economic Cooperation and Development and the political and legal environment to which the assets and project are subject shall be stable;*
2. *The political and legal environment shall not be considered to be stable unless there is a low risk of specific changes in law, unilateral changes in contracts or tariffs, regulatory actions and the imposition of exceptional taxes or royalties that would result in material losses for the infrastructure project entity;*
3. *For the purpose of paragraph 2, insurance and reinsurance undertakings shall consider recent changes made in the countries where the infrastructure assets and infrastructure project entity are located.*¹⁵

The EIOPA recommendation is a valuable standard for assessing sovereign and political risk. Minimizing political uncertainty will make a jurisdiction more attractive to long-term investors. While some leading institutional investors are gradually increasing their exposure to infrastructure assets, the vast majority of these investments are concentrated in their home markets.¹⁶

Tax Treatment

Tax treatment is always an important consideration for investors. **A clear framework for the tax treatment of an infrastructure investment, particularly with respect to the treatment of capital gains and the treatment of cross-border investment is a prerequisite for long-term investment.** The negative impacts on cross-border infrastructure investing as a result of the Base Erosion and Profit Shifting (BEPS) project is detailed on page 10. This project will introduce significant uncertainty into the tax outcome of investing in certain countries, and may impact an investor's willingness to invest in that particular country.

Economic Certainty

Investors need confidence that the project is economically viable at both a macro and micro economic level. A stable and predictable macro economic policy framework with stable prices, interest rates, and exchange rates will encourage investors to commit to long-term transactions. This is particularly the case in emerging market economies, where political and economic risk has historically been a concern.

At a micro economic level, projects must be supported by a realistic assessment of demand and needs (e.g., toll prices that make sense to consumers). While a particular project may provide jobs in the short-term construction phase, it is important that investors obtain a clear understanding of future long-term demand such as consumer affordability and the existence or development of alternative options.

Structural and Contractual Certainty

Without structural certainty regarding the investment and the regulatory framework within which projects exist, a projected investment return may have little resemblance to reality. The level of risk-sharing between public authorities and private investors should be clearly defined from the outset. This needs to be documented and supported by clear and transparent legal procedures that can be benchmarked against international standards.

The legal enforceability of contracts is a core component of any investment and is vital to investment in infrastructure. There must be transparent and predictable dispute resolution procedures, whether at the local, national or regional level. These procedures help to build stability and investor confidence.¹⁷

2. Focus on Transparency

Investors require transparency, clarity and the availability of data (including information regarding the project pipeline and the procurement process) for infrastructure investments. This information must be sufficient to assess core project risk. Typically, this information includes:

- ▶ Cash flows and the ability of the project to meet financial obligations under stressed conditions based on relevant historical experiences.
- ▶ The predictability of revenues based on the level of output or usage, and whether revenues will be funded by payments from a large number of users or by a counterparty of suitable credit quality.
- ▶ For infrastructure debt, the robustness of the contractual framework, including the strength of the security package, covenants, representations, warranties and remedies.
- ▶ Structural requirements, such as the strength of the project sponsor.
- ▶ Financial risks such as refinancing risks, the level of leverage, and the maturity of any debt.

- ▶ Construction risk and an assessment of the financial strength and experience of the construction company.
- ▶ Operating risk where material risk related to the operation of the assets is provided by an operating company.
- ▶ The extent to which the design and technologies used are proven.

Relevant risks necessarily vary considerably from project to project. Public commissioning bodies should be cognizant of the needs of investors and should seek to provide information on the most relevant risks for each project type.

Data

A clear focus on establishing high-quality data and analytics is key. Institutional investors require asset level data, credit analysis, and time series data as part of their risk analysis. Investment in infrastructure will be fostered when this data becomes more widely available.¹⁸ In order to make infrastructure investment more efficient and accessible, **we recommend developing a standardized common framework for upfront and ongoing reporting of transaction information and performance of projects.** In practice, this involves setting forth best practices for assessing projects based on sound technical methodologies. Public commissioning bodies need to agree on consistent standards for both project assumptions and for compiling and disseminating relevant data. Initiatives by the European Commission to encourage specialized rating agencies or co-operation between European and national multilateral development banks in data sharing could be invaluable in this process.

Project Pipelines

In some jurisdictions, the issue with infrastructure investment is not always a lack of capital for investment in infrastructure but rather a lack of information regarding existing and future investable projects. **A clear long-term pipeline of projects is fundamental for investors to develop teams with the necessary skill-set to identify investable projects.** We recommend that governments prepare national investment plans for the long term – we suggest a five-year minimum time horizon – with consideration given to communicating longer-term needs and priorities. Pipelines should provide a clear indication of how the government intends to fund projects so that investors can obtain assessment of the potential future demand for project financing over a set time period.

Where regional bodies such as the EU exist, the ability to aggregate opportunities using common standards and terminology will allow investors to assess projects more effectively and determine which ones are most likely to meet their investment needs. In the US, a nationwide standard would be effective in aggregating projects across state lines.

The need for a long-term investment plan has been recognized by many international bodies, and we support ongoing initiatives to create a pipeline of projects such as the G20 Infrastructure Hub.¹⁹ In the EU, until very recently, there has been no pan-European centralized hub that collects and makes available information on the upcoming pipeline of infrastructure transactions and when they are expected to come to market (although national initiatives, such as the UK National Infrastructure Plan, exist).²⁰ As part of the European Fund for Strategic Investments (EFSI) initiative, the European Commission and European Investment Bank will develop a pan-European Project Pipeline, which will set out projects, and a European Investment Advisory Hub to bring market participants together. We welcome and commend these developments. Their success will depend on the quality of data provided and the extent to which it reflects investors' needs.

We also welcome the UK Government's recent announcements regarding improving transparency for the UK Investment Pipeline, particularly with respect to the Northern Powerhouse banner.²¹ The provision of more project detail and the recognition of investors' expectations of a range of investment opportunities (measured in terms of both risk return and sector) will be critical in turning investor attention into action.

As described in the sidebar, governments can create obstacles or they can streamline processes. In the US, we recommend reforming the review process under the National Environmental Policy Act of 1969 (NEPA) in order to facilitate infrastructure projects and their financing.

Procurement Processes

In addition to providing transparency regarding the availability of projects, governments and other commissioning bodies must consider transparency of the procurement process.

Projects can be complex, and it may not be clear to investors what actions they must take to participate effectively in the procurement process. An effective procurement policy should reflect the increasing presence of capital markets' solutions when designing funding requirements. **We recommend public bodies and investor representatives work together to create model documentation and guidelines as the basis for tendering projects at all levels.**²² Developing a more standardized approach to public private partnerships would encourage and facilitate greater interest in the market from investors. In particular, national and regional development banks can play an important role in developing best practices given their dual role both as investors and as public or supranational bodies.²³

RECOMMENDATIONS TO REFORM THE REVIEW PROCESS UNDER NEPA

In the US, NEPA requires federal government agencies to conduct an environmental review of infrastructure projects before they are permitted to proceed using federal dollars. NEPA mandates that federal agencies assess each project's potential impact on the human and natural environment before approval. Unless a project qualifies for a categorical exclusion, this process requires the creation of an environmental assessment document.

The NEPA approval process can postpone the construction of infrastructure projects for years, even if their environmental impacts are minimal. An environmental assessment can run to several thousand pages,²⁴ an EIS (Environmental Impact Statement) is often over 1,000 pages long,²⁵ and the US Government Accountability Office reported in April 2014 that "based on the information published in the Federal Register...the 197 final EISs in 2012 had an average preparation time of 1,675 days, or 4.6 years," not including any estimation of the environmental assessment document or any work done before or after the EIS.²⁶

We recommend reforming the administrative policies, procedures and practices to implement a timelier and more efficient environmental review process under NEPA. This will require sharing best practices across federal government agencies, as the various federal agencies have each established procedures and the agencies interpret NEPA differently.²⁷ Given the advancement of information technology since the adoption of NEPA 35 years ago, the NEPA process should be updated to facilitate an expedited process. In August 2011, President Obama urged a speedy delivery of major infrastructure projects held up in the NEPA process.²⁸ He encouraged utilizing information technology to improve the accountability, transparency and efficiency of the permit and review process, and he suggested that the relevant agencies develop best practices for expediting these decisions that may be executed on a wider scale.²⁹ While this initiative was limited to specific infrastructure projects at the time, the core principles for improvement are applicable today and should be considered in an effort to improve the infrastructure approval process in the US. To ensure a consistent and transparent framework for infrastructure project approvals, environmental reviews under NEPA should be completed under a specified time frame, such as one year, and should be no longer than 300 pages – the length that is currently set forth in Council on Environmental Quality regulations.³⁰

Infrastructure financing often contains intricate legal content that adds complexity, which not all institutional investors are able or willing to tackle. Larger institutional investors with dedicated infrastructure finance teams may not have an issue with such complexity, but smaller institutional investors may not have the capacity to invest at the scale required by many infrastructure projects. To allow governments to tap into the pool of funds that smaller investors might be able to supply, the development of model project documentation by standardizing core elements of project documentation would be beneficial.

Finally, one area of particular concern is the planning and approval process, especially where different levels of government approvals or licenses are required. This process is especially complex in the US, where different approval and permitting requirements often exist at the federal, state, and local levels, each with their own highly prescriptive and sometimes duplicative requirements. Clarity and predictability of the project approval process is essential in avoiding undue delays to projects.

3. Determine Funding Structures that Align the Interests of Investors and Public Authorities

It is important that infrastructure investment opportunities properly align the interest of investors and public authorities. Structures that facilitate cooperation between public and private sector investment in infrastructure can effectively leverage public capital. In the US, this will require attracting more private capital by revisiting various regulatory requirements and incentives. In the EU, it will entail appropriately structured transactions that do not crowd out private capital with public investment. It is critical to achieve the proper economic structural alignment to encourage the flow of private capital.

There are a host of ways in which public authorities can encourage investment in infrastructure, including appropriate risk sharing mechanisms, such as credit enhancement mechanisms, subsidies, co-investment in either equity or subordinated debt, or first-loss guarantees. These include:

- ▶ An investment grade rating can help broaden the investor base by attracting the universe of institutional investors limited to investment grade assets.
- ▶ Public guarantees and / or credit enhancement may be used to upgrade the rating of a transaction that might otherwise be less acceptable to investors, for example to address political risk or concerns about design and new technology uncertainties.
- ▶ Public authorities need to be cautious not to inefficiently deploy guarantees and / or credit enhancement to improve the quality of projects that are already investment grade, potentially deterring or crowding-out investors who might prefer the additional yield of an un-enhanced project.

- ▶ Credit enhancement can assist in financing projects that face challenges in long-term financing or might otherwise not be financeable at all.
- ▶ Credit enhancement could benefit large projects, where liquidity may be an issue, by potentially lowering the cost of financing for the project, thereby enhancing value-for-money.³¹

National or regional promotional banks can play a key role in advising and assessing the need for public funding of other structural supports for infrastructure transactions. Ideally, they should adopt a flexible approach that allows for the use of public balance sheets in stressed market conditions when private capital is in short supply balanced with the ability to withdraw from the market when conditions are more benign.

4. Develop a Stable and Consistent Regulatory Environment for Infrastructure Investment

As we consider ways to incentivize private investment in infrastructure, it is imperative that the appropriate institutional and regulatory environment exists to provide the foundation for long-term coordination between public and private actors.

A Long-Term Coordinated Decision-Making Process by Governments

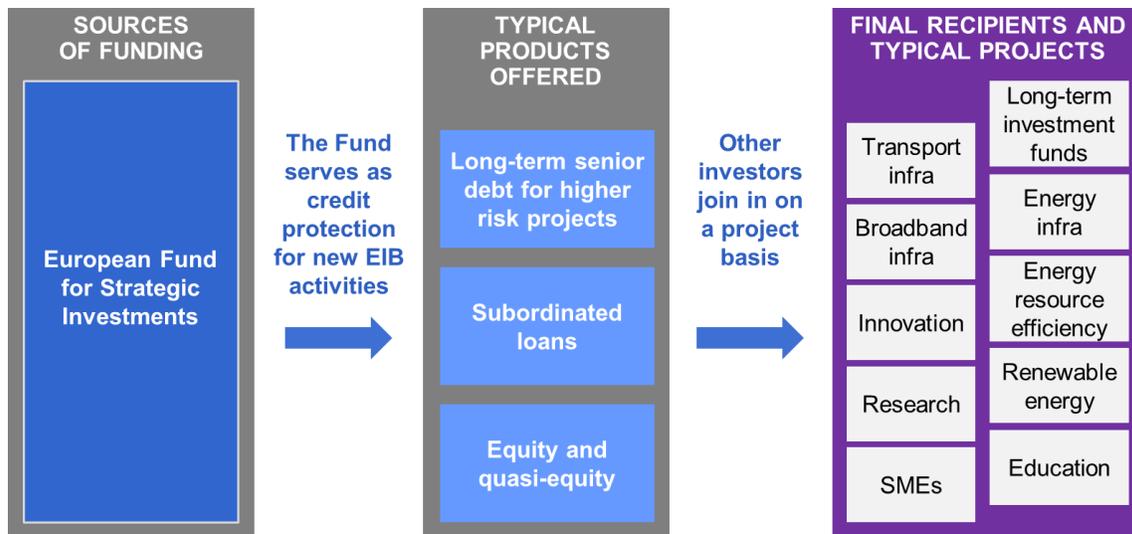
Coordination of project commissioning and funding is key. Governments and supranational commissioning bodies need to bring together a long-term framework for investment. It is an ongoing challenge to reconcile short-term budgetary constraints and long-term investment. We encourage jurisdictions to build an institutional framework which allows governments to bridge the gap between short-term imperatives and long-term investment horizons. We recommend initiatives, such as the establishment of national infrastructure boards, which could coordinate divergent actions of government departments and cooperation with national or regional development banks with a clear focus on delivering the outcomes set in national infrastructure plans.

We highlight some initiatives in Europe and North America that seek to address the need for a long-term institutional coordination framework and aim to increase the number of investable opportunities and incentivize investors to finance infrastructure.

The European Union

The recently-announced European Fund for Strategic Investments seeks to accelerate the amount of private sector investment in infrastructure in the EU and to mobilize €315 billion in investment across the EU. This will leverage €21 billion of public funding from the European Union and European Investment Bank.

Exhibit 3: EFSI MECHANISMS³²



Source: EC, EIB. As of June 2015.

Exhibit 3 describes the mechanisms of the EFSI. The EFSI and its various components (outlined in Exhibit 4) have the potential to address the funding gap in the EU and deliver the transparency and stability that infrastructure investors need.

The United Kingdom

The UK Government has recently announced the establishment of a new National Infrastructure Commission as an independent body to enable long term strategic decision making to build effective and efficient infrastructure for the UK.³³ This Commission will look at the UK's future needs for nationally significant infrastructure, with the aim of maintaining the UK's global competitiveness and providing greater certainty for investors by taking a long-term approach to major investment decisions facing the country. While it is still too early to judge the Commission's effectiveness, we welcome the focus on strategic long-term decision making.

The United States

Although there have been numerous proposals for new legislation, to date only a few programs have gone forward. In July 2014, President Obama launched the Build America Investment Initiative (BAII) to increase infrastructure investment and encourage economic growth. This initiative established the Build America Transportation Investment Center as a resource to connect investors with infrastructure projects and improve access to federal credit programs. BAII also established the Build America Interagency Working Group, a federal inter-agency working group, to improve coordination to accelerate financing and completion of projects of regional and national significance. In January 2015, President Obama announced new steps that federal agencies are taking to improve public private partnerships in infrastructure, including a proposal to create a new kind of municipal bond, a Qualified Public Infrastructure Bond

Exhibit 4: EFSI COMPONENTS

EFSI Components	Potential Benefits to Investors
European Investment Advisory Hub	The European Investment Advisory Hub brings together market participants. Benefit can be derived from the involvement of national commissioning bodies to encourage consistent practices. Extending the breadth of offerings in the market, e.g., by warehousing smaller projects so that they become of investable size, could be of particular benefit for projects based in smaller member states of the EU.
Project Pipeline	The Project Pipeline can add benefit by including a wider range of opportunities, including those which are not eligible for EFSI funding. The Pipeline's value add will be shown by the willingness to include investor due diligence criteria in the portal's design. We recommend including sufficient descriptive fields with detailed guidance of the types of information investors typically need to see.
EFSI Financing <i>(see Exhibit 3 above)</i>	The list of eligible investments is broad, and we welcome the economic viability and additionality tests. It is important that the investment committee is able to act independently to avoid watering down economic viability. It is critical that EFSI funding does not lead to a crowding out of private sector investment by financing otherwise viable projects.

(QPIB).³⁴ QPIBs would extend the benefits of municipal bonds to public private partnerships, lowering the cost of borrowing and attracting new capital. Several legislative proposals including Congressman John Delaney's 2013 bipartisan Partnership to Build America Act and 2015 Infrastructure 2.0 Act³⁵ and Senator Deb Fischer's 2015 Build USA Act are still being discussed.³⁶

LEGISLATIVE PROPOSALS IN THE US

- ▶ In 2015, Congressman John Delaney proposed the Infrastructure 2.0 Act. This bill would establish the American Infrastructure Fund (AIF) to provide bond guarantees and make loans to state and local governments and non-profit providers for qualified infrastructure projects. The AIF would issue American Infrastructure Bonds with an aggregate face value of \$50 billion that would be leveraged to provide \$750 billion in loans or guarantees. The bill would incentivize US corporations to buy AIF infrastructure bonds, as purchase of these bonds would qualify corporations to repatriate overseas earnings at an 8.75% tax rate. The bill would allocate \$25 million to create regional infrastructure accelerators in the US.
- ▶ In 2015, Senator Deb Fischer introduced the Build USA Act, which would establish an American Infrastructure Bank (AIB) with a bipartisan board. The AIB would issue public benefit bonds and provide financing to core infrastructure projects from bond proceeds. Individual states could enter into three-year agreements with the AIB, during which time they would remit to the bank unused federal funds received for highway activities. In return, states would receive 90 cents on the dollar for core infrastructure projects. The remaining 10% would be available as project loans at below-market rates.

Mexico

Mexico's Constitutional Reforms of 2013 have the potential to position the country for strong, long-term economic growth. The reforms have created an environment conducive to long-term capital deployment, established enhanced capital market structures that facilitate capital allocation to infrastructure and stimulated the flow of investable opportunities. In particular, these reforms open up the energy and telecommunications sectors for increased infrastructure investment. The reforms allow Mexico's state-controlled oil company to partner with private sector firms, and some of the country's oil fields will be opened to outside exploration and development. In telecommunications, reforms are intended to improve competition and diminish concentration in the sector through the creation of a new, constitutionally autonomous regulator with the authority to order divestitures, enforce regulations, and apply targeted sanctions on companies it deems dominant in the market. Further, in April 2014, the Mexican Government announced a four-year National Infrastructure Plan to invest approximately

\$590 billion in infrastructure.³⁷ According to the plan, the government will cover 63% of costs and private investment will finance the remainder. The 2013 constitutional reforms will facilitate the private investment goals by giving developers and investors greater certainty to invest in infrastructure, such as a transparent bidding process and clearer rights for investors.

Encouraged by the structural reforms and growing supply of addressable investments, in October 2015 BlackRock acquired Infraestructura Institucional, Mexico's leading infrastructure investment manager. We will be investing the capital of interested local and international clients in Mexico's national infrastructure program.

Increase the Potential for Greater Investment through Pooled Funds

Infrastructure investment is often interpreted to mean a single large project. In reality, infrastructure investment needs are much broader than this assumption implies. Investors are frequently subject to requirements for investment diversification and concentration. Investors can have concentration limits on the percentage of a particular product that they can invest in, and they often have minimum size requirements to make due diligence worthwhile. This may prevent many projects from attaining funding. Increasing the availability of infrastructure investment by grouping smaller similar projects together, especially if structured using standardized documentation, into pooled investment vehicles of a size that makes them investor-ready would facilitate this process.

There is a need to consider structures that could facilitate faster or more efficient take up of infrastructure investments. We welcome initiatives such as the ELTIF, which actively encourages investment into assets such as infrastructure by both smaller institutional investors and appropriately advised retail investors.

Avoid Unnecessary Barriers

Developing a supportive policy framework for infrastructure also means avoiding conflicting regulatory measures. Pooled solutions on their own will not fully deliver unless they are properly aligned with the capital charges for institutional investors and are subject to a supportive tax regime.

Capital Treatment

Many institutional investors are subject to detailed regulatory capital requirements, such as the EU's Solvency II regime in the case of insurers.³⁸ A holistic view of infrastructure investing is imperative and must avoid counterproductive measures. This means finding the right calibration for investors' regulatory capital treatment.

Regulation must agree on the scope of what infrastructure investment is, encourage treatment as a distinct asset class and allow for innovation while reflecting the actual risk profile of such investments.

Capital charges should recognize the benefits of investing through pooled funds such as closed-end funds with no or low levels of leverage (e.g., ELTIFs or other national regulated funds). These funds are often designed to be bought on a buy-to-hold basis and provide portfolio diversification benefits. The calibration of capital charges is particularly important to ensure that the benefits of the infrastructure investment risk categories are not unnecessarily limited. In addition to pooled funds, other types of vehicles such as Special Purpose Vehicles (SPV) and balance-sheet-separately-managed accounts, which are often used by insurers, should be considered as eligible for preferential capital treatment.

Provided risk and returns are passed through to the underlying investor, it should not make a difference if the project asset is held through an alternative investment fund or private fund or a dedicated SPV. The position would be different if the economic result were markedly different, for example if a fund were permitted to take on significant levels of additional leverage that would result in a different outcome from investing directly in the underlying project. In such a situation, a different treatment is merited. The regulatory capital treatment of infrastructure investments should appropriately reflect the risk of the underlying assets and the structural elements of the fund.

OECD BEPS

The Organisation for Economic Co-operation and Development's (OECD's) BEPS initiative seeks to address double non-taxation by multinational corporations. We support the overall aim of this initiative. However, if implemented as proposed, BEPS will lead to significant unintended consequences for investment funds, in particular, those investing on a cross-border basis in real assets such as infrastructure, real estate, and renewable energy.³⁹ Cross-border flows and investment in these assets classes will fall as a result.

As it stands, BEPS will make investing in these assets via pooled funds unattractive and will consequently reduce their level of funding contrary to the aims of the initiatives undertaken by the EU in particular (such as the EFSI and the ELTIF). Action 6 of BEPS will be particularly detrimental to non-collective investment funds (commonly referred to as alternative funds), as they are likely to be deprived from treaty relief.

Potential solutions that would allow the aims of BEPS to be met and promote infrastructure investment by investors exist. We suggest that the OECD and member governments work with industry to provide guidance as to how funds and their investors, especially alternative funds, can appropriately be treated in a post-BEPS world without impairing cross-border investment. Towards this end, we propose three approaches:

- ▶ A full look-through to the fund's beneficial owners such that direct treaty relief is respected.
- ▶ Provide that a "Qualified Fund" be respected as tax resident when most of its investors would otherwise be entitled to treaty benefits directly.
- ▶ Consider the substance that a fund or its service providers have in the jurisdiction where it is claiming tax residence.

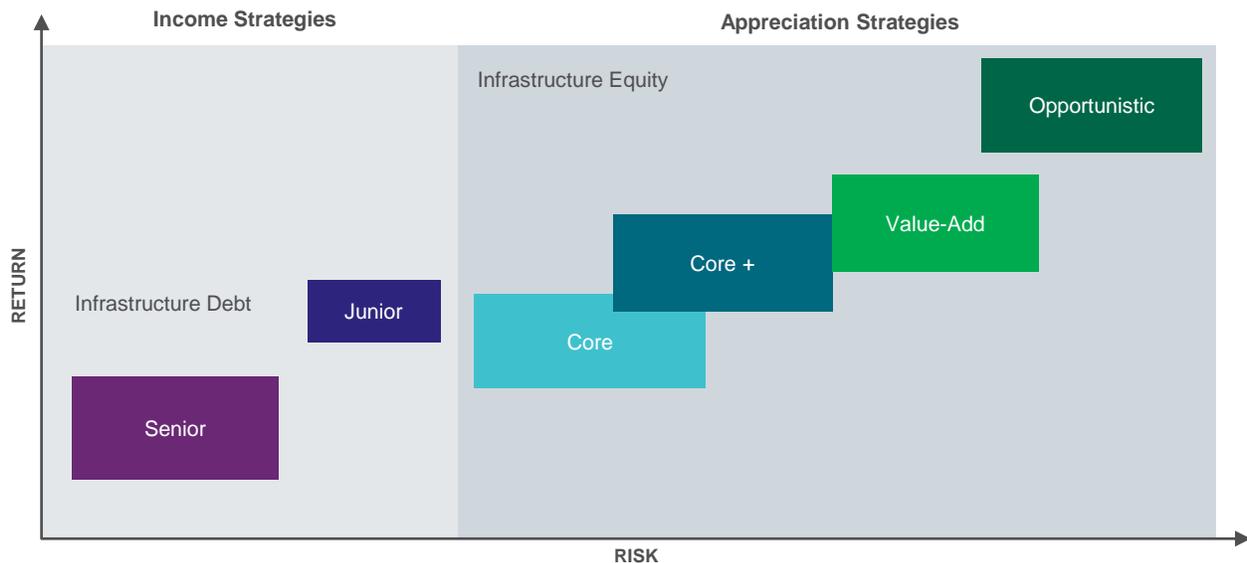
We strongly recommend that the short time remaining before BEPS is finalized next year be taken to explore these solutions.

Conclusion

Encouraging capital markets investment in infrastructure has the potential to bridge the world's infrastructure funding gap. A holistic and consistent policy framework is necessary to incentivize greater private capital investment in infrastructure. This framework should provide certainty, transparency, an alignment of public and private interests, and a stable and consistent tax and regulatory environment. Striking the appropriate balance between public policy and investor needs will facilitate greater private infrastructure investment.

Appendix: Infrastructure Strategies

Exhibit 5: A FULL SPECTRUM: INFRASTRUCTURE STRATEGIES AND COMPARATIVE RISK AND RETURN



Source: BlackRock, February 2015. From "Infrastructure Rising: An Asset Class Takes Shape" (Apr. 2015). For illustrative purposes only.

Exhibit 6 shows the characteristics of the different strategy categories in infrastructure investment to better assess potential investments, both in terms of whether they are likely to deliver desired outcomes, and also whether they are priced appropriately for the risks they present.

Exhibit 6: A INFRASTRUCTURE STRATEGIES: KEY CHARACTERISTICS

	Investment Grade Debt	Junior Debt	Core Equity	Core + Equity	Value-Added Equity	Opportunistic Equity
Key Risks	Operating Assumptions, Investment Structure	Market Risk, Operating Assumptions, Strategy Implementation	Operating Assumptions, Leverage Levels, Regulatory	Construction	Strategy Implementation	Market Risk, Political Risk, Currency Risk
Revenue Certainty (contracted)	Yes	No	Yes	Yes	No	In Some Cases
Already Revenue Generating?	N/A	N/A	Yes	No	In Some Cases	In Some Cases
Main Return Driver	Income	Income and Appreciation	Income	Income and Appreciation	Appreciation	Appreciation
GDP Sensitivity	Low	High	Low	Low	High	High
Greenfield or Brownfield	Both	Both	Brownfield	"Dark Green"	Both	Both
Development Risk	In Some Cases	In Some Cases	No	No	In Some Cases	In Some Cases

Source: BlackRock, February 2015. From "Infrastructure Rising: An Asset Class Takes Shape" (Apr. 2015). For illustrative purposes only.

RELATED CONTENT

- ▶ *ViewPoint* – [BEPS: Eliminate Double Non-Taxation Without Impeding Cross-Border Investment](#) (Feb. 2015)
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- ▶ [Infrastructure Rising: An Asset Class Takes Shape](#) (Apr. 2015)
- ▶ Comment Letter – [EIOPA Call for Advice from the European Commission on the Identification and Calibration of Infrastructure Investment Risk Categories](#) (Aug. 2015)
- ▶ BlackRock Investment Institute, [The Price of Climate Change: Global Warming's Impact on Portfolios](#) (Oct. 2015)
- ▶ [Rethinking Risk in a More Uncertain World – Global Insurers' Investment Strategies](#) (Oct. 2015)

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