Foresight

A global infrastructure perspective

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A new PATH to increased infrastructure investment in the US

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Will the government's tax relief for non-US pension investors catalyze the infrastructure market? The passing of the Protecting Americans from Tax Hikes (PATH) Act into US legislation should spark a new wave of institutional investment into US infrastructure. For certain non-US pension investors, the Act reduces much of the tax drag that had long complicated investments into 'real property' assets in the US. For all investors, it will be important to understand the relative tax position of competing bidders and its impact on pricing. Yet while the Act should eventually unlock a flow of new foreign investment capital, significant questions still remain to be answered before foreign players will be able to confidently dive into the market.

Ending the year with a bang

For non-US pension funds and US infrastructure owners, it was nothing short of a holiday miracle. Foreign institutional investors had for years been warning that the Foreign Investment in US Real Property Tax Act (known as FIRPTA) was having a dampening effect on investment into US infrastructure assets and projects.

The problem was that — unlike most other US capital gains earned by foreign investors — the FIRPTA legislation imposed a tax on gains made from foreign investments into US real property interests (USRPI). And it quickly became clear that a wide swath of infrastructure investments would come into 'scope' — from the fairly obvious (such as ports, roads or mine sites) through to the somewhat less obvious (potentially tolling infrastructure for example).

Faced with an increased tax liability, new compliance requirements and reporting processes, many foreign institutional investors understandably shied away from infrastructure as an asset class or were required to use complex structures. Those that did invest into US infrastructure needed to put significant effort towards managing FIRPTA tax requirements and liabilities.

A new PATH

For qualifying investors (Qualified Foreign Pension Funds, "QFPFs"), the provisions included in the PATH Act essentially bring infrastructure investment back in line with the tax-free treatment of other US capital gains. Passed into legislation on 18 December 2015, the Act covers a range of issues (including the treatment of certain REIT investments). Most dramatically, however, is the Act's exclusion of QFPFs from the application

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of FIRPTA. The definition of a QFPF is not entirely clear; however, those funds that do qualify will enjoy exclusion from the application of FIRPTA. Those funds which do not qualify will be left to manage through the complexities of the FIRPTA rules.

Not surprisingly, the passing of the PATH Act has been cheered by both QFPF investors and infrastructure owners alike. For OFPF investors, the provision means that foreign and US pension funds will now be competing on a level playing field for infrastructure investments. This should drive more equity capital into the market which, in turn, should help unblock infrastructure pipelines.

Some clarification needed

While the passing of the PATH Act makes clear the government's intention to remove some of the barriers to foreign infrastructure investment, some issues still need to be resolved. Who, for example, qualifies satisfies the requirements to claim status as a QFPF? Further, pension funds can take many forms around the world, sometimes involving multiple entities structured around a single pension-related pool of capital. In other cases, some pensions utilize an agency or investment company structure. From the legislation, it is not entirely clear which entity can claim status as a QFPF. Clearly, many questions will still need to be resolved before many foreign pension investors can confidently rely on the benefits offered through the PATH Act.

Investment will come

While it may take a few months for investors to get the clarification they require on the new provisions, we are confident that the passing of the PATH Act will provide a much-needed shot in the arm for the US infrastructure market. The reality is that foreign pension funds — historically led by the Canadians, Australians and Europeans — have been far more active in infrastructure markets than their US counterparts and should therefore bring a new level of sophistication to the market.

We are also seeing increased activity from the emerging market pension funds — in particular those from Asia — who are now starting to broaden their capabilities into infrastructure. Most will see the US as a safe, transparent and mature market in which to make their first infrastructure investments.

Over the past few weeks, we have talked to many pension fund investors — both US and foreign — to help clarify some of the big issues and understand the implications of the provisions. And our discussions suggest that investment will soon start to flow into the US market as a result of the PATH Act. It should be a holiday miracle that keeps on giving.

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