

## Private Infrastructure Investment and the COVID-19 Pandemic

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The COVID-19 outbreak has already had an effect on private infrastructure investing, with reports of a number of mergers, acquisitions and financing activities in the infrastructure space having recently been postponed. As the pandemic continues to impact global financial markets, uncertainty related to financing costs and exchange rates – coupled with the simple inability of people to travel and visit infrastructure assets – may result in additional temporary disruption in M&A and capital markets activity in the infrastructure space.<sup>1</sup>

However, given the demand for infrastructure investments, the focus of fundraising and the general characteristics of this asset class, private infrastructure investment will likely show resilience even in the new environment.

On the demand side, certain GDP-linked assets like toll roads and airports will feel the initial impact of the travel restrictions. But at the same time, with more and more people working from home, assets like data infrastructure will continue to be in high demand, as the exponential growth in data consumption that has occurred in the recent years is only increased by COVID-19 travel disruptions.

The growth in data consumption will likely continue to drive opportunities to invest in both data transmission and storage assets – including fiber networks, data centers and telecommunication towers – and perhaps serve as a hedge against temporary impacts on transportation assets.

More generally, the COVID-19 outbreak will not change the accumulated global infrastructure investment need through 2035, which is [estimated to be \\$69 trillion](#) (excluding energy), or the [estimated infrastructure funding gap](#), calculated as the difference between a region's investment need and current investments, which for the United States is estimated to be \$4 trillion.

Certain core areas of expertise on the part of infrastructure fund managers will likely be important for driving success in 2020 during and after the COVID-19 disruption. As governments around the world continue to increase their targets for generation from renewable sources, asset and power market diligence will be crucial to pricing, especially in a competitive bidding posture.

Hydro, solar and wind assets benefit from low variable operating costs relative to fossil-fueled power generation. Their potential in generating significant cash margins in the absence of fixed-price power purchase agreements will depend on the reliability of projections of the power market conditions in the relevant geography, and the operating experience of fund managers, as opposed to mere reliance on financial and tax incentives.

Financial and legal engineering in large-scale development-stage investments could provide another avenue for successful deployment of capital. This strategy is opposite to the familiar investing in legacy companies that offer average growth but a steady cash stream. Development capital deployment will look to certain liquidity events, such as construction financing, tax equity investments, sponsor recapitalizations or sale of the asset as the milestones for return of capital.

The main challenge for this particular kind of investment will be the ability to scale. If executed successfully, more traditional infrastructure funds could be well-positioned to provide the development capital with attractive monetization opportunities.

Such opportunities could involve other infrastructure funds investing more long-term capital to secure stable cash yields through a buy-and-hold strategy, or providing back leverage that can provide proceeds for distributions and/or reinvestment in new projects without a loss of ownership or control.

While the utilities sector remains attractive to infrastructure investors, navigating and garnering political support for such investments will be essential to a successful strategy. The various public proposals for acquiring Santee Cooper are a recent example of both the creativity and challenges of investing in this space.

As reported by [The State](#), South Carolina lawmakers have three different offers for the state-owned utility, which incurred significant indebtedness associated with the construction of a nuclear power project: an offer to buy, an offer to manage and an offer to reform by the utility itself. The path forward will depend on the offer that garners the most political support.

Ultimately, successful investments in the utilities sector (and other assets that are viewed as quasi-public goods) will be a function of whether the market forms a consensus on the most attractive funding model that can meet the growing demands of our society and also provide an attractive return to investors.

Understanding the scope, pace and limitations of the transition between existing hydrocarbon energy production and low-carbon technologies – and anticipating the new financing strategies that will need to be put in place to accommodate this transition – will be essential to driving future investments. There is a dual challenge at play: producing more energy and reducing carbon dioxide emissions.

Meeting this challenge will require innovative thinking, in part because it is not just capital that will need to be redeployed – it is technology as well. Growing new businesses that support the transition by using existing technologies currently deployed to boost oil and gas production in wider applications across the low-carbon energy space is one example.

Other forms of redeployment might include adding more biofuels into diesel and petrol, using low-carbon forms of energy to power refineries, and deploying carbon-capture technologies. A number of these redeployment businesses will have proprietary elements and offer higher returns, but the form of capital deployment to incubate and grow them will present new legal challenges.

Finally, optimizing and innovating the financing structures related to capital deployment in this space will continue to be a key challenge. The legal technology underlying some of the debt investments in infrastructure assets remains antiquated and needs to be updated, in part, by incorporating elements of leveraged finance to provide additional flexibility for the equity investors that responds to a fluid investment market landscape.

For example, reinvestments of residual revenue and expansions of such assets in response to market demands should be generally permitted without senior lender consent to the extent such reinvestments and expansions are credit-accretive to the original lenders. Great progress has been made by sponsor counsel in this regard in the last year, but the trend should continue.

Moreover, as more asset managers begin raising dedicated infrastructure debt funds, we should expect equity investors to be offered additional flexibility by such investment vehicles, with financing solutions more tailored to their financing

objectives.

Aside from the length of the COVID-19 disruption, the scale of private capital participation in infrastructure investments in 2020 will also likely depend on a number of factors outside the infrastructure fund managers' control. One factor is the privatization drive on the part of municipal and state-owned utilities to meet the growing demands on their electricity transmission and distribution systems, especially as they try to ensure that systems have the flexibility to transmit and distribute energy from renewable sources.

Depending on capital constraints, as the economy rebounds from the COVID-19 outbreak, even privately owned utilities might turn to private capital for similar growth projects. The continuation of policies supporting middle-class growth in countries such as Chile, Colombia, Peru and Brazil will determine the investment pace of electricity and gas transmission buildouts in these jurisdictions.

Lastly, the pace with which, companies look to divest ancillary assets to sustain operations and improve the quality of their balance sheets will affect investments in transportation, including terminal upgrades and port expansions.

*This article was co-written with Fred Day, senior vice president at Brookfield Infrastructure Partners L.P.*

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1. E.g., Nathan Walters, "[Petrobras suspends refinery sales](#)," Argus Media, March 20, 2020; Jinjoo Lee, "[CPV postpones Three Rivers deal due to COVID-19](#)," SparkSpread, March 19, 2020; Ivan Castano, "[Coronavirus: Brazilian Gas-Fired Plant Funding Postponed By Outbreak](#)," SparkSpread, March 18, 2020; Rory Gallivan and Brendan Malkin, "[Zenith Energy Sale On Hold Due To Covid-19](#)," SparkSpread, March 19, 2020.↵

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