Ogier

Infrastructure funds can sometimes create a 'Catch-22'

Insights - 19/05/2017

From a structuring perspective, infrastructure funds are most frequently established as either a limited partnership or a limited company. Partnerships are the familiar vehicle for private funds, whereas companies will be used for listed vehicles.

Obviously there will be nuances, depending on the asset class and the type of investors being targeted. “You can give limited companies characteristics that resemble a limited partnership, particularly in offshore jurisdictions like Guernsey, but generally it will be one of the two options described,” says Bryon Rees, investment funds partner from Ogier in Guernsey.

There are some inherent difficulties with infrastructure funds, given the incubation period for setting up one of these vehicles. Bryon notes that ideally, investors want the fund vehicle to have a seeded portfolio in place or at the very least identified target assets – they will want to be confident that the capital will be deployed and, particularly in the case of listed funds, that their investment will not be subject to extended cash drag.

Not all managers, however, can come to the table with a book of seed assets which are lined up and ready for investment by the new fund vehicle.

This creates a bit of a Catch-22 for many of these funds. How does the investment manager balance investor expectation for capital deployment with the need for a long enough runway to identify the right assets? Time is not always on their side.

“Some have fallen down because of the difficulty of raising a book of capital from investors given that the investment period may potentially be over multiple years,” says Bryon. “Identifying and vetting investments takes time – this is one of the reasons why the largest infrastructure funds tend to launch in the private space.

“There are some notable listed infrastructure funds but it remains easier to raise a private infrastructure fund given the ability to draw down commitments gradually and because of the size

of investment which investors would prefer to make.”

Private funds generally raise higher amounts of capital than listed funds. What a private fund provides, in a limited partnership arrangement, is the ability to use capital calls and draw down capital as and when required, whereas a listed fund would need to have all of its shares fully paid up before listing on the London Stock Exchange or elsewhere.

A listed fund could potentially decide to invest in a single or limited number of infrastructure assets, thereby making it easier to put the capital to work, but the difficulty with this is that the fund may not then be considered suitable for listing in the eyes of the listing authority.

“The regulator will expect to see a spread of investment risk for a premium listing on the LSE and that the portfolio will be comprised of a sufficient number of assets. What investors will be looking for is disclosure in the prospectus on the nature of those assets. Fortunately, there are alternatives in the form of the Specialist Fund Segment of the Main Market of the LSE for vehicles which will invest in fewer assets or may not satisfy all of the rules comprising Chapter 15 of the UK Listing Authority's Listing Rules.

“By comparison, those considerations may be seen to fall away for a private fund. Spread of investment risk will be for the manager to determine (based on the investment proposition agreed with the LPs), not the listing authority by reference to the relevant rules,” explains Bryon.

Given the sheer depth and breadth of infrastructure projects to choose from, one might be forgiven for understanding why the investment manager, looking to launch an unlisted fund, might want to attract what are known as ‘blind pool’ investors. In short, these are investors who commit to investing in a vehicle with no seed assets or identified target assets.

This is a much harder sell, however.

“Unless you are a particularly high-profile fund manager with an extensive track record, investors will want to know upfront what the portfolio is expected to be composed of,” states Bryon. “If the infrastructure investments you are planning on making are in an area of the market where there are significant investment opportunities, then investors maybe more minded to invest blind.

“It could be that the fund itself doesn’t invest directly in infrastructure but rather is exposed to the asset class – for example, a fund-of-funds.

“You could see how a listed vehicle would be attractive from a manager's perspective. The listed vehicle provides the investment manager with a pot of permanent investor capital to seed a portfolio of private infrastructure funds.”

Getting the seed capital and the initial traction is critical, after which it becomes easier to attract other investors.

Aside from the sheer number and variety of infrastructure projects, another element of complexity that managers have to consider is the regulatory and political vicissitudes of the countries they invest in. This creates a range of potential risks.

“Investing in a wind farm, for example, might be predicated on the operator selling electricity at a particular price, which could be affected by regulation. Infrastructure projects in the energy sector will require a lot of diligence by fund managers.

“For private infrastructure funds investing in the energy sector, there will likely be added regulatory complexities that could increase costs for the fund; especially if it requires working with advisers, lawyers and specialist valuation agents in local markets.

“These are specialist investments. Investors will want assurances that their capital is protected and being managed appropriately,” says Bryon.

To that end, the more successful infrastructure fund managers are those with well-developed networks of experts spanning the target markets in which they wish to invest. Having local expertise and knowing how to handle idiosyncratic risks, both political and regulatory, is a vital consideration for any institution when assessing which managers to invest with.

Indeed, investors also have to consider what the added complexities, and risks, could be to UK infrastructure projects following the Brexit decision; what will the regulatory impact be relative to wider EU regulation?

“All these critical factors will need to be thought through” asserts Bryon. He says that in terms of structuring a private fund, the most frequently used option is to have a limited partnership where a group of investors band together as limited partners under a partnership agreement.

“The general partner of the partnership then appoints the investment manager. This is the tried and tested model and is generally no different for private equity and real estate funds,” he added.

In Europe, there are various markets to consider for setting up limited partnerships. There is the English limited partnership and each of the Channel Islands has a partnership regime too. In addition, in recent times, jurisdictions like Luxembourg have updated their legal regime to better support global private equity, real estate and infrastructure managers with the introduction of a Special Limited Partnership (SCSp), which unlike the SCS, has no legal personality and therefore more closely based on the Anglo-Saxon LP model.

“As a limited partnership will not typically have a legal personality, the LPs should be taxed on a look-through basis.

“The team structuring a new vehicle will look to minimize tax leakage within the fund structure, which one of the reasons why we see fund promoters heading to Guernsey. The aim will be for

investors to be taxed principally in their home jurisdiction," says Bryon.

He notes that structuring teams will look to take advantage of jurisdictions with good double taxation networks, as well as those jurisdictions which are familiar to investors.

"The ultimate structure of a fund will depend on a combination of factors – where the assets are located, where the investors are based and how investment will be structured."

This interview first appeared in Global Fund Media's May 2017 special report "Investment opportunities in infrastructure debt".

About Ogier

Ogier is a professional services firm with the knowledge and expertise to handle the most demanding and complex transactions and provide expert, efficient and cost-effective services to all our clients. We regularly win awards for the quality of our client service, our work and our people.

Disclaimer

This client briefing has been prepared for clients and professional associates of Ogier. The information and expressions of opinion which it contains are not intended to be a comprehensive study or to provide legal advice and should not be treated as a substitute for specific advice concerning individual situations.

Regulatory information can be found under Legal Notice

Meet the Author

Bryon Rees

Partner

Guernsey

E: bryon.rees@ogier.com

T: +44 1481 752312

Key Contacts

Tim Clipstone

Partner

British Virgin Islands

Guernsey

E: tim.clipstone@ogier.com

T: +44 1481 752265

Related Services

Investment Funds

Hedge Funds

Regulatory

Legal

Related Sectors

Private Equity

Funds Hub