Research and Insights

The 2020 US election: An infrastructure perspective

September 2020

Ausbil's Listed Infrastructure Team has been looking over the form guide for the coming US election, and what differences the two candidates might bring to the world of infrastructure investing. This is what we know now, but of course in the run-up to Election Day we could see any number of new policy initiatives launched.

Q: Context: Is infrastructure in America well invested?

A massive infrastructure funding gap. With respect to infrastructure, both Republicans and Democrats recognise the need for and the stimulative benefit of infrastructure investment, particularly when fiscal spending is needed during recession. However, even before COVID-19, there was an urgent need for spending on American infrastructure. As an example, in 2017 the American Society of Civil Engineers estimated that there is a US$2 trillion funding gap over 10-years for infrastructure in the US[i]. COVID-19 may well be the catalyst for the winner to spend more on infrastructure, and to implement more collaborative policies with states, municipalities and private companies to mobilise more investment.

To date, both candidates are pledging pro-infrastructure spending policies. So far, Trump has committed to $1 trillion of investment over ten years on highways and transit, rural broadband, 5G and other non-transportation infrastructure. By contrast, Biden is focusing on $2 trillion of investment in sustainable infrastructure and clean energy, 5G and rural broadband.[ii]

Whoever wins the White House, the desperate need for more infrastructure spending and more economic stimulus could prompt clearer and more aggressive policy promises from both sides. This time might be different in this regard.

Q: What are the key issues for each candidate at a glance?

A Trump win. If Trump is re-elected, we expect taxes to remain low and the roll-back of more regulation. Trump appears to favour supporting the established fossil fuel industries over renewable energy, or what we call 'future energy' opportunities such as wind, solar, batteries and hydrogen. This could be positive for energy infrastructure such as pipelines, though the ability for new pipelines to be built has already been seriously stalled by environmental activism over recent years. Any lack of proactive policies in the renewable space that could expand the investment opportunity-set in infrastructure could be a missed opportunity during a second Trump term. Whatever the case, 2019 was a record year for renewable energy investment in the US. Whilst Trump himself has made negative remarks on renewable energy, his administration has been more progressive in allowing the development of renewable energy projects on public land than previous administrations.

A Biden win. As a seasoned legislator, Biden has an extensive track record in government, so similarly to Trump, he is a known quantity for investors which already helps reduce a significant amount of risk. Given Biden's strength in the polls, the market is currently pricing the possibility of a Biden victory. When Biden was VP under Obama, during the challenges and recovery from the Global Financial Crisis, he gained directly relevant experience to where we are now with the current pandemic recession. Considering Trump's response to date on COVID-19, a change of government could be well-received by markets hoping for a more focused effort to eradicate the risks. However, there is a fine line between how both candidates are viewed on this as Trump errs on maintaining a functioning economy even with the high risk of growing infection rates, while the market might perceive Biden as a risk in being more partial to lockdowns and controls to help stem the virus – the risk/reward trade-off on this is difficult for market analysts to calculate.

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Q: What are Biden's policies, and how could they impact infrastructure?

Policies to promote renewable energy generation. Taking a contrarian position to Trump, Biden has put forward a plan entitled, 'Build Back Better', for US$2 trillion in spending and policy initiatives that includes creating a 100% carbon-free electricity industry in the US by 2035. This materially accelerates existing state mandates that are in place, such as in New York and California, and also provides a huge opportunity for the listed utility companies such as NextEra (NYSE: NEE), Ameren (NYSE: AEE) and Eversource Energy (NYSE: ES). NextEra, in particular, would likely see its growth profile further accelerate given its leading position in the development and ownership of renewable energy (wind, solar and batteries) in the US. Furthermore, all three companies would undertake significant investments in their respective regulated utilities – replacing fossil fuel generation with renewables, and updating and reinforcing their electric grids in order to support further penetration of renewables. This investment would increase the asset bases of companies, and as they earn a return on this larger asset base, the increase in profitability could be significant.

Pull-back on fossil fuels. Another of Biden's proposals is to potentially end new oil and gas leases on federal land, and end offshore drilling, though it is currently understood that existing leases would be honoured, which makes sense given the revenue they generate for the government. In 2019, 24% of total US oil production was produced on federal lands and waters, though over 80% of this is offshore production[iii]. This proposal could impact some oil and gas pipeline companies as it would hamper growth in the exploration and production of oil and gas across federal lands and waters, effectively reducing the terminal value of many assets. The risk of not issuing new leases on federal land is partially mitigated by the fact that only around 25% of carbon dioxide emissions in the US come from fossil fuels extracted from federal land[iv]. Moreover, in 2019 only 12% of natural gas produced was on federally managed lands[v], with growth mostly coming from shale plays that sit on private lands, a figure which is falling as big energy diversifies into renewables. This policy has been well flagged, and the oil and gas companies have already started to adjust their plans in anticipation. A by-product of this proposal could be upward pressure on oil and gas prices, which would be supportive for the existing and new industry as a whole, attracting more investment capital.

Proposes to tax carbon emissions. In addition to pulling back on new investment in fossil fuels, Biden plans to tax carbon emissions. This would significantly impact fossil fuel electricity generation (coal and gas) and related infrastructure which still accounts for the dominant share of base load generation. If the generation is currently included within a regulated structure, however, then the cost of such a policy is likely to be absorbed as a 'pass-through' to the end consumer, with minimal impact to the company. However, for generation plants that are classified as a 'merchant', and not included within a regulated structure, then the impact is likely to be material. Ausbil Essential Infrastructure does not include merchant generation within its definition of essential infrastructure, so would be immune from any negative impact on merchant generation assets.

Ruralisation of broadband. Biden has also proposed new policy initiatives in communications, such as rural broadband expansion[vi], which could benefit the mobile phone tower companies such as American Tower (NYSE: AMT), SBA Communications (NASDAQ: SBAC) and Crown Castle (NYSE: CCI). There is likely to be opportunity for these companies in facilitating a rapid build-out of 5G broadband mobile networks across rural America should such a policy be enacted.

Raising taxes. Biden has stated that he favours increasing the corporate tax rate, which was lowered by Trump from 35% to 21% in 2017, back up to 28%[vii]. The cut to the corporate tax level had a material benefit to company profitability, and was at least partly responsible for a rise in the share prices of listed companies in 2017 and early 2018. An increase in the tax rate is therefore likely to have the opposite impact on earnings and share prices. Some Wall Street brokers are forecasting that an increase in the tax rate from 21% to 28% would reduce the earnings per share of S&P 500 companies by around 9%[viii]. Across infrastructure, the impact of raising taxes would be varied as essential infrastructure companies are largely insulated from a potential tax increase.

- **In communications.** Mobile phone tower companies, for example, are relatively insulated from such a change as they are structured as tax-efficient REITs (real estate investment trusts) that pass through gross revenue before tax to investors, which is then taxed at the investor level rather than at the company level.

- **In utilities.** Similarly, regulated utilities tend to pass through taxes to the end customer as mandated in their governing regulations. This was what we saw when the tax rate was cut by Trump, utilities saw no benefit from the tax cut as it was passed through to the consumer via lower bills. If tax rates increase, then the reverse of this mechanism is likely to occur, with negligible impact on utility earnings, but for the consumer it is likely to mean higher utility costs, which will feed into inflation. Due to the way regulation works in the US, an increase in the tax rate would be positive for the utilities as their near-term cash flow would actually increase, a nuance most market participants do not appreciate.

- **In energy.** A tax increase would be marginally negative for US energy infrastructure names as, all else being equal, it brings forward the time that these companies pay cash taxes, simply utilising existing tax shields faster. However, this impact could be mitigated through existing regulatory mechanisms which could allow for higher taxes to be recovered in the rates that they charge their customers.

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Q: What are Trump's policies, and what would they mean for infrastructure?

Sympathetic support for fossil fuels. As Trump has been in power for a few years, his policies are fairly well known. In the run-up to the previous election, Trump pledged his support for the coal industry given its place at the heartland of many of his supporters. Since taking power, Trump has removed the US from the Paris Climate Agreement and has also rolled back some of the regulation for Environmental Protection[ix]. The Trump administration has also made pro-fossil fuel moves such as planning to open up the Arctic Wildlife Refuge for oil and gas exploration[x].

Trump is therefore likely to continue on a pro-fossil fuel policy, which could be a positive for the oil and gas pipelines, both in terms of increased volumes and the potential for new pipelines to be built. We would be cautious on both of these. The environmental movement in the US has grown considerably in terms of size and resources over the last few years, and organisations such as the Sierra Club[xi] routinely protest any new project that impacts the environment. In addition to protests, court challenges to not only new pipelines, but existing pipelines have increased materially in recent years. It is unlikely that even a pro-fossil-fuel Trump can hold back this trend.

Support for renewable energy. Whilst Trump has been clearly pro-fossil fuels, and has made disparaging remarks about renewable energy, even insinuating that noise from wind turbines causes cancer[xii], he is not anathema for renewables. In fact, 2019 was a record year in the US for renewable energy investment, with investment totalling US$55.5b, up 28% on 2018[xiii].

The record investment in US renewables shows that renewables investment is likely to remain very strong irrespective of the outcome of the 2020 presidential election. Inevitably, a Biden win would likely lead to a further acceleration, but a Trump win is also likely to mean continuation of the status quo. This is due to the superior economics of renewables in many parts of the US versus other forms of power generation, strong support for emission reduction policies by state governments and energy regulators, and also the potential continuation of Federal Government support for the sector. The long-term renewables thematic will remain strong under either Republican or Democrat governments.

In terms of tax incentives, the timelines for tax incentives for renewables to end in the US have been extended 12 times, under both Republican and Democratic governments, and were most recently extended in 2019 under the Trump administration. Moreover, in response to COVID-19 and the potential impact on renewable investment in the US, the US government extended the 'safe harbour' requirements for renewable energy projects to qualify for tax incentives to ensure any pandemic-related delays did not impact investment and returns.

With all that said, the Trump administration has seen a record rise in renewable energy across the US, and his administration has made positive moves towards renewable energy such as giving the green light for the Gemini Solar farm in Nevada, a 690MW development that is the largest solar farm project ever approved in the US[xiv]. NextEra (NYSE: NEE), the largest developer and owner of renewable energy projects in the US, upgraded its earnings guidance for both 2020 and 2021 on the back of accelerating renewable energy investment in the US.

More tax breaks. A win for Trump is likely to see further tax streamlining following his first-term tax reductions, including the implementation of 'Made in America' tax credits, expanded tax breaks for investing in lower-income communities, and a lower capital gains tax rate[xv], which all point towards economic growth-friendly policies for the US economy.

Q: Is the federal structure of the United States of America a hindrance to mobilising spending on infrastructure?

The federated structure of the US drives significant complexity in matters of law and jurisdiction, with infrastructure assets governed by federal, state and municipal laws. For example, almost all airports in the US are owned by municipalities and while there are federal laws governing aviation, states and municipals are also involved in approvals and regulations. In infrastructure, this means that the President who is best able to promote economic growth is more likely to benefit infrastructure, particularly given the multi-jurisdictional and granular world of rules and policies that govern infrastructure assets.

Q: Who are the people actually voting for?

While we all believe age is no limit, in this election the two candidates are well into their 70s (Trump is 74 and Biden is 77), with Donald Trump holding the record as the oldest in history on the first day of his Presidency. By way of comparison, George Washington was 57 when he first became President, Jefferson was 57, Lincoln was 52, Reagan was 69, Bush Sr was 64, Bush Jr was 54, and amongst the youngest, Roosevelt was 42 (following the assassination of McKinley), JFK was 43 (youngest ever elected), and Clinton was a babyfaced 46 year-old. Why does this matter? Because at the current ages of the contestants, the risk of a power transfer to the Vice President for one reason or other becomes an increasingly elevated probability. At this stage, that deals in Kamala Harris (Dem) and Mike Pence (Rep), and their views on policy, a potential complication for determining what outcome is better for infrastructure investors, and one that is too moot for inclusion here.

Q: What are you seeing from other governments around the world, given the current environment?

One thing that is clear for most governments is the need for stimulus and incentives to support existing jobs and create new ones so that the unemployment rate is reduced as quickly as possible. Accelerated infrastructure investment is seen, almost unanimously, as an essential part of the solution for avoiding economic stagnation and for stimulating employment and demand. Infrastructure spending not only upgrades old and obsolete infrastructure, it creates jobs with a multiplier effect as better infrastructure can make the economy more fluid, reduce the cost of doing business, and stimulate even more activity through availability, thereby having a positive long-term impact on GDP growth.

We are currently seeing governments discuss both direct infrastructure investment (funding infrastructure projects themselves), and indirect investment via companies that own and operate existing assets, many of which are listed. Given the urgent need for investment, and the increasingly uncertain economic outlook, governments and regulators need to focus on accelerating project approvals whilst also offering returns that are attractive enough for companies to take on the risk of going ahead with a project, and for investors to actively allocate new capital to these companies.

Around 80% of all infrastructure assets around the world are still owned by governments that can no longer afford to maintain, replace or expand them. Selling assets into the listed market not only provides governments with fresh capital, but also provides a route for these new companies to raise additional private and public capital needed to upgrade their assets. We've seen several examples of this over the past years, and this route could well speed up in the coming years, thereby providing investors in essential infrastructure more opportunities to invest.

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xiv. Arevia Power, "Gemini Solar Project," accessed 16 September 2020, https://www.geminisolarnv.com/
xv. MacKay Shields, "The US Presidential Election and the Outlook for Fiscal Policy," September 2020, MacKay Shields, New York.

Infra-know
The UK government has repeatedly slashed its forecasts for the cost of wind and solar electricity generation. In 2025, offshore wind costs are now expected to be 47% lower than thought in 2016, and solar cost estimates have been cut by over 50% since 2013. Both solar and wind costs are now expected to be significantly cheaper than coal, gas or nuclear generation by 2025. These cost reductions are the genesis of the ‘energy transition’ that will see investment in renewables grow rapidly, along with their steady displacement of fossil fuels.

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