Infrastructure Investment Trusts (IITs)

to help fund African Infrastructure development

Investment in infrastructure is critical for the African to build its competitive position in the global economy.

Fraser Hughes Reports

With infrastructure in the legislative spotlight at a global level, there is an opportunity to unlock a much-needed wave of new investment by tapping into private capital via a listed infrastructure investment vehicle.

A common objection to private involvement in infrastructure investment is a political concern that large private equity firms would unfairly benefit from owning assets that the African population needs to use. However, there is a way to both protect against this and offer the opportunity for the wide ownership of African infrastructure. In fact, this idea has already been tried and tested for decades.

The Real Estate Investment Trust (REIT) which is in existence in over 35 countries, has allowed tens of millions of individual investors either directly, or through their retirement savings, to enjoy the benefit of investment in commercial real estate. For example, it is estimated that 80 million Americans own REITs through retirement savings and other investment funds. That's a true success story. South Africa, Kenya and Nigeria all have introduced REITs in recent years to varying degrees of success.

By adopting the principles and rules of REIT legislation and adapting for infrastructure assets, the African nations have the foundation to create a clearly defined purpose-built vehicle – an Infrastructure Investment Trust (IIT) – built on successful aspects of the REIT, but specifically focused on infrastructure investment. In fact, India already has its own version called an InvIT. We believe an Infrastructure Investment Trust (IIT) can pathe the way to more efficiently finance infrastructure investment. Moreover, the global investment community has a long history of investing in REIT-like structures so a similar clearly defined structure for infrastructure will require very little investor education.

A clearly defined African Infrastructure Investment Trust (IIT) could act as a magnet for global capital to fund much needed African infrastructure development, reduce pressure on government balance sheets, and allow the broadest possible ownership. What is needed to unlock this potential wave of new investment, and the associated increase in jobs and economic activity that would follow, is a 21st century revamp of some of the 20th century's most successful corporate structures and concepts.

IITs A SOLUTION TO FUNDING AFRICAN INFRASTRUCTURE

Infrastructure is a young but rapidly growing asset class. According to the 2018 Preqin Global Infrastructure Report, there was $150bn waiting to invest (dry powder) in infrastructure assets in 2017. Put simply, investors are struggling to buy infrastructure assets directly. To compound this issue, over 50% of institutional investors surveyed in the Preqin report plan to allocate more capital to infrastructure over the longer term. Overall, global institutional investors are well under their target allocations to infrastructure.

Creating an IIT structure, coupled with the pent-up global demand for targeted infrastructure investment could open the floodgates of private capital. The conditions are in place to attract investment into African mission-critical transportation and utility infrastructure assets. From an investment perspective, the steady cash flow characteristics of infrastructure projects would also mean that the IIT could be used as part of a stable, lower-volatility, yield-oriented investment allocation. This type of asset class is in high demand by investors.

IITs CREATION

An IIT structure could be designed to be specifically tailored to the characteristics of infrastructure assets, including the nature of qualifying assets and qualifying income. Figure 1. compares the main elements of a blueprint REIT and a purpose-built African IIT. **Specifically, an IIT would define qualifying income to include revenues derived from the transmission, transportation, and/or distribution of:**

- **energy**
- **data**
- **power**
- **vehicles** air, sea, road, rail

It should be noted that much of African infrastructure investment requires new construction projects. This involves a period of no income and, in fact, losses from upfront investment. An IIT would need to capture the tax loss pass-through benefits of a private partnership structure, which cannot be captured in current REIT rules. An IIT that includes the ability to pass through tax losses to offset an investor's ordinary income would create a powerful investment incentive from a broad base of long-term global investors.

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FIGURE 1: EXTENDED REIT OR PROPOSED IIT COMPARISON

Source: NAREIT, GLIO

	REIT	IIT (PROPOSED)
PURPOSE	Allow broad access to income producing real estate	Allow broad access to income producing infrastructure and development
LEGISLATIVE FORMATION	REIT Act contained in Cigar Excise Act extension of 1960. REIT Modernization of 1999.	De novo structure per infrastructure bill, or evolution of REIT or even MLP structure
DISTRIBUTION	90% plus of taxable net income to shareholders	No distribution requirements to allow incentivized investment
QUALIFYING ASSETS	>75% of assets in real estate (real property or loans secured by property)	Transportation, utilities, energy distribution, communications infrastructure assets
QUALIFYING INCOME (EXISTING)	>75% of gross income from real estate (rents or interest from mortgages), no more than 25% of assets invested in stocks of taxable REIT	-NA-
QUALIFYING INCOME (PROPOSED)	Broaden the accepted definition of rent to include any payment for use of real property including fees and tolls (to encompass infrastructure)	90% of gross income derived from qualifying income from transportation, utilities, energy distribution and communications infrastructure
OWNERSHIP	Minimum 100 shareholders, no more than 50% of shares held by five or fewer individuals	Widely held
TAXATION	Dividend paid deduction means up to 100% of earnings not taxed at the corporate level, distributions include pass through of depreciation	Dividend paid deduction means up to 100% of earnings not taxed at the corporate level, distributions include pass through of depreciation; up front infrastructure development can be offset against ordinary income

CONCLUSION

As the global infrastructure asset class grows, it is paramount that governments create the conditions for the efficient deployment of capital to maintain and upgrade national infrastructure. In addition, governments need to proactively encourage the development of new infrastructure projects that offer long-term economic benefits and that are constructed under the eye of an environmentally aware global investment community.

New and the upgraded infrastructure is essential for the African nations to develop their competitive position in the global economy. The challenges of funding and operating infrastructure in today's economy require an enlightened approach to attracting private capital through the widest possible global investor base. A listed infrastructure investment vehicle, through a de novo clearly-defined Infrastructure Investment Trust (IIT), can provide global investors with a familiar, easily understandable and liquid exposure to infrastructure.

The climate is right for the African nations create the legislation to attract a deep liquid pool of private global capital through an IIT, similar to global real estate through the REIT structure. The African IIT has the opportunity to satisfy long-term investor demands for attractive yielding stable income, plus offer shareholder and regulatory transparency. Moreover, an IIT will contribute in the long-term upgrade and development mission-critical African infrastructure, without increasing the tax burden on the African nations populations. Ai