ALLEN & OVERY

Biden's infrastructure plan: big ideas, little detail (so far)

Key takeaways for infrastructure and energy investors

The time is ripe for America to reinvest in and modernize its ageing infrastructure. After decades of inertia and legislative gridlock, the Biden Administration seems intent on getting things moving again. With his newly announced American Jobs Plan, the President has taken the first step toward fulfilling a key campaign promise: to spend more than USD2 trillion over eight years to modernize America's infrastructure and drive the transition to clean energy.

However, the details remain thin, and for the private sector, the implications of the American Jobs Plan – if and to the extent that it is voted into law – are far from clear. The Plan makes very few express references to private capital or private contractors, and is to be funded by a large increase in the corporate tax rate. There is also a risk that an influx of new federal funding may "crowd out" private investors in sectors such as roads and mass transit, which have offered good (if not plentiful) opportunities for long term capital deployment in the past.

Taking a more optimistic view – the immense scale and ambition of the Plan makes it almost inevitable that there will be some "winners" from the private sector. In addition, the extension and expansion of tax credit programs for renewable energy (and the introduction of new incentives to support electric vehicles and grid resilience) recognize the central role of private capital and expertise in building a more sustainable and less carbon-intensive future. We expect that corporates, funds and banks with a strong commitment to ESG will be particularly well placed to participate in the new opportunities that are created by the Plan.

In this article, we attempt to "read between the lines" and identify the aspects of the Plan which are the most promising for infrastructure and energy investors, while also identifying some key missed opportunities.

Building Back Better (and Greener)

Since early in the 2020 campaign, a commitment to "Build Back Better" has been a cornerstone of President Biden's policy platform. In this context, it is clear that "Better" means "Greener". The American Jobs Plan includes numerous initiatives aimed at accelerating the decarbonization of the American economy.

Extension and Expansion of ITCs and PTCs

Plan proposes to extend investment tax credits (ITCs) for solar projects and production tax credits (PTCs) for wind projects for an additional 10 years, subject to a phase down and with an option to receive a refund to the extent a credit exceeds taxes owed (similar to the 2009 stimulus bill's cash grant program). If passed, this extension would provide much-needed certainty for renewable developers and investors. The refundability of the credits would permit the industry to continue to grow beyond the available tax capacity needed to absorb all of the credits produced. In addition, the Plan will expand tax credits available to energy and related infrastructure projects in a number of ways:

– Expand the scope of ITCs to cover energy storage projects. This is an important step that recognizes the role of utility scale batteries and other forms of storage in maintaining grid stability and resilience, as renewables continue to replace traditional baseload power sources.

– Support the development of 15 decarbonized hydrogen demonstration projects in distressed communities with a new PTC. If successful, we expect that this program could be expanded to include community and utility-scale projects in a range of other settings.

– Allow ITCs and PTCs to be claimed as "direct pay" refund rather than merely tax credits. Although the precise mechanism is yet to be confirmed, we understand that these refunds may take a similar form to the cash grants that were offered for solar and wind projects in the wake of the Great Recession. This has the potential to make ITCs and PTCs more accessible for smaller projects and corporate and owner-operator investors, and to loosen the sector's reliance on tax equity markets. The growth of the renewables market has eclipsed the ability of large banks and corporates to use all of the tax credits.

– Establish a targeted ITC for buildout of high voltage transmission lines, as discussed further below.

– In a move to better utilize the recently enacted ITC for offshore wind, the Biden Administration, separate from the Plan, announced its goal of installing 30,000 MW of offshore wind turbines by 2030. The Biden Administration plans to support these installations with USD3bn of loan guarantees through the DOE's Innovative Energy Loan Guarantee Program and upgrades to coastal port infrastructure.

Revamping the Electricity Grid

the Plan allocates USD100bn toward making America's electricity grid more resilient. Although full details have not yet been released, this funding is expected to include ITCs to incentivize private investment in at least 20 gigawatts of new high voltage transmission lines. If properly designed, these incentives could introduce an important new source of capital investment into grid development and resilience (noting that there is currently no direct mechanism for recouping the cost of new transmission lines in most markets).

The Plan also proposes to create a new Grid Development Authority within the federal Department of Energy (DOE). Among other things, the Authority would be tasked with investigating how to use existing rights of way along roads and railways to build new transmission lines. This has the potential to create a more streamlined path through state and local permitting issues that have derailed long range transmission projects (and limited the ability of new generators to connect to the grid) in the past.

In the wake of catastrophic grid failures in Texas (following the severe winter storms in February 2021), these initiatives seem more likely than other parts of the Plan to receive bipartisan support. In contrast, the Biden Administration's accompanying proposal to require all utilities to draw 100% of their power from zero-carbon sources by 2035 has little chance of making it through the Senate.

Supercharging the Electric Vehicle Market

in a boost for all of the (mostly private) stakeholders in the electric vehicle industry, the Plan allocates USD174bn toward new charging infrastructure and point of sale rebates for American-made electric vehicles. In a strong indication of the Biden Administration's priorities, this amount comprises 28% of the Plan's total allocation for transport projects. It is approximately 50% more than has been allocated to roads and bridges, and is roughly equal to all mass transit funding combined.

The centerpiece of the proposal is to offer federal grants and incentives to encourage state and local governments to work with the private sector to build 500,000 electric vehicle charging stations nationwide by 2030. However, the Plan as officially released by the White House so far provides no detail on how this would work in practice, or the role of the private sector in it. We see huge opportunities for private capital and project financing to be deployed to help fund this build-out. Indeed, this is already an area that has attracted significant interest from our clients in the past year, as public authorities and private companies seek to electrify their vehicle fleets and begin to explore innovative options such as "vehicle-to-grid" or "V2G" solutions (which allow idle electric vehicles to store and discharge energy from intermittent renewable sources).

The Plan also proposes to eliminate the 200,000 vehicles per manufacturer cap for existing point of sale rebates. This is an important step in maintaining the relevance of the rebate as a consumer incentive, given that Tesla and GM are already exceeding the cap at current levels of demand.

We will observe with interest as to how responsibility for implementing these landmark electric vehicle initiatives is spread between the Department of Energy and the Department of Transportation, given that both departments now have a strong supporter of electric vehicles at the helm. President Biden's Secretary of Energy, Jennifer Granholm, has an impressive track record in the sector already, both in her former role as the Governor of Michigan (in which she pursued EV-friendly policies designed to spur new development in Michigan, the traditional heart of the U.S. automotive industry) and in her capacity as a board director of EV-related companies. In his prior role as "Mayor Pete", Secretary Buttigieg also promoted initiatives to support EV infrastructure as an air quality improvement measure in South Bend, Indiana.

More Funding for Carbon Capture and Storage

in a nod to conventional power sources and industries such as steel and cement manufacturing, the Plan pledges additional support for the development of carbon capture and storage technology. The Plan proposes to support this initiative through modifications, including a sought after direct pay option to the current 45Q tax credit, with a particular focus on underground carbon sequestration and the retrofitting of existing power plants and heavy industry factories. The Plan would dovetail with the bipartisan SCALES act proposal that increases funding for pipeline infrastructure via low interest loans, increases funding to the EPA for issuing Class VI sequestration permits, and providing funding for large-scale saline storage caverns that permanently sequester carbon.

Transportation Funding – Recycling Old Ideas?

Hopes of an innovative new approach to federal transportation funding were raised when the Biden Administration appointed "Mayor Pete" Buttigieg, the former mayor of South Bend, Indiana and a former presidential nominee, as Secretary of Transportation. However, at first glance, most of the Plan's transportation initiatives look decidedly familiar to anybody who has worked on American transportation policy over the past 50 years.

In terms of its sheer size, the aggregate allocation of USD621bn to transportation initiatives – which includes USD115bn for roads and bridges, USD80bn for Amtrak, USD85bn for other mass transit and USD25bn for airports, in addition to USD174bn for electric vehicles as noted above – undoubtedly has the potential to be transformational. However, there is a noticeable lack of detail on funding mechanisms and procurement strategies, and almost a complete absence of references to private sector involvement. As such, it seems likely that large portions of the Plan's transportation funding is intended to be provided in the form of traditional, direct funding to state and local governments, or to replenish the under-funded Highway Trust Fund.

As such, there are grounds for concern that the Plan will not convincingly address the underlying structural causes of the shortfall in federal transportation funding (and in particular, road funding) – namely, the failure to escalate the gas tax with inflation, declining fuel use as vehicles become more efficient, and a failure to use available funds in a strategic manner to leverage private investment. The appropriation of general revenue to plug this gap is (absent additional deficit spending) essentially a "zero sum game", in that it reduces the finite amount of taxpayer resources available for other purposes.

While raising the gas tax could partially address the shortfall in transportation funding in a more sustainable way than appropriations funding, it remains questionable as a long-term solution as America's vehicles become "greener," increasingly efficient and/or reliant on alternative fuel sources. There are other more innovative options which are worthy of lawmakers' consideration.

One promising strategy, which has been the subject of various pilot projects (and is known to be favored by Secretary Buttigieg) is to replace the gas tax with a mileage-based charge, often referred to as "vehicle miles travelled" or "VMT". As the U.S. moves away from combustion engines toward hybrid, electric and hydrogen-fueled vehicles, a VMT-based user charge arguably represents a more accurate, equitable and sustainable way of collecting funds for highway maintenance and repair. However, the Plan does not appear to include any support for the further investigation or rollout of a VMT approach. As compared to the political controversy that is already being provoked by the Biden Administration's alternative source of funding (namely, a significant increase in corporate tax rates), VMT may offer a more realistic path to achieving bipartisan support for key aspects of the Plan.

Another strategy, which would be particularly welcomed by the infrastructure investor community, would be to incentivize state and local agencies to undertake more P3s and similar DBFOM-style arrangements for roads, bridges and related infrastructure. Indeed, this would seem to be the obvious procurement strategy for the Plan's stated goal of fixing the 10 most economically significant bridges in the country (as well as a significant portion of the "worst 10,000 smaller bridges"). While the Plan does not make any express mention of P3s or similar initiatives, it does emphasize that *"America lags its peers – including Canada, the U.K., and Australia – in the on-time and on-budget delivery of infrastructure."* While indirect, we interpret this reference to the world's three most advanced P3 markets as an encouraging sign that P3s may have significant supporters in the Biden Administration.

In a similar vein, the Plan earmarks USD25bn for a dedicated fund to support "ambitious projects" which are considered too large or complex to be supported by existing federal funding programs. While indirectly phrased, this line item could be intended to catalyze proposed "mega-projects" (or close funding gaps on existing ones) that also require significant private sector investment.

Although not appropriate for every project, we view innovative public-private financing strategies as generally offering greater economic sustainability and more impact on a dollar-for-dollar basis, as compared to a strategy where Federal, State and local governments are required to directly fund the entire cost of a project.

Digital Infrastructure – the New Black(top)?

During the pandemic, it has become even more apparent that digital infrastructure is now as critical to our society as physical roads and bridges. In this context, it is not surprising that the Plan earmarks USD100bn for bridging the digital divide between cities and rural areas and bringing broadband to larger swaths of the United States.

Although not expressly stated in the Plan, we think it is a necessary inference that significant private expertise and financing will also be required to accomplish the Biden Administration's goals in this rapidly growing sector. Private sector companies have traditionally dominated America's technology and communications sectors, and their participation will be needed to roll out a modernization program of this scale and complexity.

In addition, while the initially released text of the Plan is short on detail, prior iterations of the Democratic Party's digital infrastructure plan have specifically recognized the role of public-private partnerships. For example, the Moving Forward Act (passed by the House in 2020) proposed to establish a Broadband Infrastructure Financial Innovation (BIFIA). Apparently modelled on the longstanding Transportation Infrastructure Finance and Innovation Act (TIFIA), the BIFIA program would have offered financial assistance for broadband build out in the form of secured loans, lines of credit and loan guarantees for eligible projects. P3s were to be expressly authorized as a permissible delivery method under the proposed BIFIA program, and the draft project eligibility criteria seemed to specifically encourage private investment. We will be watching closely for the release of the draft legislation to implement the American Jobs Plan and will be surprised if it does not include some version of the BIFIA program.

Best of the Rest – Water, Social Infrastructure and Affordable Housing

The American Jobs Plan also promises to provide significant investments in clean water, social infrastructure and affordable housing. This includes USD111bn for water infrastructure (plus an ambitious plan to replace all of the lead water pipes in the nation), USD213bn for the development of affordable housing and USD34bn for social infrastructure. While the Plan does not offer many specifics at this stage, we will be watching closely for further announcements. Based on past experience in certain U.S. states (and comparable international examples in the UK and Australia), it is clear that well-designed partnerships between the public sector and the private sector can drive innovation and help taxpayer dollars go further in all of these sectors.

Conclusion – Grounds for Optimism, but a Long Road to Implementation

In many ways, the American Jobs Plan is more notable for what is missing than for what is included. It is long on the "what" and short on the "how" and leaves key questions unanswered – to name a few:

– How will the money be spent – tax subsidies, grants, credit support through loans and guarantees or a combination of all of the above?

– To what extent will traditional federal programs such as TIFIA and Private Activity Bonds (PABs) be carried forward, and will their funding be increased?

– How does the Biden Administration plan to staff up the sizeable bureaucracy that will be needed to set up and administer the disbursement of Plan funds?

– How much autonomy will be given to state and local governments to select projects and award contracts that use federal funds?

– How will the inflation of construction costs be handled (particularly in a market where demand for construction is elevated by the influx of federal funding) and will federal appropriations be indexed?

At present, however, all of the foregoing questions remain secondary to the business of politics. Without significant compromise, it is unlikely that key aspects of the Plan will attract the bipartisan support that the Biden Administration is seeking. On the other hand, any watering down of the more radical and redistributive aspects of the plan will displease progressive proponents of the "Green New Deal" within the Democratic Party.

We will be watching closely for new developments over the coming weeks and months. With the Biden Administration aiming to pass the Plan into law by the Fourth of July, a lot is set to happen in a short space of time.

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