Top five takeaways from Hogan Lovells Sovereign Investment Conference and a tax list

09 November 2017
Private Equity Alert

On 26 October, Hogan Lovells hosted its inaugural Sovereign Investor Conference where investment professionals as well as deal and regulatory lawyers discussed the key issues facing government-sponsored investors. Topics they touched on included alternative lending strategies, which are becoming increasingly popular and are helping institutional investors identify new income streams; developments and current trends in infrastructure, and the impact of legislative and regulatory developments under the Trump administration on U.S.-bound investment.

Prominent takeaways from the conference include:

- **Redefine Lending**: With the markets at all-time highs and interest rates starting to move in the US, asset values are likely to become more compressed. Under the current environment underwriting standards have never been worse, covenants and quality of EBITDA have never been lower, and the leverage multiples -- when you adjust them-- are extremely high. And this holds for Europe as well, where quantitative easing has yielded only tepid growth. The key to alternative lending is to focus on niche markets and products, sectors where you can profit today. Look for complexity in products such as credit to a portfolio. And look for opportunities to add value in unique ways. Examples include hard asset leasing, royalties, litigation financing, franchise financing and insurance products.
- **Recognize Risk:** Market cycles and stress testing are critical to making investment decisions. Having people with the right experience to help create unique structures for secondary mezzanines or add new product offerings will mitigate risk when broadening a portfolio. The panel members suggested investing as though a deep recession were only one year away so as to ensure there were enough less volatile products in a portfolio. Otherwise, like the frog in the slowly heating kettle, we're cooked before we know it.
- **Interest in Infrastructure:** Trump's trillion dollar infrastructure investment initiative, lots of dry powder, and new entrants desperate for return are driving investment from pension funds, sovereigns, insurers and larger institutional investors in U.S. infrastructure. However, there are still many risks associated with investing in assets that are, by and large, controlled by state and local governments, not the White House. They include local politics, a tax exempt bond system that can impact how the assets will perform over time, CFIUS filings and risk of the investment failing, other environment and regulatory hurdles that could impede profitability, and uncertainty involving tax under the new administration.

- **Infrastructure Pockets for Sovereigns:** When investing in infrastructure, panelists recommended, sovereign investors should focus on existing assets that had been overlooked and under-loved such as certain pockets of the power industry, emerging markets or greenfield investments, some of which are coming to market as PE funds reach maturity and exit. However, they also require experts with local knowledge who are able to understand the asset and originate opportunities.
- **Uncertainty for Regulation and Tax:** Unlike the illusory $1 trillion pledge by the Trump Administration for infrastructure, prospective tax changes are real with a tangible impact on investors. Our panel noted that non-US investors should be concerned about what appears to be growing hostility to foreign direct investment (FDI) and suggests they think consider what steps they may take to encourage US legislators to think positively about FDI. It is not clear how the regulatory environment, including tax, will change under the Trump administration. This is causing many investors to hold back from making investments in the U.S. However, there is still a lot of interest and dry powder ready to be invested in the U.S. as there are diverse opportunities to take advantage of in the current market. Hedge funds and private equity funds are particularly interested in how Trump's tax plan will impact the financial industry.

The Tax List:

Our panel convened **before HR 1**, the house tax reform proposal, was released. But our panel identified 9 key issues for tax reform:

(i) Corporate rate – what will it be?
(ii) Pass through rate – to whom will it apply?
(iii) Deduction for interest payments – how much will be disallowed, and how will the grandfather rule (if included) work?
(iv) Carried interest – what will happen?
(v) Repatriation rate – what will the rate be, and how will the baskets work?
(vi) Inversions – how will this play out?
(vii) Territoriality – will this change to a territorial system happen, and in what format? What exceptions will apply?
(viii) Deduction for state and local taxes – will it survive, and in what form?
(ix) "K" plans and IRAs – will they be cut, notwithstanding Trump's statements of support?

For more information about this conference or future conferences, please contact us.

Contacts

Babak
Nikravesh
Partner

> Read the full article online