It is impossible to predict how the alternative investments sector in Africa will weather the COVID-19 crisis. However, looking at how the industry endured the last significant market disruption and contraction, the Global Financial Crisis, is useful. Research from the African Venture Capital Association (Avca) shows that both dealmaking and fundraising declined sharply in Africa after the crisis\(^2\). A 2020 Avca survey shows similar trends with 92% of private capital investment managers reporting that they were either not fundraising or that they expected that the pandemic will influence the timeline of their fundraising materially\(^3\).

The economic damage wrought by COVID-19 will likely significantly reduce African government spending on infrastructure. To build and sustain investor confidence in African infrastructure as an investable asset class, African governments must take bold steps. Unless attractive and stable investment environments can be created and promoted in this globally competitive and complex environment for private capital, significant long-term investment is unlikely to follow. African institutional investors have a limited pool of capital to invest, with a 5% allocation to infrastructure investments, as provided for in the AU’s 5% Institutional Infrastructure Agenda.\(^4\)
The 5% Agenda is an initiative that the AU Development Agency (AUDA-Nepad) has developed under the guidance and recommendation of the AU’s Programme for Infrastructure Development in Africa (PIDA), the Continental Business Network (CBN) and the African Sovereign Wealth and Pension Fund Leaders Forum (ASWPFF). The 5% Agenda represents a pact where African governments commit to work collaboratively on project design and better alignment of infrastructure investment policy regimes with the investment mandates of African assets owners. This includes pursuing the 5% Agenda’s new institutional investor public-partnership (IIPP) model, similar to those successfully pursued by pension funds and the governments of Australia and Canada.

In return, African institutional investors represented by the ASWPFF have agreed to increase their allocations to African infrastructure investment to 5% of assets under management and support the African Institutional Infrastructure Co-Investment Platform initiative for African sovereign investors and international pension and sovereign wealth fund peers to collaboratively co-invest in each other’s markets across the continent.

The 5% Agenda’s Institutional Investor Public-Partnership (IIPP) model, which was endorsed by AU heads of state, is compelling as it offers governments with limited funds and competing expenditure requirements world-class, essential and well-maintained infrastructure assets. Consumers and civil society rely on reliable infrastructure delivery, budgetary discipline and long-term real investment returns; and institutional infrastructure investment over the full life-cycle of the assets. As it is over the full life-cycle of the asset, rather than the investment, economic or political risk of the projects for the assets to catalyse and increase economic and private-sector development, job creation and regional and domestic trade and investment competitiveness are significantly improved.

This increased 5% share of African institutional investment, will also have the following five key impacts for Africa’s infrastructure development and financing:

- Unlocking African institutional savings capital to implement regional, domestic and trade-related infrastructure projects on the continent and industrial infrastructure projects that facilitate the African Continental Free Trade Area (AfCFTA)
- Bringing PIDA and the AU’s Presidential Infrastructure Champions Initiative (PICIs) projects to financial close, for improved access to energy, transport, digital and trade-related infrastructure
- Broadening and deepening the currently shallow African primary and secondary capital markets.
- Contributing significantly to regional integration and job creation.
- Facilitating co-investment partnerships with international institutional investors and financiers – especially into green infrastructure, who are hesitant to allocate to African infrastructure, in the absence of African institutional co-investors that serve as anchor partners.

The 5% Agenda’s potential to attract sustained foreign direct investment (FDI) and nurture the necessary long-term structural changes, could be catalytic in deepening African capital markets and unlocking significant FDI. This capital could transform the continent.
9.2. CLOSING THE INFRASTRUCTURE GAP THROUGH LONG-TERM PARTNERSHIPS AND IIPPs

The continent has a significant infrastructure funding gap, estimated to be in excess of USD 100bn annually by the African Development Bank\(^24\). This offers an opportunity for governments and institutional investors to form significant long-term institutional investment public partnerships (IIPPs). The ability to fund this gap can have a significant beneficial effect for the continent, through both direct and indirect impacts. The indirect effect on trade and commerce through improved operating conditions can result in compounding secondary and tertiary multiplier effects that include:

- Creating direct jobs.
- Improving the operating environment for enterprises, increasing employment further and increasing tax revenue.
- Lowering the cost of goods for citizens, effectively decreasing poverty.
- Creating more stable and supportive environments for SMEs – the drivers of GDP growth — to flourish.
- Improving intercontinental connectivity, which will drive intercontinental trade. Better connectivity will also lower the cost of goods and support import substitution on the continent.
- Driving the continent’s green infrastructure investment agenda in pursuit of the Paris Agreement.

The African Development Bank has estimated that the continent’s shortfall in infrastructure investment translates to an effective two percentage points (i.e. 2%) reduction in annual GDP growth\(^25\). The multiplier effect of targeted, well-designed infrastructure investment programmes will have the effect of dwarfing the impact of the COVID-19 pandemic in the medium-term. Governments across the world have used private sector investment to accelerate infrastructure investment, and the mobilisation of this capital is crucial for the continent’s recovery.

9.3. INHIBITORS AND ENABLERS OF INFRASTRUCTURE INVESTMENT

BUILD A ROBUST INVESTMENT ECOSYSTEM

One of the most significant inhibitors of infrastructure investment on the continent is the absence of an investment ecosystem for this type of asset class. For the industry to flourish, it requires bankable projects, project developers, project preparation funders, project finance consultants, bankers that specialise in infrastructure funding, infrastructure investment managers, institutional investors with an appetite for the asset class and various intermediaries and market makers. The lack of development in Africa’s infrastructure market is well illustrated by the lack of growth in the number and value of deals over the last 20 years.

Although there are some market participants, a healthy ecosystem will include numerous participants as this increases competitiveness and efficiency. For the formation of such an ecosystem, a sufficient supply of assets at a price that justifies their inherent risk is required (both supply through the pipeline of investable projects presented by the government and demand from institutional investors for investment products) pressure needs to be exerted to create this ecosystem. This again highlights the need for IIPPs to catalyse investment.

GRAPH 28: INVESTMENT OPPORTUNITIES IN AFRICAN INFRASTRUCTURE – JULY 2018

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HOW SOUTH AFRICA’S REIPPP ENCOURAGES INFRASTRUCTURE INVESTMENTS

The Renewable Energy Independent Power Producer Procurement (REIPPP) programme in South Africa provided a catalyst for deeper market formation by providing a steady stream of investable assets. The constant supply of investment opportunities over time allowed for the establishment of a capital market for these assets. Investment houses and banks either established or significantly expanded their teams. Many see the REIPPP programme as the most successful public-private partnership (PPP) in Africa in the last 20 years and is among the top 10 privately-funded renewable energy programmes in the world.

The key success factors necessary to run South Africa’s REIPPP programme have been identified as follows:

- Build an enabling policy and regulatory environment.
- Capacitate and authorise a leadership team to manage the REIPPP programme.
- Provide adequate resources for hiring experienced transaction advisors.
- Ensure the design of an auction process built on international best practice.
- Draft high-quality, bankable documentation and contracts.
- Ensure a procurement process built on fairness, transparency and credibility to earn private-sector trust.
- Develop capital markets that provide adequate and competitively priced funding.

These critical success factors are required to build a long-term sustainable private-public partnership (PPP) programme. This requires an enabling policy and regulatory environment that encompasses a wide range of policy and regulatory interventions, including procurement legislation, value for money frameworks, and the establishment and strengthening of PPP units and laws. These reforms are critical to attracting significant FDI and local institutional capital.

PROVIDE REGULATORY CLARITY

Although some of the previously mentioned legislative and regulatory reforms cannot be concluded in the short-term, there are some smaller, yet meaningful changes in regulation that can be made to enable the participation of local institutional investors. One of these is to provide regulatory clarity, as institutional investors often cite a lack of clarity as to why they do not consider alternative investments as part of their investment strategies. Initial reforms do not require a large-scale overhaul of legislation and regulation, but rather the clarification of existing regulations.

With small and illiquid listed equity and corporate bond markets, and severe restrictions on investment outside of their own country, African institutional investors have a very limited investment landscape. This makes it even more critical to explore alternative assets. African institutional investors through the 5% Agenda and the African Union’s Continental Business Network (CBN), have a unique understanding of political risk, as well as country-specific (local currency) return requirements and have a unique role to play in building the ecosystem. Alternative assets also include several uncorrelated asset types, such as infrastructure and the addition of these assets would make portfolios more resilient by ensuring diversification of risk.

To improve regulation of infrastructure investment, the regulator needs to begin by having a clear definition of infrastructure, paying particular attention to what is, and is not deemed to be, an infrastructure investment. This is particularly relevant if regulators want to consider setting investment limits for such assets. An often-cited reason for institutional investors not wanting to invest in infrastructure is that they believe it to be the role of government to invest in infrastructure and that institutional investors already lend the government substantial money in the form of government bonds. It is these kinds of arguments that call for the use of clear definitions when considering infrastructure investments (see boxed text regarding infrastructure definitions).

Clarity from regulators is also required regarding the statutory standing of the different investment structures used by asset managers to invest in infrastructure assets, such as collective investment scheme vehicles and limited liability partnerships. Another aspect that may require attention is the regulation that manages of these vehicles would be subject to.

Finally, the initial categorisation of infrastructure as an alternative investment, has in some areas worked against efforts to mobilise capital to fund infrastructure projects. The term “alternative investment” implies something different to the norm of standard assets (such as equity, bonds and cash) and typically includes investments in private equity, venture capital, commodities and hedge funds, among others. Hedge funds, in particular, are often considered risky by conservative institutional fiduciaries, so lumping infrastructure with them under alternative investments incorrectly imply that infrastructure is a riskier type of investment.

In reality, investment opportunities in infrastructure present themselves as standard assets such as equity and bonds and should fall under these asset classes for risk management and regulatory reporting purposes using the look-through principle. Investors can report these investments as being in underlying infrastructure projects, and the total exposure to “infrastructure assets” could then be separately measured and if necessary, regulated.

- Provide regulatory clarity to institutional investors regarding what kinds of alternative investments are permissible and how they will be regulated.
- Give regulatory guidance to local institutional investors on what risk management will be required when pursuing alternative investment programmes.
- Make it a regulatory requirement that institutional investors consider alternative investments (including infrastructure) when designing an investment strategy.

INFRASTRUCTURE INVESTMENT TRUSTS

An infrastructure investment structure that is growing in popularity (and as recommended in a June 2020 G20 and OECD infrastructure report), that allows institutional and retail investors access to infrastructure investment, is the infrastructure investment trust. Modelled on the Real Estate Investment Trust (REIT), these vehicles aggregate a portfolio of infrastructure assets to allow investors access to a diversified portfolio of yield-bearing infrastructure assets. They are generally listed on highly liquid exchanges and allow investors access to lower custodial and diversified investments in infrastructure assets.

The long-term inflation-linked nature of infrastructure assets makes them extremely attractive as investment opportunities. However, they are currently packaged in closed-ended, limited life vehicles. One of the main advantages of an infrastructure investment trust is its perpetual nature, allowing institutional investors access to these highly desirable assets in the most efficient way.

The use of REITs has been well-developed in the South African market, enabled by the highly liquid JSE and a deep commercial and retail property market. Infrastructure investment trusts have been used very successfully to aggregate portfolios of telecommunications towers and other physical infrastructure assets. These trusts can be measured effectively.

The need for regulatory clarity to enable investment into Infrastructure includes not only clarity regarding permissible investments, but also what is included in the definition of an infrastructure investment.

- Use a common definition of infrastructure throughout the economy and capital markets.
- Categorise infrastructure assets as being part of their underlying asset classes such as equity and bonds for risk management purposes. Use the look-through principle for infrastructure funds containing a blend of these asset classes.
- Develop an accepted classification system for infrastructure assets so that investment in different types of infrastructure can be measured effectively.

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CAPACITATE GOVERNMENT

The implementation of infrastructure investment programmes requires significant skills from government and the private sector. For example, South Africa’s REIPPP programme required the support of over 100 professionals from 13 firms offering legal, financial, technical or socio-economic and environmental advisory services.

While the extensive use of professional firms is expensive and the limited market of specialised professionals makes conflicts of interest challenging to avoid, a successful infrastructure investment programme requires such support. DFIs that are active on the continent can assist governments and ensure long-term change by providing technical assistance to African governments. To avoid any conflict of interest in future funding transactions, experts deployed should preferably not be employed by
AUDA-CBN’s 5% PLATFORM AIDS TO BOOST INVESTMENT INFRASTRUCTURE ASSETS

The AUSDIFP is collaborating with the Continental Business Network (CBN) on its 5% Agenda infrastructure co-investment platform.

The platform was established following extensive consultations with domestic and international asset owners and their trustees, which revealed the developmental challenge for domestic and global institutional investors seeking to allocate assets to African infrastructure as an investable asset class.

The platform originated as an example of small-scale projects directly contributing to local economic development and sustainable job creation and would allow SMEs to participate in the delivery of projects, which has shown an appetite. Execute these to build market confidence and allow SMEs to participate in the delivery of projects, which have shown an appetite.

Africa-wide food in tariff policy for renewable energy sources. Instead of relying solely on large power producers, electricity production should be decentralised. This can be done by creating an enabling regulatory environment for locally or privately produced renewable energy. (#smarteregulation)

The development of trust between institutional investors and the government is a crucial component of long-term institutional investment, public partnership and institutional investment public partnership. When infrastructure investment is prescribed by a government, the ability of institutional investors to perform their fiduciary duty is severely constrained. Investors should be free to execute their fiduciary duty to invest only in suitable opportunities, taking into consideration the required risk and return profile and social needs of the ultimate asset owners.

INVESTMENT FOUNDATIONS

CANADA, COLOMBIA CREATE INFRASTRUCTURE CO-INVESTMENT FUND

Calais de Depart et Placement du Quebec, based in Montreal, created an infrastructure co-investment fund with the Colombian government and four pension funds. The Organisation contributed up to USD 500m to the fund. Colombia’s national development finance agency and administrators of Colombia’s pension funds Colfondos, Old Mutual, Porvenir and Proteccion contributed a combined USD 490m. Infrastructure investments targeted renewable and other forms of energy, transportation, social infrastructure, telecommunications, water and basic sanitation.

This platform is unprecedented on the continent.

1. Establish the development of non-competitive co-operation agreements that allow for knowledge and investment costs to be shared. Advisors independent of the transaction should be used to enable effective risk management.

Foreign institutional investors have long cited the lack of local institutional investors as an obstacle to participating in African infrastructure investment opportunities as they would like to see local institutions trusting in the opportunities. In turn, African institutional investors have cited the lack of capacity and the large cheque sizes of foreign infrastructure investment as an obstacle to participating in the asset class.

Leverage the 5% Agenda to create African institutional infrastructure co-investment platforms that combine African institutional investors, international pension and sovereign funds and DFIs (local and international), to collaboratively co-invest. Such a platform would represent all participants interests.

This kind of collaboration allows each party to contribute critical elements to the success of the partnership. DFIs would bring their know-how and credibility to international investors; local institutional investors would bring their market knowledge and the long-term commitment from local governments that results from the exposure of local capital holders to the success of the project. Finally, international institutional investors would bring extensive knowledge of the asset class as well as the ability to invest substantial amounts of capital.

The terms of a co-investment platform would need to allow for participants to grow their trust in the arrangement over time. These would include being able to choose in which projects they participate, a shared understanding of due diligence requirements and a sharing of the results of viability and due diligence investigations undertaken by all parties. The platform could also be coordinated by a highly trusted African market participant with international peers (see Mobilising international institutional capital on next page).