National Treasury
REPUBLIC OF SOUTH AFRICA

Capital Project's Unit

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# TASK TEAM
# ON PRIVATE SECTOR FINANCING OF
# INFRASTURCTURE

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1. The Task Team on Private Sector Financing of Infrastructure was formed in June 2013. Membership consists of the National Treasury, where the Government Technical Advisory Centre chairs the Task Team, the Presidential Infrastructure Coordinating Committee (PICC), the Development Bank of Southern Africa (DBSA), the Financial Sector Charter Council, COSATU, the Association for Savings and Investment for South Africa (ASISA), the Banking Association of South Africa (BASA), the South African Venture Capital and Private Equity Association (SAVCA), and the South African Insurance Association (SAIA).
2. The Task Team is concerned with **providing a forum where representatives of the finance sector can raise and work through general issues affecting their increased involvement in the financing of infrastructure projects in South Africa**, within a context of a desire for increased collaboration between the private and public sectors.

3. The Task Team is focused on **identifying blockages to the private sector financing of infrastructure**, problem-solving around this, and making recommendations to be taken forward by the relevant private or public sector parties for resolution.

4. The focus is mainly on '**blockages' of a financial nature**, for example to ascertain the level of concern over the impact of Basel III on banks' appetites for financing infrastructure investment in South Africa. In addition, whilst banks have traditionally played a very prominent role in providing finance for infrastructure in South Africa, institutional investors are looking to play a larger role in infrastructure investment, and so the Task Team needs to understand how this might evolve and what would be key to their increased participation. The Task Team also wanted to understand from equity investors what particular constraints they might be experiencing.

5. **Understanding where private sector investors are coming from, and where they are trying to go**, is particularly important at this point in time for two reasons:

   (1) **Infrastructure finance is evolving** – not just in South Africa, but globally – in a way that is increasingly dependent on making more use of different types of investors to ensure that it is possible to meet the demand for infrastructure projects which required a supply of long-term financing.

   (2) **The requirement for resources to finance infrastructure projects is substantial**, and will continue to be so into the long-term (again both in South Africa and globally), given the role that infrastructure investment plays in improving service delivery, and ultimately in boosting economic growth and raising quality of life.

6. The first task of the Team was to establish **an atmosphere of collaboration, trust and confidence**, as this was explicitly identified as key to building the type of working relationship that would be conducive to problem-solving. Happily, this is now in place – and the Task Team is able hold open, honest and constructive discussions, where all the members bring different ideas, perspectives and suggestions to the table – making it a very constructive atmosphere.

7. The next task was to create **a common understanding of what each group's objectives** were, and the context in which they are operating. This was very important for determining at the outset what it would take to work together and achieve common objectives.

8. Next, the three professional bodies, ASISA, SAVCA and BASA organized consultations where **a panel consisting of government task team members met with individual organisations to hear directly from them what their experiences and concerns were in relation to financing public infrastructure projects**. The panels spent a very intensive period of five days in mid-2013 listening, asking questions and digesting what was being relayed. The discussions were most insightful, as the financial organisations were very willing to engage, and expressed immense appreciation at the opportunity to talk to Government. It was heartening to receive so much support, goodwill and cooperation, in discussing how the public and private sector can work together to achieve the development objectives of the country. Many of those consulted with offered to supply ideas, case studies, international experiences, models, research capacity, contacts, assistance with facilitating further sessions and workshops with the industry; but most particularly, the participants just wanted to continue to have the opportunity to share their expertise and participate in discussion with Government over how their role could evolve.

9. It was clear from this first round of consultations that **there is significant appetite collectively in the private sector to continue investing in infrastructure, and as long as the public sector offers opportunities that are appropriately packaged, the private sector will invest**.

   In general, investors see infrastructure is an asset class that holds great interest for the different sub-sectors of the finance industry:

   (1) **Banks reported a continued strong appetite for this class**, but Basel III requirements will have an impact by creating a preference for shorter tenor investments, which will affect the cost and volume of funds they will make available for longer-term financing (i.e. longer than 7 years).

   (2) There is a continuing and **significant appetite amongst equity investors for this asset class**. The nature of their business keeps them focused on opportunities with higher returns, however, and the pool of funding available is far less than the banks.

   (3) **Institutional investors (pension funds and life offices) are looking to see how they can get more involved in financing infrastructure** – in particular, the financing of unlisted infrastructure investments, which is not a traditional asset class for them to invest in. They are attracted by the opportunity to get involved in long-term investments where they might give a higher return than traditional financial market opportunities, as well as to diversify their portfolios, especially into counter-cyclical investments. Infrastructure offers assets that could deliver long-term, low-risk, inflation-linked, relatively predictable and non-volatile earnings profiles. This industry is in the process of becoming more comfortable with the opportunities and risks that are involved, and this varies considerably amongst the different institutions according to their risk appetite; this is largely a function of the extent of the mandate they are given by their clients, the need to be cautious in how savings for pensions or insurance are invested, and their potential to fund and build up expert teams capable of analyzing infrastructure projects as potential investment.

10. **The key areas that need to unblocked for financiers to invest more in public infrastructure**, according to the consultations, can be clustered into three areas:

   a. **The availability of projects to invest in**. Investors have difficulty in seeing the pipeline of projects that will be available for investment, and thus gearing up their organisations to take advantage of this. Ideally, investors would like to see a pipeline of repeat projects in a sector, so they can build up capacity to analyse this class of investment asset and thus the skill-set to support investment decision-making and participation.

   b. **The need for efficient, effective (procurement) processes that allows investors to access investment opportunities**. Widespread difficulties are being experienced with long lead times or lack of capacity in the public sector when executing project transactions. Lack of certainty on policies and regulations governing infrastructure sectors or projects also hampers investment.

   c. The need for the financial intermediation space to evolve to allow new players, **new finance instruments or new approaches** to allow for a wider pool of finance to be accessed. Different investors have different risk appetites and thus a range of investment products are needed to suite the spectrum of investors; some of these products can/will be developed by the industry alone, others will require some engineering/accommodation from Government's side.

11. **A second round of consultations was held in mid-2014, from which it was clear that fundamentral change is already taking place in the finance industry.** It appears that the Renewable Energy Independent Power Producers programme has been the catalyst for this. This has served to build an appetite for other types of infrastructure, and for more direct investment in projects, for both debt and equity investment, and even getting involved at the construction stage of projects:

   a. Institutional investors still have large appetite for indirect investment, primary through debt instruments, such as bonds or funds (estimated at just under R1 trillion), but a number of players are growing their organisation's capacity to **invest directly** in project opportunities.

   b. The latter is being done by **developing partnerships with banks**, which is the surest way to get access to funding opportunities;

   c. The relationship of institutional investors with banks is evolving, from institutional investors being more of the junior partner (i.e. a 'taker' of the terms and conditions offered to them by banks that play a role in shaping the entire transaction), to **institutional investors becoming equal partners who are jointly shaping transactions**, with their preferred terms and conditions.

   d. From originally participating in financing deals mainly through debt, there is now an increasing number of institutional investors that willing to **put equity** into them.

   e. There is an increasing willingness by institutional investors to invest **from the early stage of projects** (i.e. construction stage) which is regarded as the riskiest stage for investors. This is again reflected in their willingness to provide funding for REIPPs, perhaps as this programme and the technologies involved are seen to either have low risks or managed their risks well.

f. Various institutions are building up teams to invest in infrastructure, including both small and large organisations. Small institutions regard being industrious in finding opportunities through clever networking and relationship-building and then putting deals together, to be instrumental for their survival; big institutions see themselves as having sufficient resources to take the risk of building infrastructure-specific teams, some by importing experts from overseas to lead the process. However, it is still clear that t**he extent to which opportunities are available, will determine the pace and manner in which industry will continue to grow their capacity to invest in public infrastructure**.

12. In response to the diagnosis of the issues faced by the finance industry, **the Task Team decided that the best way to assist with solutions would be to adopt sectors to track and assist with specific problem-solving, starting with the IPPs.**

13. **The reason for focusing on IPPs first is that this was judged to be the area where there could be a strong focus on issues around the financial intermediation**, given that the financial sector felt comfortable that this was an area where the project pipeline and procurement processes are not at issue (unlike with many other sectors). The first rounds of financing IPPs were shaped very much around banks (and with debt-financing), which has becoming saturated; hence, the timing is right for the process to evolve to allow greater participation by institutional investors, and a more prominent role for equity. The following has been underway:

a. Sessions were facilitated by the Task Team to allow the private sector (particularly institutional investors) to meet the IPP team personally, to learn about the programme and its requirements, and respond by sharing their own financing insights, requirements and inputs. The need for IPP procurement documentation to adapt to these needs was one of the discussion themes.

b. As the IPP Unit then identified the need to cater for financial instruments such as **project bonds**, and for **refinancing opportunities**, the Task Team became involved in supporting this initiative. International expert assistance was brought in, through a World Bank facility, to access experiences in other peer countries and contribution capacity and expertise for assisting the IPP Unit to draw up appropriate documentation. This involves running intensive consultations that will produce consensus on what will be acceptable for future procurements that caters for the needs of investors, the IPP procurement team, the JSE and financial regulatory bodies. The work is currently underway and expected to be completed and in operation within the next year.

c. A related intiative launched by Treasury and JSE, is a workstream underway to look at regulatory adaptations that will be required for **listed project bonds**. An initial workshop has been held to scope out the issues already identified, and will be followed by further industry and other stakeholder consultations, and result in a standardised framework being developing for listing project bonds on the JSE.

d. **On all of these initiatives, the aim is for standardized frameworks and documentation to be produced**, which can set a precedent for future projects, by being replicable and adaptable for use on other programmes and sectors. Observer parties in the process currently including the the DBSA, the GTAC Transaction Advisory Services Unit (formerly the PPP Unit), and will also include those involved in sub-working groups of the Task Team.

14. While energy provides a significant opportunity at this stage, **other sectors also offer opportunities, but on a smaller scale and within very different contexts.** This is partly because other sectors are not as easily organized into bidding rounds of multiple opportunities at a national level, because their projects are not as easily commodified, are more specific to a particular geography, and where opportunities arise on a more ad hoc basis. Another reason can be the preference of the state in not wanting to make these opportunities available for direct investment by the private sector (particularly if this involves equity investment, as this implies giving up partial, whole or temporary ownership of public infrastructure).

15. However, following on from the energy (IPP) focus, the next area to receive attention will be **transport**.

    a. The Department of Transport (DoT) is looking to increase private sector participation in transport projects, and has begun engaging with GTAC and the National Treasury over frameworks that can guide this. The work of the Task Team is being shared with the DoT, and a working relationship established to share all the current learnings from the Task Team, Treasury and other parties.

    b. There have also been initial engagements with Transnet's Private Sector Participation (PSP) team over their PSP programme, and facilitation provided to meet with the IPP team and share best practice. This relationship will continue to benefit from the Task Team's learnings.

16. **Another important area is municipal infrastructure financing**. The National Treasury and Department of Cooperative Governance and Traditional Affairs (CoGTA) recently held a conference on "Urban Investment Partnerships", which pointed to the need for developing financing solutions in this area. Task Team members assisted with aspects of the conference, and as an outcome, a working relationship is being established with the Task Team, in order to share in the work being done on financing instruments and frameworks. The DBSA is also involved in these work areas.

17. **Progress on the social infrastructure front has been much slower**. Types of infrastructure that rely more on budget support than on user tariffs have been harder to make progress on, given the greater complexities that must be considered in coming up with viable financial models, acceptable risk-sharing arrangements, and convincing value-for-money proposals under these circumstances. Some members of the Task Team are involved in separate initiatives, for example on student accommodation, and in future a greater focus on the Task Team on social infrastructure is expected.

18. Lastly, there is ultimately one central challenge that needs to be addressed on the intermediation space that will be key to the sustainability of private and public sector collaboration. A legacy of positive experiences needs to be created of projects that offer value for money for all parties concerned: **for the state (and hence taxpayers), the consumer of services, the private sector financiers, the institutional policy holders whose savings are being utilised, and lastly the economy as a whole**. By creating precedents where a 'square deal' can be achieved, and which demonstrate affordability and practicality, this will determine whether appetite for further projects will continue to be fostered amongst all the parties involved.