MERCER
MAKE TOMORROW, TODAY

National Association of Securities Professionals (NASP)

MiDA
Mobilizing Institutional Investors to Develop Africa's Infrastructure
For Mutually Beneficial U.S.-Africa Investment Opportunities
www.mida-infra.org

USAID
FROM THE AMERICAN PEOPLE

INVESTMENT IN AFRICAN INFRASTRUCTURE
CHALLENGES AND OPPORTUNITIES

SEPTEMBER 2018

MARSH & McLENNAN COMPANIES

EXECUTIVE SUMMARY

PREFACE

MiDA, or "Mobilizing Institutional Investors to Develop Africa's Infrastructure," is a partnership between the National Association of Securities Professionals (NASP) and the United States Agency for International Development (USAID) Office of Private Capital and Microenterprise (PCM) and the Africa Private Capital Group of the Southern Africa Mission. The initiative seeks to facilitate and expand opportunities for infrastructure investment in Sub-Saharan Africa for investors seeking higher returns while making a meaningful impact on development and advancing US interests in the region. MiDA Advisory Council members include chairs of boards of trustees, executive directors and chief investment officers of some of the largest US pension funds, insurance companies, endowments and foundations.

The NASP-USAID Investment Partnership's objective is to expose US institutional investors to opportunities to co-invest with their African counterparts in Sub-Saharan Africa's infrastructure as part of their global infrastructure investment strategy. Further, MiDA seeks to increase opportunities for US financial services providers looking to deepen relationships with African institutional investors that currently hold an estimated US$1 trillion in assets, of which billions are invested in the United States.

MiDA engaged Mercer Investment Consulting LLC in a collaborative effort to investigate the barriers (perceived and real) to and opportunities for increasing institutional investors' allocations to Sub-Saharan African infrastructure and to provide strategic recommendations to MiDA regarding possible courses of action the initiative could take. This abbreviated version of the report reflects some of the key findings from Mercer's research (further details of which can be found in the appendix) as well as an overview of the themes we encountered, which are covered in greater depth in the associated full report.

INTRODUCTION

Through interviews with 11 leading infrastructure investors globally — seven asset owners and four asset managers, collectively controlling more than US$1 trillion in assets[1] — Mercer identified key challenges and opportunities for mobilizing institutional investors for the financing of public infrastructure in Sub-Saharan Africa (SSA). The following commentary summarizes key findings from Mercer's broader research, which are intended to frame the challenges and opportunities highlighted toward the end of this document.

Lead contributors to this report:

Mercer:

Max Messervy, Senior Associate, Responsible Investment Consultant

Alex Bernhardt, Principal, US Responsible Investment Leader

MiDA:

Daniel Bond, Senior Advisor

Aymeric Saha, Managing Director

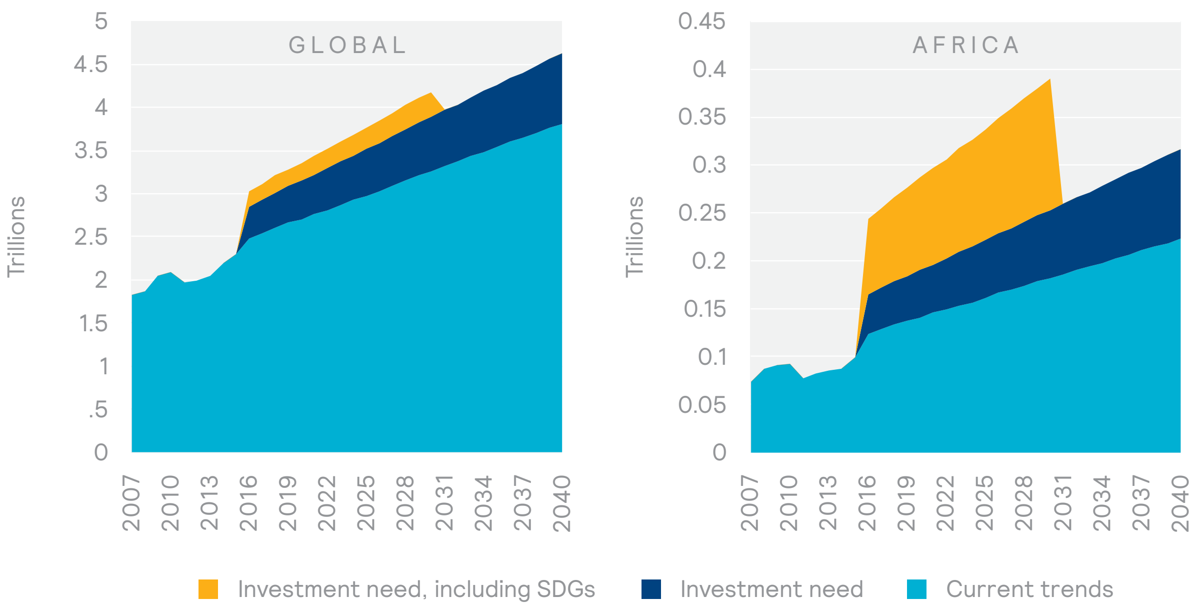
[1] As of 12/31/17 or more recent.

THE NEED

Figure 1 below shows an US$18 trillion aggregate gap in global infrastructure spending versus projections of need when the United Nations-adopted Sustainable Development Goals[2] (SDG) are considered, or more than US$700 billion per annum through 2040. Comparable figures for Africa show a US$3.3 trillion aggregate gap when the SDGs are considered, or more than US$132 billion per annum above current baseline investment levels through 2040. To close even the minimum gap for infrastructure investment needs without considering SDG targets, significant private capital investments in African infrastructure will be needed, since public spending on infrastructure has stalled in the wake of the financial crisis and is unlikely to increase significantly in the decades to come.[3]

The total assets under management of asset owners in the Organisation for Economic Cooperation and Development (OECD) area is estimated at more than US$55 trillion,[4] of which approximately 1% is already allocated to unlisted infrastructure assets.[5] Increasing this amount by 2.5 times, from roughly US$550 billion to US$1.4 trillion, would be sufficient to close the US$700 billion global annual funding gap. This would represent a very small portion of OECD asset owner assets (US$700 billion of US$55 trillion, or 1.3%) but would also represent a very significant shift in the portion of that capital allocated to infrastructure. Only 19% of this increase, or about a quarter of a percent of total asset owner assets, would need to be allocated to Africa to meet the need there.

Figure 1. Infrastructure Spending Projections: Global and Africa, in Trillions USD



Source: Global Infrastructure Hub's "Infrastructure Outlook: Africa" (2018), available at https://outlook.gihub.org/region/Africa.

[2] In 2015, the United Nations adopted the SDGs, an ambitious set of principles with the ultimate goal of eradicating all forms of poverty by 2030. The SDGs commit all signatories to achieving sustainable development across economic, social and environmental dimensions, and, as such, the goals are quite comprehensive in scope. A number of the SDGs have direct implications for infrastructure development. This includes but is not limited to Goals 6, 7, 9 and 13, which concern ensuring water availability and energy access for all, building resilient infrastructure and combatting climate change, respectively.

[3] World Bank Group, Office of the Chief Economist for the Africa Region. *Africa's Pulse: Volume 15* (2017), p. 86, available at http://documents.worldbank.org/curated/en/348741492463112162/pdf/114375-REVISED-4-18-PMWB-AfricasPulse-Sping2017-vol15-ENGLISH-FINAL-web.pdf.

[4] OECD. *Survey of Large Pension Funds and Public Pension Reserve Funds* (2018), p. 10, available at http://www.oecd.org/finance/private-pensions/survey-large-pension-funds.htm.

[5] Ibid, page 15.

HISTORICAL UNDERINVESTMENT

Compared to Latin American infrastructure markets, SSA shows both a materially lower total transaction count and growth trend and substantially lower total transaction values on an annual basis (per Figure 2a below). The pervasive infrastructure spending gap between SSA and other key emerging market regions is further demonstrated in Figure 2b, showing differentials in investment by country income classification group as determined by the World Bank.[6] The majority of SSA countries are classified as either low or lower-middle income on this scale. This chart dramatizes infrastructure underinvestment in low-income countries in particular.

Figure 2a. Infrastructure Transaction Value and Count — A Regional Comparison of Latin America and the Caribbean (LAC) and Sub-Saharan Africa (SSA)

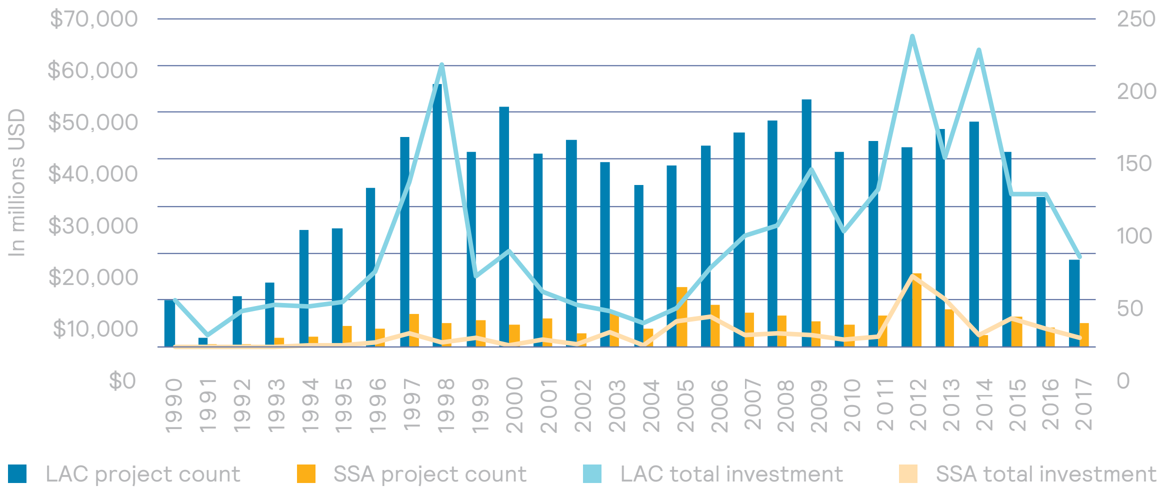
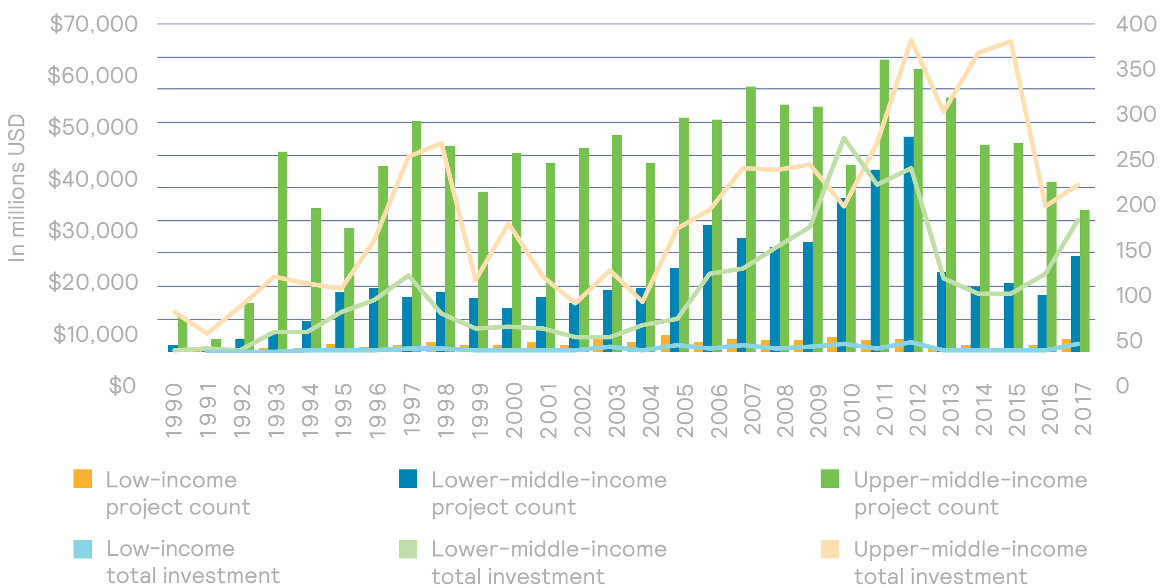


Figure 2b. Infrastructure Transaction Value and Count — A Comparison of Low-, Lower-Middle- and Upper-Middle-Income Countries



Source: World Bank Private Participation in Infrastructure (PPI) Database, available at http://ppi.worldbank.org/visualization/ppi.html.

---

[6] The World Bank. *World Bank Country and Lending Groups* (2018), available at https://datahelpdesk.worldbank.org/knowledgebase/articles/906519.

AFRICA RISK PERCEPTIONS ARE OVERBLOWN

Based on our interviews, asset owners already invested in SSA infrastructure are generally positive about their experiences and outlook for future involvement on the continent. However, asset owners that have not previously invested in SSA do not typically consider the continent for expansion of their infrastructure programs, primarily due to concerns around heightened risk. Although data challenges persist in tracking the results of private and emerging markets investments generally — and in SSA in particular — indications from available data point to the strong performance potential for SSA infrastructure investment. The charts in Figure 3 below show that African infrastructure project default rates have been quite low, even when compared to developed markets, whereas returns for many forms of African debt have been quite high.

Some reasons for these lower default rates among African infrastructure projects cited in interviews follow:

- Generally, only well-structured projects can get financed in Africa due to the perception of high risk.
- Most projects have some form of development finance institution (DFI) support and/or risk mitigation and are developed by experienced international consortia, thus reducing risks.
- Most projects have offtake agreements, thus mitigating demand risk.
- Most projects have revenues denominated in US dollars, thus reducing currency risk.

Figure 3a. Project Finance Default Rates 1990-2016

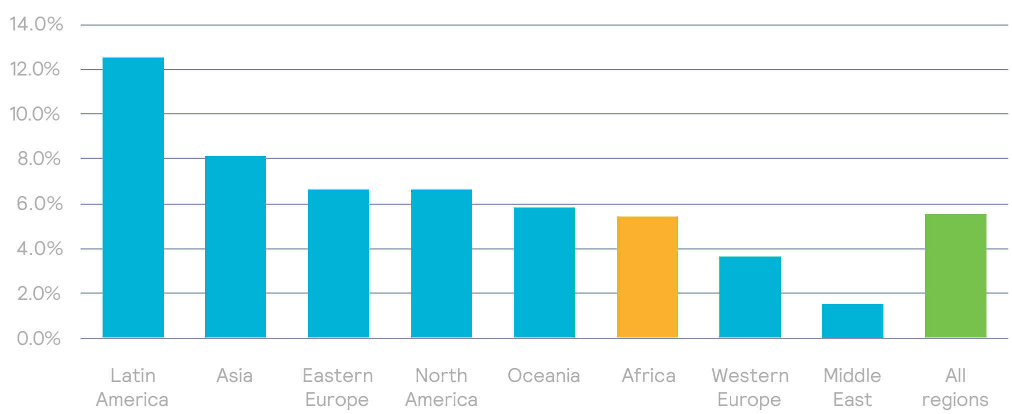
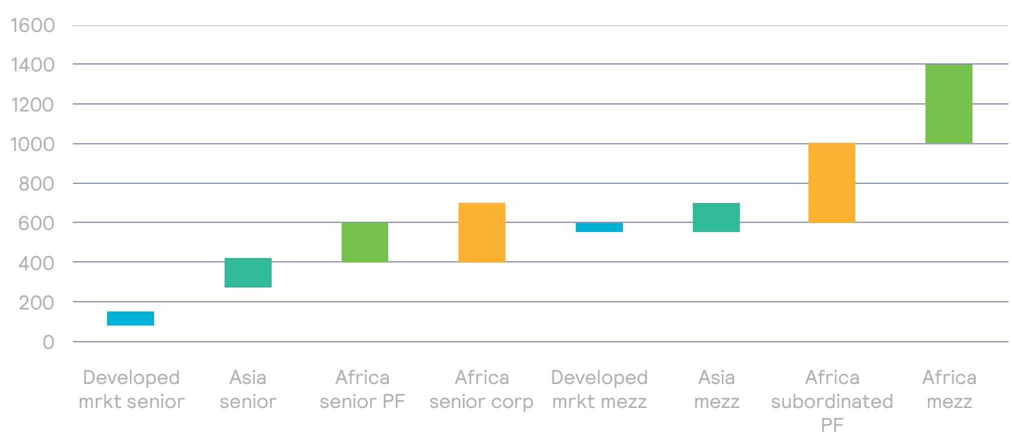


Figure 3b. Current Infrastructure Debt Spreads, in Basis Points



Default Rates Source: Moody's Investors Service. *Default and Recovery Rates for Project Finance Bank Loans, 1983-2016* (2018), p. 24, available at https://www.moodys.com/research/Moodys-Default-and-recovery-rates-for-project-finance-bank-loans--PR_380331.
Spreads Source: Investec Asset Management, Industry Expert Interviews as of May 2018.

CHARACTERISTICS OF AFRICAN INFRASTRUCTURE INVESTORS

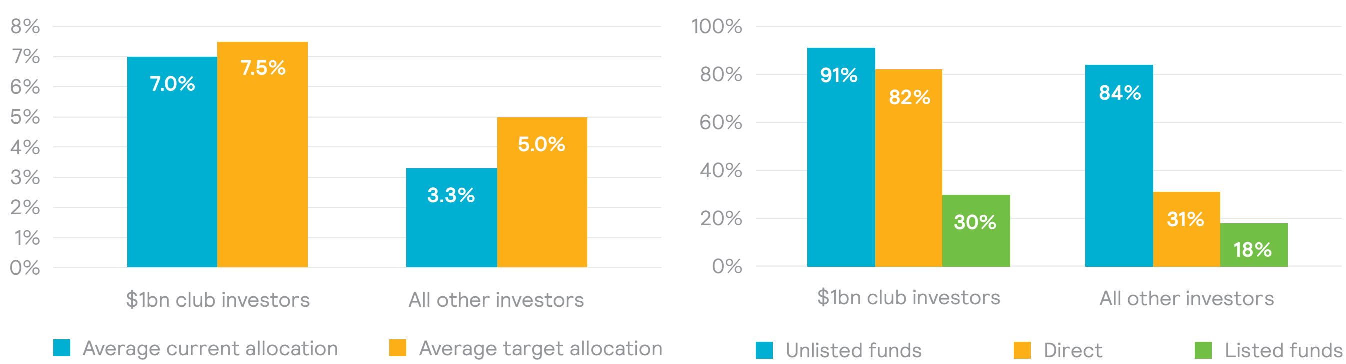
The decision for an asset owner to invest in African infrastructure is complex and influenced by a variety of factors, including participants in the investment value chain. Since asset owners with large allocations to infrastructure are more likely to have adequate capacity to make regionally diverse investments (including in emerging markets), the focus of the following commentary is on large infrastructure investors. Smaller asset owners, on the other hand, though they may have an infrastructure allocation, are more likely to favor global funds that can offer them regional diversification. Although global funds may include exposure to Africa, specific allocations are not common among smaller asset owners (rather, in these cases, the focus should be on allocations made by their external fund managers).

The 75 asset owners globally with larger than US$1 billion allocations to infrastructure are a relatively heterogeneous group. Although Canadian investors make up six of the top 10 such investors by current allocation size, and Australian investors account for 14 of the total, overall, the 75 come from more than a dozen different countries and represent several different investor types (including asset owners, asset managers and insurance companies). Some commonalities these investors share include:

- Size (an average AUM of US$100 billion)
- A dedicated infrastructure allocation (as opposed to an allocation included within a broader real assets mandate, for instance)
- An ability to access infrastructure exposure directly as well as through unlisted funds (indicating greater internal staff capacity)
- An average allocation to infrastructure of 7% of total AUM

By comparison, asset owners with a smaller allocation often bundle infrastructure in with other asset classes, rarely invest directly and have an average allocation of only 3.3%. Notably, large infrastructure investors also tend to be fully allocated, falling just 50 bps shy of their infrastructure targets in aggregate, as shown in Figure 4, whereas smaller investors tend to struggle to meet their allocation goals.

Figure 4. $1bn Club Infrastructure Investor Characteristics



Source: Preqin. "The $1bn Club: Largest Infrastructure Fund Managers and Investors," Real Assets Spotlight, Volume 1, Issue 3 (August 2016), available at http://docs.preqin.com/newsletters/ra/Preqin-RASL-August-16-Feature-One-Billion-Club-Infrastructure.pdf.

UNLOCKING MIDA'S IMPACT

In the following columns, we set out the key challenges and opportunities in mobilizing institutional investor demand for investments in SSA infrastructure. Through focusing on these points, MiDA (alongside other initiatives focused on catalyzing investor impact toward achieving the SDGs[7]), can best position its efforts on overcoming the SSA infrastructure funding gap and unlocking the social, environmental and economic progress that will follow as a result. What follows is abbreviated from the full report.

KEY CHALLENGES

Clarifying the Role of SSA Infrastructure in Investors' Portfolios: The potential for improved diversification, higher returns or strengthened portfolio support for climate change mitigation and sustainability goals are all possible reasons for investors to consider SSA infrastructure, yet these motivations are often not sufficiently articulated.

The Necessity for Patience and Long-Term Commitments: The benefits of investing in SSA infrastructure are frequently felt to be insufficient to justify the higher (perceived) barriers to entry into this market and to endure the longer timeframes often required to realize potential upsides.

Risk Perception and Reality Gap: Perceptions of the high risk of investing in SSA infrastructure do not appear to be borne out by investors' experiences, though quality data that demonstrates this point clearly is hard to come by.

Regulatory Inhibitors: Regulations governing some OECD-based asset owners — including, for example, regulatory capital charges — present barriers to investing in SSA infrastructure for the types of investments currently available.

Gaps in Financing: Other forms of investment (for example, seed capital, refinancing facilities, municipal and project bonds) are necessary to incentivize greater investment in SSA infrastructure.

Contractor Challenges: A shortage of qualified and creditworthy project sponsors and contractors is a key impediment to increased institutional investment in infrastructure (and overall development) in certain SSA countries.

Asset Owner Bandwidth: Investing in SSA infrastructure requires greater staff or third-party resources than some investors can allocate.

KEY OPPORTUNITIES

Collaborative Investing or Club Deals: Help investors reduce underwriting costs and overcome staffing limitations by working together on SSA infrastructure funds or projects.

Education on Risk Mitigation: Provide information to investors about the risks of specific countries, sectors and investment vehicles and how various risk mitigation measures can help overcome them. This includes providing investors with opportunities to experience SSA infrastructure project development firsthand (see Appendix).

Engaging Local Investors: Help institutional investors overcome barriers to entry into the SSA market by working with local institutional investors.

DFI Investment Partnerships: Help institutional investors work with DFIs to reduce the risks and costs of investing in SSA infrastructure.

Enhanced Refinancing Opportunities: Given that institutional investors do not like to take construction risk, provide more opportunities for them to invest in projects after they are operating successfully (for example, by creating refinancing facilities).

Aligning With Climate and Sustainability Targets: Show how investing in SSA infrastructure helps address investor concerns about the economic consequences of unmitigated climate change, supports Paris Agreement implementation and advances the SDGs.

[7] Mercer. *Crossing the Bridge to Sustainable Infrastructure* (2017).

APPENDIX

MIDA 2018 INVESTOR DELEGATION TO AFRICA: SENEGAL AND SOUTH AFRICA

The NASP-USAID Investment Partnership for Mobilizing Institutional Investors to Develop Africa's Infrastructure, or "MiDA," with a mission to expand opportunities for US institutional investors seeking infrastructure investments in Sub-Saharan Africa for commercial profit while making a meaningful impact in the region, convened two Investor Delegations - the first in May 2017 visited South Africa, and the second in February/March 2018 visited Senegal and South Africa. These have been the largest delegations of US asset owners and fund managers ever assembled to visit Sub-Saharan Africa to get direct exposure to local markets and opportunities in private equity and infrastructure. Further, US asset managers and financial services providers met with dozens of African asset owners that invest billions in offshore assets in the United States to present their products and services and deepen relationships. As a result of these efforts over the last 12 months, MiDA members have closed on new deals totaling close to US$500 million[8] flowing in both directions, exemplifying the real and mutually beneficial US-Africa commercial and development opportunities that exist.

As part of the research effort supporting this report, Mercer participated in the 2018 Investor Delegation to Africa, where we met with key asset owners and managers investing in African infrastructure development.

KEY 2018 INVESTOR DELEGATION TO AFRICA STATISTICS[9]

- Thirty MiDA investors traveling from 10 cities in the United States
- Ten days, two countries, three cities in Africa
- Forty-five US and African asset allocators mobilized, representing close to US$1 trillion in pension, insurance, endowment and foundation assets
- The Largest US and African pension funds as key participants: CalPERS and the Government Employees Pension Fund of South Africa (GEPF), represented by the Chair of the Investment Committee and the Head of Investments and Actuarial Services
- The second- and third-largest African pension funds as key participants — South Africa Eskom Provident Pension Fund (EPPF) and Government Institutions Pension Fund of Namibia (GIPF)
- Some of the largest US pension funds represented, such as the Teachers Retirement System of Texas and the United Auto Workers Retiree Medical Benefits Trust
- 100+ asset managers and financial service providers engaged
- The largest global custody bank and the largest African bank as major partners — BNY Mellon and Standard Bank
- Three of the most influential pension consulting firms participating in major roles — Mercer, Wilshire, Alexander Forbes — along with Dalberg Global Development Advisors
- Seventy presentations and speakers, including 30 asset managers making business presentations to investors on infrastructure, private equity and other asset classes
- Meetings with one head of state, six ministers, one US ambassador, one USAID mission director, one US consul general, 40+ chairs/CEOs/CIOs in the financial services industry
- Ten strategic partners, including the United Nations, the Senegal Sovereign Wealth Fund, the Senegal Investments Promotion Agency, Association of Black Securities and Investment Professionals (ABSIP), Council of Retirement Funds of South Africa (BATSETA), Institute of Retirement Funds South Africa (IRFA), Standard Bank, BNY Mellon and African Agri Council
- MiDA is also engaged in an infrastructure transaction support partnership with the World Bank for specific initiatives in Kenya and South Africa.

[8] MiDA. *Newsletter Special: MiDA 2018 Investor Delegation to Africa: Senegal and South Africa* (2018), p. 2.

[9] Ibid, p. 6.

MARSH & McLENNAN COMPANIES

www.mercer.com/responsible-investments

6007794b-GB 220618