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We would like to thank Prescient and the ASISA Foundation for funding this short article.

AN INTRODUCTION TO INFRASTRUCTURE INVESTMENT

This article is the first in a series about infrastructure investments, and seeks to provide investors with an introduction to this increasingly important alternative asset class.

"Investing in infrastructure projects presents funds with the opportunity to achieve long-term suitable returns for members, while at the same time contributing towards much-needed economic and socioeconomic outcomes."

WHAT IS INFRASTRUCTURE INVESTING?

Infrastructure investments are gaining increasing attention as necessary investments for retirement funds in South Africa. Investing in infrastructure projects presents funds with the opportunity to achieve long-term suitable returns for members, while at the same time contributing towards much-needed economic and socioeconomic outcomes.

- Opportunities in infrastructure are diverse.
- Generally infrastructure investments offer portfolio diversification due to their low correlation with more traditional asset classes, such as listed equity.
- Generally given infrastructure's long-term nature, it can be an appealing investment for retirement funds, particularly in times of rising interest rates and inflation.

CAN RETIREMENT FUNDS INVEST IN INFRASTRUCTURE?

Currently, there is no specific allocation to infrastructure investments as per Regulation 28 of the Pension Funds Act.

Funds may have exposure to infrastructure through different assets classes, such as listed or unlisted debt or equity. Currently, Regulation 28 allows retirement funds to allocate 10% of their investment portfolio to private equity investments, for example. *

ACCESS TO AND TYPES OF INFRASTRUCTURE INVESTMENTS

There are different ways to access infrastructure investments across various sectors, for example through direct investment, publicly listed funds, private infrastructure funds or private infrastructure fund of funds.

Each opportunity should be assessed on its own merits, relative to the suitability of the investor, such as risk profile, investment time horizon and return objectives.

Examples of infrastructure investments include social projects, transportation projects, communication projects or energy focused projects.

CHARACTERISTICS OF INFRASTRUCTURE INVESTMENTS

- **Investment horizon:** Infrastructure investments are typically long term in nature.
- **Less liquidity:** A large portion of these assets are unlisted which, among other factors, can make them less liquid.
- **Search for yield:** The current search for an enhanced yield in a low interest rate environment has fuelled the demand for investments of this nature. Added to this, the lower interest rate environment can be positive for investments of this nature, as it results in lower project funding costs.
- **Stable returns:** Infrastructure investments are less tied to economic cycles, therefore providing more stable returns.
- **Portfolio diversification:** The performance of the underlying assets in infrastructure investments is uncorrelated to more traditional asset classes, such as listed equities.

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LONG-TERM INVESTING IN INFRASTRUCTURE

This article is the second in a series on infrastructure investment and aims to provide investors with key insights into the various categories and lifecycles of infrastructure assets, as this can impact the risk-return profile of an investment.

"It must be noted that not all infrastructure assets offer the virtues of inflation hedging and it is important for investors to understand the different categories of infrastructure assets."

An economic and social good

Infrastructure facilities and services are essential for efficient production of goods and services, transport and trade – all of which spur economic growth – which in turn helps reduce poverty. It also has a tremendous impact on the quality of life and wellbeing of any country.

In recognising the essential role that long-term financing for infrastructure plays in supporting strong, sustainable, balanced and inclusive growth, it is understandable that long-term investment vehicles, such as retirement funds, are approached to provide this type of financing for infrastructure projects.

In most countries, governments are struggling to keep up with the infrastructure development that is required, an issue that is only being exacerbated by the economic fallout of COVID-19.

Institutional investors are increasingly seen as suitable funding partners for infrastructure investments, given their long-term liabilities, which makes inflation-linked assets (such as infrastructure) attractive.

Understand the nature of an infrastructure project before investing

Given the long-term operating capacity of most infrastructure assets, they align well with the goals of long-term investors, such as retirement funds.

However, it must be noted that not all infrastructure assets offer the virtues of inflation hedging and it is important for investors to understand the different categories of infrastructure assets, as well as the different life-stages of their development, as these result in different cashflow profiles.

TWO MAIN STAGES OF INFRASTRUCTURE INVESTMENT

Greenfield infrastructure is an investment into new infrastructure – new development and construction projects.

For an investor, some inherent risks of these projects include construction risk and off-taker risk. The creation of the asset primarily involves funding the project, with the risk of the project not reaching commercial status.

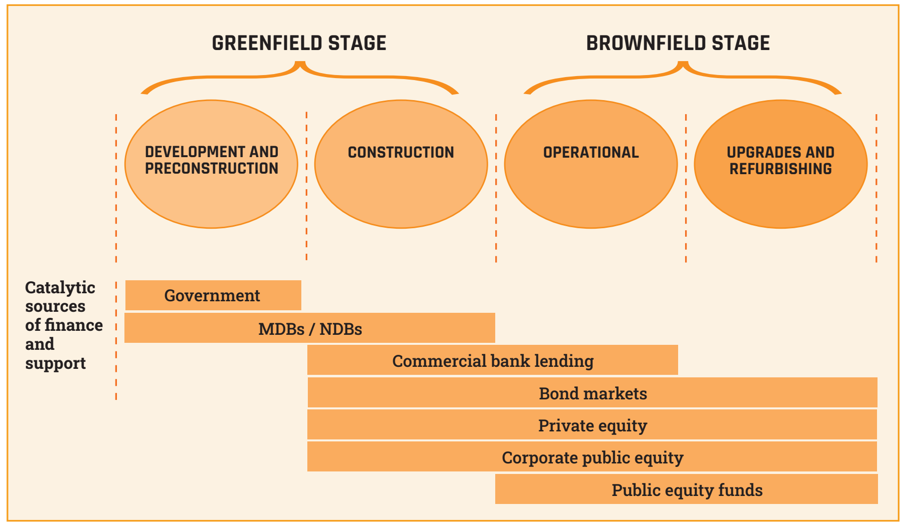
Greenfield infrastructure assets do not traditionally provide inflation-hedging features.

Brownfield infrastructure is an investment into existing and ready-to-operate – or already operating – infrastructure assets.

For an investor, these assets can generate revenues. Given that the infrastructure already exists and is in use, the risks of investing are substantially less than in a greenfield project, where the future cash generation is uncertain.

Brownfield infrastructure investments are also often scalable and therefore greater cashflows can be generated.

STAGES OF INFRASTRUCTURE PROJECTS AND PREDOMINANT SOURCES OF FINANCE PER STAGE



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INFRASTRUCTURE EXPOSURE THROUGH MULTIPLE ASSET CLASSES

Retirement funds seeking exposure to infrastructure assets have a number of investment instruments or asset classes available to them. This third article in our infrastructure investment series takes a closer look at the options available to investors.

Infrastructure exposure

- Regulation 28 of the Pension Funds Act supports retirement funds investing in a diversified portfolio of assets across multiple asset classes. *
- This can, for example, be achieved by investing in a portfolio of infrastructure assets, where the fund is able to achieve diversified exposure to the infrastructure theme across multiple asset classes.
- There are a number of investment instruments available for investors – such as retirement funds – seeking exposure to infrastructure assets, as is set out in the table.

Investment instruments and vehicles

- The table ranks instruments based on several dimensions, firstly defining them into broad asset categories and then by principal instruments.
- Besides the fact that investors can be creditors or equity holders, some investments – particularly public-private partnerships (PPP) contracts and concessions – may have debt-like characteristics due to contracted cashflows.

Modes		Infrastructure finance instruments		Market channels
Asset category	**Instrument**	**Infrastructure project**	**Corporate balance sheet / Broader entities**	**Capital pool**
Fixed income	Bonds	Project bonds	Corporate bonds, green bonds	Bond indices, bond funds, Exchange-traded funds (ETFs)
		Municipal, sub-sovereign bonds		
		Green bonds, Sukuk	Subordinate bonds	
	Loans	Direct/co-investment lending to infrastructure project, syndicated project loans	Direct/co-investment lending to infrastructure corporate	Debt funds, (GPs)
			Syndicated loans, securitised loans (ABS), CLOs	Loan indices, loan funds
Mixed	Hybrid	Subordinated loans/ bonds, mezzanine finances	Subordinated bonds, convertible bonds, preferred stock	Mezzanine debt funds (GPs), hybrid debt funds
Equity	Listed	YieldCos, closed-end funds	Listed infrastructure & utilities stocks, closed-end funds, Real Estate Investment Trusts (REITs), Infrastructure Investment Trusts (IITs), Master Limited Partnerships (MLPs), Special Purpose Acquisition Companies (SPACs)	Listed infrastructure equity funds, indices, trusts, ETFs
	Unlisted	Direct/co-investment in infrastructure project equity, PPP	Direct/co-investment in infrastructure corporate equity	Unlisted infrastructure funds (GPs)

SOURCE: The Organisation for Economic Co-operation and Development (OECD)

The asset class chosen for investing in the infrastructure project or fund will depend on, among other factors:

- the nature of the asset (debt, equity, listed or unlisted);
- regulatory and tax considerations;
- and on how investors have defined and allocated infrastructure in their portfolios based on their own portfolio of assets measured against liabilities.

Smaller investors with limited resources and small amounts of capital allocated to infrastructure are limited to collective or pooled and corporate investments, while large funds may be able to commit capital directly to infrastructure projects.

Infrastructure finance

Loans and bonds form the largest categories of infrastructure finance. Debt instruments can be structured to have long-term maturities that extend over the life of long-term assets, such as infrastructure. Debt instruments can take the form of direct loans held on the balance sheets of financial institutions or may be structured for resale to investors via private markets (private-placement debt), or public markets through registered corporate and government bonds.

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PRESCRIBED ASSETS

In this fourth article of our series on infrastructure investment, we take a look at the discussion around prescribed assets in South Africa. Should legislation be formally tabled in this regard, such assets would need to be structured as attractive investment opportunities to attract domestic and foreign investors into the full spectrum of infrastructure assets in South Africa.

WHAT ARE PRESCRIBED ASSETS?

The term "prescribed assets" refers to a government policy that requires investors, like retirement funds, to hold a certain amount of investments in government-specified assets, such as government or state-owned entities' (SOEs') bonds. These assets could be issued by SOEs for more direct or standalone projects, such as a highway, power plant or other specific public infrastructure initiative, or by the government directly for "general purposes", such as funding transport or water infrastructure.

THE DEBATE AROUND IMPLEMENTATION

The ANC's 2019 election manifesto proposed the introduction of prescribed assets on financial institution funds, but to date no official regulation or legislation has been tabled – leaving many questions as to the form this would take.

Currently, the primary concern around implementing prescription in South Africa is that it leads the country's savings (insurance and retirement fund assets collectively representing R6.2tr per ASISA figures) becoming an instrument of state policy, and so avoids the investment discipline of financial markets and the fiduciary responsibility of trustees and their appointed asset managers, in turn resulting in lower-than-expected market returns for investors.

IS PRESCRIPTION NECESSARY?

- In order to attract domestic and international investors into the full spectrum of infrastructure assets in South Africa, such assets need to be structured as attractive investment opportunities, providing revenue streams and risk-return profiles that match investors' return expectations and liability structures.
- Domestic retirement funds are already significant investors in government or SOE-issued bonds, having held, over the past 20 years, on average, about 20% of total assets in these bonds.
- Financial institutions have also indirectly participated in funding public sector spending through their purchases of South African government and SOE bonds, valued at some R1.3tr.
- Prescription, therefore, does not seem to be of absolute necessity, and even if it were to be necessary, it seems to result in unintended consequences that will do more harm than good.

CRITICISMS ON PRESCRIPTION:

- Likely forced **investment in SOEs,** which have been plagued by mismanagement and lack of delivery.
- **Limiting investment decisions:** Prescription is at odds with the fiduciary duty of those entrusted with the responsible management of retirement fund members' savings.
- **Interfering with capital allocation function of capital markets:** Forcing the market to invest in assets producing lower-than-traditional market returns and/or forced investment in high-risk assets removes the competition for funding and the performance incentive, as well as depriving more deserving projects of much-needed finance.
- **Inflation and real returns:** Forced investment into specific assets pushes up the price, or pulls down yield, resulting in artificially low interest rates. This pushes them down to below inflation rates, resulting in negative real returns for investors. This results in 'cheap money', which distorts the asset allocation process further and causes higher rates of inflation.
- **Investors** should be free to change their investments to adapt to changing markets conditions and investment goals.
- **SA's credit rating** will be negatively impacted by prescription, which would see foreign investors (many of whom are pension funds) being forced to withdraw from South Africa.

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UNDERSTANDING THE DIFFERENT TYPES OF INFRASTRUCTURE

The different types of infrastructure that investors have access to are probably best broken down according to whether their key focus is economic, social or environmental. This article seeks to provide an overview of these infrastructure investment themes.

INFRASTRUCTURE THEMES AND INVESTMENT INSTRUMENTS

Investors have access to multiple types of infrastructure projects or themes, usually across hard economic and social infrastructure and green or environmental infrastructure types. Multiple investment instruments, such as bonds, listed equity and private equity, are used to enable investment into infrastructure projects, traditionally described as alternative or real assets.

ECONOMIC INFRASTRUCTURE	SOCIAL INFRASTRUCTURE	ENVIRONMENTAL/GREEN INFRASTRUCTURE
Return-seeking investment in the construction, improvement or replacement of economic infrastructural framework in South Africa	Return-seeking investment in the construction, improvement or replacement of the physical infrastructure that helps to improve the lives and prospects of South African citizens	Return-seeking investment in firms, funds and projects that seek to improve environmental sustainability outcomes, to mitigate climate change, and to foster the green economy
Also known as hard infrastructure: usually capital-intensive and high-cost investments	Also known as soft infrastructure: usually requires human capital and helps deliver services to the population	Green projects include renewable energy, green buildings, energy efficiency, recycling and clean technologies
EXAMPLES		
Investment in energy infrastructure, the logistics network, water infrastructure, commuter transport infrastructure, the provision of liquid fuels and broadband infrastructure	Investment in affordable housing, healthcare and education, as well as supporting B-BBEE and SMEs	Projects may be funded publicly, privately or through public-private partnerships (PPPs)

Infrastructure as a public good

In economic terms, infrastructure often involves the production of public goods or production processes that support natural monopolies. Because infrastructure very often involves the production of either public goods or goods that lend themselves to production by natural monopolies, it is very typical to see public financing, control, supervision or regulation of infrastructure. This usually takes the form of direct government production or production by a closely regulated, legally sanctioned, and often subsidised monopoly. An example of this monopoly would be Eskom, for power generation and distribution; and SANRAL, for South Africa's national road network, including toll roads.

Assessing potential investment in infrastructure

When considering investing in infrastructure, it is essential that the policy environment and potential risk-returns measure up.

Factors typically assessed include, among others:

- historical financial performance;
- a forward-looking view of the infrastructure asset's operations and its sustainability;
- the extent to which there is alignment of interests between all stakeholders of the infrastructure asset;
- management's experience and track record;
- the composition of the board of directors, including their skills and experience;
- an assessment of the ESG factors that could affect the risk profile of the infrastructure asset; and
- understanding the competitive environment and industry in which the infrastructure asset operates.

SOURCE: Futuregrowth

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INFRASTRUCTURE RESOURCES FOR RETIREMENT FUNDS

Infrastructure investment is an important tool to create jobs, propel economic recovery, and position our economy for sustainable growth. A number of local and international initiatives and resources are available to investors. This final article in our series on infrastructure investments highlights three resources that may be of interest to retirement funds.

SOUTH AFRICA'S NATIONAL INFRASTRUCTURE PLAN

The South African government adopted a National Infrastructure Plan in 2012 that intends to transform our economic landscape, while simultaneously creating significant numbers of new jobs, and to strengthen the delivery of basic services. The plan also supports the integration of African economies.

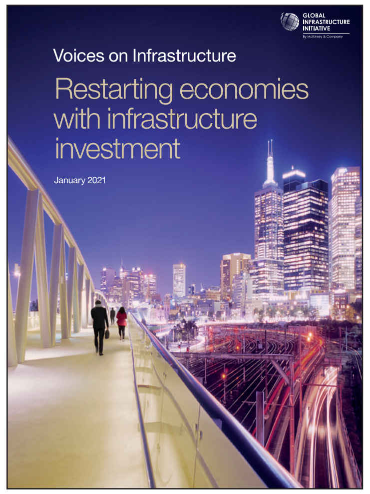
This document is a high-level summary of the National Infrastructure Plan. It sets out the challenges South Africa needs to respond to in planning and developing enabling infrastructure that fosters economic growth.

More recently, government has announced the establishment of Infrastructure South Africa. Infrastructure South Africa will play a coordinating role and serve as the conduit to develop all government infrastructure projects that require funding from the fiscus.

Source:
http://www.economic.gov.za/downloads/presidential-infrastructure-coordinating-commission/#piccbook

Further PICC resources: http://www.economic.gov.za/picc

RESTARTING ECONOMIES WITH INFRASTRUCTURE INVESTMENT



More than ever, many countries are faced with the need to invest in updated infrastructure to support growing populations; address inequities in the distribution of infrastructure services – from transportation to healthcare; and decarbonise their industries.

Voices on Infrastructure, Restarting Economies with infrastructure investment (January 2021) is a collection of insights on restarting economies with infrastructure investment published by the Global Infrastructure Initiative (GII).

Source:
https://www.globalinfrastructureinitiative.com/sites/default/files/voices/edition/pdf/GII-January-2021-Voices_0.pdf

Further GII resources: https://www.globalinfrastructureinitiative.com/about

PRIMER ON RESPONSIBLE INVESTMENT IN INFRASTRUCTURE

This publication by the Principles for Responsible Investment (PRI) clarifies key concepts of responsible investment in private infrastructure equity and debt, and how the six Principles apply to infrastructure.

The PRI defines responsible investment as "an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long-term returns".

Source:
https://www.unpri.org/infrastructure/primer-on-responsible-investment-in-infrastructure-/2700.article

Further PRI resources: https://www.unpri.org/investment-tools/alternative-investments/infrastructure

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