New funders needed for infrastructure

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BANKS' limited ability to finance long-term projects opens up opportunities for other types of funders to make returns and help South Africa implement its R3.4-trillion infrastructure programme.

As infrastructure development is critically important for economic growth, it cannot be left for governments and the banks to "go it alone", Mergence Investment Managers portfolio manager Mark van Wyk said last week.

Stricter regulations and liquidity constraints since the 2008 financial crisis and increased capital requirements imposed by Basel 3 have restricted banks' ability to lend money to infrastructure projects.

The proposed changes to banks' liquidity coverage and net stable funding ratios require banks to match the tenure of their funding to the time for which they are granted loans.

According to financial services firm Deloitte, this means if a bank wants to fund a 20-year infrastructure project, it would have to restructure its balance sheet to receive funding from its investors for the same time period.

Deloitte financial services partner Wayne Savage said last week that South African fund managers — a main source of funding for local banks — are reluctant to provide such long-term finance due to the perceived unfavourable returns.

Banks therefore charge a premium on long-term finance, making their loans uncompetitive, and open doors for alternative funding at lower costs.

Some governments raise money through infrastructure bonds, but in South Africa, bonds are generally only issued for high-level infrastructure, such as the South African National Roads Agency, but not for smaller projects like housing, Mr van Wyk said.

This leaves the private sector, he said, where instruments such as debt funds focused on social impact could help finance development projects.

A debt fund may invest in short-term or long-term bonds, securitised products, money market instruments or floating rate debt.

Deloitte infrastructure and capital projects leadter Andre Pottas said instead of banks funding the entire project, a model could evolve in which banks finance only the initial stages of a project.

"The remaining funding will stem from project bonds or loans sold to institutional investors, such as pension funds and life companies that have an appetite for long-dated assets to match their long-dated liabilities," he said.

In Europe and the US, project funding often includes an equity tranche and a short-term debt tranche.

Initially, the project promoter funds the equity tranche and the bank finances the debt.

"Once the project is commissioned and proven, the funding is refinanced, with an infrastructure fund taking the equity piece from the promoter," said Mr Savage.

The debt, or project bond, is often listed and sold to institutional investors such as pension funds.

Mr van Wyk said Mergence, through its High Impact Debt Fund — with assets under management of R90m — channels pension and insurance funds into impact investing including smaller infrastructure projects.

Mr van Wyk said impact investments via debt funds can earn yields as competitive as those of fixed income bonds or money market instruments.

"And investors can say they have honoured the call be government in the National Development Plan for the private sector to come to the party," he said.