



Mark van Wyk

ON MY MIND

Fusion of capital and democracy

Pension funds have been slow to invest in infrastructure and need to come to the party.

● An interesting trend is emerging out of the broader theme of how to finance infrastructure development and construction on the African continent. It is a move from the sovereign to the local. The topic was discussed under the banner of “the democratisation of infrastructure capital” at a side meeting of the recent World Economic Forum Africa (WEF) held in Durban in May.

The meeting, attended by various African and European development banks and other institutions, explored ways to speed up and increase infrastructure spend in order to unlock economic development in Africa, in some cases by “leapfrogging” on the back of technological innovations brought about by the so-called fourth industrial revolution.

A need was identified for early-stage investment and development funding, such as for feasibility studies and impact assessments, in order to get projects from the concept stage to bankability. Development financing, with a higher risk profile than bankable projects and a typical five-year time span, is the preserve of development banks, agencies and intergovernmental agreements.

But once projects are bankable, institutional investors and specialised funds are able to fund the construction and the operations of the plants. The focus on infrastructure development is also shifting away from national projects to cities, local municipalities and corporates. This is as a result of rapid urbanisation and cities being more agile in project execution. In the UK, for example, there are about 25 private water companies or concessionaires that maintain water infrastructure across the main cities.

This move to the local level is welcome. It will bypass the inefficiencies

of dealing at a national level and paves the way for strong investment opportunities via debt or equity, including public-private partnerships.

There are investors – and not just banks – that are interested in potential infrastructure development funding opportunities. Competition is heating up and this is a good thing. We are likely to see more social, green and infrastructure bonds launched, as well as more listings through special purpose acquisition companies (Spacs).

Potential international investors include infrastructure and private equity fund managers, many of whom stated at the WEF that they are deterred by SA’s recent rating agency downgrades. Bear in mind that while the downgrades are at the sovereign level, this does not necessarily have an impact at the project level, where bond yields remain quite stable.

Domestically there are institutional fund managers, such as ourselves, whose pension fund clients seek diversification across their portfolios into alternative assets such as infrastructure, which provide stable long-term cash flows, low correlation to other asset classes, inflation protection and generally low sensitivity to economic growth cycles.

Infrastructure opportunities are usually long-term investments, typically spanning 10 to 20 years. Furthermore, the returns are attractive with median net internal rates of return for most unlisted infrastructure funds ranging from the mid-teens to low 20s. As a result of client interest and demand, Mergence has expanded its suite of infrastructure and development funds, which includes a composite bond fund, tapping into both listed and unlisted investments.

Unlike many other African countries, SA has deep debt capital markets

and we can largely finance our infrastructure needs without relying on development finance institutions. A key change for SA’s pension fund industry occurred in 2011 when regulation 28 of the Pension Funds Act was amended to allow for an allocation of up to 15% in “other”, alternative investments which include private equity funds, hedge funds and other derivative or pooled vehicles.

Take-up has, however, been slow. RisCura in its 2015 “Bright Africa” report analyses asset allocation by pension funds across 10 African markets. SA has the second-lowest allocation to “other” assets, at 2.3%. This compares with a 0.7% allocation in Botswana, 8.5% in Namibia, 10.9% in Swaziland and 38% in Zambia. The global average allocation to this “other” category is estimated at 24.8%.

Mergence supports efforts for infrastructure to be considered as a potential separate investment category in its own right under regulation 28. We have been encouraged by some developments. The Association of Savings & Investments SA (Asisa) and other interested stakeholders are exploring means of overcoming the challenges that investors face in accessing investment into infrastructure projects. These include avenues such as listing debt instruments.

Surely pension funds investing in infrastructure represents a good opportunity in “democratising” infrastructure assets? To my mind, pension fund members should be questioning their boards of trustees on whether or not they are invested – or considering investing – in infrastructure and so help to build the socioeconomic environment that will affect their lives positively, now and into retirement. ✕

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Pension fund members should be questioning their boards of trustees on whether or not they are invested in infrastructure projects