



Quantifying Risk, Enabling Opportunity.

## **Infrastructure Investment - A Cure or A Curse**

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# 0. Profile

## Taka Sande

MBA, BSc Civil Eng, PMP®, Cert.Dir®



I am a Certified Director® by the Institute of Directors in Southern Africa (IODSA) and I am currently an Adviser at the National Treasury of South Africa. I offer executive and corporate governance advisory services to infrastructure development, asset management and project management companies, high-tech start-ups, local government, and private organizations in Southern Africa. ESG and Infrastructure Project finance and capital projects form part of my extensive list of specialties.

# 0. Profile

Position	Organization	Period
Non-Executive Director	GTEDA	July 2021 - Current
Advisor	National Treasury, GTAC	June 2020 - Current
Non-Executive Director	MSeth Properties (Pty) Ltd	May 2020 - Current
Non-Executive Director; Chairman of Finance Committee	Project Management Institute (PMI) South Africa	Sept 2019 – Current
Managing Director	Fasford SA (Pty) Ltd	Jan 2015 - Current
Associate Principal: Real Estate	Bigen Africa Services (Pty) Ltd	Jan 2013 – Nov 2018
Project Manager	Bigen Africa Services (Pty) Ltd	Jan 2009 – Dec 2013
Projects Engineer	Bigen Africa Services (Pty) Ltd	Aug 2006 – Dec 2008
Projects Engineer	Ncube Barrow Consulting Engineers	Jan 2005 - July 2006
Provincial Water Engineer	District Development Fund	Jun 2001 - Dec 2004
Resident/Design Engineer	CNM YBJ Consulting Engineers	Jan 2000 - May 2001

# 0. Profile

Qualification	Year	Institution
Certified Director® (Cert.Dir.®)	2020	Institute of Directors in Southern Africa (IoDSA)
Bridging the Gap between Strategy Design and Delivery (Short Course)	2020	Brightline Institute
Financing Infrastructure in African Cities (Short Course)	2019	Institute for Housing and Urban Development Studies (IHS) of Erasmus University Rotterdam
Financing and Investing in Infrastructure (Short Course)	2018	Bocconi University
Property Development and Investment Certificate	2017	University of Cape Town
Private Equity and Venture Capital (S/Course)	2017	Bocconi University
Project Management Profession® (PMP®)	2009	Project Management Institute (PMI)
Master of Business Administration (MBA) Degree	2007	Zimbabwe Open University (ZOU)
BSc (Hons) Civil Engineering Degree	1999	University of Zimbabwe

# 1. Introduction

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## Infrastructure Investment - A Cure or A Curse

### International Cases of Pension Funds Investing in Infrastructure

- Australian, Canadian, and Dutch pension funds have long invested in infrastructure via companies or private equity funds that run large projects, or even by directly investing into these projects themselves.
- Californian civil servant pension fund bought a 10% stake in Gatwick Airport in England.
- Investments in solar power plants, building of roads, etc with agreements with governments long term lease agreement.
- International pension funds have also bought stakes in large infrastructure assets.

# 1. Introduction

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## Proposed Amendments to Regulation 28 of The Pension Funds Act

The recent changes to the Regulation are informed by a number of calls for increased investment in infrastructure given the persistent current low economic growth climate.

- ❑ **Is this an opportunity?**
- ❑ **Infrastructure is compatible with the Sustainable Development and ESG principles.**

## 2. ESG and Sustainable Development

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What is EGS?

*'The assessment of a company's corporate **governance** system (including consideration of conflicts and interest and transparency of operations), **environmental** and **social** issues related to a company's operations'* – CFA Institute



## 2. ESG and Sustainable Development

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Environmental	Social	Governance
<ul style="list-style-type: none"><li>• Climate change</li><li>• Carbon emissions</li><li>• Air and water pollution</li><li>• Deforestation</li><li>• Water management</li><li>• Water scarcity</li></ul>	<ul style="list-style-type: none"><li>• Human rights</li><li>• Labour standards</li><li>• The Community</li><li>• Data protection and privacy</li><li>• Gender and diversity</li></ul>	<ul style="list-style-type: none"><li>• Executive remuneration</li><li>• Risk management</li><li>• Boards and committee composition</li><li>• Whistle-blower policy lobbying</li></ul>

ESG Investing is often used synonymously with **sustainable investing** or **sustainable investing**.

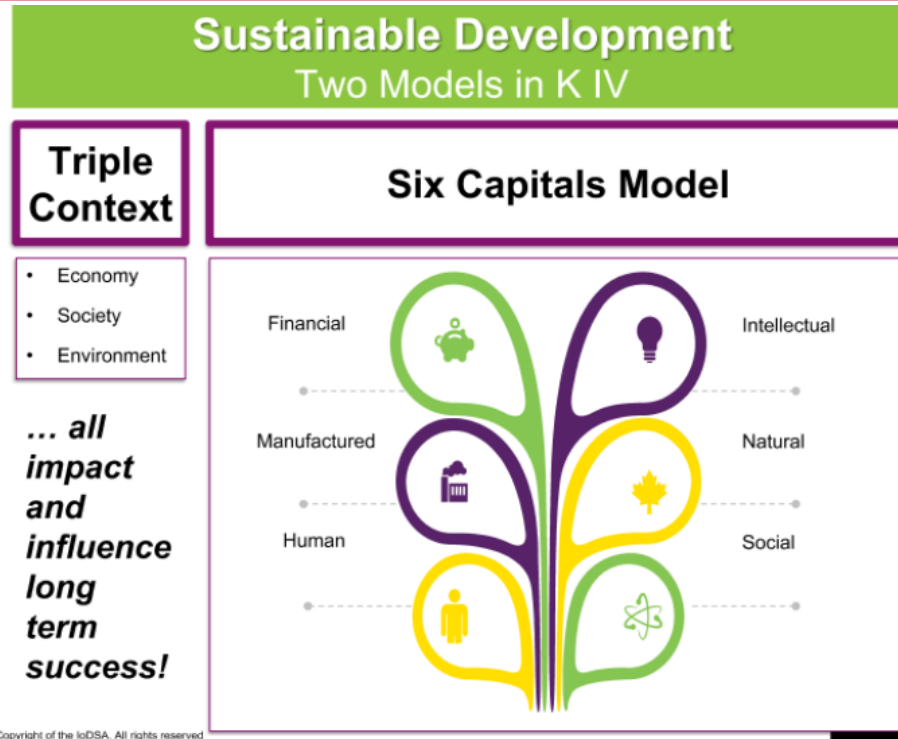
## 2. ESG and Sustainable Development

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### ESG and Sustainable Development

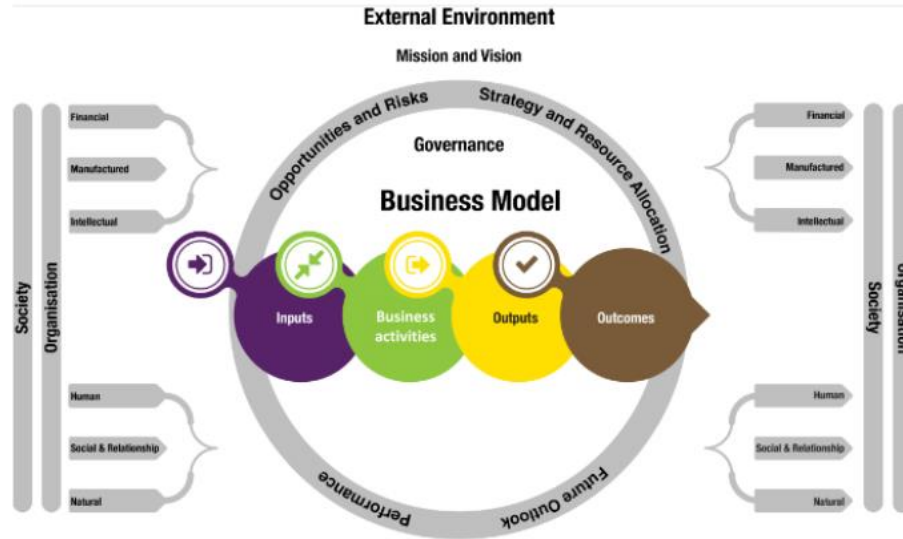
- Investment managers should be aware that they are **managing people's money**. What are the interests of the people?
- According to the *King IV Report on Corporate Governance* - Value creation should be reflected by the **6 capitals**, in the spirit of **corporate citizenship**.

## 2. ESG and Sustainable Development



## 2. ESG and Sustainable Development

### Capitals and the Value Creation Process



Source: Integrated Reporting Framework, IIRC

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## 2. ESG and Sustainable Development

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Financial Reporting

vs

Integrated Reporting

### King IV Principle 5

#### Reporting

**Principle 5:** The governing body should ensure that reports issued by the organisation enable stakeholders to make informed assessments of the organisation's performance, and its short-, medium- and long-term prospects.



# 3. Relevance of the Regulation 28 of the PFA

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Regulation 28 of the Pension Funds Act governs the way managers of pension funds invest in various asset classes, to safeguard workers retirement savings against risky investments.

Asset managers are to make;

- (i) sustainable,
- (ii) responsible and
- (iii) transparent investments when dealing with Funds.

### 3. Relevance of the Regulation 28 of the PFA

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Retirement funds are required to invest in a diverse range of instruments and asset classes, such as equities, bonds and cash.

Regulation 28 governs this by **limiting the percentage** that institutional investors or managers of pension funds may invest in these various instruments and asset classes as well as geographical areas.

For example, **currently** institutional investors may only invest up to **30%** in assets around the globe, excluding of Africa.

**□ The proposed amendment changes this.**

### 3. Relevance of the Regulation 28 of the PFA

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#### National Priority

- **State of the Nation Address** on **11 February 2021**; *Investment in infrastructure is at the heart of our economic reconstruction and recovery plan. Government is working closely with financial institutions and multilateral development banks to find innovative ways of funding large scale infrastructure investment. We call on the private sector to be part of the implementation of the country's Infrastructure Investment Plan as there are opportunities for them to invest.*



# 3. Relevance of the Regulation 28 of the PFA

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## National Priority

- **State of the Nation Address** on 11 February 2021.
- **Budget Speech by the Minister of Finance**, Tito Mboweni, 24 February 2021; highlighted two issues concerning retirement funds that warrant exploration: changes to regulation 28 of the Pension Funds Act to allow for increased investment in national infrastructure projects, and the introduction of auto-enrolment for all employed workers.

# 3. Relevance of the Regulation 28 of the PFA

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## National Priority

- **State of the Nation Address** on 11 February 2021.
- **Budget Speech by the Minister of Finance**, Tito Mboweni, 24 February 2021
- **National Treasury** released a **Media Statement** on Friday 26 February 2021; regarding the publication of the Draft Amendments to Regulation 28 of the Pension Funds Act Regulations, 1962, published under the Pension Funds Act 24 of 1956.

# 3. Relevance of the Regulation 28 of the PFA

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## National Priority

- **State of the Nation Address** on 11 February 2021.
- **Budget Speech by the Minister of Finance**, Tito Mboweni, 24 February 2021.
- **National Treasury** released a **Media Statement** on Friday 26 February 2021.

*Public comment on the proposed amendments to the regulation closed on 29 March 2021.*

# 3. Relevance of the Regulation 28 of the PFA

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## Summary of Proposed Amendments

- The proposed amendment is to introduce a more precise **definition of infrastructure** with various limits and **aggregate limits** for exposure in all these instruments and asset classes already permitted through Regulation 28.
- This will also help to establish better parameters for the purposes of **data collation and measurement**.

# 3. Relevance of the Regulation 28 of the PFA

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## Some Proposed Amendments

- By including specific definitions for 'infrastructure' and 'hedge fund';
- The proposed amendments do not introduce infrastructure as a new asset class alongside existing ones like equities, debt instruments and property but allow for infrastructure investments to be recognised within those asset classes. References to 'infrastructure' have been included in new Regulation 28(2)(c)(x) as a principle with which Funds are required to comply when making investment decisions.

### 3. Relevance of the Regulation 28 of the PFA

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Proposed Amendments means that;

- ❑ The overall investment in infrastructure across all asset categories may not exceed 45% of domestic exposure and an additional 10% for the rest of Africa.
- ❑ Pension funds can also invest in infrastructure via shares in companies that are involved in the sector.
- ❑ They can buy bonds that fund specific projects or issued by large infrastructure investors like the Industrial Development Corporation and the Development Bank of Southern Africa.
- ❑ The decision to invest in any asset class remained up to the **board of trustees** of each fund.

# 3. Relevance of the Regulation 28 of the PFA

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## What Motivated the Amendment?

To encourage asset managers to increase investments in infrastructure projects and to bridge the existing infrastructure gap. This is part of the government's **economic recovery framework**.

South Africa currently spends about 5.8% of its GDP on infrastructure, while the National Development Plan: Vision 2030 targets a 10% GDP spend on infrastructure.

# 3. Relevance of the Regulation 28 of the PFA

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## What Motivated the Amendment?

### ❖ Persistent Slow Economic Growth

Government is facing financial challenges of all time.

- The economic decline became worse from 7 to 10 year ago.
- Impact and effects of 'state capture' on the economy.

### ❖ Poor Infrastructure

The state of our country's infrastructure has begun to deteriorate, and in many areas, infrastructure delivery has slowed down or halted due to a failing economy, exacerbated by the effects of the Covid19 pandemic.



# 3. Relevance of the Regulation 28 of the PFA

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## What Motivated the Amendment?

### ❖ Energy Crisis

South Africa faces a large gap in the energy sector. There has been a move to focus on funding and allowing independent power producers to add generation capacity to the national grid.

Business and the economy grows through energy.

# 3. Relevance of the Regulation 28 of the PFA

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## What Motivated the Amendment?

### ❖ Inefficiency Public Service Delivery

In the local government and the national government.

Effective and efficient means of delivery is required to bypass corruption and mismanagement in the public Service.

- Local government eg Clover cheese factory relocating from North West to Durban due to municipal service delivery challenges.
- Some state-owned enterprises eg Medupi Power Station (BER airport in Berlin took 30years to build)

# 3. Relevance of the Regulation 28 of the PFA

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## What Motivated the Amendment?

### ❖ Sustainable Investment Opportunity

Infrastructure development improves the quality of life and provides a base for improved economic activities.

Infrastructure investment is compatible with the Sustainable Development principles, during implementation and operation.

- *Imagine, A worker contribute to pension fund but does not have decent housing, receive poor health service, poor water quality, etc*

# 3. Relevance of the Regulation 28 of the PFA

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## What Motivated the Amendment?

### ❖ Governments Infrastructure Investment Plan

The Infrastructure South Africa (ISA) has been formed as an entity which falls under the Department of Public Works to act as a single entry point for all the projects in the country's Infrastructure Investment Plan (IIP). ISA will be responsible for project preparation, packaging, funding pathways, and providing strategic oversight over all gazetted projects.

There are approximately **276 projects** in the IIP valued at more than **R2.3 trillion**. They include roads, affordable housing, water provision, and energy projects. Approvals for more than 50 of these projects have been fast-tracked. These projects urgently needs to get off the ground.

The new methodology, called the **Sustainable Infrastructure Development System (SIDS)**, will guide the country's infrastructure development agenda.

## 4. The Brighter Side

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There is already a track record of investing in large scale infrastructure in South Africa through PPPs. For example;

- Our toll roads
- Gautrain Project

## 4. The Brighter Side

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### □ Private Investment in Government is already high

- The pension fund industry is already significantly invested in government stocks on the JSE.
- For example, “of the  $\pm R1.1$ -trillion under management (excluding the Government Employees Pension Fund), pension funds hold  $\pm R202$ bn in government stock and another  $R28$ bn in state-owned enterprises and municipalities.” Gerrit Craucamp, Novare Actuaries and Consultants

## 4. The Brighter Side

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### □ High Returns

Infrastructure has potential to provide an alternative source of competitive risk-adjusted returns, especially in the current economic landscape which is marked by low-return asset classes.

Over the past 25 years, Futuregrowth, which is part of Old Mutual, has invested billions in infrastructure, including in 29 independent power producers. Its Futuregrowth Infrastructure and Development Bond Composite fund has more than R15 billion in assets under management, delivering an average annual return of 12% since 2000 by investing in government bonds and other vehicles that fund infrastructure projects.

## 4. The Brighter Side

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### □ ESG and Sustainable Investing Principles

Investing in critical infrastructure development projects will help achieve positive, measurable impact on both the environment and our society.

Investing on ESG and Sustainable principles is not always a good investment but infrastructure tends to be a relatively good investment.

The proposed amendments presents the potential to yield a win-win for both our socio-economy and investors.



## 4. The Brighter Side

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### □ Is infrastructure the New Property?

- Covid-19 has wreaked havoc on one of the retirement industry's favoured asset classes, property, which used to deliver solid returns.
- Now South African offices and malls are almost empty as the pandemic fall-out continues. Rental rates are being slashed, and it could be years before the sector recovers.

Infrastructure investment is starting to look more interesting than before.

## 4. The Brighter Side

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### □ Other reasons that makes infrastructure investment stand out

- Long term assets with long economic life,
- Low technological risk,
- Provision of key public services,
- Strongly non elastic demand,
- Natural monopoly or a near monopoly of market contexts,
- High entry barriers,
- Regulated assets,
- Frequent natural hedge against inflation,
- Stable and predictable operating cash flows,
- And a low correlation with traditional asset classes and overall macroeconomic performance.

## 4. The Brighter Side

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### □ Message from the SAICE

*Infrastructure development drives economic development and become the foundation for economic stability. Infrastructure development is a major contributor to the growth of the economy, and government alone cannot solve the problem of meeting the needs of sustainable development.*

*Recently, there has been a move towards a more collaborative approach in dealing with reviving our economy. Government is now even more focused on Public-Private Partnerships (PPPs) as there is just not enough money in the fiscus to maintain our ailing infrastructure and develop new infrastructure for basic service delivery. – March 2021*

## 5. Words of Caution

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### ❖ The Definition of 'Infrastructure' in the Regulation

General definition includes; 1) transport, 2) energy, 3) water (and sanitation), and 4) social infrastructure (private hospitals, private education, student accommodation, and social housing)

The Infrastructure Development Act, 2014 states that: "infrastructure" means **installations, structures, facilities, systems, services, or processes which are part of the National Infrastructure Plan.**

The general interpretation of this definition is that private infrastructure is not covered by the proposed amendments.

Is the intention for the amendments to focus only on funding of public infrastructure?

## 5. Words of Caution

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### ❖ **The proposed amendments favour listed instruments.**

- Most infrastructure finance transactions are complex, multiparty contractual arrangements that carefully define and apportion the project risks.
- The question of liquidity.
  - Infrastructure is built from loans hence private equity funds will be the most suitable way.
  - Infrastructure is a multi-year investment, up to 15years.

# 5. Words of Caution

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## ❖ Feasibility of the Projects

The feasibility of the projects comes into question;

- Institutional and contracting arrangements, eg PPP, SPVs, etc
  - Engineering Procuring Construction Contract (EPC)
  - Operation and Maintenance Agreement (O&MA)
  - Supply Agreement eg for materials
  - Sales Agreement (SA), government guarantees off-take with agreements
  - Concession Agreement (CA), to operate.
- Implementation framework
- Legal and statutory process
- Financing model and bankability
- Regulatory framework

# 5. Words of Caution

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## ❖ Infrastructure Investment Risks

- Pre-completion phase risks; Planning and Construction phases
- Post-completion phase risks; Operation phase
- Risks common to both phases

## 6. Last word

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- Infrastructure investment provides a better opportunity to invest based on the ESG and Sustainable Development principles.
- The amendment to the Regulation 28 of the PFA is intended at accelerate investing in infrastructure.
- However, each opportunity has its unique risk profile and potential rewards.