Urban Investment Partnership Conference

27 and 28th August 2015

Financier's Perspective on Financing Urban Development

Thank you for the opportunity to share some thoughts with you at this first urban investment partnership conference

Introduction

By way of introduction, my background is that of a fixed income fund manager and as such over the years have had the pleasure of meeting some of the municipal managers and treasury officials and not only investing in their municipal bonds, but also managing some of their money market funds.

While I represent the Association for Savings and Investment South Africa, ASISA, whose membership is made up of most of the life companies, asset managers who manage pension fund assets and product platforms in South Africa, I would like to share with you some thoughts and experiences on the broader financing environment within the context of the financing of infrastructure in general, that are equally applicable to the financing of local authorities.

International Environment

In terms of the international environment, globally many jurisdictions have announced major infrastructure programs as a counter-cyclical measure following the global financial crisis. However, governments' budgets have come under pressure and at the same time banks, who have been the traditional private sector funders of infrastructure, will, going forward, be constrained by the new Basel III requirements in terms of providing term finance. As a result many countries have started considering the merits of having long-term investment portfolios, such as life offices and pension funds play a greater role in the funding of infrastructure.

Life offices and pension funds have long term investment objectives. Similarly, infrastructure assets often have to be financed over twenty years or more. The return on these assets are typically linked to inflation or GDP growth which make these assets a very good hedge against the liabilities of these long term investors, which is why there is great interest in engaging with the public sector.

Coming out of the work of the OECD and the G20 a set of investment principles have been prepared for sign-off by Finance Ministers and Central Bank Governors appropriate to the participation of the long terms investors in the financing of infrastructure. Further, the B20, which feeds into the G20, is recommending to the G20 that infrastructure be viewed as a new and separate asset class.

Within the OECD, pension funds have on average less than one percent invested directly in infrastructure, and this is in line with South Africa, and yet countries that are more familiar with this type of investment, like Canada, have examples of large retirement funds investing up to 15%.

Enabling Environment

So what is the environment that is required to enable this type of investment? In terms of OECD research, to create the appropriate enabling environment to attract the long term savers into funding infrastructure, governments need to:

- Develop a national long-term policy framework for infrastructure investment- South Africa has largely achieved this through the National Infrastructure Plan within the context of the NDP

- Improve the integration of the three tiers of government- again this has largely been set up in South Africa through the Presidential Infrastructure Co-ordinating Commission- thePICC, and the Infrastructure Development Bill
- Create a national infrastructure pipeline of projects- the 18 Strategic Integrated Projects (SIPS) go some way in meeting this objective
- Governments need to ensure regulatory stability
- They need to create an appropriate transfer of risk
- The regulatory environment for long term investment needs to be reformed- here one thinks about the negative impact on long term investment of Basel III for banks and Solvency II for life assurers;
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There are also certain actions required from the private sector:

- There is a need to improve trustee knowledge and amend mandates to accommodate investments into infrastructure
- They need to support the pooling of funds to accommodate the size of infrastructure transactions
- They need to create new products and instruments to invest in

<u>South Africa</u>

So what has been happening in South Africa to get the private sector more involved in the financing of infrastructure?

In 2013 a National Treasury Task Team for the private sector financing of infrastructure was set up. The task team is chaired by National Treasury and the members of the task team are the PICC, Department of Public Enterprises, DBSA, ASISA, BASA, South African Venture Capital Association, the Short Term Insurance Association of South Africa and Labour.

In July/August of 2013 the Task Team met with the individual members of the various Associations with the objective of establishing from them what the blockages were to their investing in infrastructure. The following action plan within three work programs resulted from those meetings:

- The first one is the need to improve the investment environment- this seeks to address:
  - Long lead times and poor procurement processes
  - The lack of certainty on policies and regulations
- The second program is the need for projects that can be financed by the banking as well as the long term investor communities- this seeks to address:
  - The need for more feasibility studies and project preparation
  - The need for a centrally published pipeline of bankable projects
  - The pipeline needs to deliver a constant deal-flow to encourage investors to up-skill themselves to be able to analyse these projects, and
  - The need for greater private participation at an earlier stage
- The third program is taking financial intermediation to the next level- this seeks to address:
  - The need for new funding structures and finance vehicles
  - The need to re-position the role of the DFI’s
  - The need to engage the institutional investor industry on client mandates

These programs are currently being worked on by both government and the private sector, and this conference is a further step towards meeting those objectives.

In May 2014 the Task Team again met with the members of ASISA individually with the objective of establishing:

- What was the capacity of the institutions to invest directly into infrastructure
- How they saw their relationship with the banks in this space
- How they saw the role of the DFI's
- What needed to be done about client mandates, and
- What kinds of intermediation mechanisms needed to be created to get as broad a segment of the institutional investors investing into infrastructure

What came out of these engagements was that:

- The ASISA members had made great progress in up-skilling themselves in this space over the previous year
- There was going to be an on-going need for partnerships with the banks who will still largely be taking the lead when it comes to origination
- There was a great need for aggregator vehicles issuing standardised notes
- There is the need for trustees training and investment mandates to be amended to specifically incorporate infrastructure investments, and
- There may be the need for certain regulations to be amended

2015 to date

This year there have been:

- Meetings with some of the banks to talk about how they are going to restructure their renewable loans in a form that could be sold to the institutional investors
- Discussions on the structuring of various pooling vehicles
- Meetings with the DBSA on the role they and the international DFI's are playing in project preparation
- Engagements with the World Bank on the topic of Project Bonds as appropriate instruments for the funding of infrastructure in South Africa
- The JSE is working on the creation of a professional board for the listing of some of the new instruments

Next Steps

And this brings us to-day.

We are very aware that service delivery takes place within local authorities which is why this conference is so important to explore the opportunities for partnerships with the various market participants. We see this conference as the next step in the road we have travelled over the past three years to get the private sector more involved in the financing of infrastructure.

The savings industry has some R12 billion invested in listed Municipal Bonds and direct infrastructure investments of some R77 billion that include investments in affordable housing, roads, water, urban regeneration, and student accommodation. Over the next day-and-a half there will be the opportunity to jointly explore new opportunities for further investment into urban infrastructure.

I wish you well in your discussions and I look forward in participating in these.

Thank you.