



FINANCE AND DEVELOPMENT OF CAPITAL PROJECTS

Understanding the challenges for infrastructure finance: Lenders' Perspective

Presentation to the Nigerian Institute of Quantity Surveyors

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Introduction

Introduction

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- Capital projects are projects initiated by a business or entity that requires the investment of a large amount of capital.
- They are usually funded via debt and/or equity.
- Infrastructure projects such as railways, roads, dams, subways, pipelines, refineries, power plants, buildings etc. are common examples of capital projects
- Project viability needs to be ascertained prior to securing the requisite funding for capital projects.
- For the purpose of this presentation, we will classify capital projects as infrastructure projects.

Introduction contd.

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- Infrastructure plays a key role in economic growth and poverty reduction as well as in regional integration.
- Inadequate infrastructure hinders growth by reducing the competitiveness of businesses.
- This presentation seeks to broaden our understanding of the challenges for infrastructure finance and development as well as the way forward

The Infrastructure Bottleneck

The Infrastructure Bottleneck

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- ❑ Infrastructure is a basic pillar of economic competitiveness
- ❑ A McKinsey study estimates the share of total infrastructure financing in GDP will need to increase from around 3.8% to 5.6% in 2020 worldwide.
- ❑ Development of new infrastructure is required to support economic growth and alleviate poverty.
- ❑ Unfavourable economic and fiscal environment limits infrastructure spending in critical areas including land transportation, water networks and energy grids.

The Infrastructure Bottleneck

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- ❑ Privatization of existing assets may provide additional funding to government for new infrastructure which is largely inadequate
- ❑ Key sources of increasing infrastructure demand, such as the large infrastructure gap in developing countries, will therefore require additional sources of financing from the private sector
- ❑ Lack of pipeline of properly structured projects creates mismatch between infrastructure investment demand and supply of infrastructure finance

What makes Infrastructure Special & Its Financing Difficult

What makes infrastructure special and its financing difficult?

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- ❑ Though the direct payoffs to an owner of an infrastructure project may not cover its costs, the indirect externalities can still be hugely beneficial for the economy as a whole
- ❑ Infrastructure projects involve a large number of parties and complex legal arrangements
- ❑ Infrastructure projects often comprise monopolies i.e. highways, water supply etc. and the need to prevent abuse of monopoly power
- ❑ Many infrastructure investments generate cash flows only after many years and the initial phase of an infrastructure project is subject to high risks

What makes infrastructure special and its financing difficult? Contd.

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- ❑ The uniqueness of infrastructure projects in terms of the services they provide makes infrastructure investments less liquid
- ❑ The time profile of cash flows, high initial risks and illiquidity make purely private investment difficult and costly.
- ❑ The incentive-compatibility of contracts, the nature of contingencies and the proper sharing of risks among the different agents are pivotal.
- ❑ The quality of institutions and the rule of law are often determining factors in the supply of infrastructure finance, even when a project by itself appears to be financially viable.

Financing Instruments for Infrastructure Projects

Different financing instruments for different phases of infrastructure finance

Phases of Infrastructure projects and their characteristics

Phase	Economic and Contractual issues	Financial Characteristics	Potential Investors
 <p>Planning</p>	<ul style="list-style-type: none"> • Contracts are written • The phase takes 10-30 months. • Secure interest from lenders based on rating, also credit insurance or govt. guarantee 	<ul style="list-style-type: none"> • Identify equity investors • Equity sponsors need to secure commitments by debt investors. • Early commitment by lenders come at a high cost. • Leverage can be high. 	<ul style="list-style-type: none"> • Equity sponsors (govt. or construction companies) need a high level of expertise. • Debt investors are mostly banks through syndicated loans.
 <p>Construction</p>	<ul style="list-style-type: none"> • Monitoring incentives are essential. Private involvement (as opposed to purely public) can ensure this. 	<ul style="list-style-type: none"> • High risk phase • Relatively high default rate • Initial commitment by debt-holders must extend 	<ul style="list-style-type: none"> • Refinancing / additional financing is difficult and expensive at this stage • Equity sponsors may have to provide additional finance
 <p>Operation</p>	<ul style="list-style-type: none"> • Ownership and volatility of cash flows due to demand risk are key • Flexible-term present value contracts and availability-based fees reduce volatility, risk and financing costs 	<ul style="list-style-type: none"> • Positive cash flows. • Risk of default diminishes considerably 	<ul style="list-style-type: none"> • Refinancing of debts (bank loans or government funds) from initial phase • Bonds, though a natural choice, are not very common

Attracting Finance for Infrastructure Development

The contractual design of projects to attract Finance

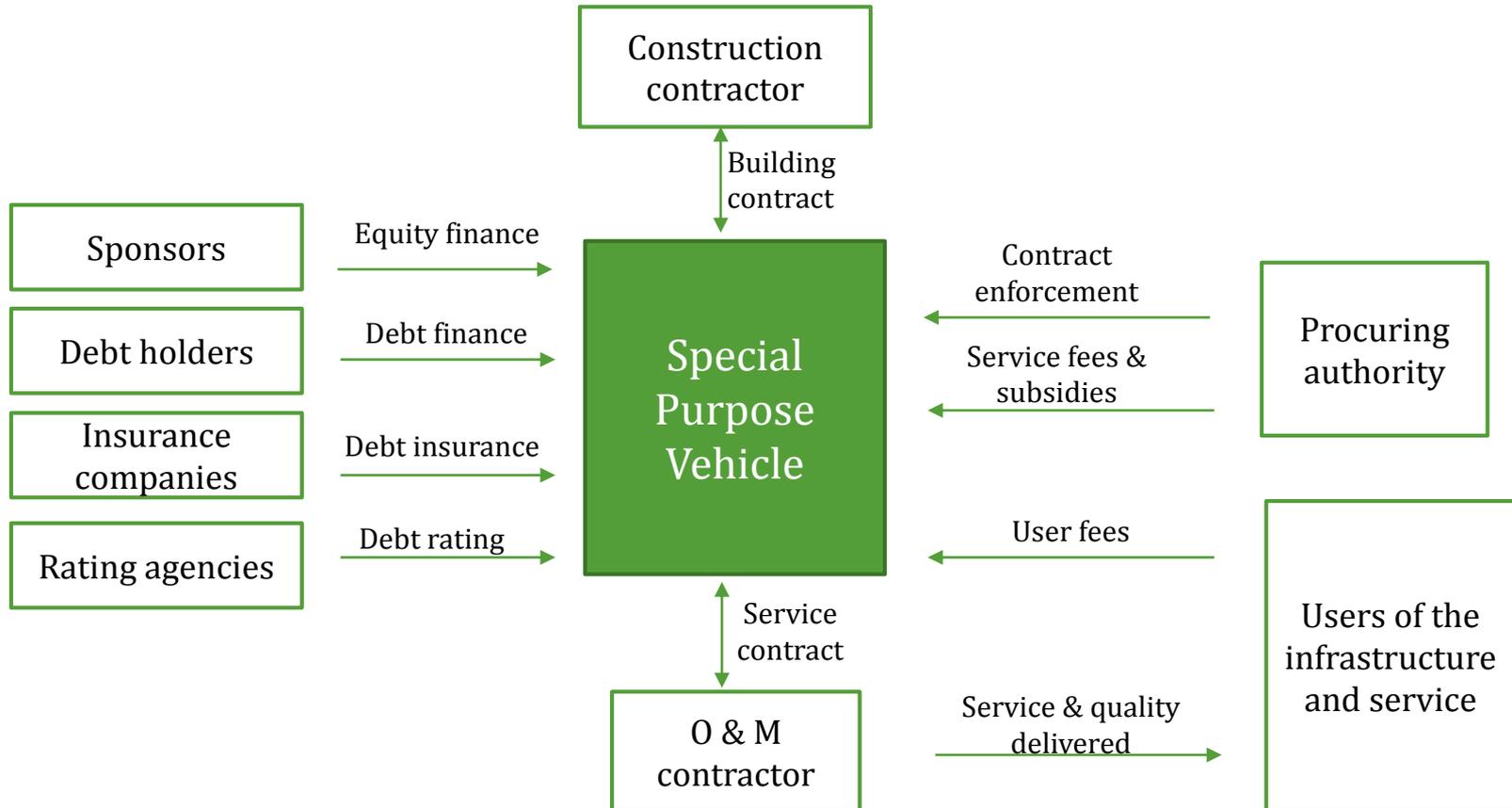
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- ❑ Infrastructure financing hinges on the techniques of project finance which entails two sets of contractual arrangements:
 - the creation of a legally and economically self-contained entity (SPV) against which all legal contracts are written; and
 - a set of contracts dictating the distribution of risks and returns
- ❑ The creation of a project SPV allows the contractual pledging of cash flows to creditors and the distribution of risks among the contract partners.
- ❑ Contractual arrangements can take many forms, from simple management contracts to part or full private ownership

The contractual design of projects to attract Finance contd.

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Web of contracts of an SPV



The contractual design of projects to attract Finance contd.

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Dominant Counterparty:
Public sector

Dominant Counterparty:
Private sector

Types of contractual structures

Operation & Maintenance services (O&M)	Concession (Public ownership of the facilities)	Concession (Private ownership of the facilities)	Full privatization
Management of public facilities by private parties	Rehabilitation of existing facilities, management and transfer	Design, build, own, management and transfer	Asset sales
Leasing agreements	Design, building, management and transfer (service agreements with the public administrator)	Merchant plants	Divestitures

Main risks and relative allocation among the involved parties

Construction: Public Investment: Public Commercial: Public Operation: Private	Construction: Private Rehabilitation: Private Commercial: Public/Private Operation: Private	Construction: Private Commercial: mainly private Operation: Private	Investment: Private Commercial: Public/Private Operation: Private
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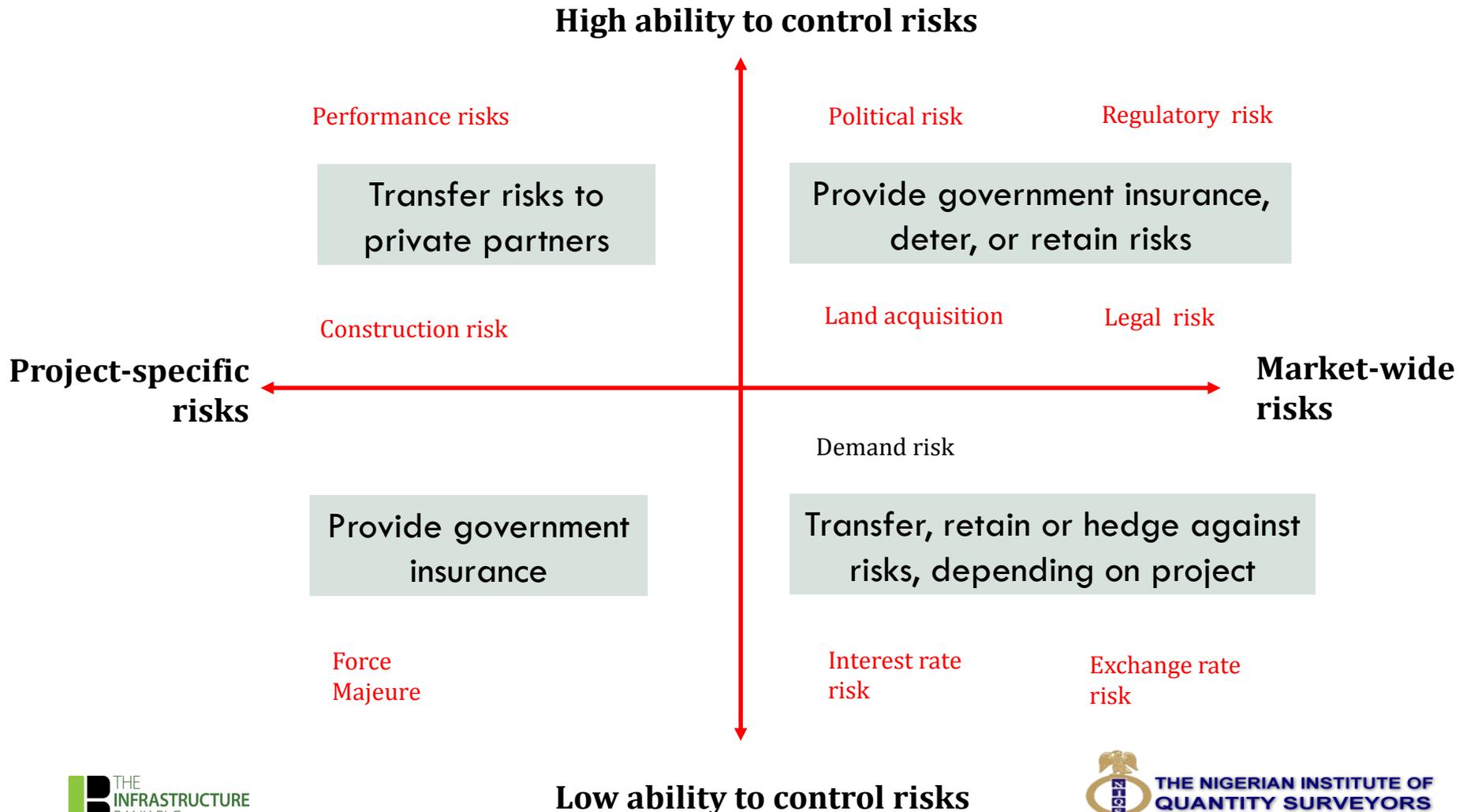
Low or relatively low
Predominantly public
Public

Risk incurred by private partners
Responsibility for financing
Project governance

High or very high
Private
Private

Optimal risk transfers in public private partnerships

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The potential for new financing instruments

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- ❑ The inherent challenges of infrastructure finance call for new types of financing instruments
- ❑ Infrastructure equity or debt investors face two simultaneous issues:
 - ❑ long-term commitments of financial resources to an investment which is typically not liquid, and
 - ❑ an inherent difficulty to price the associated long-term risks.
- ❑ Traditional financing instruments, such as direct equity stakes or bank loans, force investors to deal with these two problems at the same time.

The potential for new financing instruments contd.

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- ❑ Financial instruments can help to separate liquidity risks and the pricing of long-term risks.
- ❑ Bonds or infrastructure funds render infrastructure investments tradable, and therefore help to increase their liquidity
- ❑ Securitisation of infrastructure loans seems also desirable, as this can help banks to diversify their risks and alleviate large bulk risks of a single project which are difficult to quantify.
- ❑ In addition, the vast resources of capital market, which are currently hardly tapped by infrastructure projects, are much more accessible with a boarder mix of financial instruments.

The Infrastructure Bank PLC

Our Vision

To be the premier focal point for infrastructure development in Nigeria

-- by being the premier institution in the area of infrastructure development

-- by serving as a rallying point for all other stakeholders

Our Mission

To facilitate the transformation of Nigerian infrastructure for enhanced productivity

- by identifying and structuring infrastructure projects that will have a transformational effect at Local, State and National level*
- by modernizing Nigeria's infrastructure base for a more productive Nigeria*

Who We Are Today

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- ❑ Private sector leadership and discipline
- ❑ Internationally trained and experienced staff, skilled in infrastructure project finance structuring
- ❑ Sound risk management regime
- ❑ Robust corporate governance structure
- ❑ Strategic alliances with international financial and technical partners (DBSA, PwC, IDC, Aurecon, CANAC, Banco Efisa, ICF-GHK)
- ❑ Strong advisory services capabilities; in alliance with strategic partners, TIB is developing and preparing infrastructure projects in line with global best practices

Uniquely Positioned to Meet Needs

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- ❑ Unique position as an institutional PPP
- ❑ Licensed to tap and channel Local and Foreign Direct Investment for infrastructure development funding in Nigeria
- ❑ Significant market gap in satisfying Pension Funds' requirement for quality long-term debt products
- ❑ Huge latent infrastructure demand nationwide
- ❑ Dearth of suitable training and technical assistance programs locally

Public Private Partnership Structure

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Unique PPP shareholding structure

- ❑ Private sector shareholding: 69.0%
- ❑ **Total Public Interest Shareholding: 31.0%**
 - ❑ *Federal Government owns:* 10.3%
 - ❑ *Combined 36 State Governments:* 5.2%
 - ❑ *Combined 774 Local Governments:* 10.3%
 - ❑ *Total Government shareholding:* 25.8%
 - ❑ *Nigeria Labour Congress:* 5.2%
- ❑ Run along private sector lines with emphasis on corporate governance and a clear remit to make significant socio-economic and development impact

Process and Corporate Governance

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- ❑ Standard project/deal cycle
- ❑ Compliance with CBN regulations and BOFIA
- ❑ Compliance with SEC rules and regulations
- ❑ Board Committees with formal charters
- ❑ External auditors (KPMG)
- ❑ Adoption of IFRS in 2012
- ❑ Shareholder balance between profit motive and social, developmental and environmental remit

Focus Areas

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- ❑ **Transportation infrastructure** (road, rail, air and water)
- ❑ **Municipal Common Services** (Markets, roads, abattoirs, etc)
- ❑ **Power and Renewable Energy**
- ❑ **Mass housing and District Development**
- ❑ **Water and Sanitation**
- ❑ **Hospitality**
- ❑ **Social infrastructure** (education and health)

Track Record

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- ❑ US\$1 billion Rehabilitation and Reconstruction of 127km Lagos-Ibadan Expressway (Transaction Adviser – (TA)/Fund Arranger – (FA))
- ❑ US\$1 billion Renewable Energy and Efficient Energy Projects (REEEP) (Transaction Adviser/Fund Arranger)
- ❑ 50MW and 100MW solar power plants in Ondo and Jigawa States respectively – (Transaction Adviser/Fund Arranger)
- ❑ Nigerian Railways Rehabilitation and Revitalization Project (Advisory)
- ❑ Federal Roads Maintenance Agency (FERMA) Operation and Maintenance concession of 10 Federal roads (Advisory)
- ❑ Infrastructure Plaza: high-end mixed use real estate in Abuja (Transaction Advisory/Fund Arranger)
- ❑ Development of 20,000 Mass Housing units for Federal Paramilitary Forces (Catalytic Loan/Transaction Adviser/Fund Arranger)
- ❑ Osun State Oshogbo-Ila Odo Road (Development Loan / Arranging and Advisory)
- ❑ Ngurore International Cattle Market in Yola South LGA, Adamawa (Development Loan)
- ❑ Road Projects in Babcock University, Ogun State (Development Loan)
- ❑ ₦25bn Public Mass Transit Revolving Fund (Fund Management / Agency Management Agreement)
- ❑ Preferred Bidder on the Lagos Metro Rail Transit – Redline Project: a 37km rail line from Alagbado to Marina with a project capex of US\$2billion (Proprietary Investment / Transaction Advisory)

Conclusion

Conclusion

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- ❑ The supply of properly structured projects seems to be a major hurdle in channelling available finance into infrastructure and this requires substantial expertise.
- ❑ Governments, the concessionaire for many types of infrastructure projects, have a critical role in setting up investable projects.
- ❑ The promotion of private sector infrastructure finance hinges above all on a sensible transfer of risks and returns which not only provides financing but can lift efficiency
- ❑ As returns from projects are generated only over a long period of time, the focus needs to turn more to the operational aspects of infrastructure, rather than merely its construction.

Thank you