

A herd of elephants, including several adults and young calves, is walking across a dry, dusty landscape. The elephants are moving from left to right. The background shows a hazy, overcast sky and distant trees.

Infrastructure Investment Panel Discussion

September 2020

Contents

- Infrastructure return profile
- Proposed Infrastructure Fund
- Challenges to Infrastructure Investment
- Regulation 28



Infrastructure Investment return profile



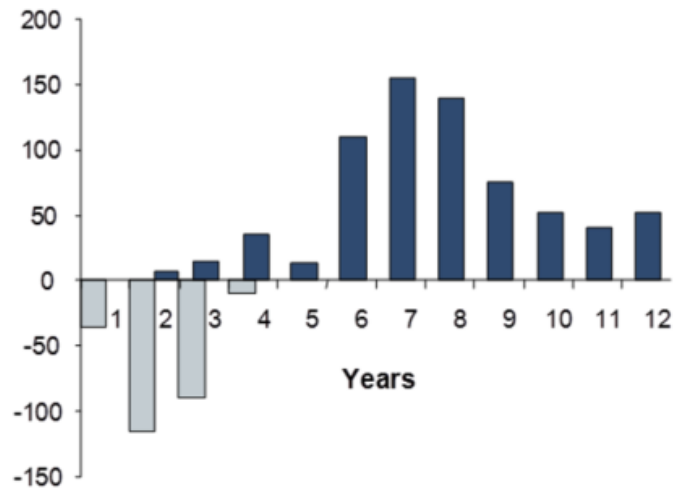
Nature of Infrastructure return profile



- Infrastructure investment can either be direct equity, mezzanine or debt financing and returns linked to the asset class profile.
- Typical deals are structured over the life of the project and the off-take agreement in place.
- Infrastructure Investment is a great tool for diversification of returns in a portfolio.
- Investment should be part of an asset allocation strategy and a building block for developmental impact investment mandates.
- Infrastructure assets are long term in nature and act as a natural asset/liability match for retirement funds.
- Fund term is typically longer than 10 years.
- Institutional investors gain diversified exposure to sectors such as power, healthcare, transport, education, SMME development and housing.
- Infrastructure assets have an illiquid trading nature due to their niche or developmental character.
- Returns are impacted by the deal structure, strength of guarantee, security and off-take agreement.
- Operating Infrastructure assets are significantly de-risked therefore are priced lower.
- Project and construction risk impact the return expectations.

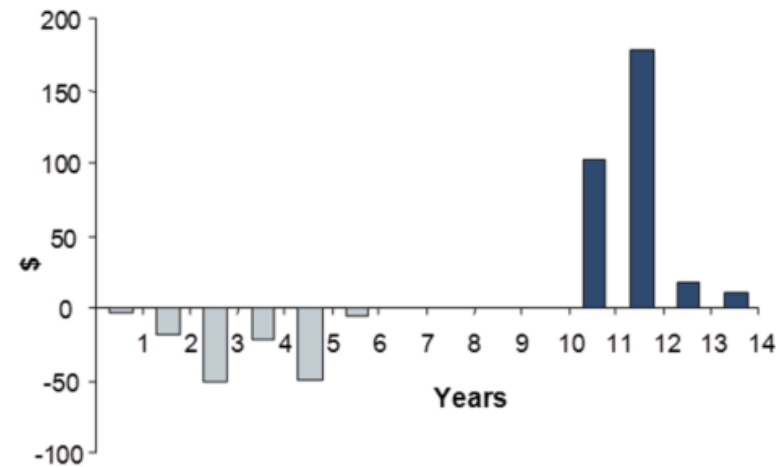
Cash flow profile - an example

Infrastructure Debt Fund Cash Flow



Capital Calls

Private Equity Fund Cash Flows



Returns to Investors

- Debt funding has a self-liquidating structure throughout the term of the project.
- Cash flows are linked to the amortizing payment profiles from the operating projects invested in.
- Cash flows received by the project are distributed back to the investors.

- The cashflow from the project is dependent on performance and high valuation exits.
- The cash flows received upon exit from the project is distributed to the investors at the end of the term of fund.

Fund Returns – Example of an Infrastructure Debt Fund



	1 year	3 years
Fund return	6,74%	8,61%
Benchmark (CPI+2.5%)	5,72%	6,02%
Alpha relative to Benchmark	1,02%	2,59%
Target return (CPI+4%)	6,22%	7,34%
Alpha relative to Target	0,52%	1,27%
Performance of other Asset Classes		
FTSE/JSE ALSI*	-10,78%	-0,81%
SA Listed Property*	-39,98%	-18,33%
ALBI*	2,90%	8,11%
CILI 15*	-2,88%	1,01%

Return data is annualised

**Source: Third Way/Bloomberg/Riscflash for period ended 30 Jun 2020*

Commentary of InfraFund



Key take away points from Infrastructure Fund presentation



- South Africa's current economic growth is unsustainable, and it has resulted in a rising unemployment and deep levels of inequality.
- Post 1994, South Africa economy was traditionally dependent on mining therefore it has had a negative effect on unemployment.
- Going forward, Government needs to focus on sectors such as Infrastructure and Agriculture to rebuild the economy.
- Efforts should be based on creating a robust pipeline therefore Infrastructure Fund has a project pipeline of 276 projects worth R2.3 trillion.
- Infrastructure projects needs to be funded outside the Fiscus given constraints.
- DBSA is overseeing the establishment of the Infrastructure Fund and it will be used to crowd private sector players.
- Details of the fund will be shared with private sector players for further input.
- Fund Managers and Banks will be involved in the design and structuring of the InfraFund.
- Projects in the Infrastructure Fund will be packaged as one of the following:
 - Debt Capital Markets with Projects Bonds;
 - CPI Linked debt/bonds;
 - Blended finance instruments.
- To improve pipeline, Government has identified the need to invest more in Project Preparation Investments to assist with design and produce quality projects.

Challenges to further Infrastructure Investment by Institutions in SA



Challenges to further Infrastructure Investment by Institutions in SA



- Lack of sufficient project preparation.
- Limited Project preparation funding.
- Inadequate deal structuring to suit institutional investors.
- Risk sharing model does not correlate with return expectations.
- Political uncertainty and lack of political will.
- Inability to use the successful REIPPP model in other areas for infrastructure Investment.
- Limited knowledge by Pension Fund trustees and some asset allocators
- Limited governance budget
- Limited liquidity of Infrastructure investments.

Regulation 28 and proposed amendments



Applicable Reg 28 Limits

Asset Class	Limit per instrument / issuer / entity	Limit for asset class
Hedge funds	2.5% - per hedge fund 5% - per fund of hedge funds	10%
Private equity	2.5% - per private equity fund 5% - per fund of private equity funds	10%
Unlisted property (shares or immovable property)	5% per entity	15%
Unlisted debt (issued by an unlisted entity)	5% per issuer	15%
Unlisted equity	2.5% per entity	10%

Reg 28 Overview



- South Africa Pension Funds registered with the Pension Funds Act, 1956 are required in across various asset classes, such as bonds, property, cash and international assets, to reduce risk.
- Regulation 28 of the Pension Funds Act regulates the limits across asset classes to protects its members.
- Regulation 28 is a safekeeping mechanism against risky investments and can be a tool to provide protection against the downside of the market and smoothen out lines of volatility to return and provide diversification.
- The Listed Equity market experienced downward movements arising from COVID-19 which may result in asset class breaches.
- Regulation 28 facilitates diversification through its limitations in terms of geographical areas, asset classes and instruments.
- Regulation 28 has similar characteristics with exchange control regime, which aims to control the outflow of capital from the country.
- Regulation 28 can be a constraint on institutional investors in optimising their portfolios.
- Regulation 28 is an example of quantitative asset restrictions, and it limits the extent to which retirement funds may invest in particular assets or specific asset classes.
- The primary goal is to protect the members' retirement provision from the effects of poorly diversified investment portfolios.
- This is done by limiting the maximum exposure to asset classes perceived to be riskier, ensuring that no unnecessary risks are taken with retirement money.

Thank you!

LEAD THE WAY.



Get in touch with us:

+27 (0) 11-684-1192 / info@thirdway.co.za

1st Floor, 11 Crescent Drive, Melrose Arch, Johannesburg, 2076.



Mechanics of the InfraFund

