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Unleashing the Potential of Institutional Investors in Africa

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1. Introduction

It has been estimated that financing the UN Sustainable Development Goals (SDGs) globally will require annual investment levels of USD 3-4 trillion, while in Africa associated investment needs are estimated at about USD 600-700 billion a year². Given the enormity of the financing needs, during the Third International Conference on Financing for Development in Addis Ababa in July 2015, the global community tasked the multilateral development banks (MDBs) to significantly scale up their activities and leverage financial resources by moving from “billions to trillions”. As is the case globally, the achievement of the SDGs in Africa will require a new approach to financing development, and in particular an approach that significantly increases access to long-term private finance on the continent.

Infrastructure development - energy, transport, communication and water supply - is the largest component of the SDGs and a key driver of economic growth, contributing significantly to increased productivity, poverty reduction and human development³. Poor infrastructure inhibits the private sector, including global institutional investors⁴, from successfully entering African markets⁵. The African Development Bank’s Africa Economic Outlook 2018 estimates that to keep up with the pace of growing populations and rapid urbanization and maintain economic growth, about USD 130-170 billion would need to be invested annually into African infrastructure up to 2025⁶.

The MDBs currently have private capital mobilization ratios of less than 1:1 (private to public) across their portfolios: private sector-related activities account for only about 30% of MDB activities⁷. This ratio needs to increase significantly and would need to more than double over the next decade to get anywhere close to current financing needs⁸. In this context, MDBs, including the AfDB, must scale up their efforts to leverage financial resources from the private sector and to help the continent meet its development needs. The overall resourcing needs

² UNCTAD (2016).

³ UNCTAD (2016).

⁴ There is no single definition of an “institutional investor”. This broad category can include investment funds, insurance companies and pension funds, sovereign wealth funds, private equity funds, hedge funds, and exchange traded funds. The category can be expanded to also include mutual funds, money managers, investment banks, commercial trusts, and endowment funds. Institutional investors in this paper are defined as global and national pension funds, sovereign wealth funds, and insurance companies.

⁵ A recent World Bank study found that the poor state of infrastructure in many parts of Africa reduced national economic growth by 2 percentage points every year and cuts business productivity by as much as 40%.

⁶ African Development Bank (2018).

⁷ For AfDB, private sector operations are about 25% of the total portfolio.

⁸ Blended Finance Task Force (2018).

across the AfDB's priority areas (the High 5s) over 2016-2025 are estimated at over USD 1 trillion. In total the AfDB has committed to mobilize over USD 269 billion during the same period⁹. In order to finance this ambitious agenda, a greatly enhanced role for institutional investors will be critical.

Institutional investors such as pension funds, sovereign wealth funds (SWFs), and insurance companies hold the necessary resources to enable the MDBs to scale up from "billions to trillions" at a global level. Institutional investors, together with commercial banks, collectively have about USD 120 trillion¹⁰ in assets-under-management (AUM), which are expected to grow 5% annually until 2020¹¹. Only about 0.1% of the global assets and 12% African institutional investors' assets would be needed to bridge the continent's annual USD 107 billion infrastructure gap¹². The role of MDBs is particularly critical both in terms of mobilizing domestic capital and crowding in private investment. There is a clear opportunity for the MDBs to play a catalytic role by tapping into institutional investors' resources to support infrastructure development on the continent by using innovative investment vehicles.

AfDB's recent initiative Africa Investment Forum (AIF), organized for the first time in November 2018 in Johannesburg, South Africa, brought together global investors, pension funds, sovereign wealth funds, and other institutional investors to invest in Africa through investment marketplace approach. The main goal of the Forum is to catalyze investments into the continent through a unique marketplace platform designed to advance projects to bankable stages, raise capital, and accelerate the financial closure of deals. The Forum is seeking to help reduce intermediation costs, improve the quality of project information and documentation, and increase active and productive engagements between African governments and the private sector.

2. Infrastructure Investment in Africa

Infrastructure investment on the continent over the past five years has averaged about USD 75 billion a year. According to Infrastructure Consortium for Africa (ICA 2016), the major sources of financing are the MDBs and the bilateral donors in forms of overseas development assistance

⁹ AfDB's own estimates; its commitment is US\$164 bn (resource mobilization between 2016 and 2025). Of this amount, the AfDB will finance from its own balance sheet USD 106 bn. In terms of additional resources, USD 90 bn is expected to be mobilized from the private sector and USD 75 bn in form of co-financing from other public sector entities.

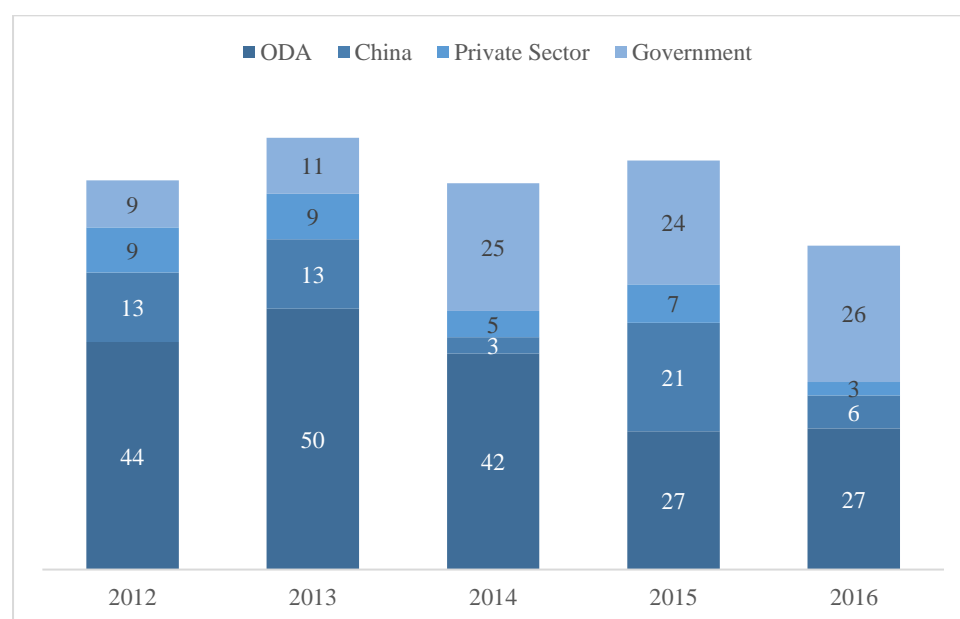
¹⁰ Maurer (2017).

¹¹ PwC (2016).

¹² Author's own calculation

(ODA) (44%), followed by African governments (42%), Chinese investment (10%), and the private sector (4%) (Figure 1).¹³ Overall spending on Africa's infrastructure, from all reported sources, declined from USD 83 billion in 2015 to USD 62.5 billion in 2016 - of which USD 26.3 billion was from budget allocations of African governments and USD 36.2 billion from external finance. Commitments to infrastructure investment fell 21% in 2016, largely due to declines in Chinese and private sector financing.

Figure 1: Infrastructure Investment Commitments in Africa, by Source, 2012-16 (USD billions)



Source: Infrastructure Consortium for Africa (ICA) Reports 2012-2016.

African infrastructure gap. According to recent estimates by AfDB (2018), Africa requires investment of about USD 130-170 billion a year in infrastructure, given the rapid growth in population and urbanization in the continent. About 40% of this amount is required for the energy sector alone. Africa would need to spend 4.6% of its GDP on infrastructure each year until 2025 to bridge this gap.¹⁴

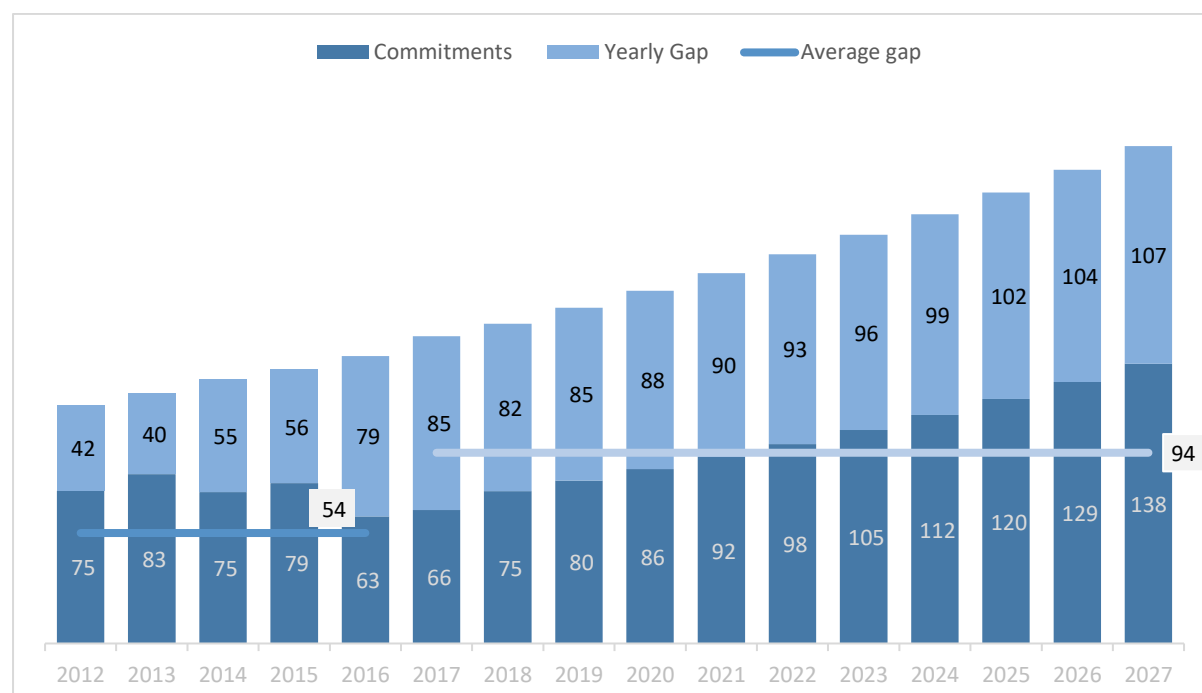
The USD 75 billion currently invested yearly is therefore insufficient. There is still an estimated infrastructure funding gap of about USD 67.6-107.5 billion (average USD 94 billion a year over 2017-2027), which is expected to widen over the medium term primarily due to

¹³ The investments made by the private sector are mainly in the energy sector (97%) (WBG/PPIAF's Private Participation in Infrastructure Database).

¹⁴ McKinsey Global Institute (2017).

increased demand, limited domestic revenues, and global economic headwinds, particularly China's slowdown and the reduction in earnings associated with the decline in the prices of several key commodity exports (Figure 2) .¹⁵ Given the constrained resources within the development community as well as low domestic resource mobilization across the continent, bridging this gap presents a significant opportunity for the private sector, especially institutional investors.

Figure 2: Infrastructure Commitments and Gap, 2012-2027 (USD billions)



Source: Authors' analysis based on Infrastructure Consortium for Africa (2016).

Note: Data for 2012-2016 commitments come from ICA (various annual reports); 2017 commitments value is an average; a growth rate of 7% is applied for time period 2018-2027; and a log-linear model is considered for 2018-2027.

3. Institutional Investors Landscape

3.1. Global institutional investors

Institutional investors play a key role in the global economy. Despite the financial crisis and falling commodity prices, global institutional investors have experienced strong growth and have been rapidly accumulating assets-under-management during the past two to three decades,

¹⁵ AfDB (2018).

estimated at USD 84.6 trillion in 2017 (Table 1). The investable assets are projected to increase to over USD 100 trillion by 2020, an annual increase of about 5%.¹⁶

Table 1: Growth of Global Institutional Investors (USD trillion)

Type of investor	2017	2020
Pension funds	47.0	57
Insurance companies	30.4	35
Sovereign wealth funds	7.2	9
Total	84.6	101

Source: PwC (2014): Asset Management 2020: A Brave New World, and author's calculations

Global pension funds serve as a channel to mobilize the savings of millions of people, converting savings into post-retirement income, with total assets equal to about 62% of the combined 2016 GDP of the countries they operate in. The largest pension funds are in North America, followed by Europe and the Asia-Pacific region. The largest reserve is held by the US Social Security Trust Fund at USD 2.8 trillion, followed by Japan's Government Pension Investment Fund (GPIF) at USD 1.1 trillion. As of 2016, global pension funds had allocated their assets by investing about 46% in equities, 28% in bonds, 24% in other investments, and held 3% in cash (Willis Towers Watson 2017). The asset allocation of pension funds is influenced by a variety of factors, including market trends, investment strategy, regulation, risk appetite, liability considerations, governance structures, tax issues and domestically available assets to invest in.

Sovereign wealth funds (SWFs) have emerged as a potential solution for countries to manage foreign reserves accumulated from commodity sales or from strong export growth. Currently, there are more than 122 operating or prospective SWFs world-wide. The sovereign investor landscape is highly concentrated, with 15 of the largest funds managing more than 70% of the sovereign assets in the world, mainly outside the OECD countries, primarily in Asia and the Middle East. SWF assets are expected to grow from USD 5 trillion to USD 9 trillion between 2012 and 2022, owing to rapid accumulation of foreign assets by many SWFs, particularly by oil-exporting countries, financial globalization, and sustained large global imbalances (PwC 2014).

¹⁶ PwC (2016).

Insurance companies play an important role as bearers of risk and are a vital source of investments in promoting countries' GDP growth. In absolute terms, insurers conduct the lion's share of their business in the world's largest industrialized regions. Global insurance companies are expected to increase their assets-under-management from USD 31 to 35 trillion¹⁷ between 2017 and 2020, for an annual increase of 4.4%. This estimated growth is directly linked to the policy and regulatory changes taking place in the insurance industry.

3.2. African institutional investors

Within Africa, the assets-under-management of domestic institutional investors are expected to rise to USD 1.8 trillion by 2020 from USD 1.2 trillion in 2017 (Table 2).

Table 2: African Institutional Investors, (projection to 2020; USD billion)

Type of investor	2017	2020
Pension funds	676	1100
Insurance companies	329	445
Sovereign wealth funds	243	300
Total	1248	1845

Source: PwC (2014), Okpamen (2015), and AfDB's own analysis

African pension funds have been expanding in several countries across the continent, offering a viable option for long-term financing opportunities. PwC (2015) estimates that pension funds' assets-under-management in 12 African markets will rise to about USD 1.1 trillion by 2020, from USD 676 billion in 2017. Economic growth, the rise of the continent's middle class the deepening in financial markets, and regulatory changes that are bringing more people into the social security net have contributed to the expansion of pension funds across the continent. Between 2010 and 2015, Africa's population grew by 2.6% a year and more than half the global population growth until 2050 is expected to occur in the continent. Also, the African middle class is projected to continue to grow and reach 1.1 billion by 2060, corresponding to 42% of the continent's population. So far only 5-10% of the population in sub-Saharan Africa is estimated to be covered by pension schemes (with the exception of South Africa), whereas the corresponding number for North Africa is about 80%.

¹⁷ PwC (2016) and author's calculations

Based on asset size as a percentage of GDP, the top three pension funds on the continent are in South Africa (87.1%), Namibia (76.6%) and Botswana (47.3%).¹⁸ Currently South Africa holds about USD 207 billion¹⁹ in assets – but strong growth is coming from other parts of the continent. In Nigeria, where regulatory changes were implemented in 2006, pension funds have managed to accumulate over USD 20.2 billion in assets, and Ghana’s pension fund resources reached USD 1.6 billion in 2016.²⁰ In terms of investment, pension funds in Africa have historically invested heavily in domestic debt. Countries such as Tanzania, Uganda and Nigeria have a stronger focus on investing in fixed income assets, mostly government bonds, whereas some southern African countries such as South Africa, Botswana, Namibia and Swaziland have a higher allocation of funds in equity investments.

African SWFs have grown in recent years as a result of significant revenue increases from commodities, notably in oil-exporting countries such as Libya, Nigeria, and Angola. African SWFs managed USD 154 billion in assets in 2016, representing 2.1% of the global SWF industry, and their number has risen from 15 in 2011 to 21 in 2016.²¹ About 83% of African SWF assets are derived from oil revenues and 17% from mineral and other non-commodity sources. According to IE-SWFLab 2015 data, the Libyan Investment Authority (LIA), is the largest SWF in Africa with assets of over USD 67 billion, followed by the Algerian Revenue Regulation Fund (RRF).²² In sub-Saharan Africa, Botswana’s Pula Fund (see Annex 1) and the Ghana Petroleum Fund are two examples of well governed funds with a successful investment track record. Both funds try to combine the twin goals of preserving future income and investing in the local economy. Some other examples of expanding SWFs in the region are the Nigerian Sovereign Investment Authority (NSIA) and the Angolan Sovereign Wealth Fund (FSDEA).

African insurance companies are closely linked to economic growth in the region. Whereas Africa represents 15% of the world population, it accounts for only 1.6% of the global insurance market. Compared with the OECD average of 10%, insurance companies have a low average penetration rate of about 3.5% of GDP. With a volume of USD 46 billion (72%), South Africa is the largest insurance market in Africa and contributes an average per capita premium of over USD 1,000. Other major markets include Egypt, Morocco, Kenya, and Nigeria,

¹⁸ Sy (2017).

¹⁹ Willis Tower Watson (2017).

²⁰ Organization for Economic Cooperation and Development (OECD) (2016).

²¹ Sovereign Wealth Lab (2016).

²² Sovereign Wealth Center, fund profiles: <http://www.sovereignwealthcenter.com/fund-profiles.html>.

accounting for 85% of total premiums.²³ The average premium per capita for Africa is over USD 65, small compared with the world average of about USD 640 and the top 10 countries' average premium of over USD 3,800. The continent's insurance industry continues to expand despite the recent economic downturn. Global insurance companies have recently amplified their investments Africa, covering different insurance lines.

4. Institutional Investors' Asset Allocation Models

While institutional investors, both global and African, share common investment goals such as capital maximization, economic development, and stabilization, they tend to have different investment requirements, guidelines, and liability profiles, and hence utilize different investment strategies²⁴. In general, institutional investors traditionally target fixed-income securities and government bonds. Following the financial crisis in 2008 and the low interest environment, institutional investors have been adapting their investment strategies towards higher returns by diversifying their asset allocation into alternative asset classes and expanding into new geographic regions. While SWFs have traditionally invested more in equity and fixed-income instruments, pension funds have been relying more on debt investments. Insurance companies apply a mix of different investment strategies.

Three models largely define the approach taken by institutional investors (Table 3)²⁵:

- First, the Norwegian model, based on the strategy of the Norwegian Sovereign Wealth Fund (NBIM), which invests primarily in traditional public market assets such as equities or fixed -income.
- Second, the Yale or endowment model, which is strongly equity- and return-driven and based on adding risk to the portfolio by investing directly in private asset classes. This model is applied, for example, by Singapore's GIC, Temasek and the Qatar Investment Authority (QIA).
- Third, the Canadian model, which is characterized by largely insourced (direct) investment, with a higher allocation than most to private market alternative asset classes.

²³ African Insurance Organisation (2017).

²⁴ PwC (2016).

²⁵ Hudson (2015).

Table 3: Institutional Investors' Investment Models

Category	Norwegian Model	Yale or Endowment Model	Canadian Model
Strategy	Bases its investment strategy primarily in traditional public market assets – whether that be equities or fixed income	Bases its strategy on concentrating its investments in illiquid assets such as property, infrastructure and private equity	Leans more towards absolute return strategies and is more often managed in-house, with a well-diversified portfolio
Team	Uses an in-house team with a small allocation of assets to external managers	Uses in-house expertise for the selection of an asset class/strategy, with external managers then taking on most of the responsibility for the investments	Large number of investment staff and strong internal investment capabilities
Investor type	Passive investor (indirect investment)	Active investor (direct investment)	Active investor (direct investment)
Markets	Investments in developed markets with relatively minor exposure in emerging markets	Balanced exposure to both developed and emerging markets	Due to large size of AUM, more exposure to developed markets, but increasing asset allocation to emerging markets
Risk profile	Low-risk investments	Higher-risk investments	Higher-risk investments
Risk return / cost	Low	High	High
Asset quality	Liquid	Less liquid	Less liquid
Exposure (% of portfolio)	Small exposure in individual investments	Greater exposure in small number of investment opportunities	Relatively greater exposure per investment based on the size of the investment
Asset class	Public equities and fixed income	Real estate, private equity, absolute return strategies and commodities	Strong foundation in alternative investments and direct investments; absolute return oriented
Operational strategy	Limited operational autonomy and board dependence; low degree of delegation and limited investment flexibility	Operational autonomy and board independence; high degree of delegation and investment management flexibility	Operational autonomy and board independence; high degree of delegation and investment management flexibility
Examples of funds	Norwegian Pension Fund	Future Fund of Australia, Qatar Fund, Temasek	Canadian Pension Funds

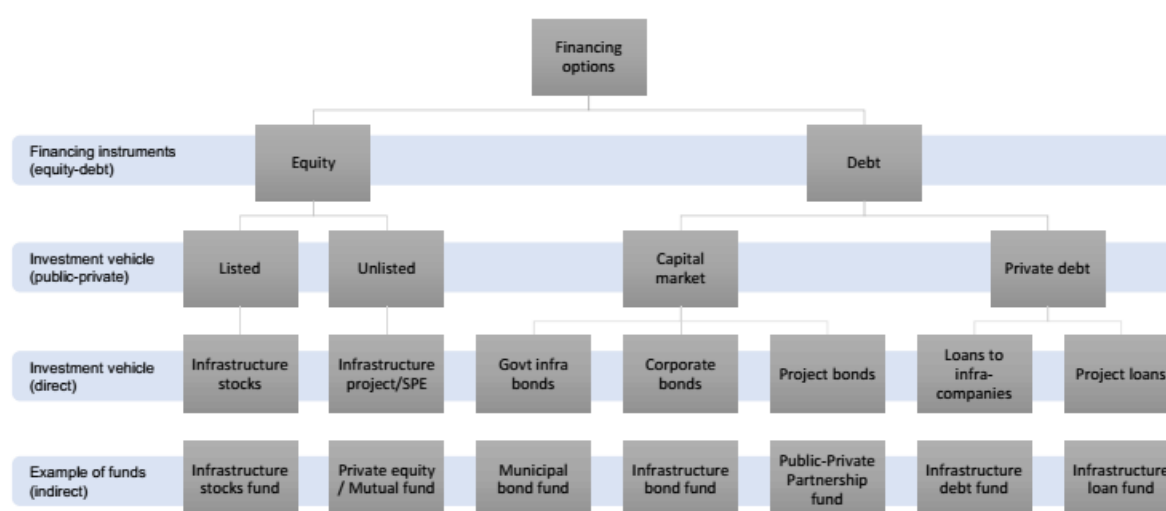
Source: AfDB analysis based on Hudson (2015).

5. Institutional Investors' Investment in Africa

In recent years, there has been growing interest from institutional investors in the infrastructure sector largely thanks to the persistent low-interest-rate and low-yield environment globally, which has led investors to pursue diversification and return-enhancing strategies by taking on additional risk in alternative assets, including in emerging markets. Consequently, overall asset allocation by institutional investors in infrastructure increased from 4.9% in 2011 to 5.7% in 2014.²⁶

Infrastructure investments are packaged in different ways to facilitate institutional investors' involvement. The investments can take various forms like equity or debt, and they can be channeled through different types of investment vehicles (for example, publicly listed or private/unlisted), depending upon the financial structure of the project and investors' requirements. In practice, institutional investors approach infrastructure investment universe in two main forms: direct investment or indirect investment (Figure 3).

Figure 3: Infrastructure Financing and Investment Options



Source: World Bank (2007)

In terms of direct investment approaches, institutional investors can act as single investors (i.e., by private holding of an infrastructure company), or combine efforts with other investors—institutional, asset management firms, or commercial banks—to achieve greater

²⁶ Preqin (2015).

scale. On the fixed-income side, instruments such as project bonds through private placement can be issued by a consortium running an infrastructure project, or an institution can make a direct loan to an infrastructure project.

There is a range of different institutional arrangements for the indirect route—for example, a commercial fund or a fund provided by government institutions. They may form a trust-type structure with their counterparties, or they can jointly set up an infrastructure fund through which they collectively gain exposure to several projects, thereby diversifying their risk. Likewise, a government or development bank may be a lead investor, working in partnership with other institutions, or it can set up a fund that it runs for institutional investors to invest in.

Recently, the bond market in Africa has been growing and increasing numbers of institutional investors have been expressing interest in infrastructure investment through bonds. Between 2007 and 2017, at least a dozen sub-Saharan African countries, including Angola, Côte d'Ivoire, Ethiopia, Kenya, Namibia, Nigeria, Rwanda, Senegal, Tanzania, and Zambia, issued sovereign bonds, raising commercial debt in excess of USD 35 billion for infrastructure projects and other expenditures (Table 4). Global investors are also actively investing in African infrastructure through specialized “infrastructure funds” in indirect form, like Africa50 and Nigeria Infrastructure Fund, with a target size up to USD 3 billion per fund (Table 5).

Table 4: Bonds Raised by African Governments

Country	Bond amount (US\$ mn)	Details
Ghana	6,500	2007-2017 for infrastructure investment and debt repayment
Côte d'Ivoire	3,595	2010-2015 for debt restructuring and development projects
Gabon	3,000	2007-2015 for infrastructure projects
Zambia	3,000	2012-2015 for infrastructure projects
Senegal	2,668	2011-2017 for infrastructure projects
Angola	2,500	2012-2015 for economic development
Nigeria	2,500	2011-2013 for infrastructure projects
Kenya	2,291	2014-2017 for debt repayment and infrastructure investment
Mozambique	1,577	2013-2016 debt repayment and infrastructure investment
Namibia	1,250	2011-2015 international reserve buffer
Ethiopia	1,000	2014 for infrastructure projects

Source: AfDB internal analysis.

Table 5: Top Africa-Focused Infrastructure Funds Backed by Global Institutional Investors (indirect investment)

Fund	Vintage	Target Size (USD mn)	Main Geographic Focus
Nigeria Infrastructure Fund	2018	2,000	Africa
Actis Energy Infrastructure Fund IV	2017	2,000	Diversified Multi-Regional
AP Møller Africa Infrastructure Fund I	2017	1,000	Africa
Climate Investor One	2017	1,030	Diversified Multi-Regional
Africa50	2015	3,000	Africa
Pan African Infrastructure Development Fund II	2015	1,000	Africa
Actis Energy Infrastructure Fund II	2008	1,000	Diversified multiregional
Abraaj Infrastructure and Growth Capital Fund	2007	2,000	Africa & Middle East
Pan African Infrastructure Development Fund	2007	1,000	Africa

Source: Preqin's online database (2018).

Global pension funds presently hold about 3.4% of their assets-under-management in the infrastructure sector worldwide and are targeting to increase this allocation to 4.5% by 2018, amounting to about USD 340 billion in capital.²⁷ Canadian pension funds have the most aggressive investment plans in this regard, with intention to increase their share in direct investment in the infrastructure sector up to 20% within the next few years. Canadian pension fund invest about 4.5% of assets-under-management in infrastructure across the globe. For instance, Canada's Ontario Municipal Employees Retirement System's (OMERS) allocations in unlisted infrastructure amounted to 17% as of end-2016, with a target allocation of 21.5%. In addition, the Canadian Pension Plan Investment Board (CPPIB), Ontario Teachers' Pension Plan (OTPP), and Quebec Pension Plan infrastructure asset allocations were 5.5%, 8.4%, and 4%, respectively.

In Australia, average pension funds allocation to infrastructure has risen from 2% of assets-under-management in the 1990s to 5% in 2013, and infrastructure funds are the dominant vehicle for pension fund exposure to infrastructure, given the lack of depth and liquidity of Australia's corporate bond markets. From the African pension funds, the South African Government Employees Pensions Fund (GEPF) invested 1.2% (about USD 3.8 billion)

²⁷ Preqin (2017).

of total assets in infrastructure including in the road network and the power sector. Other African pension funds have invested about USD 680 million in the infrastructure sector.²⁸

Other examples of funds planning to increase their target allocation to infrastructure include CalPERS (US), which is planning to increase its asset allocation from 0.4% to 2.3% by 2018 and the Australia Future Fund, whose allocation to infrastructure increased to 7.6% in 2017.²⁹

Similar developments can be observed in the insurance industry. In terms of infrastructure investment, insurance investors like Allianz, Axa, and Prudential plan to increase their investment from 3.2% to 4.6% over the medium term, which translates into about an additional USD 350 billion for infrastructure investment globally.³⁰

Institutional investors' appetite for investments in African infrastructure has been limited for a variety of reasons. However, in recent years, some African pension funds have raised their asset allocation in infrastructure and other alternative asset classes. For instance, the South African GEPIF, the largest African pension fund³¹, in partnership with local asset managers, is investing up to 25% in illiquid assets such as road networks, power, affordable housing, and health. The Nigeria Sovereign Investment Authority (NSIA) allocates about 40% of its assets to domestic projects, giving priority to sectors such as power, highways, and farming. In August 2016, NSIA teamed up with Old Mutual, an insurance group, to launch a USD 500 million property-related vehicle. In January 2017, the Angolan Sovereign Wealth Fund FSDEA announced USD 180 million investment in a deep-sea port.

Recently, A.P. Moller, a privately held investment company with approximately USD 20 billion under management, raised USD 550 million for an Africa Infrastructure Fund, targeting a total investment of USD 1 billion (Table 6). The fund has received commitments from large Danish pension fund anchor investors, including PKA, PensionDanmark, and Lægernes Pension.

These examples demonstrate the key role that institutional investors can play in supporting the continent's development. As an alternative to investing in domestic debt, local institutional investors can play an instrumental role in bridging the aforementioned African infrastructure-financing gap.

²⁸ Sy (2017).

²⁹ CalPERS website and Future Fund news update (2017).

³⁰ Preqin (2017).

³¹ Ballantine (2015).

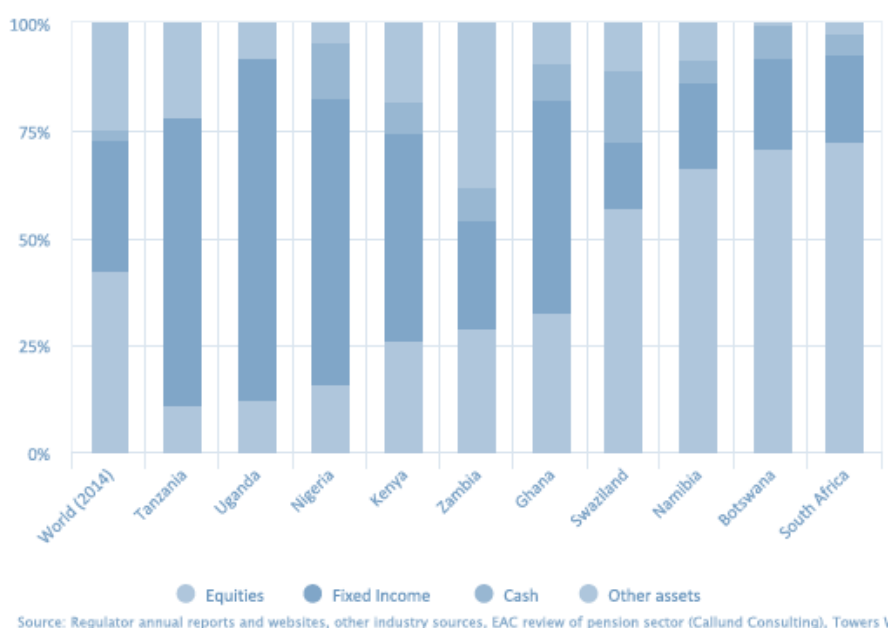
Table 6: Selected SWF Investments in Africa

Fund	Vintage	Target Size (mn)	Main Geographic Focus
Nigeria Infrastructure Fund	2018	2,000	Africa
Actis Energy Infrastructure Fund IV	2017	2,000	Diversified multiregional
AP Møller Africa Infrastructure Fund I	2017	1,000	Africa
Climate Investor One	2017	1,030	Diversified multiregional
Africa50	2015	3,000	Africa
Pan African Infrastructure Development Fund II	2015	1,000	Africa
Actis Energy Infrastructure Fund II	2008	1,000	Diversified Multi-Regional
Abraaj Infrastructure and Growth Capital Fund	2007	2,000	Africa & Middle East
Pan African Infrastructure Development Fund	2007	1,000	Africa

Source: Author's data compilation from various sources

In most OECD countries and many non-OECD countries, bonds and equities remain the two predominant asset classes for pension funds. While globally there is a larger allocation to equities (42.3%), the picture in Africa is more disparate. Broad asset allocation in sub-Saharan Africa has favored equities that have shown a steady increase alongside the development of capital markets and regulatory change. In Nigeria and East Africa, asset allocation is dominated by fixed-income allocations, which predominantly constitute local bonds. When viewed with the high asset growth in these regions, this reflects the constraints of regulation as well as local investment opportunities. This typifies one of the largest challenges that the pension funds face: identifying appropriate local investment and development opportunities at the same pace as asset growth.

Figure 4: African Pension Funds Asset Allocation



Source: Regulator annual reports and websites, EAC review of pension sector (Callund Consulting), Willis Towers Watson (2015), and analysis of RisCura data (<http://www.riscura.com/brightafrica/africas-institutional-investors/asset-allocation/>).

6. Challenges in Attracting Institutional Investors to African Infrastructure

The Bank's Strategy and Operational Policies department conducted phone interviews during August-November 2017 with 13 institutional investors (7 global and 6 African) and 15 industry experts.³²

The discussions focused on mapping out the institutional and operational challenges and risks related to investing in Africa, potential approaches for collaboration with MDBs, and examples of on-going MDB collaboration that institutional investors felt could be replicated and scaled up. Institutional investors indicated that they face significant challenges in assessing

³² An initial shortlist of potential investors to be contacted was put together based the nature of their business (pension fund, sovereign wealth fund, insurance company, asset manager), size of the assets-under-management, geographical location, and potential interest in investing in Africa. The industry experts interviewed were selected based on their familiarity with the topic, that is, number academic publications published. Phone interviews were scheduled based on the interest and availability of the interviewees. Among the seven global investors interviewed were two insurance companies, two SWFs, one pension fund, and two asset managers, of which six are located in OECD countries and one in an emerging economy country. Of the six regional interviewees three were pension funds, one SWF, one insurance company, and one asset manager. Five of the regional interviewees are located in the sub-Saharan Africa. All of the interviewed investors have already made investments in Africa and most of them have invested or are considering making investments in the African infrastructure. The investors' risk appetite varied from a relatively conservative investment strategy (only investing in government papers) to a more risk-averse strategy, particularly in the case of the asset managers.

and mitigating risks related to their investments. These are associated with numerous factors at the project level, such as the small size of projects, high development and transaction costs, and lack of appropriate financing vehicles and instruments. At the country level, the challenges are largely related to insufficient information available about investment opportunities and lack of transparency coupled with legal, governance, and monitoring bottlenecks. These challenges hinder institutional investors from entering the African market. Four broad categories of risks identified by institutional investors included: i) political and regulatory risk; ii) market and credit risk; iii) technical and commercial risks; and iv) factors related to the enabling environment.

6.1. Political and regulatory risk

Political and regulatory risks arise from governmental actions, including changes in policies or regulations that adversely affect infrastructure investments. Such changes may be broad in nature (like convertibility of currency risk) or they may be linked to specific industries or public-private partnership (PPP) deals. In some cases, risks may emerge also from the behavior of government contracting authorities. Political risks can be highly subjective and difficult to quantify, and therefore challenging to price into infrastructure finance.

Interviewed investors indicated that political and regulatory risks are the most challenging ones to mitigate due to their volatile and uncertain nature. This is because such risks are associated mainly with weak regulatory systems and legal enforcement capacity in countries, excessive and slow bureaucracy, lack of transparency and accountability, lack of institutional capacity for project preparation, and lack of finance. Many institutional investors consider Africa to be a “frontier market,” with high country and political risks, in which investors lack expertise.

In many cases, regulatory requirements in the investor’s country of origin restrict their decisions on how funds can be invested in terms of sectors, percentage of shares, and geographical scope. Many countries have quantitative and qualitative restrictions for the investment of funds in private, alternative, illiquid, project, and fund investments.³³ Also, global regulatory frameworks such as Basel III and Solvency II discourage investors in terms

³³ Only nine OECD countries impose no ceiling on pension fund investment: Australia, Belgium, Canada, Ireland, the Netherlands, New Zealand, the United Kingdom, and the United States.

³³ Other rules can constrain restrictions on unlisted or non-transparent investments, foreign exposure, lower credit ratings, and the use of derivatives.

of the use of their capital. For example, the Norwegian Pension Fund (NBIM) has made some investments in Africa but it can only invest in international equities, fixed income, and real estate; unlisted investments or direct investments are not allowed within the national regulation. The fund's fixed-income investments are allocated 70% to government bonds and 30% to securities issued by the corporate sector.

Nonetheless, regulatory reforms implemented in recent years are slowly making it possible for both global and African institutional investors to participate in alternative asset classes by increasing the allocation thresholds, including infrastructure.

6.2. Market and credit risk

Market risks arise from the fact that the overall market environment is subject to volatility. Such volatility can be caused by macroeconomic factors such as inflation, changes in real interest rates, and exchange rate fluctuations (currency risk). Exchange rate fluctuation is a major source of concern for global institutional investors, since it depends not only on political decision-making, but also on other macroeconomic developments that are beyond the control of the government. Currency transfer and convertibility risks arise because there is generally limited liquidity available in the market, and governments often impose restrictions on the transfer of funds to non-resident creditors.

In an effort to overcome or substantially mitigate counterparty credit risk, structuring infrastructure projects is challenging. Global investors mentioned during discussions that while every country and project in Africa is unique, mitigating counterparty credit risk or perceived credit risk is typically the single most challenging aspect of project development and delivery.

6.3. Technical and commercial risks

Technical aspects such as the investors' risk appetite, return expectations, and deal size are essential factors to be considered when structuring an infrastructure project or a vehicle. Technical risks are determined by the type of the investment (greenfield or brownfield)³⁴, project complexity, and skills of the stakeholders.

The interviewees confirmed that the minimum deal size for smaller size investors is USD 100 million, whereas large global institutional investors are interested in a minimum

³⁴ Investopedia.com definition: "Green-field and brown-field investments are two different types of [foreign direct investment](#) (FDI). Green-field investments occur when a [parent company](#) begins a new venture by constructing new facilities in a country outside of where the company is headquartered. Brown-field investments occur when a company or government purchases an existing facility to begin new production."

ticket size of over USD 500 million. Investors seek higher returns for investments in emerging markets, although many are still relatively conservative regarding investments in (unlisted) infrastructure investments. Some smaller investors with more exposure to markets feel confident about their investment strategies, in terms of both the returns and the risks.

Table 7 offers a broadly illustrative summary of portfolio asset allocations and return expectations of the different categories of institutional investors. Within each category, there could be significant variations in both asset allocation and return expectations.

Table 7: Institutional Investors' Allocations and Return Expectations in Africa

Investor Category (ROI-expected return on investment)	Public equity (ROI: 5- 6%)	Liquid fixed income^a (ROI: 1.5- 2%)	Private equity (ROI: 10%+)	Other illiquid (ROI: 5%)	Cash (ROI: 1- 2%)
Pension funds (%)	50	25	10	10	5
Insurance companies (%)	10	70	5	10	5
Endowments/foundations (%)	45	15	10	25	5
Sovereign wealth funds ^b (%)	45	40	10		5
Mutual funds (U.S.) (%)	45	25	n/a	n/a	20

Source: Kenneth Lay's (see acknowledgements), experience and observations, validated with references to many sources. Notes: a. 10-year maturities. b. Asset allocations among sovereign wealth funds vary widely depending on their respective purposes and on the authorizing environment in which they operate. Stabilization funds invest much more heavily in fixed income, while long-term national savings funds invest in fully diversified portfolios similar to pension funds or endowments.

The average return on investment over a 10-year period is similar in emerging markets compared to developed markets (about 10%). However, investors consider it much riskier to invest in emerging markets, particularly African countries. Given perceptions about risks associated with investment in Africa, investors seek to maximize their returns translating into around 10-20% a year for equity. Expected returns in the greenfield phase are significantly higher than those in the brownfield phase.

The risks associated with a specific infrastructure project generally arise from the nature of the underlying asset itself, contracts with the public sector and its exposure to the environment in which it operates. The magnitude of a risk varies depending on the country (and its underlying investment climate), sector (and its institutional maturity) and project (and its complexity). Most interviewed investors stated that they have a preference for brownfield investments, as greenfield investments are considered to be riskier and more difficult to exit. Interestingly, several investors also affirmed that they would consider investing in greenfield

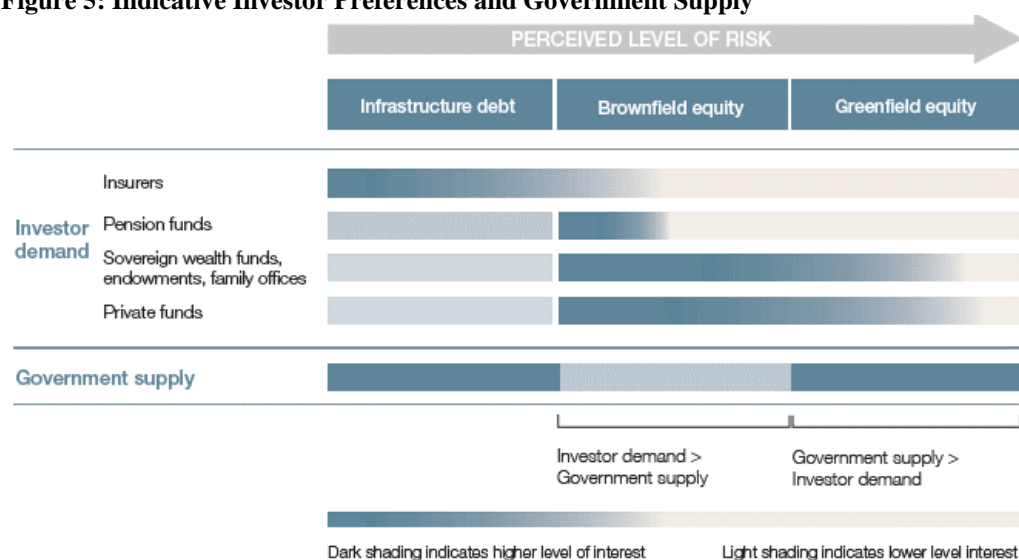
opportunities if the necessary guarantees/assurances were provided by a third party, such as an MDB.

Many investors admitted that they do not have sufficient in-house capacity to assess complex infrastructure deals. Only a few, like OMERS and GEPP, have in-house investment management teams that are responsible for their investments. It is therefore challenging for the most institutional investors to take decisions on where and how to invest, because they lack sufficient technical knowledge about the investment landscape in Africa. Investors also indicated that adequate data and investment benchmarks for illiquid assets on infrastructure and institutional investments are difficult to obtain. As a result, their investments in frontier markets like Africa are typically managed by external asset managers or equity funds.

Some other technical aspects influencing investors are, for example, scarcity of bankable projects, high development and transaction costs, poor procurement processes, and lack of standardization of contracts of the underlying infrastructure projects. In addition, the investors take into consideration factors such as portfolio concentration, investment period, and exit strategy, because one of the most relevant issues when investing in African infrastructure is the length of time it takes for financial closure.

Figure 5 illustrates perceived levels of risk for different types of institutional investors. Insurance companies are more likely to invest in infrastructure debt, whereas SWFs and pension funds prefer investments in brownfield opportunities. Some SWFs and private funds are open to invest in riskier greenfield projects.

Figure 5: Indicative Investor Preferences and Government Supply



Source: World Economic Forum (2014).

6.4. Enabling environment

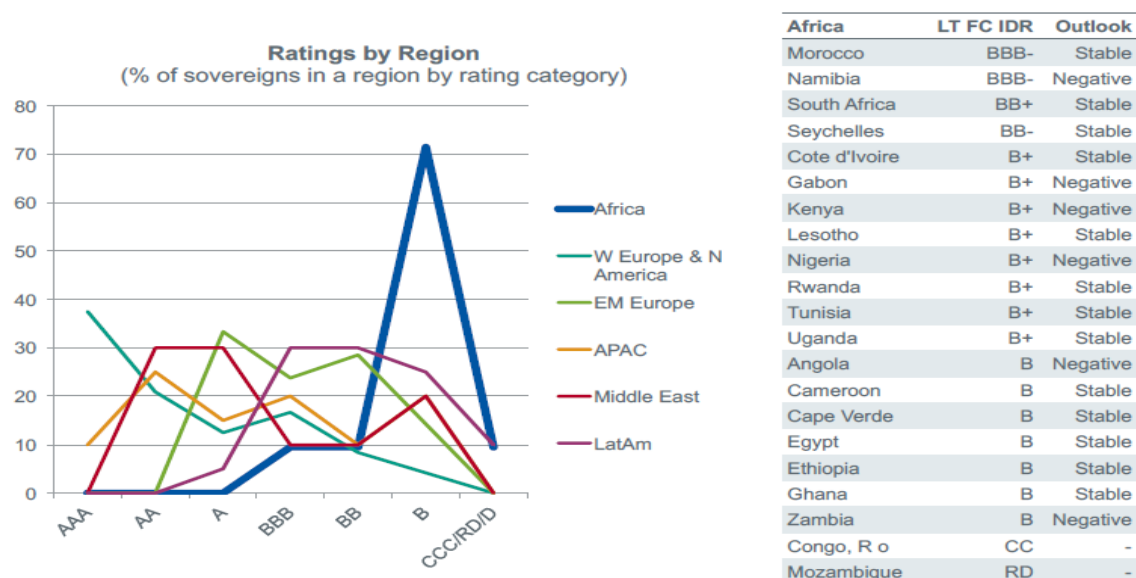
Country rating. Country or sovereign risk is one of the major bottlenecks for investments in Africa, as one of the first factors that investors evaluate. Only four countries on the continent have an investment grade rating that global investors are comfortable with. A country's credit rating, which measures its ability to honor financial obligations, is a major factor that investors consider when deciding on their investments. According to the investors interviewed, this is a major challenge for investments in Africa. For debt investments, institutional investors require a country rating to be at least be 'BBB-' on the Standard & Poor's and Fitch rating systems, and 'Baa3' on Moody's rating scale, which corresponds to an investment grade. Discussions with the investors confirmed that, in practice, investors mainly look at more solid investment grades such as 'A', but some investors are allowed to invest in projects rated as low as 'BBB' if they are co-financed by an experienced development finance institution (DFI).³⁵

Only 21 African countries are rated by at least one global level credit rating agency, and only four of these fulfill the requirements for an investment-grade sovereign rating: Botswana, Mauritius, Morocco, and Namibia (Fitch ratings). Seventeen countries have a sovereign rating, but below investment grade. Thus, over 90% of African countries have a rating corresponding to BB, B, or lower, which is below investment grade for global investors. It is important to note that the sovereign rating generally also provides a ceiling such that an individual project rating generally cannot be higher than that of the country where it is located. While this is the general rule, some exceptions are made depending on the risk appetite of the investor.³⁶

³⁵ Griffith-Jones and Kollartz (2015).

³⁶ Maurer (2017).

Figure 6: Africa - Selected Sovereign Credit Ratings



Source: FitchRatings (2017).

Business environment. In addition to the country rating, the business environment is another significant factor for making investment decisions. Based on the analysis of the World Bank's Ease of Doing Business index, which measures the cost of business regulations to companies across 185 countries, many African countries do not have business-friendly regulations in place. Of all African countries, Mauritius has the highest ranking (25) followed by Rwanda (41), which has transformed itself in the recent years into one of the region's more business-friendly destinations. Morocco (69), Kenya (80), Botswana (81), and South Africa (82) are among the other higher-ranked African economies (Table 8). Transitioning such as like Somalia (190), Eritrea (189), and South Sudan (187) find themselves at the lowest end of the ranking. The average ranking for Africa as a region is 140, which reflects the need to make significant improvements in the business environment in order for countries to become more attractive for foreign investment.³⁷

³⁷ World Bank (2018).

Table 8: Ease of Doing Business Index: Highest- and Lowest-Ranking African Countries

Country	Ranking	Country	Ranking
Mauritius	25	Sudan	170
Rwanda	41	Liberia	172
Morocco	69	Equatorial Guinea	173
Kenya	80	Angola	175
Botswana	81	Guinea-Bissau	176
South Africa	82	Congo, Rep.	179
Zambia	85	Chad	180
Tunisia	88	Congo, Dem. Rep.	182
Seychelles	95	Central African Rep.	184
Lesotho	104	Libya	185
Namibia	106	South Sudan	187
Malawi	110	Eritrea	189
Swaziland	112	Somalia	190
<i>Regional average</i>		<i>140</i>	

Source: World Bank (2018).

Note: The table lists 13 highest-ranking and the 13 lowest-ranking African countries in the Ease of Doing Business index.

In summary, the interviews confirmed that institutional investors – both global and domestic - are willing to take on long-term risk exposure as long as they obtain potentially lucrative risk-adjusted returns on their investments. They are particularly interested in increasing their portfolio diversification by expanding their investment activity into alternative asset classes such as infrastructure in emerging markets, including Africa.

7. Engagement Options between MDBs and Institutional Investors

During the interviews, investors were asked about their interest in collaborating with the MDBs. One of the key issues mentioned by the investors was that there is a clear disconnect between potential investment opportunities and investors’ needs and expectations, including the perceived lack of financial products available to address investors’ needs. The lack of reliable information about investment opportunities in Africa prevents investors from taking decisions. Therefore, a critical role of MDBs is to raise awareness about investment opportunities and develop solutions adapted to investors’ needs.

Most investors have very little experience in infrastructure transactions and managing infrastructure assets. Investors’ willingness to engage with the MDBs is mainly related to the banks’ convening power, credit rating, preferred creditor status, and risk-sharing capacity. MDBs can play a role in infrastructure deals by mitigating country level risks.

Investor preferences for types of collaboration include:

- **Co-investment:** Investors prefer co-investments with the MDBs because they feel that MDBs have a better understanding of the underlying risks at the country level and that MDBs can help mitigate potential political risks. For example, investors perceived co-investment platforms, A/B loan structures, and syndications being implemented by the MDBs all as being useful. In 2016, the AfDB closed the largest syndicated A/B Loan arranged to-date in Africa with Eskom Holding from South Africa to support the country's power generation capacity and transmission network. The loan, from the Bank's private sector window, amounted to USD 375 million in South African Rand (ZAR) equivalent and a corresponding A/B syndicated loan for up to USD 750 million.
- **Technical expertise:** Investors appreciate the technical expertise that MDBs have in project origination and the rigorous due diligence that they conduct. Investors would therefore be interested in seeing investment products that build on the MDBs' technical expertise and country-level knowledge.
- **De-risking:** Investors confirmed that MDB capital should be used as risk capital and to provide credit enhancement—by creating subordinated capital tranches, guarantees, and other applicable instruments to encourage additionality.³⁸
- **Blended finance:** Blended concessional finance for private sector projects is one of the significant tools that MDBs can use to increase to finance for important private sector activities and mobilize private capital. The investors confirmed that they were interested in learning more about the blended finance instruments that the MDBs are developing.
- **Project development:** Of particular interest to institutional investors is taking over projects that MDBs have financed during the greenfield phase, implying that the MDB would sell down the project debt to institutional investors during the brownfield phase. In this way, the MDB assumes the risk during project design and preparation, which are perceived to be the riskiest stages of the project, but would then exit the project through securitization. This will allow the MDB to monetize its infrastructure investment earlier than is currently the case and free up capital for new projects. At the same time, it will allow institutional investors to participate in less-risky projects that are already operational.³⁹ A second non-

³⁸ Examples of AfDB's de-risking products include Risk Participation Agreements (RPAs) in trade finance, Partial Risk Guarantees (PRGs), and Partial Credit Guarantees, which have been used mainly in project finance transactions.

³⁹della Croce, Fuchs, and Witte (2016)

sovereign operation (NSO) risk transfer operation under preparation by the AfDB is a synthetic securitization (Room to Run). The Bank is working with a consortium of private investors (including Mariner, Africa50, and others), the European Commission, and transaction advisors to design a transaction covering a significant portion of the Bank's NSO portfolio. In addition, the Bank is, for example, exploring opportunities to sell down exposure to investors who have appetite for brown-field projects, in the tail-end of the maturity spectrum. The Bank carried out a pilot transaction that led to the successful 'sell down' of part of one of its non-sovereign loans to an external investor in 2016, the Bank is now further exploring synthetic risk transfer mechanisms that would also enable it to achieve greater scale and capital efficiency.

- **Early stage engagement:** Even though most of the investors indicated that they would rather invest in projects that are in the brownfield phase, they felt that an early stage engagement in the design stage of the project would be useful, in order for them to start preparing for a potential buy-in to the deal at a later stage. Since deal preparation is complex and time-consuming in terms of transaction costs and resources required, it is important that MDBs engage with investors and other relevant stakeholders even before the project design starts.
- **Awareness and advisory services:** Investors indicated an appetite for MDBs' advisory services at different stages of the project cycle and they admitted that they were unaware of the full range of instruments offered by the MDBs. Not only was there a knowledge gap on the investors' side in terms of infrastructure investment opportunities in Africa, but over 70% of the interviewees were unaware of the Bank's existing instruments, such as the Partial Credit Guarantee (PCG) and Partial Risk Guarantees (PRG). The Bank was also perceived to be insufficiently agile due to its lengthy and cumbersome transaction processes. Finally, investors are only interested in products that they understand. For this reason, MDBs including the AfDB should make efforts to "package" investment information in a way that it is customized to investors' needs in terms of language and branding.
- **Coordination:** The investors also confirmed that the MDBs play an important intermediation role in facilitating the dialogue and coordination with the local governments. The MDBs are seen as central players on the country level, bringing together a wide range of stakeholders

7.1. Ongoing MDB approaches with institutional investors

MDBs provide substantial debt and equity financing for infrastructure projects in Africa and help governments design public-private partnerships for infrastructure projects. MDBs also use a number of different de-risking mechanisms, including guarantees, credit enhancement, insurance products, and subordinated equity, to offer assurances to private investors. Examples include GuarantCo, AfDB's Partial Risk Guarantee (PRG), EIB's External Investment Plan (EIP), IDA's Private Sector Window (PSW), and AsDB's Construction Period Guarantee for Asia. MDBs have also implemented co-investment platforms with private and public stakeholders, such as the Global Infrastructure Facility (GIF), Africa50 Infrastructure Fund, Emerging Africa Infrastructure Fund (EAIF), and IFC's Managed Co-Lending Portfolio Program (MCPPI).

While several Africa-focused project preparation facilities targeting public entities have been established, both within and outside the AfDB, they are rarely directly accessible to private entities. The Bank is supporting several project preparation facilities, such as the NEPAD Infrastructure Project Preparation Facility (IPPF), Sustainable Energy Fund for Africa (SEFA), Africa Water Facility, and the Private Investment Development Group (PIDG). The Bank has also selectively taken a small equity stake of UA 2.5 million in Kukuza, a project development company.

A significant challenge remains in building a sizeable pipeline of bankable projects in Africa, since the total resources available through these initiatives mentioned above are relatively small compared with the continent's infrastructure needs. An additional concern is whether the generated pipeline of projects will meet the demand and expectations of institutional investors. Therefore, a dialogue between the MDBs and institutional investors is necessary, in order to enhance the collaboration and develop additional innovative investment options and instruments tailored for this group of investors.

7.2. Examples of MDB collaboration with institutional investors

MDBs' engagement with institutional investors has largely been carried out through project preparation facilities and equity investments. Institutional investors have also directly co-invested in MDBs' investment vehicles such as the Bank's Africa50 Fund. Further examples are IFC's collaboration with NSIA's Infracredit program and AsDB's collaboration with the Philippine government and Dutch pension funds. Some of these examples are discussed below:

IFC's Managed Co-Lending Portfolio Program (MCP) in Infrastructure. In October 2016, the International Finance Corporation (IFC) launched an innovative program called MCP Infrastructure that allows third-party investors to participate passively in the IFC's senior loan portfolio. The program's aim is to raise USD 5 billion from institutional investors by increasing their investment exposure to emerging market infrastructure, with managed risk. The IFC has already received commitments of over USD 1 billion from Allianz, Prudential, and SwissRe to be invested in emerging markets. To mitigate risk, investors benefit from IFC's investment-grade profile as well as a credit-enhancement facility that has a first-loss tranche guarantee (up to 10% of each partner's portfolio), financed in part with other donor agencies. This reduces the IFC's capital requirement for the first-loss tranche, thereby freeing up capital that can be used to replicate and scale up the model (Annex 4). This new and innovative solution can be scaled up by other MDBs and expanded in African markets.⁴⁰

IFC's collaboration with the Japanese Government Pension Investment Fund (GPIF). In 2015 the IFC entered into a co-investment agreement with GPIF and the Development Bank of Japan (DBJ) in order to diversify their emerging markets equity portfolio and to capture global economic growth in a more balanced manner. GPIF invests in a unit trust managed by Nissay Asset Management Corporation, which invests in a fund of funds operated by the IFC's Asset Management Company. The cumulative investment amount is expected to be about USD 400 million.

IFC's collaboration with the Nigerian Sovereign Investment Authority's (NSIA). In 2013, the IFC entered into a partnership agreement with NSIA to help mobilize public and private resources that will open the Nigerian market for infrastructure investments.⁴¹ In early 2017, NSIA and GuarantCo, a local currency guarantee fund, co-launched a credit guarantee company called InfraCredit (Infrastructure Credit Guarantee Company) to incentivize infrastructure development. Infracredit is expected to be capitalized up to USD 200 million. The aim of Infracredit is to enhance credit quality by providing guarantees by to back local currency debt instruments in Nigeria, mainly in the form of corporate and infrastructure bonds. This will allow Nigerian pension funds to expand their investment by buying these bonds.⁴²

AfDB's Africa50 Infrastructure Fund. Africa50 is the Bank's infrastructure investment vehicle, established in 2012. It aims to mobilize private sector funding and long-

⁴⁰ IFC (2017).

⁴¹ IFC News (2013).

⁴² NSIA (2016).

term savings from within and outside Africa. The Fund promotes infrastructure development with a capital expected to reach USD 1 billion by early 2018 and a medium-term capitalization target of USD 3 billion. It focuses on high-impact national and regional projects mostly in the energy and transport sectors. The primary objective of the Fund is to increase the number of bankable infrastructure projects. In addition to providing financing at earlier stages of projects, Africa50 contributes actively to project development.⁴³ In 2017 Africa50 has made investments in Nigeria, Egypt, and Senegal, and it is engaging with investors to reach the medium-term target of capital subscriptions.

EIB's Renewable Energy Platform (REPIN). EIB's Renewable Energy Platform for Institutional Investors (REPIN) was launched in 2014. It aims to engage institutional investors in the financing of renewable energy projects in Africa to free-up balance sheets of project developers and project finance banks, reduce overall costs, and thereby encourage new investment in the sector. REPIN's market potential for re-financing is an estimated USD 292 billion, which could free up capital for 259 GW of new projects.⁴⁴

EIB's Long-Term Investors' Club (LTIC). EIB created the Long-Term Investors Club (LTIC) initiative in 2009 together with the French Caisse des Dépôts, the Italian Cassa di Risparmio di Roma, and the German KfW with the aim of bringing together major global long-term investors. Today LTIC represents a combined balance sheet of USD 5.4 trillion for investments in sustainable urban transportation and energy infrastructure in the Mediterranean countries.⁴⁵

EBRD's Equity Participation Fund (EPF). In 2016, the European Bank for Reconstruction and Development (EBRD) launched an Equity Participation Fund (EPF), which aims to increase the availability of long-term financing from global institutional investors to the economies that the EBRD serves. The first round of fundraising was completed with a total of €350 million. The Fund will allow investors to automatically take a 20-30% stake in all the EBRD's eligible direct equity investments above €10 million during a five-year investment period. [China's State Administration of Foreign Exchange](#) (SAFE) and the [State Oil Fund of Azerbaijan](#) (SOFAZ) are the cornerstone investors of the EPF. Additional institutional investors will be able to join the fund in coming months until final closing.⁴⁶

⁴³ Africa50 (2018).

⁴⁴ Climate Finance Lab (2018).

⁴⁵ Long-term Investors' Club (2018).

⁴⁶ European Bank Reconstruction Development (EBRD) (2016).

AsDB and Philippine Investment Alliance for Infrastructure (PINAI). The PINAI Fund is a private equity fund that aims to invest in core infrastructure assets in the Philippines to catalyze private sector investment.⁴⁷ The project is backed by the Asian Development Bank's (AsDB's) equity investment. PINAI focuses on new (greenfield) infrastructure projects as well as expanding and rehabilitation of existing (brownfield) PPP projects. The fund expects to cover 12% of the country's infrastructure investment needs, with about USD 14.3 billion over the project period of five years coming from the private sector. With this initiative, AsDB expects to catalyze up to USD 625 million in capital.⁴⁸ The Dutch pension group (APG) is also a partner in the fund, alongside the local Government Service Insurance System Fund of Philippines and Macquarie Group.

8. Conclusion and Recommendations

Infrastructure development is vital for Africa's transformation, as it contributes to improved competitiveness, facilitates domestic and international trade, and enhances the continent's prospects for integration into the global economy. The estimated infrastructure funding gap in Africa stands at USD 67.6-107.5 billion and is expected to widen over the medium term based on current investment trends. In order to address this challenge, African governments need to spend 4.5% of the continent's GDP a year in infrastructure until 2025.

Within this context, new opportunities for global and African institutional investors are arising. There is a growing appetite among the institutional investors to invest in infrastructure assets as they seek to diversify their portfolios. Investment opportunities within African infrastructure sector can meet these expectations in terms of deal size and financial returns. Discussions conducted by the AfDB with a group of global and African investors confirmed that multiple challenges need to be addressed before the region is ready for more investments: credit and sovereign risk, improved deal implementation, and mitigation of financial risks through a variety of instruments.

Africa's success in filling its largely greenfield infrastructure gap depends on how successful the MDBs are in financing this riskier phase and offloading their debts to institutional investors. MDBs play an important role as catalysts for private investments, as the investors often appreciate their expertise and "political clout" in new investments that are perceived as risky. Therefore, the MDBs should aim to leverage co-financing by utilizing their

⁴⁷ Asian Development Bank (2012).

⁴⁸ ADB News (2012).

comparative advantage (AAA rating, rigorous investment standards, sector and country knowledge, and political influence) to provide a quality seal and reassurance to investors.

To circumvent the challenges that the investors face, the MDBs have launched numerous key initiatives, including co-investment platforms, guarantees and project preparation facilities. However, the traction of these initiatives among institutional investors has so far been relatively limited. For this reason, MDBs should focus on solutions to scale up their project preparation facilities, set up co-investment platforms, develop innovative risk mitigation instruments, support the governance and regulatory frameworks in countries, and continue to support domestic capital market development.

AfDB's Africa Investment Forum (AIF), an innovative market platform launched in November 2018, secured investment interest for 49 projects worth US\$38.7 billion from investors. Approximately, 350 institutional investors from 53 countries across the globe were in attendance with 30 of these representing African countries. By bringing together multilateral financial institutions, pension funds, sovereign wealth funds, and private investors, the AfDB aims to create a mechanism to reduce market, political, and financial risks, and in the process improve the ease of doing business.

8.1. Recommendations

In light of the ambitious global agenda, the MDBs are playing a catalytic role in mobilizing global institutional resources by developing a collaborative approach to boost the infrastructure investment in the region. Since 2015, the MDBs have been aggressively scaling up its overall lending volumes as well as increasing the share of non-sovereign operations. As anchors and strategic partner investors, the MDBs aim to play an increasing role in crowding in financing from institutional investors. In this context, it is essential for the MDBs to understand investors' expectations and investment needs, and position itself as a key player to catalyze investments.

The MDBs are engaging with key stakeholders such as governments, institutional investors, policy makers, regulators, lenders and private sector actors, in order to develop innovative financing solutions and instruments that aim to de-risk infrastructure investments in Africa. Based on above, the following key recommendations are made in order to establish a clear roadmap for development of African infrastructure:

1. Scale up project preparation facilities

Most global institutional investors face challenges finding reliable information on investment opportunities in Africa, which increases the perceived risk of African markets. Another key challenge is related to the low capacity of governments to develop and execute infrastructure projects that hinders them from offering bankable projects with appropriate risk-adjusted returns to investors. It is estimated that high proportion of a high risk capital (about 10% of total investment) is required for project preparation on the continent. MDBs are better placed and should leverage their resources to mobilize the required high-risk capital to support project preparation and create a pipeline of bankable projects in collaboration with government, private sector, and other financial institutions.⁴⁹

To maximize efforts to create a pipeline of bankable projects, MDBs should launch multiple programs that focus on identifying and developing projects, in engagement with governments, lenders, and private sector actors.

Given the higher risk in the project preparation stage, MDBs to evaluate the performance of their existing project preparation facilities and develop a clear strategy to scale them up. In addition, as an integrated approach, MDBs should consider creating technical expertise teams along with the regional member countries \ to strengthen technical capacity at the national level.

2. Set up co-investment platforms to crowd-in institutional investors

To mitigate country and investment risk, investors are keen to partner with the MDBs, which provides them reassurance. Co-investment platforms like IFC's MCPP, the Global Strategic Investment Alliance (GSIA), the Africa50 Fund, and the Pan-African Infrastructure Fund (PAIDF) are good examples of initiatives that can be replicated and scaled up. Therefore, the MDBs should utilize their existing co-investment platforms and replicate such platforms for other infrastructure investments, in collaboration with key partners.

To de-risk investment opportunities, MDBs to form co-investment vehicles with key stakeholders to enhance the credit worthiness of investment opportunities. MDBs should aim

⁴⁹ AfDB hosts several operational project preparation facilities, such as the NEPAD Infrastructure Project Preparation Facility (NEPAD-IPPF), the Fund for African Private Sector Assistance (FAPA), the Agriculture Fast Track Fund (ATF), the Sustainable Energy Fund for Africa (SEFA), and Africa50, that address early-stage project development concerns.

to strengthen collaboration efforts with domestic and global institutional investors to form Africa-focused co-investment vehicles in line with investors' investment expectations.

3. Provide effective risk mitigation instruments

The key objective of risk mitigation is to improve the credit profile of a project to a level that is acceptable to investors. MDBs have multiple risk mitigation instruments available, but their usage so far has been relatively limited.⁵⁰ The investors are not fully aware of the MDBs' risk mitigation products.

MDBs to harmonize and enhance their existing risk mitigation instruments to develop innovative credit enhancement instruments, in consultation with key stakeholders. In addition, MDBs should consider launching a targeted communications campaign on their guarantee products and other credit enhancement instruments to educate and raise awareness among investors.

4. Strengthen the governance and institutional framework

African governments will remain the key players in providing financing, setting up the regulatory environment, and implementing policies to boost productive investments. Solid institutional arrangements are essential for effective management of the complex tasks of infrastructure project planning, design, coordination, development, implementation, and regulation. The governments should also aim to optimize the maintenance of existing infrastructure, strengthen early-stage project preparation, and prioritize investments into projects with the highest economic and social returns. Supporting African governments regulatory and policy reform initiatives should be a key task for the MDBs, which should be further explored.

MDBs to play a more prominent role in the policy dialogue with governments to push forward structural and governance reforms to attract private sector investment. Therefore, the MDBs should put more focus on promoting good governance practices.

⁵⁰ The Milken Institute reported that guarantees represent only 5% of MDBs' operations, but 45% of the private resources that they mobilize (Milken Institute 2015)

5. Continue to support domestic capital market development

Given rapid urbanization and rising income levels, it is critical that the MDBs continue to support building domestic capital markets. The MDBs are undertaking several initiatives to support financial system and capital market deepening and supporting market reform programs such as policy modernization and new frameworks governing capital markets.

The MDBs to evaluate the performance of their existing capital market operations and further explore dialogue with local financial institutions to strengthen domestic capital markets in Africa.

Annex 1: Botswana's Pula Fund

The Pula Fund was established in 1994 by the Republic of Botswana to preserve “part of the income from diamond exports for future generations.” The Pula Fund has continued to increase its resources in recent years, growing from USD 5.3 billion in 2013, to USD 6.9 billion (2015).⁵¹

In accordance with the Pula Fund's objectives, the government has strengthened its efforts to ensure that resource revenues do not finance the government's recurrent budget expenditures. Part of the revenue from mineral resources in Botswana is invested in health, education, and other public expenditures, and in stabilizing the local economy, while another part is used to accumulate foreign exchange reserves or saved in the Pula Fund for future opportunities.

The combination of government-owned fiscal assets and the central bank's foreign exchange reserves makes the Pula Fund unique, resulting in co-ownership of the fund and a hybrid governance model. The Pula Fund has a 10-year investment horizon and invests exclusively in foreign assets such as public equity and fixed-income instruments in developed economies.

Source: Alsweilem et al. (2015).

⁵¹ Quantum Global Group (2014).

Annex 2: Global Strategic Investment Alliance (GSIA)

The Global Strategic Investment Alliance (GSIA) is a global co-investment alliance platform launched in 2012 by the Ontario Municipal Employees Retirement System (OMERS), designed to gather sophisticated like-minded investors (mainly pension funds) to directly invest in infrastructure assets. Through GSIA, participating alliance members invest in core infrastructure assets with an enterprise value of more than USD 2 billion in sectors such as airports, railways, ports, power generation and distribution, and gas pipelines, mainly in North America and Europe.

GSIA aims to raise USD 20 billion, with OMERS providing USD 5 billion. In April 2012, Mitsubishi Corporation entered into binding commitments to invest jointly up to USD 2.5 billion in quality infrastructure assets, together with leading Japanese pension funds and financial institutions, namely, the Pension Fund Association, the Japan Bank for International Cooperation, and Mizuho Corporate Bank. In March 2014, OMERS entered into a co-investment agreement with Japan's Government Pension Investment Fund (GPIF), the world's largest pension fund, and the Development Bank of Japan (DBJ). Capital commitments of the GSIA stood at USD 12.5 billion as of June 2014.

OMERS Infrastructure Management Inc. (former: Borealis Infrastructure), an infrastructure investment advisory and separate management arm of the OMERS Administration Corporation, manages the infrastructure assets of OMERS and other institutional investors.

Source: OECD (2014).

Annex 3: Global Insurance Company Axa's Investments in Africa

Global insurance company Axa acquired an 18.6% stake in Eranove, a leading West African utility company in 2015. The company's operations are in power generation, transmission, and distribution, as well as water production and distribution, primarily in Côte d'Ivoire and Senegal. This long-term investment to support the growth of Eranove allows Axa to increase the exposure of its asset portfolio to the fast-growing African utilities sector and confirms the Group's intent to increase its infrastructure investments through Axa Investment Managers.

Source: Axa (2015).

Annex 4: International Finance Corporation Managed Co-Lending Portfolio Program (MCCP) with Swedish International Development Cooperation Agency (SIDA)

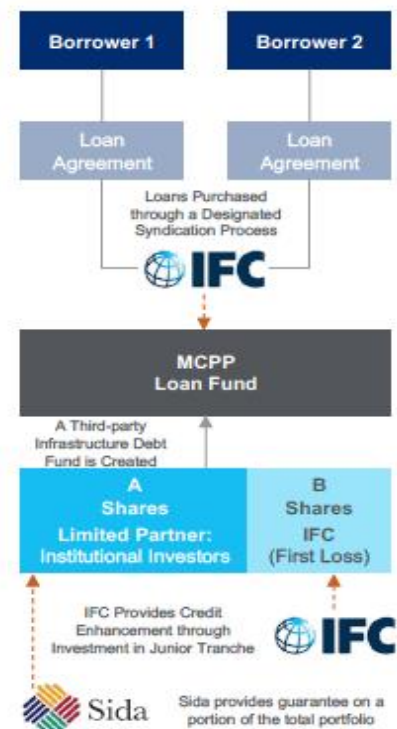
The IFC's Managed Co-lending Portfolio Program (MCCP) for Infrastructure aims to scale up debt mobilization from institutional investors by:

- allowing institutional investors to leverage the IFC's ability to originate and manage portfolio of bankable infrastructure projects;
- offering institutional investors a portfolio that has sufficient scale and diversification through a cost-effective portfolio syndication process; and
- providing a credit enhancement through an IFC first-loss tranche to create a risk-return profile akin to an investment grade profile, clearing a key capital constraint.

Partnership

- This is an innovative partnership between IFC and the Swedish International Development Corporation Agency (SIDA)
- The IFC has the first loss position, subordinated by other senior investors, improving the risk position of senior investors to an investment-grade profile
- SIDA shares the risk through a guarantee covering a portion of the loan portfolio (part with loans related to projects that meet the Swedish priorities for development cooperation)
- Each USD 1 invested by IFC/SIDA mobilizes USD 8-10 from a third party (or co-investors)

Unique Structure



Benefits to investors

Robust track record on a globally diversified portfolio

- IFC's infrastructure portfolio spans more than 60 countries and multiple sub sectors; diversification is a key driver to IFC's infrastructure debt track record
- IFC can provide investors with detailed, loan level infrastructure data extending back more than 25 years, demonstrating IFC's success in managing infrastructure loans across regions and sectors

Cost-effective syndication platform

- IFC has developed and demonstrated the viability of a portfolio syndication platform
- MCPP can allocate third-party capital in a cost effective manner
- Through a passive process, MCPP, allows the structure to operate with lower management fees than normally associated with actively managed funds

Credit enhancement

- Regulatory constraints limit the ability of institutional investors, and in particular insurance investors, to invest in non-investment grade assets
- The natural diversification offered by IFC's portfolio, coupled with an innovative portfolio first loss, allows the IFC to efficiently credit enhance the senior investors to investment grade

Source: IFC (2016).

Abbreviations

AfDB	African Development Bank
AsDB	Asian Development Bank
AUM	Assets-under-management
DBJ	Development Bank of Japan
EAIF	Emerging Africa Infrastructure Fund
EPF	EBRD's Equity Participation Fund
GDP	Gross Domestic Product
GIF	Global Infrastructure Facility
	South African Government Employees
GEPF	Pensions Fund
GPIF	Japan's Government Pension Investment Fund
GSIA	Global Strategic Investment Alliance
ICA	Infrastructure Consortium for Africa
IFC	International Financial Corporation
EIB	European Investment Bank
LTIC	Long-term Investors' Club
MDB	Multilateral Development Bank
MCP	IFC's Managed Co-Lending Portfolio Program
NSIA	Nigerian Sovereign Investment Authority
NSO	Non-sovereign Operation
MDBs	Multilateral Development Banks
OMERS	Ontario Municipal Employees Retirement
OTPP	System Ontario Teachers' Pension Plan
	Philippine Investment Alliance for
PINAI	Infrastructure
PPP	Public-private partnership
PCG	Partial Credit Guarantee (AfDB)
PRG	Partial Risk Guarantee (AfDB)
PSW	Private Sector Window (WB/IDA)
PIDG	Private Investment Development Group
REPIN	Renewable Energy Platform
ROI	Expected Return on Investment
SEFA	Sustainable Energy Fund for Africa
SWF	Sovereign Wealth Fund
SDG	Sustainable Development Goal
ZAR	South African Rand

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