

# INFRASTRUCTURE AT A CROSSROADS

**Huge investment** will go into building roads, airports and power in Sub-Saharan Africa, in spite of the mixed record of performance in recent infrastructure projects. Strong Sponsors, lessons learned around the world and experienced project teams will help avoid very costly mistakes.

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**A**frican countries have had a mixed record of performance in recent infrastructure projects. Success stories require strong sponsors, good equity support, and favourable economics. An effective interlocking series of agreements covering implementation and off-take are necessary to mitigate risks. Both government and private sponsors will need support from qualified financial advisors with a track record in complex projects to ensure that agreements are properly designed and

financing structures match expected project delivery.

Financing of infrastructure projects is driven by a demonstrable ability to repay, and the appropriate design of commercial arrangements to assure this with a high degree of confidence. One doesn't have to look far to see high-profile projects that are underperforming, having been burdened both by unrealistic plans for execution and the ability of users to pay for servicing the debt.

Furthermore, the global financial crisis put a damper on infrastructure projects for several years. Those trends appear to be slowly reversing themselves, but the burden will increasingly fall on sponsors to demonstrate that their projects are viable and carefully planned.

■ Some failures or long-delayed projects have driven home the importance of ensuring that key elements are in place. These include:

■ Strong sponsors, operating through transparent supply and implementation agreements, and compliance with technical and regulatory requirements.

■ Experienced management teams and world-class independent industry experts for design and implementation, as well as the development of operational procedures.

■ Teams with proven experience in similar environments.

■ Compensation of teams and contracts aligned with performance and meeting targets.

## PUBLIC TRANSPORT

Most emerging-market cities lack an adequate public transport system, according to a Deutsche Bank study. This is particularly true in Sub-Saharan Africa. Creating new public transport systems can be prohibitively costly and take a very long time. Auto traffic tends to grow much faster than the transport infrastructure, resulting in significant traffic jams and commuting times that destroy productivity.

Monetary disincentive, such as the congestion charge for central London, can be used more often. Shanghai, for example, has shown innovative solutions, requiring alternate travel for odd- and-even license plates, and placing heavy consumption taxes on the purchase of new automobiles. Of course, a public transport alternative must be made available if such methods are to be effective. Rather than highly expensive railway networks, bus systems are often more sensible alternatives, at least for several decades. The construction of a bus lane costs only a fraction of comparable rail lines.

However, the Gautrain project in South Africa consists of a high-speed rail line linking Johannesburg and Pretoria with the Johannesburg partnership in Africa, with the private sector providing the design, construction, operation, maintenance, and partial financing of the system. The consortium for this \$3 billion project includes a number of significant international firms with extensive track records, including Bouygues TP, Bombardier, Murray & Roberts, SPG and French Metro operator RATP.

## POWER

Power is a major funding requirement in most African countries. There have been a few successful examples, notably the bond issue by NamPower, Namibia's national capital utility, to raise \$440m. NamPower will



use the funds primarily for the construction of an interconnector, which will eventually join the electricity networks of Namibia, Zambia and South Africa. The first \$75m tranche of the bond, in July 2007, was more than 50% oversubscribed.

Andrew Alli of AFC says there now seems to be a greater consensus that private investment and management of the power sector is the best route to delivering a country's short, medium and long-term power needs. "There also appears to be a sense that this needs to be done in an environment that reflects commercially viable tariffs across the value chain," he observes, adding that operators in the distribution sub-sector need to develop strategies to ensure power delivery with minimal system losses and efficient collection of cash from consumers.

The power privatization process in Nigeria offers further encouraging signs, because the government appears to be holding bidders to strict standards of competence, rather than simply rewarding local prominence. To make the private companies perform properly, it is necessary to develop international technical partnerships, together with clear demonstration of an implementation and investment plan to overhaul the operating companies after acquisition.

The government needs to provide incentives to serve the under-served, but not impose unreasonable burdens while these companies are striving to turn around operations suffering from years of neglect. Special programs can cross-subsidize the targets that wouldn't immediately be prioritized by a strictly profit-driven operator.

## TELECOM

There is one recent striking example of success, which evidently followed all the key aspects of project finance. The Main One Submarine Fibre Optic Cable Project is an undersea cable providing much needed bandwidth to

**Fast Route**  
Monetary disincentive in conjunction with public transport alternatives such as a bus lane or high-speed rail network can address congestion problems



**Power Hungry**  
Private investment and management of the power sector is the best route to delivering short, medium and long-term power needs

Nigeria and Ghana. It was conceived in 2007 by Main Street Technologies Ltd., the core sponsor and seed investor, which undertook an intensive two-year development effort, led by the company's financial adviser, Standard Chartered. This resulted in a successful fundraising. The total project cost was US\$240m, which was financed at a debt to equity ratio of 50:50, with standby debt and equity financing totaling US\$28m. The debt agreements were signed in November 2009, with the first drawdown in January 2010. Given the nature of the project, local market conditions and the global financial crisis, there were several challenges, which had to be navigated through.

**Execution Risk** This was addressed through the presence of a strong sponsor and world-class supply contractor. A small but capable management team, supported by legal, technical, tax and financial advisers tightly managed the project development effort and the budget. The technology was supplied by a world leader in submarine telecommunications cable networks – on a “fixed-price, date-certain” basis. The supplier's involvement helped give the lenders and the capacity off-takers the required confidence as to system availability and reliability.

**Market Risk** The only previous privately owned cable project financing to have successfully closed in Africa was Seacom on the east coast. This was supported by committed off-take contracts, which transferred market risk to capacity off-takers. This was not feasible in Nigeria and Ghana, where large-scale capacity off-takers could not be found to cover the full debt service, especially before the project was fully financed. The lenders thus needed to get comfortable with a base case involving a degree of market risk.

**Demand Risk** While there was a general consensus supporting the need for additional international bandwidth capacity; it was nearly impossible to form a

precise view on the extent of the latent demand. The financing case for Main One thus had to be supported by at least three different market studies by industry experts to validate potential demand.

**AVAILABILITY OF FINANCING**

Data from the World Bank's Public-Private Infrastructure Advisory group on new PPP Infrastructure projects in the first quarter of 2010 indicated a decline of investment from the same period in 2009. Project activity also became more selective. Brazil and India saw a strong growth in investment, and they attracted half the total investment in 2009. Excluding those two countries, investment to developing countries fell by more than 25% in 2009 compared with 2008. Investment was concentrated in large projects, \$500 million to \$1 billion and above, while investment in smaller projects declined. Power projects accounted for nearly half of PPP investment in 2009, with telecoms and transport investment declining significantly.

In Sub-Saharan Africa, investment fell 13% compared with 2008, driven by a slowdown in the implementation of new projects, which plunged 60%.

**New infrastructure projects with private participation in Sub-Saharan Africa 2005–2009**

2005	2006	2007	2008	2009
40	30	26	15	11

Financial market conditions are far stricter than before the global financial crisis. For projects that are able to raise financing, the conditions usually involve lower debt/equity ratios, shorter tenures and more conservative structures. Greater project selectivity is expected to continue.

This post-crisis environment makes the presence of independent advisors all the more critical to the projects. According to the International Finance Corporation, “A credible Independent advisor will advise Government that a robust (and investment-friendly) legal and regulatory framework is critical to the successful structuring of PPPs.” An independent advisor's involvement should bring to the deal the assurance needed to attract competent strategic partners and investors, with the necessary technical and financial resources.

Most private financing has come from foreign sources because local financial markets are relatively underdeveloped. In addition, foreign financing carries additional risks, in particular, foreign exchange exposure. An alternative is to structure projects to make them more attractive to local pension funds and insurance companies, which can be a sizable and mostly domestic source of long-term funds. Private infrastructure investment instruments must be structured so that they fit into the investment strategies of those institutions. These investments contribute to overall economic growth, including the creation of new jobs, thereby generating even more resources for the pension funds and benefiting their stakeholders.

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