Baker McKenzie.

New Dynamics

Shifting Patterns in Africa's Infrastructure Funding

TRANSACTIONAL POWERHOUSE

Leading and closing complex deals – every day

Contents

FOREWORD

Moving On From a Year Like No Other

2020 was a year like no other. The impact of the pandemic has been acutely felt in infrastructure projects across Africa. Significant disruption to supply and restrictions on labor movement conspired to delay progress, and existing market volatility around commodity prices and government elections has been exacerbated by uncertainty. Previously reliable sources of project finance faltered and infrastructure investment in Africa fell sharply.

This period of turmoil notwithstanding, infrastructure remains key to unlocking the potential of Africa and market fundamentals show untapped opportunity and significant demand. The most recent numbers are not representative of ongoing investor interest in the region — there remains pivotal projects to be completed and value to be realized. 2020 represents a temporary global shock rather than a long-term localized trend.

But it is clear that shifting dynamics are beginning to play out, as the infrastructure gap grows and traditional sources of finance dry up. How infrastructure needs will be met is changing — with alternative finance stepping in where international banks are pulling back, DFIs adopting broader roles in channeling infrastructure capital and the idea of self-finance gaining momentum. These trends won't take effect overnight, but are patterns of evolution that are set to emerge over the next decade. Wheels of change turn slowly in Africa, but they turn.

In this report, we draw on new data to explore the state of the market and the key drivers of change — the outlook for project finance in Africa, key players who will fund next generation infrastructure and how to maximize both commercial and community gains.

> "We can't throw a blanket over Africa — this is a rich and diverse region of multiple cultures, economies and histories. But opportunity abounds in all corners of the continent."
>
> **Wildu du Plessis**
> Head of the Firm's Africa Practice and Partner in Johannesburg

Key findings of this report

FINANCE GAP

01 The pandemic has widened the finance gap in Africa — with international banks withdrawing and rising pressure on the public purse causing a dip in multilateral and bilateral lending.

INFLUENTIAL DFIS

02 Development Finance Institutions (DFIs) are increasingly influential in unlocking project finance — facilitating a new multi-source ecosystem of local bank, specialist fund and private investors by offering new financial products and guarantees that de-risk lending.

SUSTAINABILITY

03 Increasing focus on longevity and sustainability in infrastructure finance is driving a rethink of investment calculus — deals should be net positive for local African economies as well as bankable.

BATTLE FOR INFLUENCE

04 China remains the top international investor into Africa, but the change in US administration and shifting UK priorities post-Brexit marks a new evolution in the "battle for influence."

ALTERNATIVE CAPITAL

05 Private equity and non-bank investors are poised to deploy significant capital into the region as returns dry up elsewhere.

INVESTMENT OPPORTUNITIES

06 The scale of the infrastructure gap remains colossal — with prominent opportunities for investors in relation to core healthcare and transportation infrastructure, renewable energy and digital connectivity.

SECTION 1

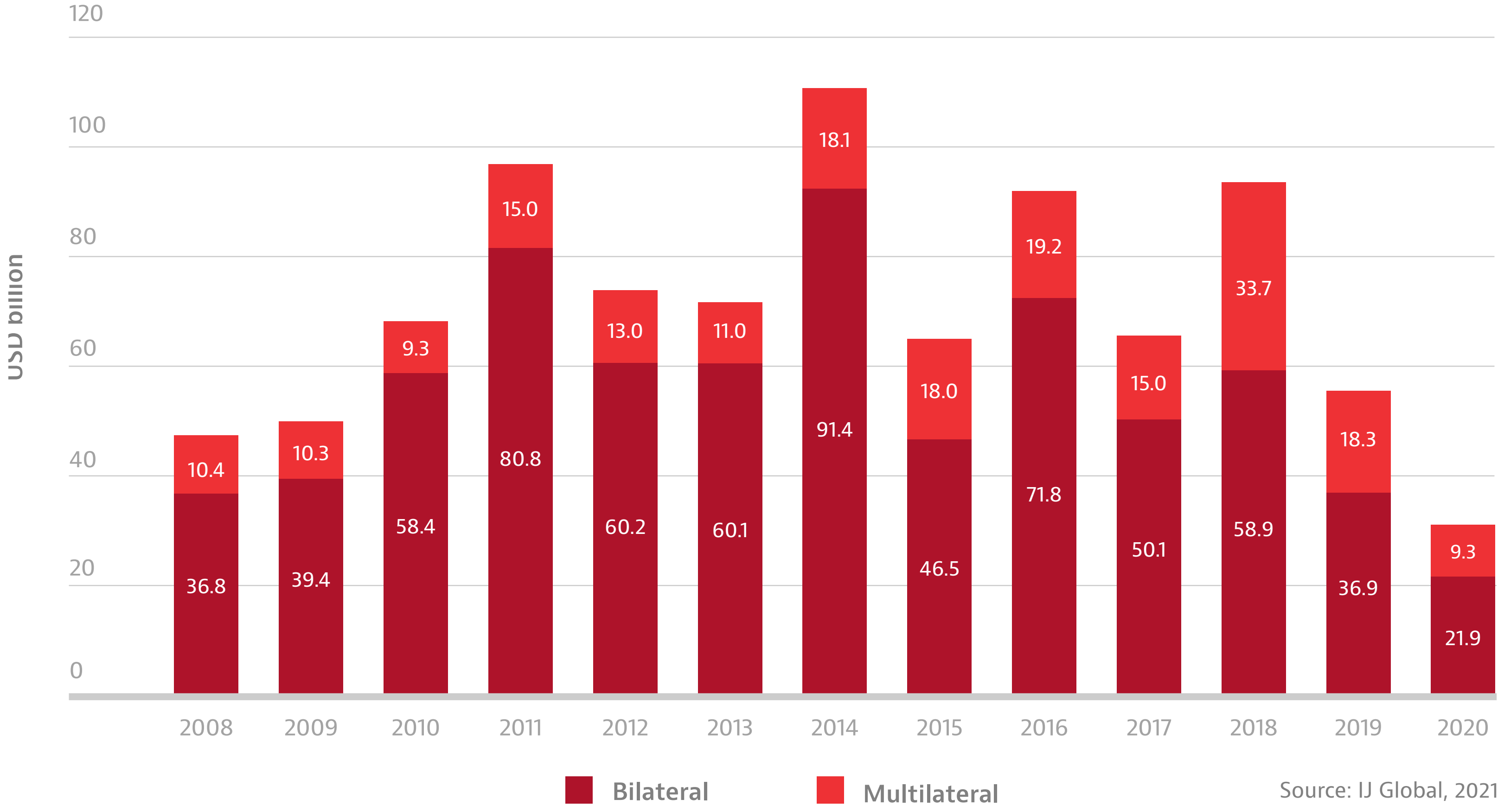
Underlying Resilience Signals Market is Down But Not Out

Multilateral and bilateral lending into Africa appears to be in decline — with investment levels falling successively in 2019 and 2020 compared to peak levels seen after the financial crisis. Deal values dropped to USD 31 billion from USD 100 billion in 2014.

The slowdown in infrastructure investment is attributable to a number of factors, including the pandemic. Economic contraction has affected Nigeria and South Africa, meaning that the region's largest economies have not been feeding in growth as in previous years, and there have been political issues at play — 2019 was a year of elections and uncertainty for South Africa in particular.

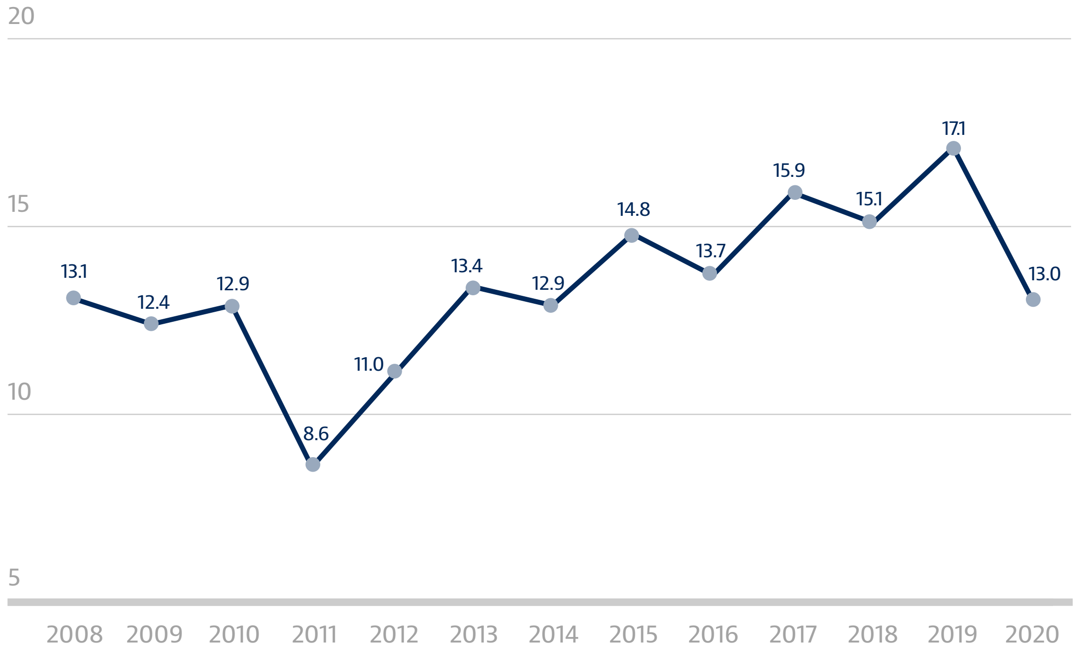
However, market fundamentals signal a region with underlying resilience and, as the global economy recovers, finance will be unlocked. There are already positive indicators of forthcoming investment. Commodity prices are rising and landmark deals are returning. For example, mining multinational Sibanye-Stillwater recently committed 6.3 billion rand to South African infrastructure projects.

Figure 1. Multilateral and bilateral lending in Africa (USD billion)



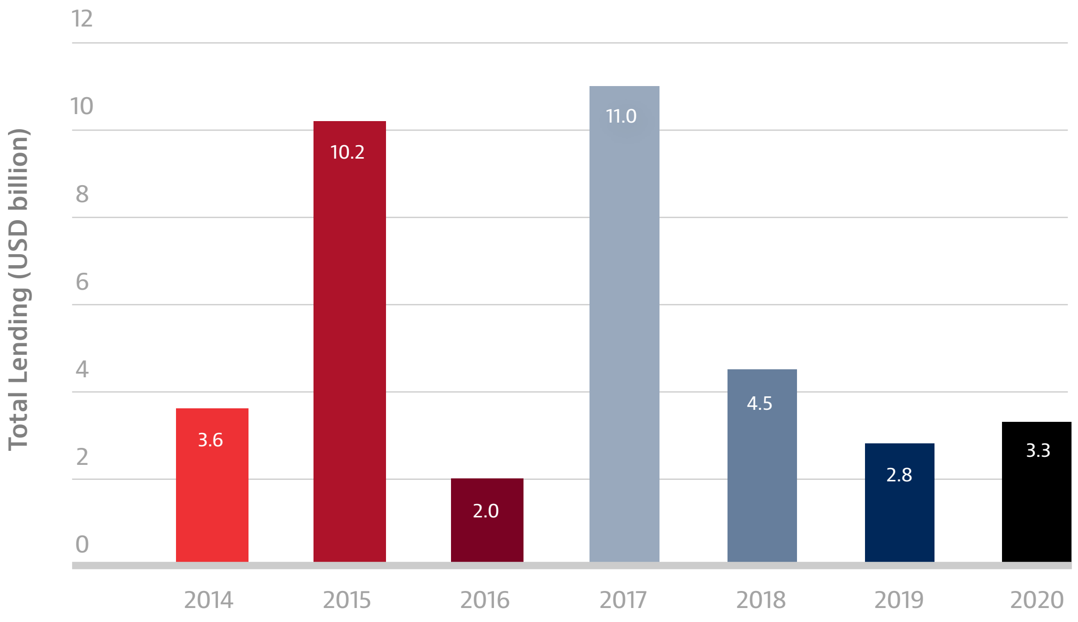
Source: IJ Global, 2021

Figure 2. Deal tenor of DFI debt



Source: IJ Global, 2021

Figure 3. Lending by Chinese banks into energy and infrastructure projects in Sub-Saharan Africa (USD billion)



Includes both DFI and commercial banks from China

Source: IJ Global, 2021

Emeka Chinwuba, Partner in New York and Banking, Finance & Major Projects Group member, notes: "Last year was a relatively difficult year across jurisdictions and for investors — with considerable uncertainty and change in the ways in which we do business. Shutdowns had a depressant effect on the infrastructure market, as deals in the pipeline were delayed and projects halted as a result of COVID-19. Full vaccination in Africa is still quite a long way off comparatively, so we can't expect a full and fast return to normal activity. But we've reached the bottom, and the only way is up."

The long-term nature of infrastructure projects means that international partners have made lasting commitments to the region, which are unlikely to be abandoned despite immediate pressure on national finances. However, data shows that deal tenor is contracting — from a high of 17 years in 2019 to 13 years in 2020. Luka Lightfoot, Partner in London explains: "Banks are likely to be focusing on managing liquidity, with lenders deploying capital selectively."

The infrastructure needs of the region are 39% greater than forecast investment[1] — with known gaps in energy provision, internet access and transportation. As a result, there is an urgent imperative to identify and enable new sources of finance outside traditional lenders and international partners. Further to the expected return of multilateral and bilateral lending, there is room for evolution to bridge the funding-opportunity gap.

580 million Africans do not have access to electricity[2]

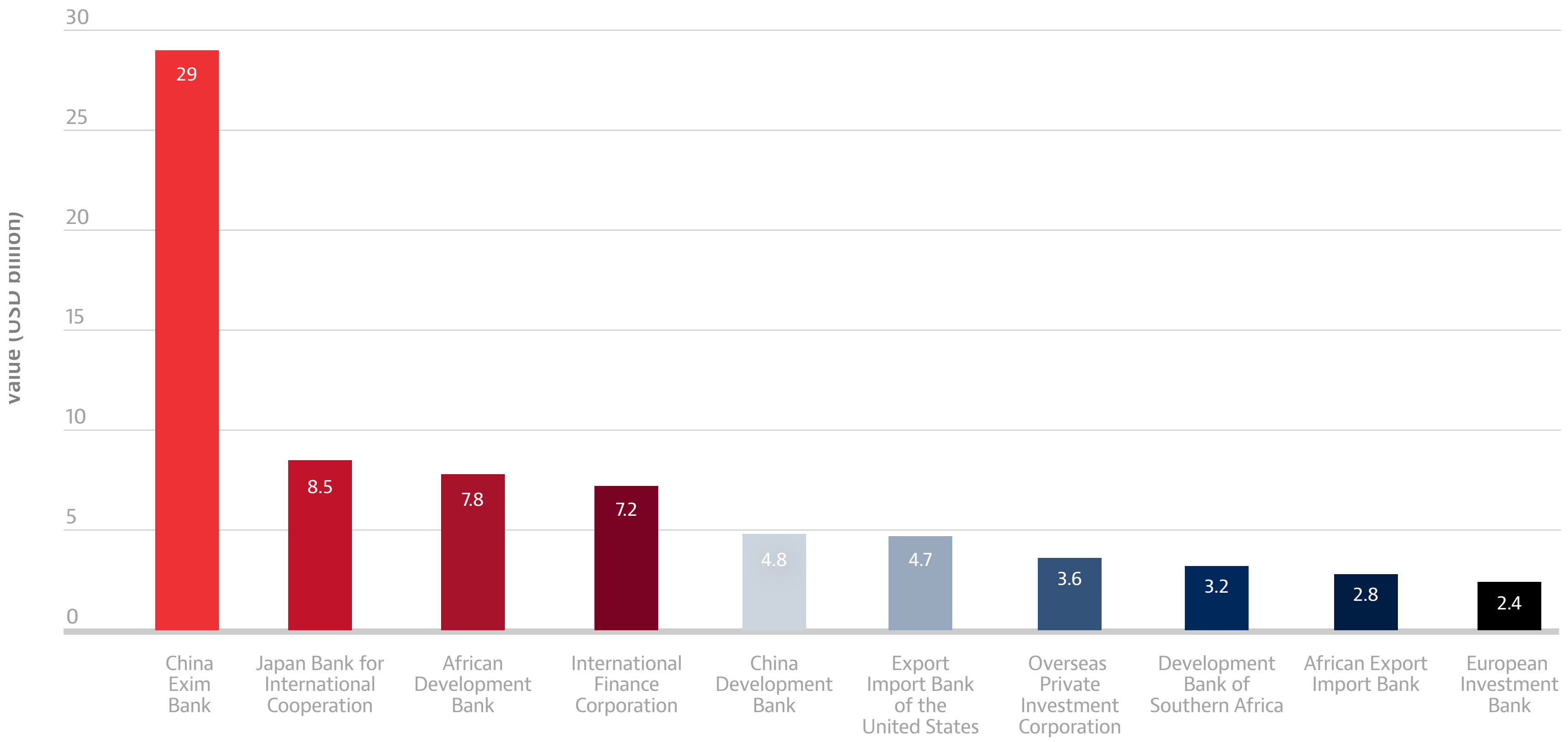
1 European International Contractors, Infrastructure Outlook to 2040, 2017: https://www.eic-federation.eu/industry/global-infrastructure-outlook-2040
2 IEA, October 2020, https://www.iea.org/reports/sdg7-data-and-projections/access-to-electricity

Lending by Chinese banks into energy and infrastructure projects in Sub-Saharan Africa saw a small uplift in 2020, although deal values are well below their 2017 peak. Simon Leung, Partner in Hong Kong, comments: "There has been a slowdown in the number of infrastructure deals from China. In the short-term, we expect to see more targeted lending — fewer projects of a higher quality using sophisticated structures — and new finance options such as factoring used to deploy Chinese capital into the region."

It is also clear that other international players have the region in their sights, with key political changes in the US and UK likely to see capital flow into Africa. Michael Foundethakis, Global Head of Project and Trade & Export Finance and Partner, in Paris notes: "The US hasn't kept pace with Chinese lending into Africa. The recent change in administration is likely to renew focus on impact — building and financing strategic long-term projects in the region, but bankability and risk-sharing remain a priority for US lenders.

Lodewyk Meyer, Partner in Johannesburg, adds: "The infrastructure funding gap is so large and of such strategic importance, it remains necessary to encourage international investment to fill it. African DFIs are very good at collaborating and I am encouraged by the actions of the new US administration, UK government and New Development Bank in particular in their willingness to work with regional institutions in this regard. The UK is making a strong play for influence, investment and trade with Africa post-Brexit. Further to key summits held in 2020 and 2021, there are signs that finance will be redirected into Africa."

Figure 4. Top infrastructure lenders in Africa (2008 to 2020) (USD billion)



Source: IJ Global, 2021

Growing a sustainable future in Africa

A conversation with Vibhuti Jain, Regional Managing Director for Africa at the US Development Finance Corporation (DFC)

Where is the greatest demand for new project finance in Africa and how is this reflected in the DFC's investment plans?

There is significant demand for project finance across the continent. Investment can help address longstanding challenges such as food insecurity and insufficient electricity, and address the needs of a growing urban and consumer population by building modern infrastructure and expanding access to affordable internet.

As we continue to confront the COVID-19, investment will also support development and distribution of diagnostics, therapeutics and vaccines, and help expand access to other critical services like clean water and sanitation. The DFC has a strong focus on achieving inclusive growth by supporting projects that benefit people and communities most in need, and by concentrating our investments in lower-income countries.

How has the global pandemic affected the outlook for infrastructure projects in Africa?

In addition to creating a global health pandemic, COVID-19 created a significant liquidity crisis, while border closures and stay-at-home orders resulted in a variety of logistical challenges to infrastructure development. These challenges highlight the critical role DFC and other DFIs play in providing financing and liquidity through challenging times.

In addition to the DFC's direct financing of African infrastructure, the Agency committed USD 250 million in 2020 to the African Finance Corporation for a tier 2 capital loan to strengthen AFC's capacity for bridging Africa's infrastructure deficit. Looking ahead, DFC's focus on COVID-19 recovery should help investors gain comfort about continuing to be involved in African infrastructure. The global pandemic has highlighted the need for strengthening local healthcare infrastructure, and DFC is committed to investing in projects that boost innovation, strengthen supply chains, and supporting businesses that can provide quality care and services in developing countries.

Latest data shows China and Japan leading bilateral investment in African infrastructure projects. Is the US losing its "battle of influence" in the region?

Our approach is very different from that of authoritarian state-based investors. We are committed to supporting investments that deliver tangible benefits to the people of the developing world, which are built with respect for local communities and the environment. By partnering with private businesses, we can ensure that the projects we support are built to high standards, and on financially sustainable terms. This attention to quality and on achieving a positive impact helps ensure that our projects will create opportunity and economic growth and stability in the countries where we invest.

We can only speak to DFC's investments in Africa, and confirm our continued interest in growing our portfolio on the continent. In 2020, DFC committed more than USD 1 billion toward transactions in Africa across 21 projects and currently has more than USD 8 billion in active commitments on the continent.

What is the outlook for public-private finance arrangements in Africa?

By statute, DFC must not compete with or supplant available sources of private sector support or crowd out private sector lending. DFC and its predecessor agency, the Overseas Private Investment Corporation, have a strong track record of working closely with commercial banks to mitigate risks and increase the volume of finance in Africa.

In 2020, DFC approved a USD 50 million loan to help create the DFC-MASSIF COVID-19 Response Co-Financing Facility, in partnership with the Netherlands Development Finance Company (FMO). This facility will lend to financial intermediaries facing COVID-19 related liquidity constraints, with a focus on those on-lending to MSMEs and prioritizing MSMEs owned or led by women.

Additionally, DFC collaborates with commercial insurers as a means of mitigating risk and contributing toward economic resilience and recovery in Africa. In one such example, DFC financing to an insurance syndicate will support the distribution of COVID-19 vaccines and other health products to developing countries, mitigating the risk of transporting temperature-sensitive shipments. We know that public-private finance arrangements will continue to be an important model for development in Africa, as an effective way of allocating risk and crowding in private capital.

In what ways are environmental, social and governance (ESG) issues driving project finance in the region?

All DFC investments adhere to high standards and respect the environment, human rights and worker rights. This close attention to standards begins when we initially review potential projects and continues over the life of all approved projects. Our new Impact Quotient (IQ) tool measures impact and helps us report development outcomes to key stakeholders, and use findings to inform future projects and maximize impact.

SECTION 2

Patterns of Change Reshape the Infrastructure Lending Ecosystem

> "The stage is set for a change in capital financing — who funds infrastructure projects and how."

Jim O'Brien

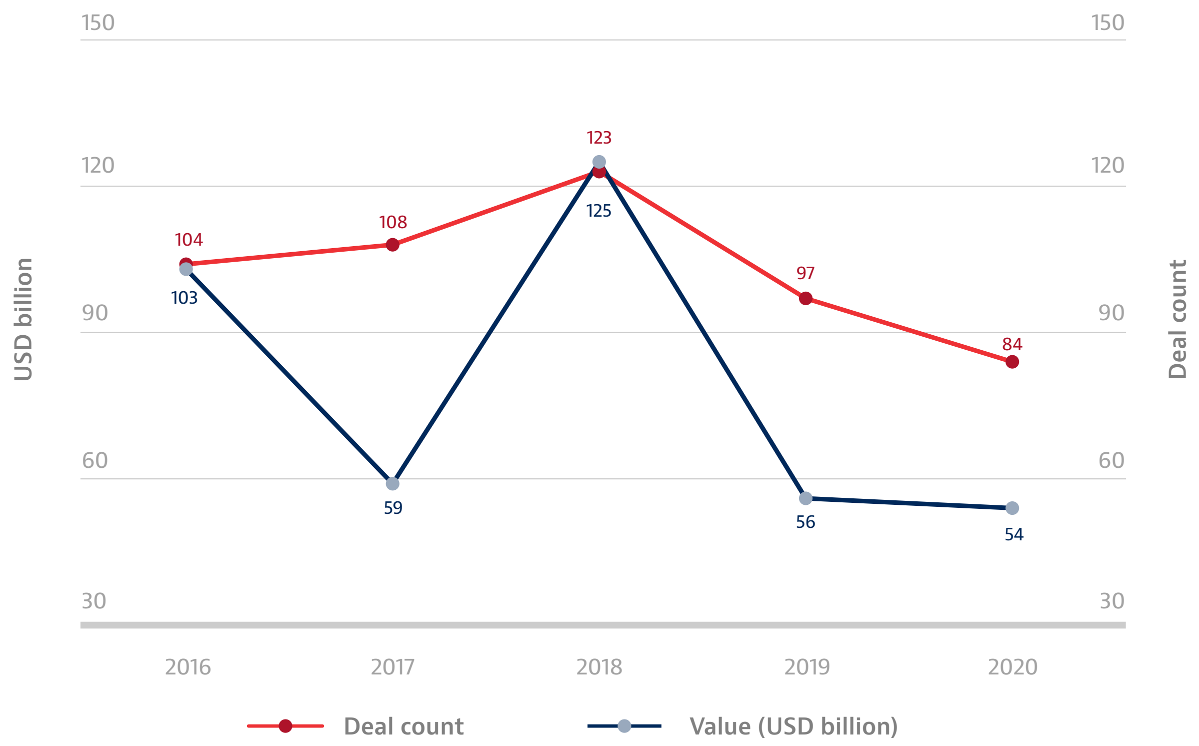
Chair of the Global Projects Practice Group and Partner in Chicago

DFIs continue to be the main providers of long tenor infrastructure finance in Africa — particularly as international banks have largely withdrawn from the region. Trends indicate that these institutions have taken a step back from project finance in general — facing higher capital requirements and ongoing uncertainty associated with the pandemic.

But the vacuum is unlikely to be filled by commercial banks. In 2020, just 84 projects were supported by commercial bank finance and their involvement in DFI and ECA deals continues on a downward trend. Instead, local and regional banks, specialist infrastructure funds and private equity and debt are stepping in to collaborate with DFIs and access returns.

DFI involvement in the infrastructure ecosystem at large is deepening. Increasingly, DFIs anchor the infrastructure ecosystem in Africa — serving a critical function for project finance as investment facilitator and a check on capital. They can shoulder political risk and access government protections in a way that others can't, enter markets others can't and are uniquely capable of facilitating
long-term lending.

Figure 5. Project Finance — Participation of commercial banks in DFI and ECA deals



Source: IJ Global, 2021

Key players report that DFIs have taken on broader roles on recent deals — offering new guarantee products to facilitate lending and even monitoring adherence to ESG commitments on key projects. This is particularly important as inbound private finance interest in Africa rises.

The amount of capital needed to fill the infrastructure gap is significant and DFIs can't bridge it alone. Private equity, debt finance and specialist infrastructure funds are primed to enter the market, and multi-finance and blended solutions are expected to grow in popularity as a way to de-risk deals and support a broader ecosystem of lenders.

Luka Lightfoot comments: "We expect to see an increase in non-bank activity in Africa in future as a result of new credit mitigation products come to market. We have seen an increase in appetite from established market participants, such as development banks, to create products that are not tied to existing arrangements that may have limited the type of finance available."

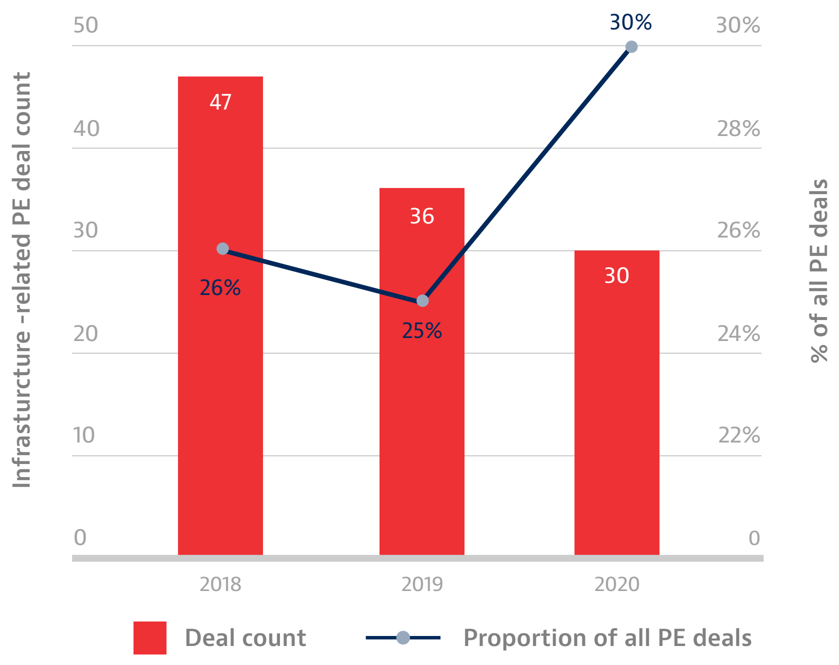
However, while there is growing interest from private capital, converting intention into investment is not without challenge. Nick Tostivin, Partner in London, notes: "The market is keen for a greater number of borrowers in the region to access international finance, especially with the support of DFIs or guarantee structures. Critical work is happening in relation to compliance and ESG transparency, which will have a big role to play in market growth and development."

Jim O'Brien adds: "While Western governments may be keen to finance climate friendly projects in the region, they must be prepared to work with what Africa has — oil and gas and minerals. For development finance to be transformational, parties must do the deals that are there and not the ones they wish were available."

The number of Private Equity (PE)-backed deals in support of African infrastructure has declined over the last three years. But the proportion of infrastructure-related deals compared to all inbound PE investments was highest in 2020 — signaling growing desire to finance fundamental energy, telco and mobility projects in the region.

Wildu du Plessis believes that foreign PE funds are poised to act: "These are the investors to watch in Africa over the coming decade. There is considerable dry powder available and a lack of stellar opportunities elsewhere. But this interest will only continue if growth in key African economies meets expectations. If growth lags, the returns calculus won't look so good and investors may rethink."

Figure 6. Infrastructure-related Private Equity investment



Source: IJ Global, 2021

The future of infrastructure finance

A conversation with Wale Shonibare, Director of Energy Financial Solutions, Policy & Regulation at the African Development Bank

What is the outlook for infrastructure finance in Africa?

Prior to COVID-19 we saw significant growth in African economies. Power, transportation and oil & gas were the key drivers of economic prosperity and ten of the fastest growing markets in the world were in Africa. However, rating downgrades, commodity price fluctuations and logistical challenges arising from the pandemic have made it more difficult to attract FDI in the immediate term. As a result, the infrastructure gap will widen.

We hope the impact of COVID-19 will be short lived and believe there is underlying resilience in the market. In its 2021 African Economic Outlook, the Bank projects that the continent will recover from its worst economic recession in half a century, with a 3.4 per cent growth in real GDP after a 2.1 per cent contraction in 2020.

Africa's infrastructure finance prior to COVID-19 was bright as evidenced by the 125 per cent capital increase in the authorized capital of the African Development Bank (AfDB) in 2019, to USD 209 billion in recognition of the investment requirements of its regional member countries. We have also seen new multinationals being created in recent years — including the Asia Infrastructure Investment Bank and New Development Bank — with a significant allocation towards Africa and ambitious plans. Similarly, international initiatives such as the Sustainable Development Goals, Agenda 2063 of the African Union and the Paris Agreement indicate the long-term commitment of multilateral organizations in Africa, particularly in support of global ESG targets.

How is the role of DFIs changing within the infrastructure finance ecosystem, relative to commercial banks and private finance?

DFIs are not here to replace commercial banks or other lenders. Our role is to step in where there are gaps and market failures. For example, where deal tenor is too long for most appetites, we have developed innovative instruments that allow commercial banks and other lenders to finance 10, 15 and 20-year projects, including "mini-perm" structures for early exit.

This is particularly relevant as private finance interest in Africa grows, and we've certainly come a long way in this regard. Just a few years ago there were no dedicated infrastructure funds operating in the region. Now, there are new specialist players emerging.

However, the bulk of these investments is still in hard currency, which is a problem given the structure of most African economies and exposure to currency devaluation. Asymmetry in the value of the investment currency compared to revenue leaves projects susceptible to volatility.

To mitigate this risk, we are keen to encourage local currency lending in more mature markets with deep reserves of local savings. For example, AfDB recently invested NGN 3.6 billion in the Nigeria Infrastructure Debt Fund, Africa's first and only listed infrastructure debt fund that extends long-term and local currency debt to infrastructure projects. African countries are also setting up domestic reserve funds such as Africa 50 and Sovereign Wealth Funds, which are locally owned and able to invest directly as an institutional investor but also as a partner to private international investors.

To what extent is China's approach to investment in the region evolving?

China's investment in Africa has grown very quickly, to such an extent that in 2015 the country provided more financial assistance to the region than the World Bank. Between 2007 and 2020, Chinese investments and contracts in Sub-Saharan Africa amounted to USD 303 billion, of which USD 104 billion was channeled to the energy sector.

We have seen a change in how Chinese players are interacting within the infrastructure finance ecosystem. The establishment of the Asian Infrastructure Investment Bank, with 10 member countries from Africa, and the New Development Bank marked a particularly significant moment in promoting collaboration. These institutions have worked hard to get African countries to engage and are connecting with established DFIs to adopt consistent lending standards.

However, China's share of African debt has also increased, and when countries are in distress and need to renegotiate, it is not always clear how much is owed to China. Greater transparency in this regard will enable a better, harmonized and consistent approach to debt restructuring and repayment for all players.

In what ways are environmental, social and governance (ESG) issues driving project finance in the region?

ESG has become extremely important in relation to project finance. Africa suffers the disproportionate impact of climate change compared to its emissions, so having environmental safeguards in place is particularly impactful.

More investors are now focused on ESG issues, and increasingly DFIs have established their own standards for promoting good business practices that are being called upon in the course of project finance deals. It is therefore not surprising that ESG issues rank very high on AfDBs' corporate agenda, particularly in a time of resource constraints and rising social pressures, with public and private organizations facing an increased need for a strong approach to ESG integration in their operations. In this regard, AfDB has developed an Integrated Safeguard System — a cornerstone of its Ten Year Strategy (2013–2022) — to facilitate economic growth that is socially inclusive and environmentally sustainable across the African continent.

SECTION 3

Closing the Gap: Infrastructure Opportunities

Infrastructure represents a rich and varied investment category. Where do our partners see new opportunities?

CORE LOCAL AND INTRA—REGIONAL PROJECT

"The pandemic represents the end of an era and the start of a new one. There will be a re-prioritization of funds and strategy through this lens. I expect to see more investments in the healthcare industry and connected infrastructure, as well as water related projects, to be top priority. We should also consider the impact of other factors aside from the pandemic. For instance, the African Continental Free Trade Agreement and what it needs to translate into increased cross-regional trends. I would expect development of transportation and logistics infrastructure focused projects to enable the acceleration of on-ground execution of intra-African trade."

Lamyaa Gadelhak
Partner, Cairo

THE GREEN ECONOMY

"I am seeing a lot of funds being established in the infrastructure space, as private funds look to set up in the region. There will be big plays in the green economy and renewable energy — particularly wind, solar and hydro power and, in the agriculture sector, projects that can enhance the output of crops."

Wildu du Plessis
Head of the Firm's Africa Practice and Partner, Johannesburg

CONNECTED INFRASTRUCTURE

"Digital infrastructure and virtual working arrangements have become more important as a result of COVID-19 disruption, so I expect new opportunities in telecoms and data. But core infrastructure will continue to be very important. Nigeria, for example, has a huge power deficit, basic transportation infrastructure across West Africa is in need of investment and port congestion remains a big issue."

Emeka Chinwuba
Partner, New York

ENERGY

"Chinese banks and State Owned Enterprises (SOEs) are very focused on financing energy projects. There is a mandate to diversify the energy portfolio and increased appetite to acquire completed assets. We have seen particular interest from Chinese banks in increasing their investment share in energy projects that have recently become commercially operational — building on minority investments made in the boom years of 2014 – 2016."

Simon Leung
Partner, Hong Kong

CONCLUSION

Building a Positive Capital Cycle to Close the Infrastructure Gap

As new lenders enter the market and established institutions evolve, a more diverse infrastructure finance ecosystem is emerging. Multi-source finance is clearly the next step for project finance to meet domestic infrastructure needs.

However, Jim O'Brien comments: "This cannot be about Western aid. We want to see commercially backed projects operating on the right deal terms to encourage local bank involvement. Making it more profitable to lend to small businesses and projects than treasury bonds ensures capital is recycled into the local economy and reduces reliance on foreign capital offered in hard currencies."

Infrastructure needs are best served by a collaborative approach between players — particularly in pioneering new products and vehicles that overcome barriers to investment. Lodewyk Meyer believes there is enough space for everyone in the market — long and short tenor, small and large projects, but he notes: "There needs to be more collaboration. A funding mix is required to fill the gap and each actor in the value chain has a role to play. The emergence of direct funding platforms — where buyer-meets-seller across the full mix of DFIs, ECAs, equity and debt finance — will be a useful innovation in administering this diversified ecosystem."

There are considerable opportunities across the continent, but not without responsibility. Lenders must consider how their investments and the projects they finance will build a positive capital cycle — a sustainable approach that facilitates self-financing via African DFIs and institutions that can multiply capital, and delivers community outcomes as well as commercial returns.

Michael Foundethakis concludes: "It is imperative that capital is sustainable and any investment it finances provides ancillary benefits to local economies. As well as being bankable and yielding attractive returns, investment should be net positive for the region."

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