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The appetite for African infrastructure: Participating in African infrastructure investing takes patience and the right team

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Institutional investors all over the world are watching patiently as many Western and Eastern nations discuss renewed commitments to infrastructure spending.

In the United States, Republicans and Democrats are providing their versions of what they would like to get done. For example, Senate minority leader Chuck Schumer of New York introduced a 10-year, $1 trillion infrastructure-building plan. Republicans, on the other hand, have already tangled with President Trump's vision of infrastructure, as senate majority leader Mitch McConnell of Kentucky said he hopes to "avoid a trillion-dollar stimulus."

Meanwhile, the Canadian government under Prime Minister Justin Trudeau has announced its intention to establish the Canadian Infrastructure Bank to provide low-cost financing for new infrastructure projects. And in China, the year-old Asian Infrastructure Investment Bank has invested in nine projects across Europe, Asia and the Middle East, and has extended loans internationally of more than $1.7 billion.

But it is the continent of Africa that also has piqued the minds of investors. There is a global realization that the need for investments there is high; opportunities are plentiful and potential rewards could be great. But, of course, there are unique risks with investing in that part of the world. Talking about the "region" of Africa can mean many things. There are obviously different areas that require different infrastructure projects with different risk profiles. However, investors are starting to look at certain asset classes and how investments today could pay off in the future.

According to the Africa Infrastructure Country Diagnostic (AICD) put out by the African Development Bank, the infrastructure needs of sub-Saharan Africa exceed $93 billion annually over the next 10 years. The bank goes on to report that less than half of that amount is being provided to the continent, thus leaving a financing gap of more than $50 billion. On infrastructure finance, the bank notes, "The poor state of infrastructure in sub-Saharan Africa — its electricity, water, roads, and information and communications technology — cuts national economic growth by two percentage points every year and reduces productivity by as much as 40 percent."

These numbers play an important role in how investors view the opportunities in the region. "Infrastructure in Africa is a huge constraint to growth and Africa's standard of living," notes Andy Louw, principal, infrastructure investments with money management firm STANLIB. Louw estimates that if everyone in Africa had a light bulb, the continent could only produce enough energy to light those bulbs for six hours per day. And, he adds, South Africa has 50 percent of Africa's installed energy capacity.

"So the infrastructure challenge we have is enormous," he says, "and with it comes complexities because we don't have the developed programs and documentation that can be quickly rolled out which allows you to invest into projects quickly and efficiently."

Power to the people

But it is just those inefficiencies and the lack of current development on the continent that provides investors with the new, untapped opportunities they are looking for. For example, power generation is a real need on the continent. According to Paul Frankish, investment director with African Infrastructure Investment Managers, the continent, excluding South Africa, produces about 50 gigawatts of power generation. By contrast India has a similar population but produces about 250 gigs of power generation capacity.

“There is a dire need for electricity and that is a focus for [us] and a lot of the other funds on the continent,” explains Frankish. “We have a focus on the clean aspects of thermal power, and this is something you need before you can add large amounts of variable power to the grid. That’s something we’ve seen — an increase in investment activity.”

For its part, AIIM manages six funds with about $1.6 billion of assets under management. That represents about 40 transactions with operations across 11 African countries. By far, adds Frankish, the majority of its investments have been in power generation.

Connecting via towers

Investors have also shown an interest in Africa’s telecommunications sector, with a focus on cell phone towers specifically. Hurley Doddy, managing director and founding partner of Emerging Capital Partners, says, “Africa, in general, has had a very big boom in telecoms since we’ve become investors.” There are about 750 million cell phones in Africa today, Doddy relates, up from only 25 million in 1999. “Africans have essentially skipped landlines and gone straight to smart phones. Eventually, those consumers will want data from those same networks, which will require a big investment into the infrastructure that supports that.”

He notes that his firm invests in IHS Towers, a telecommunications towers company invested in Africa, which operates more than 21,000 towers in four countries. “This remains a growth business,” he stresses. “It’s a big continent. You’ve got good growth in the underlying demand for telecommunications services — particularly data. We’ve helped build IHS into a big company, but there is certainly a lot of room to grow in that industry.”

On the road again

The toll-road sector is another strong area that deserves a second look by investors, according to Frankish with African Infrastructure Investment Managers. He notes that countries such as Uganda and Kenya are developing expansive toll road programs. In spring 2016, the Kenya National Highways Authority Manager of Special Projects, Kefa Seda, said that the procurement process of private investors to manage the roads is under way. The first projects to be privatized include a 298-mile road between Nairobi and Mambasa; a 119-mile highway connecting Nairobi to Nakuru; the Nairobi Southern Bypass; and the Thika super highway.

Navigating challenges and risks

In many respects, the lack of proper infrastructure networks — electricity, telecom or otherwise — perpetuates the problems that prevent the adoption of formal programs by governments to help solve these issues. STANLIB’s Louw explains the lack of formal programs makes it long, difficult and costly to invest in anything. “But when you have a team that is looking to deploy capital for infrastructure in Africa, such as ourselves, those teams are generally specific in what they are trying to achieve and can't be all things to all people." As a result, Louw adds, investors need to be "purposeful" in what they are investing in and should find areas that are considered "low hanging fruit."

STANLIB invested in renewable energy in South Africa in 2011 through the Renewable Energy Independent Power Producer's Program. "This program garnered significant interest in the investment community," says Louw. This was mainly because it had a detailed program that limited the tariff the government would pay to investors for the megawatt power produced — to protect it on the downside — but made the tariff large enough to be attractive to investors.

Frankish with African Infrastructure Investment Managers says Africa is increasingly becoming an investment destination of interest for pension investors, institutional investors and sovereign wealth funds throughout Asia, Europe and North America.

"Fundamentally," he explains, "the perceived risks of investing in Africa are greater than the actual risks encountered in practice." The outlook of those investors already on the continent, he goes on to explain, are vastly superior to those that have yet to invest. Generally, though, investors are interested in the construction risk, operations and maintenance, the currency risk, the political risk and the counter-party risk.

But these things can be mitigated. Frankish says they work with international construction and engineering contractors with guaranties in place to support any cost of timing over-runs. Robust long-term operations and maintenance contracts also are put into place, which often include performance and availability guaranties. In general, while public-private partnership models are becoming more common, government involvement would generally be as concessionaire and not through an equity stake, Frankish adds.

"Particularly in the renewable sector, the regulatory risk created through tax benefits or subsidies in developed markets is sometimes understated and in Africa, where contractual tariff-based offtakes are commonplace, regulatory [concern] is often overstated," explains Frankish.

The robust nature of the contractual agreements — which outside of South Africa are generally "dollarized" or linked to the euro — and which investors generally insist upon when investing in Africa, helps mitigate many of the risks that could come up.

The bottom line

As investments in developed regions become more scarce and/or difficult to source, large investors are looking to less-developed regions such as Africa to grow their investments. The needs of the population in terms of telecommunications, data, water and energy are making it more attractive for investors to consider taking a long-term chance. Investors need the right — i.e., local — team in place to source deals and create robust, ironclad contractual agreements to help mitigate perceived risks that investors believe are part of the regional environment. It appears the timing and needs of the continent are coalescing to make it a more attractive place for institutional investors to expand their investments.