A crucial era in infrastructure: the case for privately funding SA's infrastructure crisis

Conservatively channelling SA's deep savings pool into infrastructure could be a game changer

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South Africa should be spending at least 30% of GDP by 2030 on infrastructure to promote inclusive economic growth. Unfortunately, spend has tracked well below this target since the early 1980s, and we significantly lag other, faster growing economies in this key metric. Inadequate investment in critical infrastructure such as energy, rail, road, ports and housing has been a significant contributing factor to South Africa's poor economic performance. Better infrastructure brings with it more inclusive growth and prosperity, as well as global competitiveness – something we sorely need.

Compared to the rest of the world, SA is in the bottom quartile of gross fixed capital formation (GFCF) as a percentage of GDP, with the World Bank estimating it at 14% in 2020. This is just over half of the world average at 26%. The South African Institution of Civil Engineering (SAICE) has rated 17 out of 32 different infrastructure segments as being 'at risk of failing' or 'unfit for purpose', indicating that the situation clearly needs urgent and sustained attention for the benefit of all members of our society.

As upgrading our infrastructure takes on added urgency, and ESG considerations become increasingly important and prevalent, we are witnessing the convergence of developmental credit and commercial credit. This convergence has seen commercial credit investors waking up to the infrastructure opportunity and the asset class becoming even more relevant. However, SA is still some way behind other emerging markets, where there has been a clear shift towards providing debt to non-cyclical businesses.

Now, however, the landscape for infrastructure investment in South Africa is improving and showing large scale opportunity. Numerous government reforms include accelerated adoption of policy positions on renewable energy and independent power producers (IPPs) and a temporary ban on the scrap metal trade – one of the biggest drivers of localised blackouts and the effective collapse of South Africa's rail networks. This has coincided with the development of teams of infrastructure specialists with a wealth of private and public sector expertise, which combined with institutional-grade risk processes, can cater to a deep savings pool eager to invest in infrastructure.

Equity provides the catalytic energy to get projects off the ground and is key to the transition.

Infrastructure debt is becoming increasingly interesting for large allocators for a few reasons. Debt provides a large and attractive investment opportunity to deploy in size typically accounting for 70-90% of the funding required for projects. As a debt investor the equity upside is forgone, but in its place the investment becomes more defensive and provides greater certainty thanks to preferred rights to the underlying assets and cash flows. Debt providers can exploit their position in the funding structure to encourage, influence and incentivise borrowers to design and operate their projects in an impactful and sustainable way. Finally, the speed at which investment can take place is also fast tracked given the protections afforded to debt holders, standardised terms and the growing opportunity set in both the private and public markets.

The government's infrastructure investment plan presents ample opportunity for private investment, representing an investment value of more than R2.3 trillion in more than 200 projects, spanning sectors from transport, water and energy to human settlements and digital communications. Asset owners are starting to recognise the benefits that investment in infrastructure offers, such as predictable steady cash flow with low volatility. The actual defaults and losses experienced in infrastructure debt is lower than the perceived risk, behaving more like a portfolio of investment grade corporate bonds.

The enormous infrastructure funding need will require the involvement of both commercial and developmental lenders. On the commercial side, banks alone will not be able to provide enough support and are looking for partners through asset owners and fund managers.

The convergence of commercial and developmental objectives comes at the perfect time: South Africa has a deep savings pool which, if channelled effectively and conservatively, would not only be able to achieve commercial returns, but also curb unemployment and meaningfully address inequality and poverty. Delivering on this will require a collective effort between government, asset owners, asset consultants and the investment