Infrastructure Development
Funding and Financing

09 December 2013
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3. Funding options
   i. Recent airport developments and funding options in South Africa
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4. Funding models for the development of airports
5. Regulatory and policy challenges
The infrastructure challenge in South Africa

- The **infrastructure challenge has been escalated to a priority agenda** due to increased demand for service delivery and the need to **grow the economy** in tandem with population growth;
- These **challenges are not unique to RSA alone** but they are a continental problem and as part of the SADC region together is grappling to achieve economic growth, efficiencies and effectiveness.

**Macroeconomic drivers**

- The South African economy has averaged about 3% growth a year since 2009.
  - GDP growth is estimated to be below 2% in 2012/13, a GDP growth of 5% would meet the current needs of service delivery.
  - There was a modest recovery in job creation during 2012/13, but the unemployment rate remains high at 24.7%.
  - The national government’s budget deficit for 2013/14 is forecast to be 4.6% of GDP and public sector borrowing requirements at 7.4% GDP.
  - Total gross loan debt was R1.5 trillion as at 30 September 2013, equivalent to 44.7% of GDP.

**Current infrastructure developments**

- Budgeted public sector infrastructure spending of roughly R845 billion is planned for from 2012/13 to 2014/15 of which R300 billion is targeted to the energy sector and R262 billion in transport.
- To 2020 R3.2 trillion is expected to be invested in 43 large scale projects in areas such as:
  - Adding 11,719 MW of power generation capacity and 6596 km of high voltage transmission lines.
  - Replacing 6405 km of rail freight, coal and ore lines increasing rail network capacity by 149.7 million tons, and procuring 1317 new locomotives and 25,000 new wagons.
  - A R100 billion port expansion at Durban.
Energy and Transport represent the bulk of South Africa’s investment in infrastructure, which is now a significant proportion of total Government borrowings.

<table>
<thead>
<tr>
<th>Fiscal years</th>
<th>Energy</th>
<th>Transport and logistics</th>
<th>Water and sanitation</th>
<th>Other economic services</th>
<th>Justice, protection, and central government administrative and financial services</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011/12</td>
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<td>2012/13</td>
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<td>2013/14</td>
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<td>2014/15</td>
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Government borrowings (R billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>2011/12</th>
<th>2012/13</th>
<th>2013/14</th>
<th>2014/15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public sector borrowing requirement</td>
<td>213,9</td>
<td>235,1</td>
<td>225,3</td>
<td>200,8</td>
</tr>
<tr>
<td>General government borrowing</td>
<td>145,7</td>
<td>158,2</td>
<td>147,8</td>
<td>126,7</td>
</tr>
<tr>
<td>Non-financial public enterprises</td>
<td>68,2</td>
<td>75,9</td>
<td>77,6</td>
<td>74,1</td>
</tr>
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Source: South African Reserve Bank, Quarterly Bulletin March 2012
**Sources of Funding: Public Sector Infrastructure Programme**

- South Africa’s **public sector infrastructure programme** is expected to be **funded from a range of sources**

<table>
<thead>
<tr>
<th>Funding options</th>
<th>Source of funds utilised</th>
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<tr>
<td>- A combination of <strong>internally generated surpluses and borrowings</strong> from capital markets by public enterprises.</td>
<td>- Enterprises such as Eskom, Transnet, SANRAL and ACSA have made use of corporate bond markets and short term commercial paper facilities.</td>
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<tr>
<td>- <strong>Direct private sector investment</strong> such as the Department of Energy’s 3,625MW renewables Independent Power Producer Procurement Programme currently underway.</td>
<td>- <strong>Multi-lateral institutions</strong> such as the African Development Bank; Development Bank of Southern Africa; the World Bank; and the French Development Agency</td>
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<tr>
<td>- <strong>Mixed shareholding</strong>, such as that for Telkom South Africa (Government retaining 38% shareholding) and Airports Company South Africa (Government retaining roughly 75% of shareholding).</td>
<td>- <strong>Local institutions</strong> such as the Industrial Development Corporation and Public Investment Corporation</td>
</tr>
<tr>
<td>- <strong>Direct government contributions</strong> for entities such as Passenger Rail Agency South Africa (PRASA) and Eskom</td>
<td>- <strong>Sovereign funds</strong> (e.g. China and the Middle East)</td>
</tr>
</tbody>
</table>
Funding options

Considerations:

- Risk Management
- Transaction Costs
- Exposure to market or other disciplines
“The key to successfully raising enough investment for tomorrow’s essential infrastructure will rest in finding the optimum balance between public and private money.”

PwC: 2013
“Airports are **capital-intensive enterprises**, requiring **significant resources** to fund land acquisition, airfield development, terminal development and supporting infrastructure to successfully **meet the demands of the airlines and the service demands of travelling public**”

Source: Airport financing in the United States
Investments across the South African airport network amounted to **R17 billion between 2008 and 2011**

- **98%** of the R17 billion was funded through debt
- **Internally generated funds utilized** for investments (1994 – 2006) & maintenance CAPEX
- **Service quality improvements** were evident at all airports
South Africa now close to the top 10 countries in the world in terms of quality of airport infrastructure, bucking the trend in other sectors.

Source: WEF-GCR
Recent global airport funding

Brazil
- Plans to attract airport development funding through airport concessions as Public Private Partnerships (PPP’s)
- Four of the largest airports awarded to private concessions by 2012 with another two airports in October 2013

India
- Attraction of investment at the three largest airports through airport concessions to private investors (PPP’s) between 2004 and 2006
- Economic regulation introduced in 2009 to regulate tariffs and service levels

China
- Airport developments funded from airport taxes collected by the State Treasury
Debt financing

- Debt financing represents a significant component of infrastructure funding
- World Bank Group – infrastructure projects funding (2009) were at 70/30 (debt/equity)
- Availability of funding and cost of funds remains a critical issue
- The credit worthiness of the entity acquiring financing
Market expectations and supportive regulatory environments

- Moody’s provides its **approach to rating regulated utilities** in which it sets out the following 4 key rating factors and weighting in its assessment of credit ratings for regulated utilities*

<table>
<thead>
<tr>
<th>Moody’s Rating Factor Weighting - Regulated Utilities</th>
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<tbody>
<tr>
<td>Broad Rating Factors</td>
</tr>
<tr>
<td>Regulatory Framework</td>
</tr>
<tr>
<td>Ability to Recover Costs and Earn Returns</td>
</tr>
<tr>
<td>Diversification</td>
</tr>
<tr>
<td>Financial Strength, Liquidity and Key Financial Metrics</td>
</tr>
</tbody>
</table>

Factors cited by Moody’s

- **Predictability** of regulatory decision making: the level of political intervention in the regulatory process, and the strength of the regulator’s authority over regulatory issues.

- **Supportive regulatory environments** and cost recovery mechanisms.

- Historic and projected financial performance as assessed by standard credit metrics.

* Source: Moody’s Rating Methodology, Regulated Electric and Gas Utilities August 2009
Government guarantees and the cost of debt

**Theory**
- Government guarantees can support the amount of borrowings a state owned corporation is able to source and the yield required by debt providers.
- However, a government’s cost of capital is not independent on the level of support provided to state owned enterprises in the form of direct guarantees and/or associated contingent liabilities.
- For example, where government is either legally obligated to service the debt of a wholly-owned entity in the case of default – or there is a strong expectation of the same by debt providers – the availability of funds is reduced and the cost is greater than it otherwise would have been.

**And practice**
- The relevance of contingent liabilities is illustrated by recent actions pertaining to SANRAL, whereby in an affidavit to the Constitutional Court of South Africa (21 May 2012) the Minister for Finance stated that if SANRAL was to default on its outstanding loans there would be:
  - “considerable risk of negative consequences for the South African Government’s capacity to raise funds from capital markets. The credit rating of SANRAL in the money markets will in the first instance be severely affected, since it raises money by issuing bonds. The credit rating of South Africa would also be impacted on negatively, since SANRAL is a wholly government-owned entity and its standing affects the Government’s standing.” (emphasis added)
Regulated revenue and tariffs

Long term sustainable outcomes require internally generated funds supported by tariffs

- Proper licensing, monitoring, tariff setting and dispute resolution mechanisms must be in place.
- Tariffs and prices must recover all the efficient costs of supply
- Tariffs set to provide predictability (investor perspective)
Funding models for the development of airports

International experience has demonstrated that a variety of approaches can be found in the funding of public infrastructure. This variation is driven by the unique aspects of the sector and jurisdiction in mind.

Key factors include:

- **Infrastructure characteristics** — affecting the user profiles and revenue raising capacities of particular assets
- **Fiscal and macroeconomic conditions** — potentially restricting use of particular financing vehicles because of their budgetary consequences
- **Institutional arrangements** — defining the legal and regulatory framework as well as the intergovernmental relationship within which public infrastructure assets are operated and financed
- **Perceptions of the role of government** — and voters’ expectations for the involvement of government in delivering specific services and managing the economy
Funding models for the development of airports

Sustainability and efficiency of funding public infrastructure such as airports:

<table>
<thead>
<tr>
<th>Funding components</th>
<th>Sustainability</th>
<th>Efficiency</th>
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</thead>
<tbody>
<tr>
<td>Debt finance</td>
<td>Medium</td>
<td>Medium / high</td>
</tr>
<tr>
<td>Equity injection</td>
<td>Low / medium</td>
<td>Medium</td>
</tr>
<tr>
<td>Government grants</td>
<td>Low</td>
<td>Low / medium</td>
</tr>
<tr>
<td>Regulated revenue and tariffs</td>
<td>High</td>
<td>High</td>
</tr>
</tbody>
</table>
Regulatory and policy challenges

The regulatory environment is still developing:

- **Tariff levels** in some instances have not reached cost reflective levels needed to attract private sector participants.

- Appropriate regulatory and governance frameworks need to be applied to enable sustainable investment in infrastructure.

- Uncertain implementation of pricing frameworks further impedes investment in major projects (i.e. Sanral).

As these challenges are addressed, and with a proven track record of achievement, ongoing investment in South Africa’s infrastructure will provide the foundation for economic growth and development into the future.
Thank you