



ALTERNATIVE
INVESTMENTS
FORUM 2024

Infrastructure in a Balanced Portfolio

Alternative Investments Forum 2024

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Presenter:

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MERGENCE



Agenda

- Introduction to infrastructure
- Infrastructure to pension fund space
- Infrastructure assets creating dual returns
- Diversification and its role
- Why do pension funds not allocate to infrastructure assets?
- Conclusion



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Introduction to infrastructure



Size of the infrastructure gap

South Africa  4 

SA faces R4.8trn infrastructure investment gap by 2030

Unless country invests more – target is 30% of GDP.

By Roy Cokayne 15 Aug 2022  00:03

Funding South Africa's infrastructure spending gap

3SMedia | Jan 19, 2022 | [Construction](#) [Industry News](#) [News](#) [Other infrastructure](#)



The government is making critical headway in paving the way for private sector involvement in infrastructure investment, but there are outstanding factors that still need to be resolved if South Africa is to close its substantial infrastructure investment gap.

Need for investing in infrastructure in South Africa

Crumbling infrastructure & key SDGs informing our high priority themes with a strong impact thread

Water



Electricity



Accommodation





Types of infrastructure assets

ECONOMIC

Electricity generation

Transmission infrastructure

Commuter transport infrastructure

ICT and broadband infrastructure

Water infrastructure

Liquid fuels infrastructure

Rail & ports infrastructure

Road infrastructure

Airport infrastructure

SOCIAL

Affordable housing infrastructure

Healthcare infrastructure

Education infrastructure

ENVIRONMENTAL

Energy

Waste

Water

UNDERPINNED BY KEY THEMES:

1. DECARBONISATION

2. DIGITAL INFRA

3. TRANSPORT

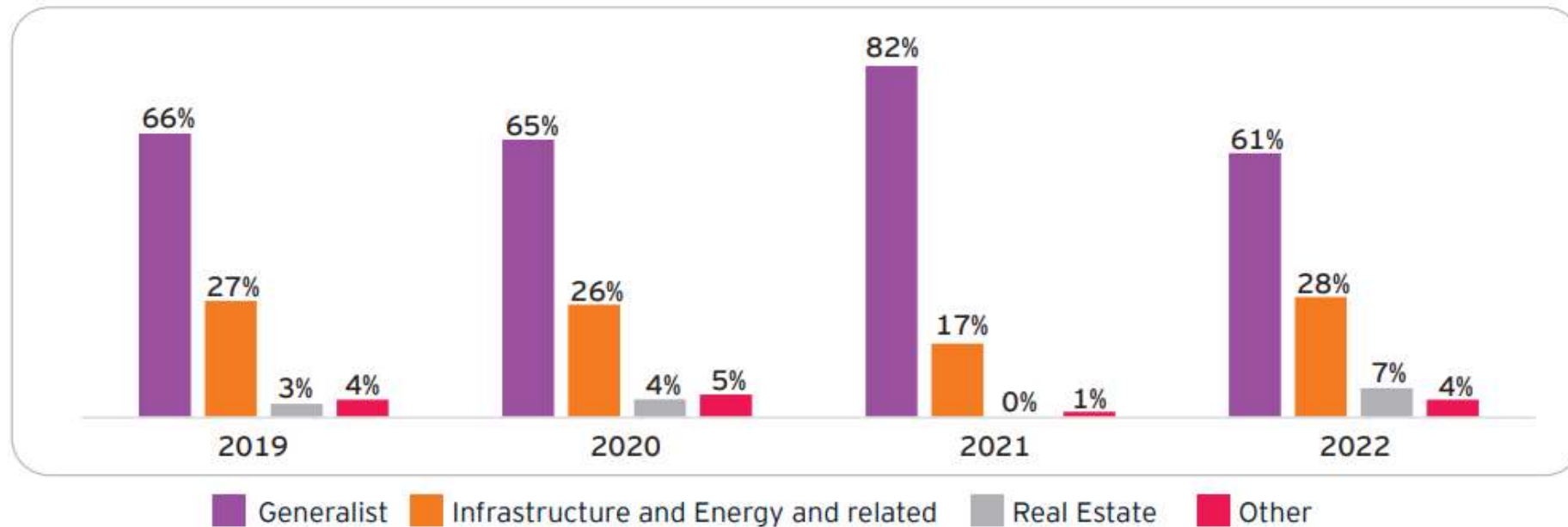
4. UTILITIES



Investment thesis | Manager view of market environment

- **Sector focused funds regained further prominence** as the proportion of FUM managed by Generalist PE funds continues to decrease, with Infrastructure focused PE funds the largest gainer

Composition of total FUM by focus of the fund (% of total at December 2019-2022)



PE fundraising in SA witnessed growth of 21% in 2022 in comparison to 2021, this is higher than the pre-pandemic average from 2015 to 2019 of R15.8bn with fundraising in 2022 of R19.6bn being 23.3% higher.

Source: SAVCA Private Equity Industry Survey 2023



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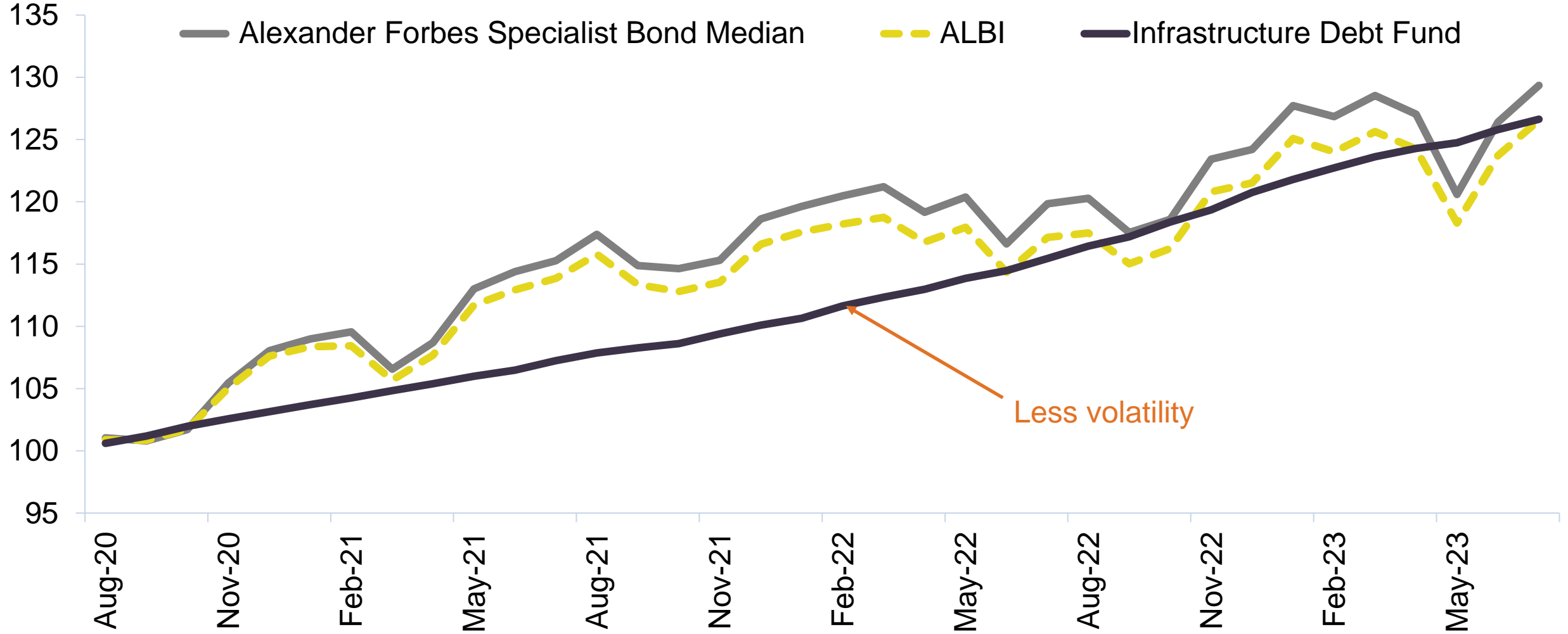
Infrastructure in the pension fund space



- Provide **diversification** to traditional asset classes
- Provide a **hedge for long-term liabilities/inflation**
- **Preserve** investment capital
- Provide sound returns to investors **through economic cycles**
- Generate an enhanced yield, underpinned by **stable cash flows**
- Act as **responsible steward** of infrastructure and development investments



Performance | Unlisted Infrastructure mandate



Less volatility



Infrastructure in the Pension Fund space

Regulation 28 – Illustration

- Maximum infrastructure investments = 45%
- Funds can allocate up to
 - **15% of fund exposure** to unlisted infrastructure through infrastructure **private equity funds**
 - **15% exposure** to unlisted infrastructure debt through **direct exposure / private infra. debt funds**
 - **15% exposure** to **listed infrastructure assets**

Funds and under which regulatory limits they would fall:

Type of Fund	Private Equity	Private Debt	Listed Debt	Listed Equity	Infrastructure Total
Example 1	15%	15%	15%		45%
Example 2	15%	15%		15%	45%



Infrastructure assets | Global Investment instruments & vehicles

Modes		Infrastructure finance instruments		Market channels
Asset category	Instrument	Infrastructure project	Corporate balance sheet / Broader entities	Capital pool
Fixed income	Bonds	Project bonds	Corporate bonds, green bonds	Bond indices, bond funds, exchange-traded funds (ETFs)
		Municipal, sub-sovereign bonds		
		Green bonds, Sukuk	Subordinate bonds	
	Loans	Direct/co-investment lending to infrastructure project, syndicated project loans	Direct/co-investment lending to infrastructure corporate	Debt funds, general partners (GPs)
			Syndicated loans, securitised loans (ABS), CLOs	Loan indices, loan funds
Mixed	Hybrid	Subordinated loans/bonds, mezzanine finances	Subordinated bonds, convertible bonds, preferred stock	Mezzanine debt funds (GPs), hybrid debt funds
Equity	Listed	YieldCos, closed-end funds	Listed infrastructure & utilities stocks, closed-end funds, Real Estate Investment Trusts (REITs), Infrastructure Investment Trusts (IITs), Master Limited Partnerships (MLPs)	Listed infrastructure equity funds, indices, trusts, ETFs
	Unlisted	Direct/co-investment in infrastructure project equity, PPP	Direct/co-investment in infrastructure corporate equity	Unlisted infrastructure funds (GPs)

Source: The Organisation for Economic Co-operation and Development (OECD)



SA Limitations

- **Limited green / project bond issuances**
 - CoCT, COJ, IDC, DBSA, Commercial banks, 2x RE projects, Growthpoint
- **Listed infrastructure**
 - Mahube, Transnet & Eskom
- **Direct investment**
 - Requires in-house team (e.g. EPPF, GEPF through PIC)
- **Private markets**
 - Widest variety of managers with both debt and equity products



Infrastructure assets | SA Investment instruments & vehicles (current)

Modes		Infrastructure finance instruments		Market channels
Asset category	Instrument	Infrastructure project	Corporate balance sheet / Broader entities	Capital pool
Fixed income	Bonds	Project bonds	Corporate bonds, green bonds	Bond indices, bond funds, exchange-traded funds (ETFs)
		Municipal		
		Green		
	Loans			Debt funds, general partners (GPs)
Mixed	Hybrid			Mezzanine debt funds (GPs), hybrid debt funds
Equity	Listed			Listed infrastructure equity funds, indices, trusts, ETFs
	Unlisted	Direct/co-investment in infrastructure project equity, PPP	Direct/co-investment in infrastructure corporate equity	Unlisted infrastructure funds (GPs)

Source: The Organisation for Economic Co-operation and Development (OECD)



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Infrastructure assets creating dual returns



Financial returns + Social returns = Sustainable Shared Value

Infrastructure investments playing a pivotal role in creating sustainable shared value





Infrastructure assets creating INVESTMENT RETURN

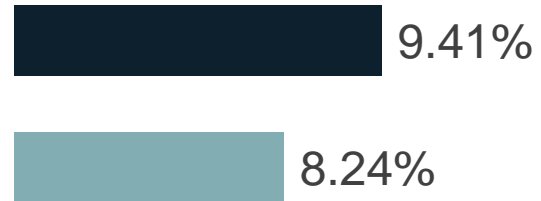
Mergence infrastructure portfolios vs benchmark for the period since inception* to 28 February 2024

■ Fund
■ Benchmark

Infrastructure & Development | Debt

Benchmark: CPI + 4%

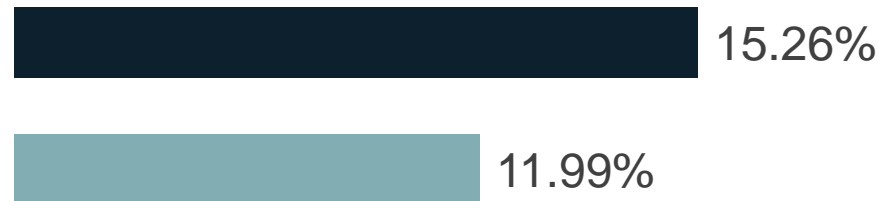
Inception: July 2010



Infrastructure & Development | Equity I

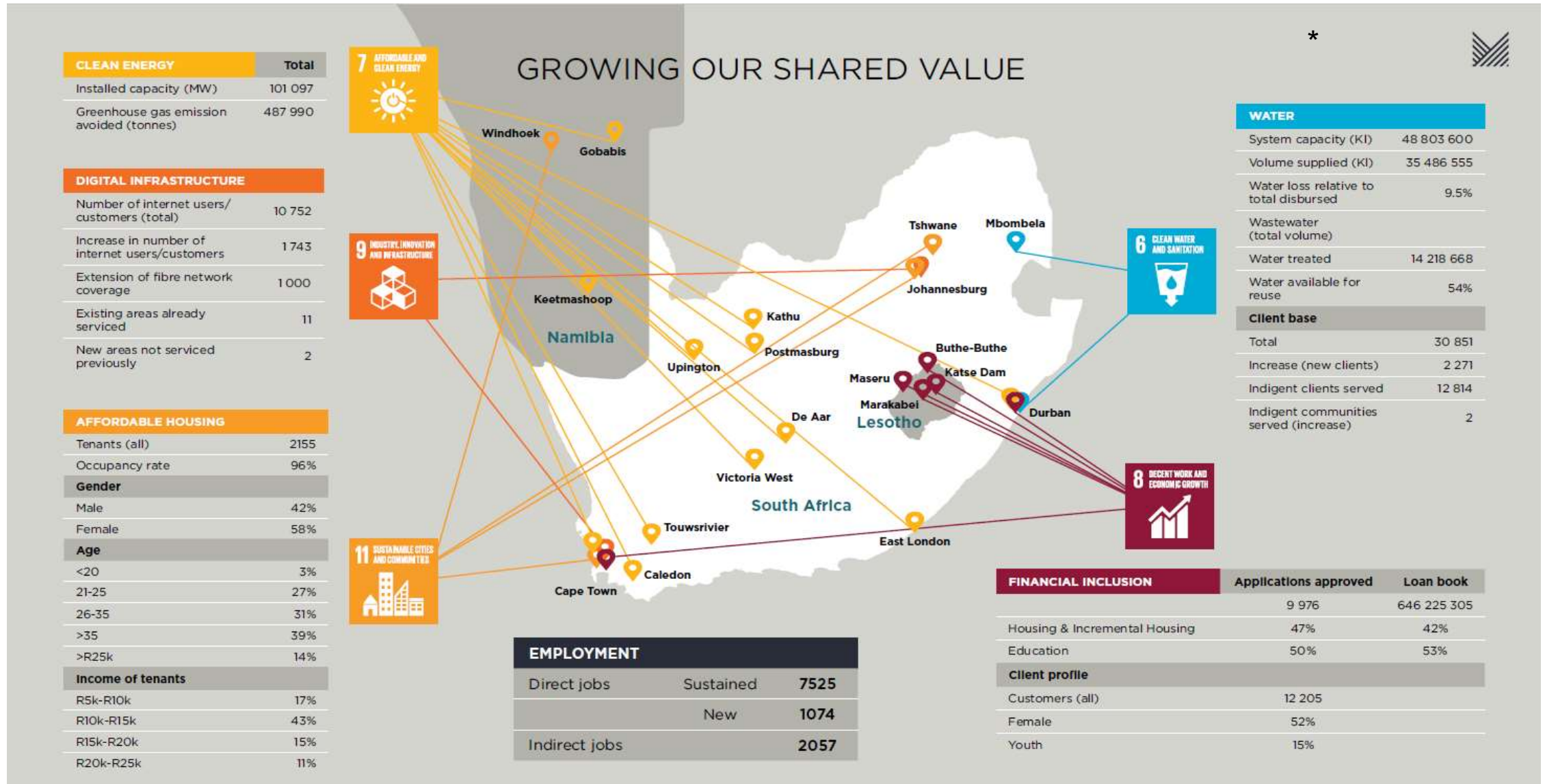
Benchmark: CPI + 7%

Inception: May 2015





Infrastructure assets creating SOCIAL IMPACT RETURN



Source: Mergence Impact Report 2022/23



Case study 1: Infrastructure assets creating impact (water)

Case study of investment in Economic Infrastructure (water concession)

DETAILS	Silulumanzi	Siza
	2023	2023
Staff Employed	293	85
No of Qualified Artisans (Plumbers, Electricians, Fitters, etc.)	19	16
No of Qualified Engineers	8	2
No of Bursaries Awarded	45	22
Value Spent on CSR Initiatives Since inception	R4,6M	> R4,3M

DETAILS	Silulumanzi	Siza
	2023	2023
Population served	570,000	80,000
Indigent customers served	~ 300,000	~ 40,000
Water capacity (million litres / day)	76	31
Wastewater capacity (million litres / day)	44	19
Length of water Network (kilometres)	1,233	278
Length of sewer network (kilometres)	694	188



Case Study 2: Infrastructure assets creating impact (affordable housing)

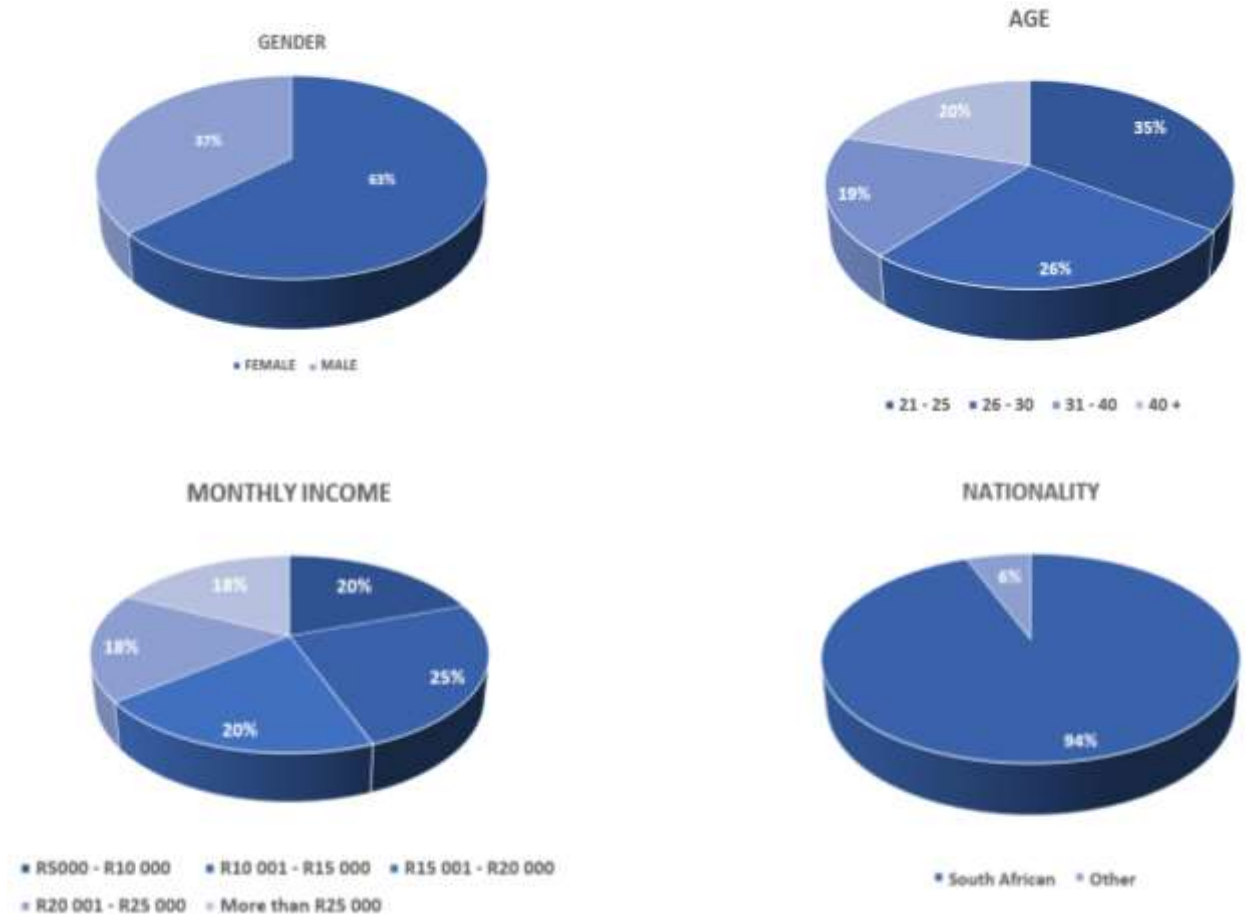




Case Study 2: Infrastructure assets creating impact (affordable housing)

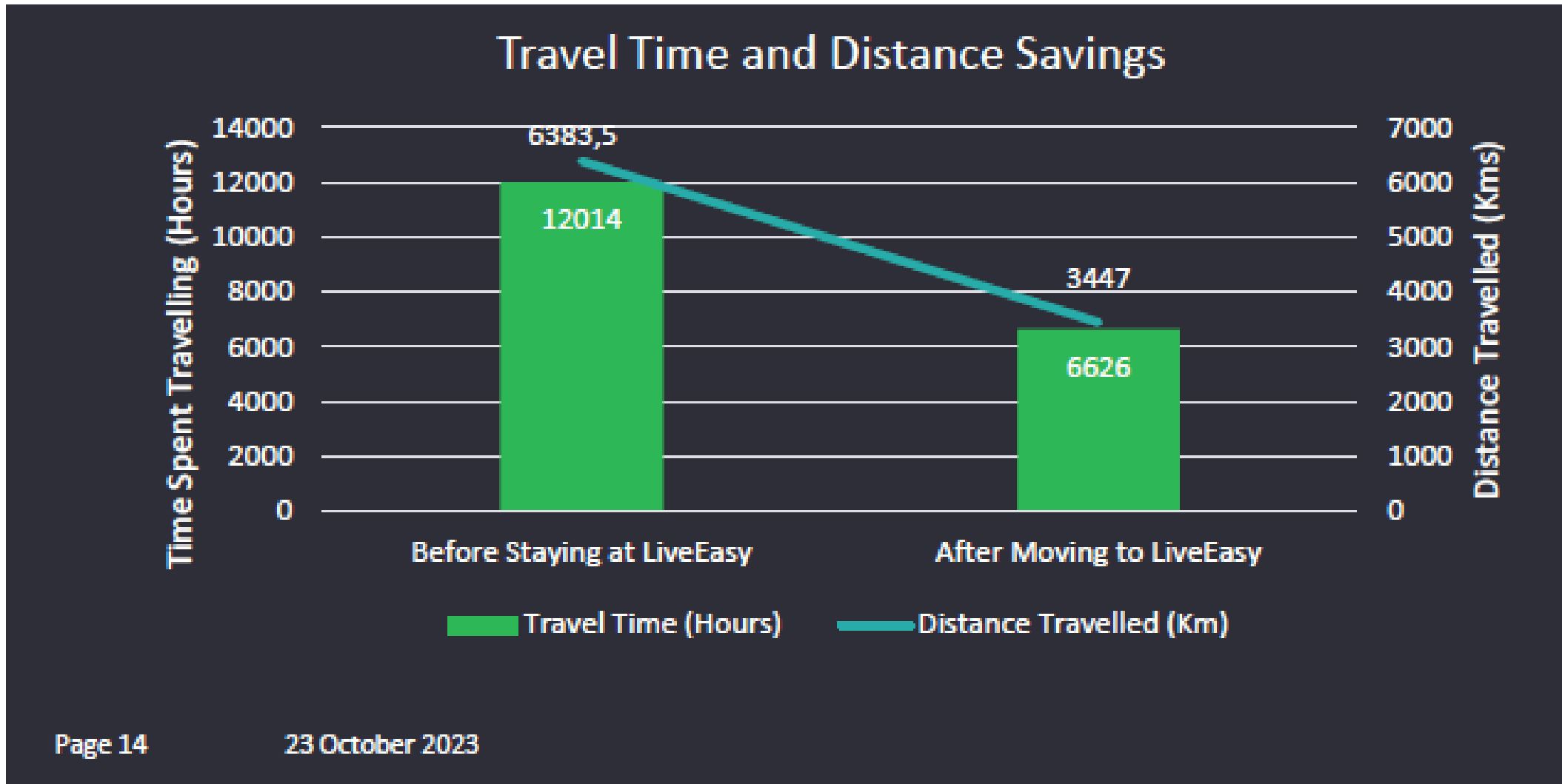
Tenant Mix

- 63% female
- 51% < 30 years old
- 65% <R20,000 per month





Case study 2: Infrastructure assets creating impact (affordable housing)





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Why do pension funds not allocate to infrastructure assets?



Factors limiting allocations towards infrastructure assets

- Limited access to information
- Perceive it as too risky
- Opaque fund constructs
- Availability of investible infrastructure assets
- Long-term investments with liquidity constraints



Solutions for limited access to information

- Seminars & training (SAVCA, BATSETA, IRFA, ASISA)
- Asset consultants
- Manager engagement



Solution for perceived risk

- Manager track record and experience





Solution for opaque fund constructs

- Advisory boards
- Independent valuations
- Client credit loss assessments
- External audits

- **Government initiatives**

- Operation Vulindlela
- Water procurement office setup in DBSA

- **Private sector led opportunities**

- Digital infrastructure
- Affordable housing & student accommodation
- Healthcare
- Energy generation





Infra sectors and risk are evolving

- Digital infrastructure larger part of most managers' strategies
- Impact of climate change on:
 - Energy generation assets – Coal vs. Renewable sources
 - Storage and grid infrastructure
 - EV charging network vs. traditional 'One-stops' on motorways
- Water



Solutions for liquidity constraints

- Liquidity is an inherent characteristic of all private market investments (incl infrastructure)
 - Debt funds: usually more predictable (driven by contracted amortisation)
 - Equity strategy: 60% during the holding period (cash to investors earlier), not only exit-strategy driven
 - Returns will reflect the additional risk



6 In summary



Key takeaways

- Underpins sustainable economic growth
- Infrastructure investments delivers attractive risk-adjusted returns and tangible impact
- Pension funds may allocate up to 45% to Infrastructure
- Listed universe very small
- Private market allocations most accessible
- Experienced fund managers in infrastructure



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THANK YOU!

