ESG and Impact Investing in Practice: Infrastructure Investment

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The Evolution of Responsible Investing

1970's → 1990's → 2010's

1970's: Socially Responsible Investing "SRI"

→

1990's: Environment, Social and Governance Investing "ESG"

→

2010's: Impact Investing

Current Developmental Imperatives

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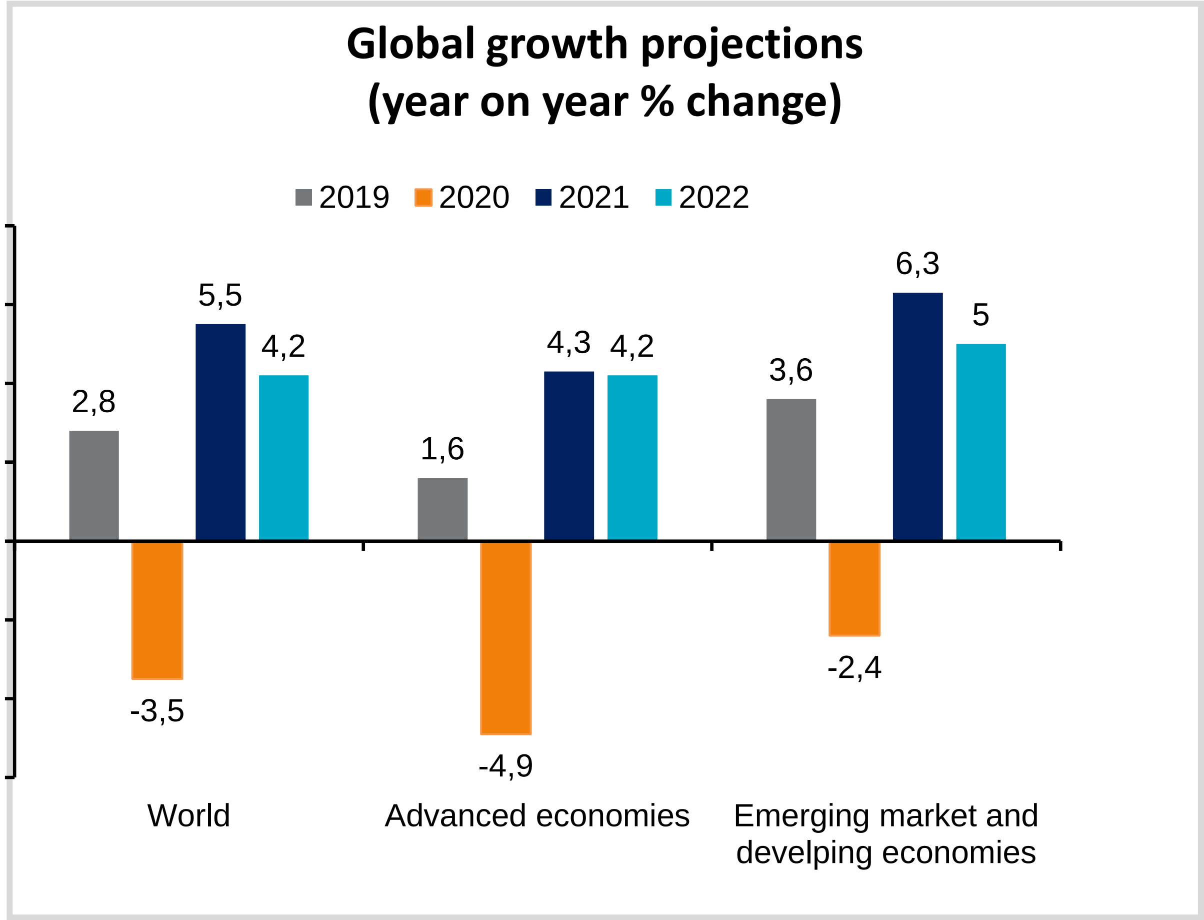
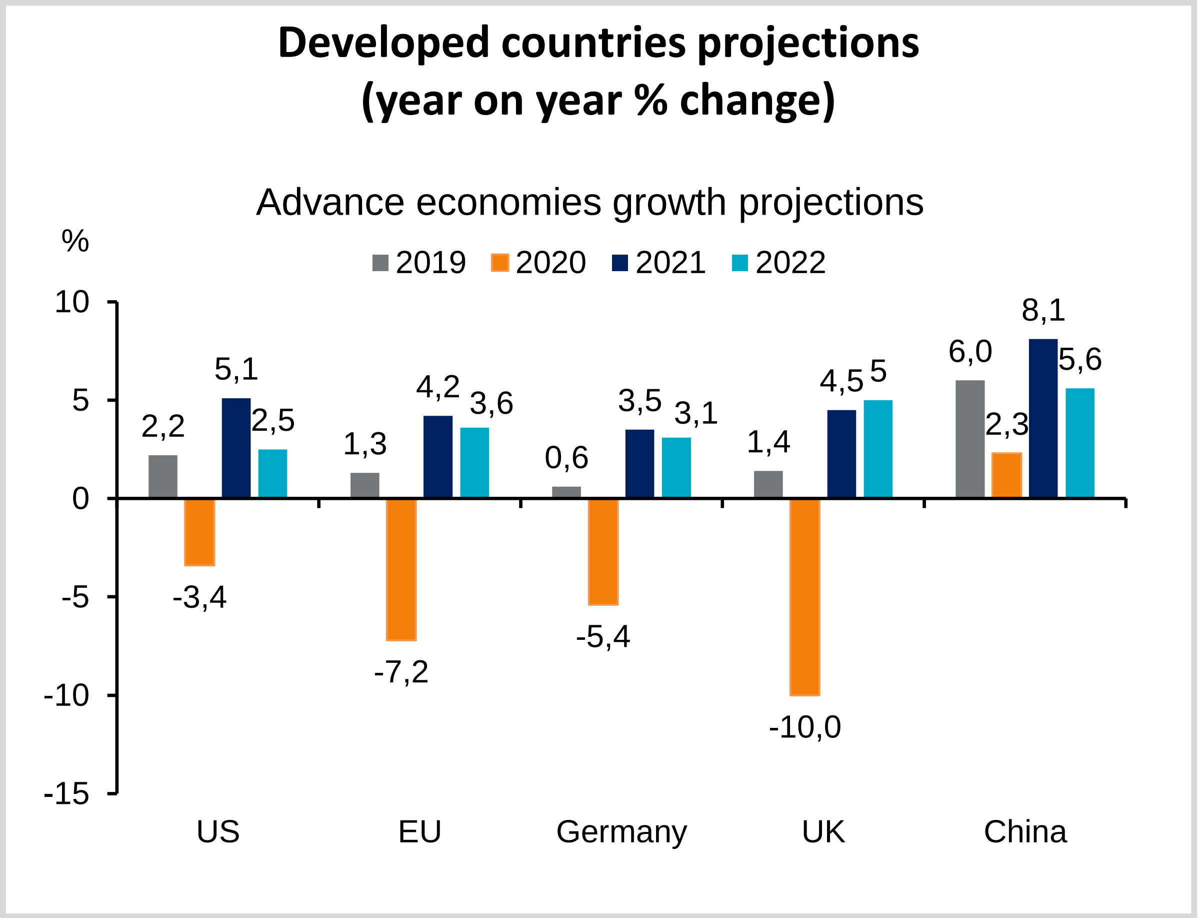
Global growth is expected to rebound in 2021





- Source: International Monetary Fund and Alexander Forbes Investments

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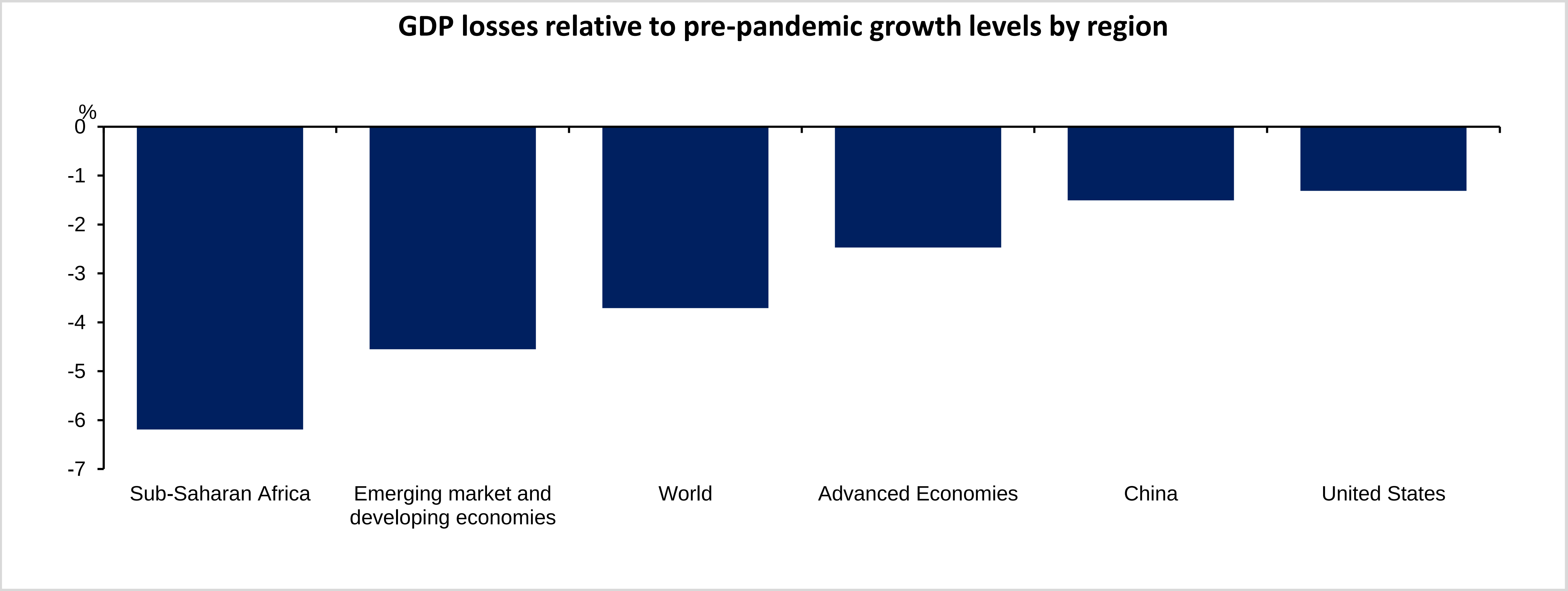
Global activity will remain well below the pre-COVID-19 projections through the forecast horizon



Source: IMF WEO January 2021 and Alexander Forbes Investments

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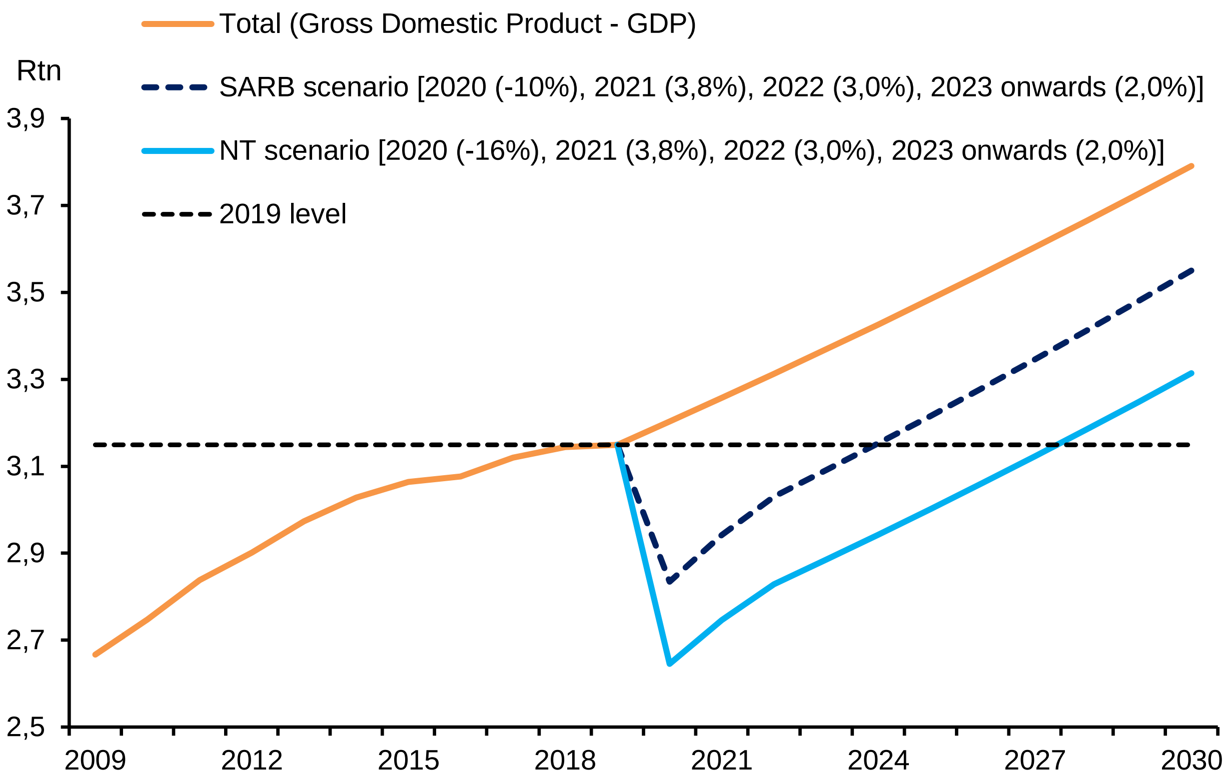
Significant Economic Damage

Detraction in SA economy to last longer than expected



Source: IMF, SARB, National Treasury and Alexander Forbes Investments

Without covid-19 real GDP would have grown to R3,8 trillion

If the economy contracts by 10% in 2020 and 3% thereafter for the remainder of the decade, real GDP reaches R3,6 trillion by the end of the decade

- R200bn permanent loss GDP
- It will take three years to return the economy to 2019 level

If the economy contracts by 16% in 2020 and 2% thereafter for the remainder of the decade, real GDP reaches R3,3 trillion by the end of the decade

- R500bn permanent loss in GDP
- It will take seven years to return the economy to 2019 level

Implementation of economic reforms is a big component that will contribute to any scenario that is better

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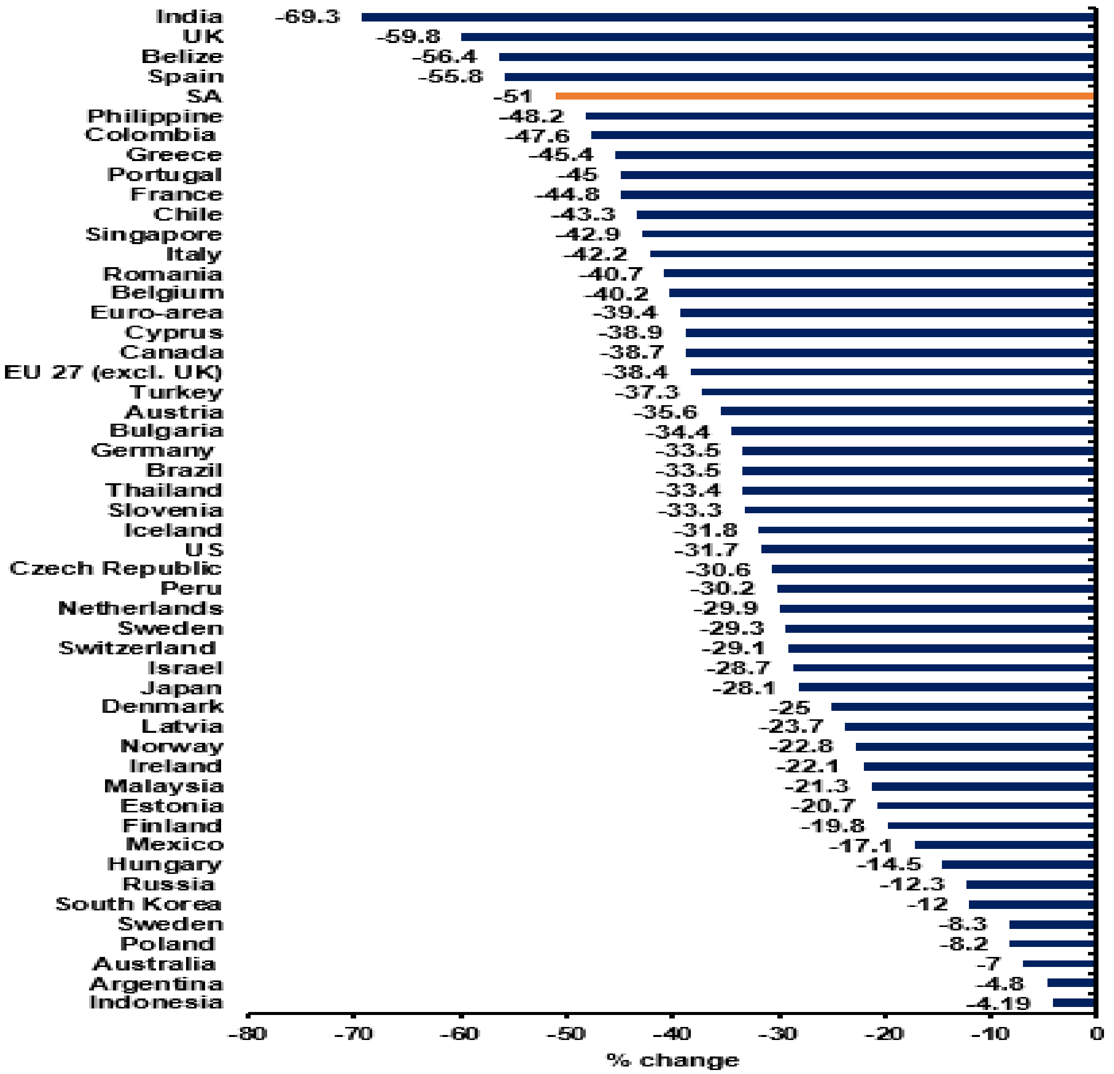
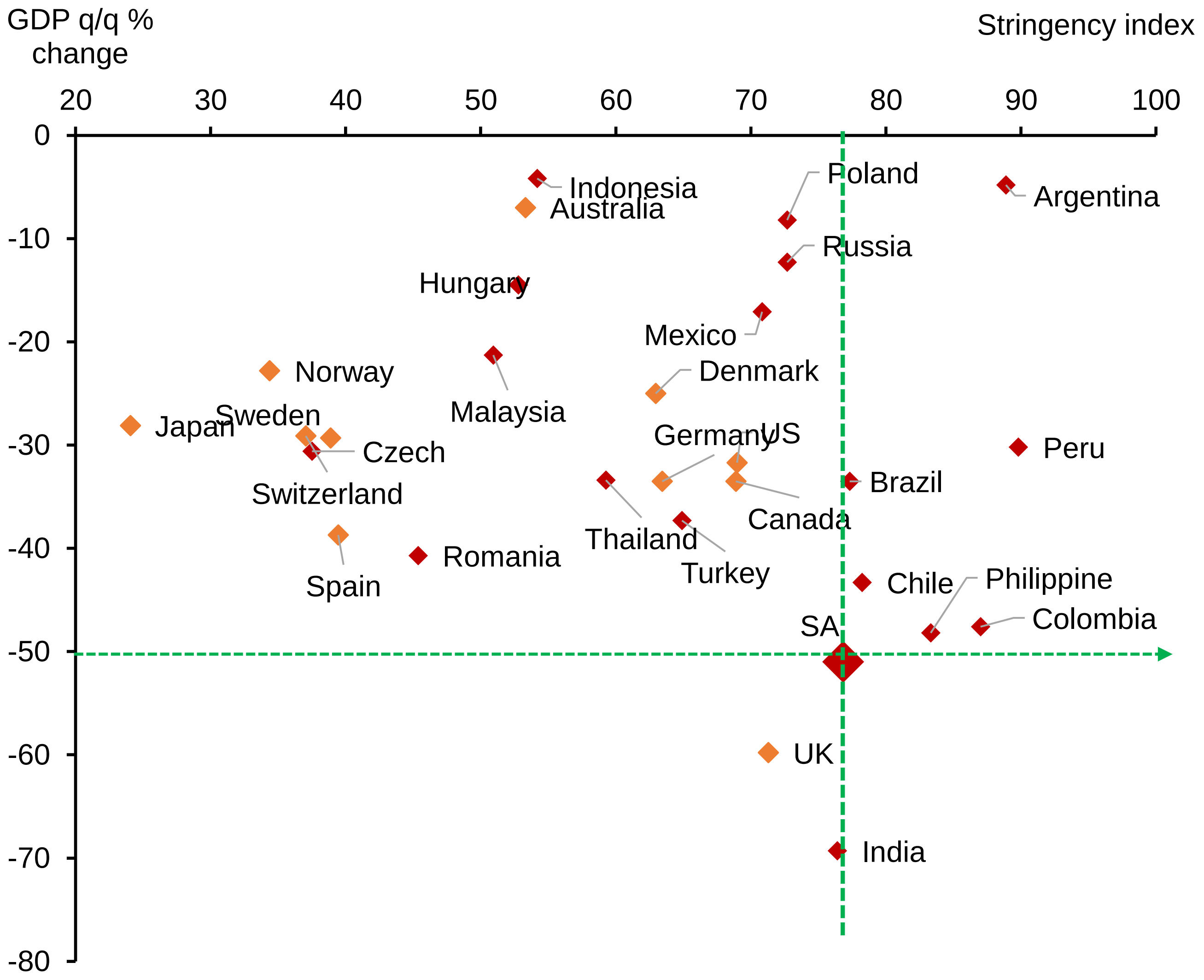
SA’s GDP in Context – More Than COVID-19 at Play

GDP performance Q2 2020 q/q % annualised, real (local currency)



GDP performance Q2 2020 q/q % annualised compared with stringency index



Source: Bloomberg and Alexander Forbes Investments

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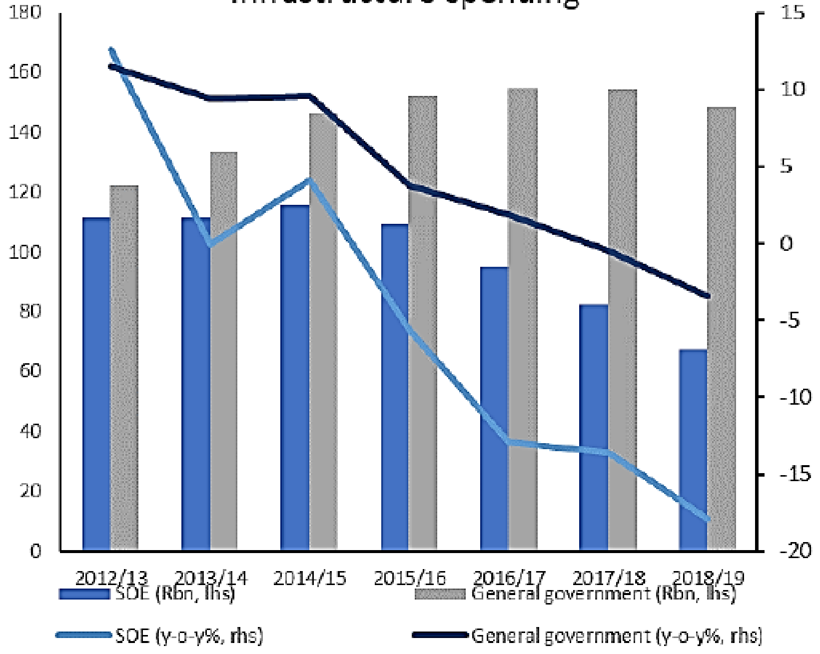
South Africa's Current Economic Reality: Infrastructure

- SA is still far from NDP target for public sector infrastructure investment
- Investment by general government (GG) down 0.8% on average in real terms between 2014 and 2019. State owned enterprises (SOEs) down by 4.9% on average
- Massive underspending in infrastructure by all spheres of government
- Corresponds with budget data which shows sharp drop in capital spending by SOE's

Historical view of public sector infrastructure spending



Source: National Treasury, BER calculations

Moody's downgraded SA's foreign and local currency sovereign credit rating to Ba1 – can further hamper economic recovery

	Moody's	S&P Global	Fitch
Foreign currency	Ba1 (1 notch below)	BB (2 notch below)	BB+ (1 notch below)
Outlook	Negative	Negative	Negative
Local currency	Ba1 (1 notch below)	BB+ (1 notch below)	BB+ (1 notch below)

Government has limit fiscal capacity to provide stimulus

	Total underspend (2014/15 - 2018/19) R' bn
SOE	109,06
GG	38,29
	147,35

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Current Discussion Items

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Current Developmental Imperatives

- National Treasury paper “Economic Transformation, Inclusive Growth, and Competitiveness: Towards an Economic Strategy for South Africa:
    - Released on 27 August 2019
- ANC’s discussion paper “Reconstruction, Growth And Transformation: Building A New, Inclusive Economy”
- Business for South Africa’s paper “A New Inclusive Economic Future for South Africa: Delivering an Accelerated Economic Recovery Strategy’
    - Both were released on Friday 10 July 2020
- Government’s “Economic Reconstruction and Recovery Plan”
    - Presented at Nedlac meeting on 13 August 2020

Common theme: invest in infrastructure in order to ignite growth in the economy and create jobs

Sustainable Infrastructure Development Symposium (SIDS) Initiative

Organised by the Investment and Infrastructure Office (IIO) in the Presidency

50 projects with value R340bn already gazetted

Purpose

underspend on infrastructure and position key projects

Representatives

ASISA, Batseta, private sector institutions, multi-lateral development banks to name a few

Number of projects presented*

200+ opportunities

Total estimated value

Approximately R2.1 trillion for investment over the next few decades

*While these were in the pipeline before the current economic crisis, there has been an urgency to fast-track these opportunities where possible to lift South Africa's economic trajectory.

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Prescribed Assets?

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Prescribed Assets

- The ANC's 2019 manifesto listed ***"the investigation of the introduction of prescribed assets to mobilise funds from financial institutions for socially productive assets"*** as one of its priorities
- Prescribed assets are mentioned under the following two sections in the manifesto:

  Investing in the Economy for inclusive growth

  - Investigate the introduction of **prescribed assets** on financial institutions' funds to unlock resources for investments in <u>social and economic development</u>

  Transform and Diversify the Financial Sector

  - Investigate the introduction of **prescribed assets** on financial institutions' funds to mobilise funds within a regulatory framework for <u>socially productive investments</u> (including housing, infrastructure for social and economic development and township and village economy) and job creation while considering the risk profiles of the affected entities

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A South African case study in Prescribed Assets

- Prescribed assets were first introduced in South Africa in 1956 when pension funds were required to invest more than half of their assets into government and SOE bonds
- The **Prudential Investment Guidelines (PIGs)** required that 53% of retirement fund assets, 33% of assets of Long Term Insurance Companies and 75% of the Public Investment Commissioners' (now Public Investment Corporation ("PIC")) managed assets be invested into government and SOE bonds
- The Jacobs Committee of 1988 was appointed to investigate prescribed assets and the distortions introduced by this prescription; the Committee **recommended that the policy be abolished**
- Prescribed assets in this format were abolished in the National Budget of 1989 *(although prescription in terms of maximums per asset classes and exposures continue in terms of Regulation 28)*

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What was the opportunity cost?

- 1960s
  - Inflation averaged 3.0%; whilst prescribed assets earned positive real returns, they **earned -6.4% p.a. versus equities** over the decade
- 1970s
  - Inflation averaged 11.3%, prescribed assets earned 7.3%, equities returned 24.5%; the **opportunity cost of investing in prescribed assets versus equities was -17.2% p.a.**
- 1980s
  - Inflation averaged 14.5%, the **opportunity cost of investing in prescribed assets versus equities was -6.7% p.a.**

	Nominal returns			Opportunity costs
	Equities	Prescribed assets	Inflation	Equities returns – Prescribed Assets returns = "Opportunity Cost"
1960s	11.3%	4.9%	3.0%	**-6.4%**
1970s	24.5%	7.3%	11.3%	**-17.2%**
1980s	20.2%	13.5%	14.5%	**-6.7%**

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Source: Gill Raine, Senior Policy Advisor at ASISA, Presentation to ASSA Investment Seminar 13 June 2019

Proposed Amendments to Regulation 28

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Amendment of Regulation 28

"The proposed review to Regulation 28 is informed by a number of calls for increased investment in infrastructure given the current low economic growth climate."

"...before making an investment in and while invested in an asset, consider any factors which may materially affect the sustainable long-term performance of the asset, including infrastructure investment, taking into account the necessary due diligence and risk adjusted returns in the best interest of the fund and its members and avoiding conflicts of interests."

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Amendment of Regulation 28

- Given the concerns that infrastructure investment would be forced via prescription, the fact that the proposed changes represent maximums rather than minimums is reassuring
- Main limit change proposed is a splitting out of Private Equity from the Alternatives (Private Equity, Hedge Funds and Other) category
  - Private Equity increased from 10% to 15%
  - No limit across these three categories i.e. funds can invest a total of 27.5% across the three versus the current 15% maximum
- Introduces subcategories of infrastructure across several asset classes i.e. equities, bonds, property, own employer, Private Equity, Hedge Funds
  - Overall limit on infrastructure across these assets classes would be 45%, plus 10% in Africa infrastructure
- The definition of infrastructure is however proposed to be narrow i.e. *"Public installations, structures, facilities, systems, services or processes in respect of which projects may be designated as strategic integrated projects"*
  - Few funds would invest into the public strategic integrated projects that this definition envisages, and therefore few are likely to breach to maximums proposed

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Proposed Amendments to Regulation 28

- The proposed narrow definition of Infrastructure is unlikely to lead to increased allocations
- More funds may allocate to private equity funds, but not necessarily infrastructure-related
- No increases are proposed to unlisted debt which is where infrasture allocaitons are more likely

And in addition:

Many investors cannot increase allocations to illiquid or unlisted investments as they need liquidity to pay member benefits

- *Defined contribution funds also offer daily unit values and ability to switch between investments*

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Liquid Investment Opportunities

- Finding ways to make investment more liquid or listed will result in a wider base and depth of investment:
  - Green bonds
  - Project bonds
  - Existing Development Finance Institutions
    - e.g. Investment Development Corporation (IDC) and Development Bank of South Africa (DBSA)
  - Infrastructure funds large enough to generate liquidity

New Investor Pools

- South African retirement funds can provide **<u>some</u>** of the required funding, but not all
- Other new asset pools are required, and specifically from international investors:
  - Sovereign Wealth Funds, Infrastructure Funds, Pension Funds, Trusts, Foundations, etc.
  - Investment from local investors is important to these investors
  - Governance oversight, compelling investment returns, well managed risks are all critical

An investor-friendly environment is imperative: prescription would be contrary to this

Case Studies

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Renewable Energy Independent Power Producer Procurement Programme (REIPPP)

Background

- The REIPPP was a competitive tender process designed to facilitate **private sector investment** into grid-connected renewable energy generation
- In an 8-year period it attracted **R209.4 billion in committed private sector investment**

- The REIPPP has made a **significant impact on the economy, job creation, community upliftment, economic transformation and climate change**
- Renewable IPPs have created **38 701 jobs** years for youth and women from the surrounding communities
- **Local communities have benefited from over R1 billion** spent by IPPs on **education** by upskilling teachers, providing extra teachers and classrooms, as well as awarding over 600 bursaries to students from disadvantaged communities
- The programme has provided **health facilities** while contributing to social development through feeding schemes, supporting old age homes and early childhood development
- It has helped to establish more than **1 000 small enterprises**
- **Broad-based black participation** has been secured across the value chain through community participation, including in engineering, procurement, construction, operations and maintenance contractors where black ownership amounts to 21%
- The REIPP programme's contribution has meant that South Africa's **carbon emission is reduced** by about 33.2 million tonnes (Mton) carbon dioxide (CO_2) and **water savings** of 39.2 million kilolitres achieved by 31 December 2018

Source: Department of Energy Press Release, February 2019

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Financial Sector Charter

Background

- The Financial Sector Charter (the Charter) came into effect in January 2004 as a result of a **voluntary** offer to develop an industry transformation Charter by the financial sector at the National Economic Development and Labour Council (Nedlac) Financial Sector Summit
- The Financial Sector Code (FSC) commits all participants to **actively promote a transformed, vibrant and globally competitive financial sector** that reflects the demographics of South Africa, which contributes to the establishment of an equitable society by providing accessible financial services to black people and by **directing investment into targeted sectors of the economy**
- Specific targets have been set in respect of **"targeted investments"** being **transformational infrastructure black agricultural financing, affordable housing, black business growth and SME funding**

Impact

- Opportunities were found to **invest in projects that gave an attractive return** to investors whilst meeting the requirements of the Charter
- Housing, Infrastructure, Agriculture, Schools, SME financing, etc.
- **No prescription was required** …
- Investors were **seeking opportunities** and successfully **invested with attractive returns**

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Source: Financial Sector Code

THANK YOU

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