BANWO & IGHODALO

WAY OUT OF RECESSION SERIES: RETHINKING INFRASTRUCTURE DEVELOPMENT

As the Nigerian Government devises means of lifting the economy out of its deepest recession in a quarter of a century, green shoots are already emerging, triggered by steady, above-the-benchmark oil prices and relative stability in crude oil production in recent weeks. However, the Government's *Economic Recovery and Growth Plan* can only be sustainably attained through the diversification of the nation's major economic base from volatile sources of foreign exchange (**"forex"**) earnings like oil.

There is a consensus of opinion on the fact that non-oil export based industries would have to be developed in order to buoy the country's local capacity, productivity and competitiveness. In this direction, the economic low-hanging fruits are manufacturing & engineering, foods & agriculture, solid minerals mining, intellectual property, energy & water resources, education, health, housing, petrochemicals, agro-allied industries, telecommunications & information technology and public transportation.

Whilst it is not in doubt that the country has huge potentials to become a big player in these sectors and that investors (local and foreign) are looking to partner with the government, inadequate infrastructure however poses a great challenge and is acting as a disincentive to private sector investments in these sectors.

It is no surprise therefore, that in a bid to return the country to the path of recovery and growth, the government's expansionary budget framework in the short to medium term has targeted the financing of substantial infrastructure in the critical sectors of the economy.

In this piece, we advocate more effort from Government at improving the infrastructure development process in Nigeria. In recognition of the need to transition from the old, ineffective era where government was the sole or principal actor in building critical national infrastructure, Government has taken steps towards the adoption of the Public Private Partnership (**"PPP"**) model for the development of public infrastructure. This is in line with international best practices which now favour robust partnerships between the public and private sectors of the economy through PPP templates that promote the harnessing of private-sector capital, efficiency and expertise for the development of public infrastructure. In essence, this article presents an overview of the Nigeria's huge infrastructure gap, the available financing mechanisms as well as the massive investment opportunities which are presented to domestic and international investors and argues for a stronger PPP legal and regulatory framework; which will take advantage of these factors to deliver the infrastructure which Nigeria sorely needs.

HIGHLIGHT OF NIGERIA'S INFRASTRUCTURE GAP

- The FGN in its 2013 *"National Integrated Infrastructure Master Plan"* projected that the country would need about ₦398.1 trillion, over the next three decades, for building world class infrastructure that will guarantee sustainable economic growth and development in Nigeria.

- According to the African Development Bank (**"AfDB"**), in its 2015 Report titled: *"An Infrastructure Action Plan for Nigeria: Closing the Infrastructure Gap and Accelerating Economic Transformation",* a Federal Government of Nigeria (**"FGN"**) specially commissioned project; the country needs an estimated US$3 trillion in infrastructure investment in the next 30 years (and about US$165 billion in the medium-term) to close its infrastructure gap.

- The Institute of Appraisers and Cost Engineers, a division of The Nigerian Society of Engineers projected in 2015 that about US$2.9 trillion investment is needed, in the next 30 years, to close current infrastructure gap in the country. That same year, a former Minister of Finance and the Coordinating Minister for the Economy, Dr. Ngozi Okonjo Iweala stated that "to fund infrastructure, Nigeria needs about US$14 billion every year.

- The Lagos Chamber of Commerce and Industry (**LCCI**) in 2016 estimated that, Nigeria's infrastructure deficit is up to US$300 billion (about ₦5.91 trillion at the then exchange rates). This figure represented 25 per cent of the Gross Domestic Product in that period**.**

- In a February 2017 editorial, BUSINESSDAY posited that "for Nigeria to close its infrastructure gap and bring itself up to the international benchmark for infrastructure stock, it needs to spend as much as $2.9 trillion in the next 30 years and 48 percent of this sum, representing $1.4 trillion, has to come from the private sector".

Figures which have recently been given by other stakeholders and institutions, of our infrastructure spending needs, are equally staggering. Essentially, the AfDB in specific terms stated that, plugging the infrastructure gap in Nigeria for a period of 15 years between 2015 and 2030 would require the following:

- **Transport –** A proposed expenditure of about US$710 billion to build new infrastructures in Roads, Railways, Ports, Shipping, Inland Waterways, Civil Aviation, Gas Transport, and Urban Transport Sectors.

- **Electric Power and Access to Energy –** A proposed expenditure of US$40.9 billion during the period 2011-2020 for upgrading grid infrastructure for electricity transmission and rural electrification, to support adequate power generation, transmission and distribution.

- **Water Resources, Supply and Sanitation –** A proposed expenditure of US$101 billion for developing infrastructures for Irrigation of agricultural farmland, and water supply to support lives and improve sanitation.

- **Information and Communication Technologies (ICT) –** A proposed expenditure of about US$ 3.5 billion for expanding and building ICT infrastructure, for telecoms and internet services in the increasing urban centers; for better tele-density; for improved internet resources for online education and research institutions; as well as establishment of a national digital library and promotion of e-application, e-learning, e-governance and e-commerce.

- **Soft Infrastructure –** According to the Infrastructure Consortium for Africa (2013), some measures are needed to support or accompany the production of physical infrastructure outputs, including research, enabling legislation, project preparation, and capacity building. The AfDB report estimated that these measures would cost about US$50 billion in Nigeria, in the period under consideration (2015 – 2030).

INFRASTRUCTURE FINANCING MECHANISMS AND INVESTMENT OPPORTUNITIES

As the largest economy in Africa and most populous black nation on earth, demographic data presents Nigeria as a global economic frontier with high rates of returns on investments. Latest country data include:

- Population of about 170 million people half of whom are youths
- Population projected to surpass that of the US by 2050 – *World Population Prospects* Report, United Nations, 2013
- Largest market for consumer goods and services on the continent
- Highest and fastest mobile telecoms penetration rates on the continent
- Largest producer of crude oil in Africa and 8th in the world
- Nineth (9th) largest proven reserve for natural gas in the world
- Large deposit of diverse solid mineral resources
- Uncultivated vast arable land
- Africa's regional economic hub

Going forward, Nigeria's bourgeoning population and increasing urbanization are all going to exert great pressure on the existing inadequate infrastructure and will compel a scale-up in infrastructure spending on housing, social amenities, health, education, road networks and energy (power, oil & gas). This provides viable investment options for investors in areas of hard/physical and soft infrastructure if Government will take steps to provide necessary investment comfort.

Nigeria's wide infrastructure gap currently requires that new thinking and new approach be adopted in the planning, financing, development and maintenance of infrastructure projects. The dominant role played by the government in the past had only created inefficient, huge public utilities and decaying, poorly maintained infrastructure; confirming argument in certain quarters that government, unlike private enterprises, is not good in handling profitable business entities. Trillions of Naira has been spent in the name of turn-around maintenance and new infrastructure projects in the past; with little or nothing to show for it. Time indeed has come, for the government to create conducive legal and regulatory framework backed by reliable political will for giving the private sector the opportunity to take the lead in the development of critical infrastructure.

Efforts being made by the government to "spend our way out of recession" are noted. Whilst fiscal measures are good, they are not sufficient and would need to be complemented by private sector capital for optimum performance; especially now that government's purse is lean due to the falling forex earnings. Developmental efforts that can be funded by private sector funds should be given to the private sector under a clearly articulated PPP policy and defined regulatory/legal framework, in order to free scarce public funds for other social developmental initiatives which are not suited to private sector funding. The expansionary budget plan contained in the government's *Medium Term Expenditure Framework and Fiscal Strategy Paper (2017 – 2019)* anticipates deficit financing of critical infrastructure through sourcing of funds from both the domestic and international capital markets. PPP initiatives can effectively be strategically deployed to meet government's needs in this area.

Presently, different mechanisms for infrastructure financing have been created and used in Nigeria while reforms of the extant legal and regulatory framework for doing business are ongoing to establish new ones. Whilst these efforts provide a veritable ground for the growth of PPP initiatives, more however needs to be done by the government, to attract the appropriate quality and quantity of investment to stimulate the infrastructural development required. Currently, the following financing models are available to investors in Nigeria:

1. DEBT FINANCING & INFRASTRUCTURE BONDS

Opportunities abound in the capital market (domestic and international), for governments at all levels as well as corporate entities/firms of developers, for raising funds for infrastructure development. Structured money and capital market instruments such as bonds and debt instruments are tested private-sector driven vehicles of financing infrastructure projects, the world over.

There are examples of projects that were successfully financed with debt capital in the recent past. The design, construction and operation of a Multipurpose Terminal Facility at the Apapa Port in Lagos was undertaken by a Nigerian investor-company, financed with a US$171 million Term Loan Facility provided jointly by the Africa Finance Corporation (AFC) and a Nigerian bank. The US$300 million Greenfield project for the development of the Tinapa Free Trade Zone in Calabar is another infrastructure financed through debt instrument. Similarly, most of the successful bidders for the various electricity distribution companies (DISCOs), who emerged from the Nigerian power sector privatization process, financed their acquisition of these power infrastructures, through debts instruments.

According to Nigeria's Debt Management Office (DMO), the country has an immediate borrowing plan for infrastructure projects encapsulated in the US$4.5 Billion Federal Government Medium Term Note (FGMTN) Programme 2016 – 2018, out of which US$1 billion Eurobond was successfully issued to investors from the international capital market in early February. In addition to this, the government is looking to borrow about US$30 billion from international creditor-nations and organizations to fund targeted projects cutting across all sectors of the economy with special emphasis on infrastructure, agriculture, health, education, water supply, growth and employment generation.

There are also opportunities for raising funds in the domestic Debt Capital Market ("DCM"), through projects-tied sovereign debt instruments. In this area, a lot of work has been done by the Securities and Exchange Commission ("SEC"). The SEC in its *"Consolidated Rules 2013"* provides for the issuance of Fixed Income Securities such as Governments' Bonds, Corporate Bonds, Supra-national Bonds and Sukuk Instruments. In 2014, the SEC Nigeria issued the *"Rule on Infrastructure Funds"*. Apart from the FGN, some States in Nigeria including Lagos, Niger and Osun have approached the DCM to raise infrastructure development funds through the issuance of bonds and sukuk instruments.

In order to enhance the liquidity of sub-national debt instruments and consequently boost state governments' capacity for raising funds in the domestic DCM, the Central Bank of Nigeria ("CBN") issued in October 2016, the "*Guidelines for Granting Liquid Asset Status to Sukuk Instruments issued by State Governments".*

All is therefore now set, for the government to take full advantage of capital market debt instruments as a special purpose tool in partnering with the private sector, to attract the huge capital needed for developing critical infrastructure which apparently cannot be met by government's fiscal provisions alone.

2. SOVEREIGN WEALTH & PENSION FUNDS

The Nigeria's $1.25 billion sovereign wealth fund ("SWF"), managed by the Nigeria Sovereign Investment Authority ("NSIA"), has three components one of which is *"Nigeria Infrastructure Fund"* with $500 million of seed capital. The NSIA is forming strategic partnerships with private sector players to raise funds for the financing of critical national infrastructure.

In January 2017, the NSIA finalized its partnership with GuarantCo for the establishment of an Infrastructure Credit Enhancement Facility in Nigeria ("InfraCredit"). GuarantCo is a development finance fund with focus on strategies for mobilizing patient capital from the private sector through the domestic capital market for the financing of domestic infrastructure projects in low and medium income countries. The purpose of the InfraCredit is to provide guarantee for enhancement of the credit quality of local currency debt instruments issued by governments and corporates, for the financing of critical and creditworthy infrastructure projects. This will provide some comfort to, and attract the interest of, major capital pools with high risk-aversion such as pension fund assets, insurance companies and SWFs.

The Nigeria's nascent but growing pension fund also provides another veritable source for infrastructure financing. As at the end of Q4 2016, pension assets under management reached circa 6 trillion Naira. According to sector analysts, about 15% of this huge pension funds is currently invested in debt instruments while a total of about 70% is held in the FGN bonds and treasury bills.

In Nigeria, investment of pension fund assets is regulated by the National Pension Commission ("PenCom") in accordance with the provisions of Part XII (S. 85-91) of the Pension Reform Act (PRA) 2014. Further to the aforementioned provisions, pension fund may be invested in Bonds (infrastructure bond) issued or guaranteed by the FGN or the CBN, as well as Bonds issued by the States and Local Governments. Under its *Regulation on Investment of Pension Fund Assets ("RIPFA"), 2012,* PenCom currently allows Pension Fund Administrators ("PFAs") to invest a maximum of 20% of pension assets under management in Infrastructure Bonds and bonds issued by Governments and supra-national bodies; which are rated BBB by a recognized or registered Rating Company. In recent times, PenCom has issued circulars to include some State Governments' development bonds in the class of investible instruments in the pension industry.

Also, in February 2015, PenCom made efforts to enlarge the framework for investing pension funds in infrastructure by issuing a Draft RIPFA which is yet to be finalized. In Paragraph 4 of the 2015 Draft RIPFA, pension funds can be invested in Bonds issued by the FG and CBN or special purpose vehicles (SPVs) created by them and supported by guarantee given by either of the two, as well as Bonds issued by States and Local Governments or their agencies fully guaranteed by Irrevocable Standing Payments Orders (ISPOs) or external guarantees provided by banks, development finance institutions or Multilateral Development Finance Organizations ("MDFOs"). Infrastructure Bonds or Sukuks are specifically listed as allowable instruments under paragraph 4.3 while Infrastructure Funds registered with the Securities and Exchange Commission (SEC) and Supranational Bonds and Sukuks by eligible MDFOs are allowable instruments respectively under paragraphs 4.7 and 4.8 of the draft RIPFA.

There is an urgent need for the government, going forward, to further provide safe and seamless mechanisms for unleashing more of this patient private-sector capital, in the financing of projects-specific infrastructure bonds. It is therefore expected that PenCom will waste no further time in finalizing its 2015 Draft RIPFA, as a first step in this direction.

3. PRIVATE EQUITY INVESTMENTS

A total investment of over $2.8 billion in 30 deals was reported by African Private Equity and Venture Capital Association (**"AVCA"**) to have been attracted into Africa at the end of June 2016. The Nigerian infrastructure gap remains one of the most attractive sectors to Africa-focused private equity investors. The legal and regulatory environment for investment must be made less cumbersome and more business-friendly by the government and regulators while more infrastructure-tied products should be developed to attract more PE investments into Nigeria.

4. INFRASTRUCTURE CONCESSION CONTRACTS

Concession contracts remain one of the most effective public-private-partnership (**"PPP"**) arrangements the world over. The Infrastructure Concession Regulatory Commission (Establishment, Etc.) Act, 2005 (**"ICRC Act"**) was passed to provide a PPP legal framework for financing, developing and managing FGN's infrastructure projects.

A good number of infrastructure projects have been developed both at federal and state levels in the country through the grant of concessions by government or government agencies either to a particular private investor or investor group (the concessionaire); to build, own and manage public infrastructure on behalf of the government for some specified period of time. Prominent among such infrastructure projects are the Murtala Mohammed Airport (MMA2) Airport Concession; Lekki-Epe Express Way Project; Lagos-Ibadan Expressway Concession Contract; Ikeja City Mall Project in Lagos; Polo Park Concession Project in Enugu; and the PPP contract signed between a State Government in Nigeria and Ropeways Transport Limited for the deployment of aerial cable cars for public transportation among others.

The FGN's *National Integrated Infrastructure Master Plan* ("NIIMP"), a 30-year-plan developed since 2013 and which encapsulated Nigeria's roadmap for upgrading its public infrastructure to international standards can only be effectively executed and substantially achieved through an innovative use of PPP initiatives.

5. CONCLUSIONS

Whilst enormous investment opportunities abound for private sector capital (particularly foreign investors) in the Nigeria's wide infrastructure gap, we recognize that challenges also exist but these are not insurmountable. The persistent volatility and liquidity challenges in the country's forex market portend uncertainty and may create hurdles for matured investments exiting the market at maturity. So also are instances of overlapping laws and overreaching regulators, social unrest and militancy, corruption as well as policy instability that comes with changing governments.

In response to the identified challenges, Government in alliance with relevant regulatory authorities is working to overhaul the entire Environmental, Social and Governance (ESG) architecture in the country and constantly engaging the Organized Private Sector (OPS) on needed legislative reforms. These efforts have started yielding positive results and are expected to create a lasting, peaceful and seamless business environment in Nigeria in the medium to long term.

In the meantime, the government is providing incentives to investors who are developing critical infrastructure in the priority areas of the economy through the Nigerian Investment Promotion Commission ("NIPC"). There is also the *National Policy on Private Partnership* (NPPP), made pursuant to the ICRC Act to regulate all concession contracts for public infrastructure development in the country and prevent corruption and opaqueness in infrastructure contracts. This further guarantees an open competitive bidding process of selecting investors for infrastructure development, as regulated by the *Privatization and Commercialization Act 1999* and in line with the provisions of the *Fiscal Responsibility Act, 2007* and the *Public Procurement Act, 2007*. Similarly, investors are further assured of a corrupt-free investment space through the enactment of the *Freedom of Information Act, 2011,* a law that allows official conducts of public officials perfecting and overseeing public contracts as well as all duties connected with public offices, to be made available to private inquirers. This complements perfectly the government's ongoing anti-corruption crusade.

In building on the legal and financial framework already put in place, we recommend that there is need for more effort in relation to the following: (1) better awareness among government officials of the public procurement process and commitment to compliance with best practices in public procurement processes and (2); implementation of initiatives to limit investors' political risks exposure. These issues often impact bankability of project in sub-Saharan Africa and are germane to the effective take-off and subsequent blossoming of a virile PPP regime in Nigeria. It is also very vital to ensure the stability of government's policy initiatives and continuity of projects by successive administrations. Respect for the sanctity of contracts is needed to limit political risks' exposure of private investors. This will ensure that changes in government do not necessarily bring about changes in priorities leading to policy instability and abandonment of projects by successive administrations. All these improve the profit profile and credit rating of infrastructure projects and hence, their bankability.

Apparently, investors who have an eye for the Nigerian infrastructure sector will find a profitable investment hub in the country as they come. It is therefore incumbent on the government to leverage on the strengths of the economy and build on its reform of the legal and policy framework in order to stabilize investors' confidence. This is the only way patient capital can be maximally harnessed from the private sector, home and abroad, for building critical infrastructure that would act as the vehicle for delivering on the government's much touted *Economic Recovery and Growth Plan.*

The Grey Matter Concept is an initiative of the law firm, Banwo & Ighodalo