2ND ANNUAL BANKING & FINANCE CONFERENCE

THEME - INFRASTRUCTURE FINANCE IN NIGERIA

LEGAL & REGULATORY ISSUES IN INFRASTRUCTURE FINANCE IN NIGERIA

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Road Map

- Introduction
- What is “Infrastructure”?
- Features of Infrastructure Finance
- Funding Options & Finance Providers
- Legal & Regulatory Issues
- Recommendations

Introduction

- Efficient & reliable infrastructure is critical to attracting long-term FDI, expanding international trade, and catalysing growth.

- State of a country's public infrastructure is a key index for measuring its economic development & growth.

- Like most African countries, Nigeria's infrastructure has been comatose for decades, plagued by several challenges including, without limitation:

  - insufficient investment
  - investment obtained on unfavorable commercial terms
  - non-maintenance & neglect

Introduction (Contd.)

- population growth & unchecked urbanization
- corruption: public officers, fraudulent contractors/service providers
- Activities of vandals
- civil unrests
- inappropriate political considerations

Introduction (Contd.)

- Following return to democratic rule in 1999, efforts made at revamping Nigeria's ailing infrastructure and encouraging private sector funding/participation include:
    - Increased budgetary allocation to infrastructure (maintenance; renovation; rebuild)
    - Establishment of due process office and value for money policies
    - Creating enabling environment for private sector investment
        - Market reform
        - Strong regulator
        - Appropriate pricing
        - Unbundling state monopolies

Introduction (Contd.)

- enactment of relevant legislation – e.g. Infrastructure Concession Regulatory Commission (Establishment, etc) Act, 2005 (“**the Infrastructure Act**”) – established Infrastructure Concession Regulatory Commission (“**ICRC**”); Electric Power Sector Reform Act (“**ESPR Act**”)
- Policy Enhancements
  - Banking reform (consolidation & capital increase), enhanced capacity to fund big ticket transactions
  - growing recognition by government of utility of PPPs for financing provision & rehabilitation of public infrastructure e.g. recent construction of MM Domestic Terminal 2; prospect of road tolling (Lekki road concession)
  - of current administration’s 7-point Agenda, 3 relate to infrastructural development (power & steel, mass transportation, qualitative & functional education).
  - stemming corruption - establishment of EFCC and the ICPC

- But, certainly not yet Uhuru.

What is Infrastructure ?

- "the basic framework of any organisation" **(New Lexicon Webster's Dictionary of the English Language, Deluxe Encyclopedic Edition, 1990.)**
- "the underlying framework of a system; especially, public services and facilities (such as highways, schools, bridges, sewers, and water systems) needed to support commerce as well as economic and residential development." **(Black's Law Dictionary)**
- In the Infrastructure Act: "***development projects which, before the commencement of this Act were financed, constructed, operated or maintained by the Government and which, after the commencement of***

this Act, may be wholly or partly implemented by the private sector under an agreement pursuant to this Act"

- Broad spectrum of infrastructure covered by the Infrastructure Act: including power plants, highways, seaports, airports, canals, dams, hydroelectric power projects, water supply, irrigation, telecommunications, railways, interstate transport systems, township development, housing, government buildings, tourism development projects, trade fair complexes, warehouses, solid wastes management, satellite and ground receiving stations, information technology networks and database infrastructure, education and health facilities, sewerage, drainage, dredging, and other infrastructure and development projects as may be approved from time to time, by the FEC.

Features of infrastructure finance

- **Long tenor**

  Usually spanning between 7 to 40 years to match life of and returns on project.

- **Capital Intensive**

  By their nature, infrastructure projects are very capital intensive e.g. approximately N762million was expended in respect of the recent ‘minor' **<u>refurbishment of only certain sections</u>** of the 3rd Mainland Bridge in Lagos

- **Depending on nature of Infrastructure, repayments based on cash flows (projects which attract private investment)**

  Investors usually re-paid from earnings on infrastructure developed. (e.g. toll fares)

- **Higher Risk**

  Huge capital + long maturities + repayment structure = increased investment risk.

Funding Options & Finance Providers

Funding options

- **Government Budgetary Allocations**
- **Loan financing (strict and institutional financing)**
- **Equity (resources) of promoters/sponsors of the project**
- **Debt Capital Markets** involving the issuance of bonds, notes and or treasury bills purchased by institutional investors and HNIs for the financing of an underlying infrastructural project
- **Structured Finance** method of financing whereby financing risk is transferred, using complex legal and corporate mechanism e.g. securitisation, collateralised debt obligations & credit derivatives.

(most infrastructure projects now financed by a mix of these options)

Fund providers

- **Government**

  - Globally, government is the oldest financier of infrastructure development. It historically, used to be the sole financier, funding from infrastructure budgetary allocations.
  - Due to the need to balance competing interests, public resources for financing infrastructural development have dwindled over time. This, along with other factors, necessitated the resort to other sources of financing.
  - In recent times, about [a third] of the FGN's budgetary allocations has been dedicated to infrastructure, as depicted below:

Fund providers (Contd.)

Sector	2006	2007	2008
○ Power & Steel	5%	4.5%	4.8%
○ Water	5%	5.3%	6.6%
○ Education	11%	8.2%	7.3%
○ Health	7%	5.4%	4.8%
○ Works	6%	9.4%	4.9%
Total	**34%**	**32.8%**	**28.4%**

Fund providers (Contd.)

International Development Agencies

- Infrastructure finance is also provided by international & multilateral organisations and agencies, such as IBRD and IFC (both members the World Bank Group), USAID Development Credit Authority, ADB and EIA Fund, amongst several others.
    - USAID Development Credit Authority recently signed a US$10 million loan portfolio guarantee with Zenith Bank to provide long term mortgages of approximately ten (10) years.
- Such funding "straddles" government & private funding, i.e. some of these agencies (e.g. IBRD) provide funding exclusively to the public sector, whilst others (e.g. IFC) fund only private sector investments.

Fund providers (Contd.)

- Issue guarantees to private investors e. g. under IBRD's Guarantee Programme, project risk is shared with private investors. IBRD issues a "partial" guarantee which covers only non-commercial risks (government default or policy changes). In turn, IBRD obtains counter-guarantees and indemnities from government, to reimburse the guaranteed sum.
- To access funds from such agencies, certain eligibility criteria & requirements must be satisfied, pertaining to geographical location, level of GDP per capita income, sector of the economy in which funding is required, certain transparency indicia etc. Inability to meet these criteria restrict access to funds by developing economies.

Export Credit Agencies

private or quasi-governmental institutions which act as intermediaries between national governments and exporters e.g. the NEXIM in Nigeria. These agencies encourage the export of goods and services from their home countries by extending credit or providing insurance and guarantees (or both) to such exporters or to the foreign importers of such good & services.

Fund providers (Contd.)

Banks and other Private Institutional Investors

- Private sector participation in infrastructure financing dates as far back as 1299, when the English crown financed development of a silver mine in Devon through a loan from an Italian merchant bank. It gained global prominence in the 1970s/80s but only became relevant in developing economies in the late 1990s.
- Such investments take one of two main forms:
  - **Independent Private Investment (Project Finance)**

    Private entities fund infrastructure projects mainly through bank lendings (syndicated, complex financial structures) where existing legal framework is conducive and project permits appropriate returns to investors.

(before recent meltdowns AAA rated projects typically carried a finance mix of 85% debt:15% equity)

Fund providers (Contd.)

- **Public Private Partnerships**

  Private sector partners with government to finance the development or refurbishment of infrastructure and or deliver services traditionally financed or provided by the public sector; .

  - ✓ PPPs could take on a variety of concession models: DBCF, BOT, BOO, BOOT, LBOT
  - ✓ Common features: private investors contract with government, obtain requisite consents, approvals or permits from the latter, to hold, construct & maintain infrastructure over agreed concession period, with requirement in some cases, to transfer infrastructure to the government at expiration of concession period.

Legal and regulatory issues

- In recent years, focused and emerging legal and regulatory framework for infrastructure financing and private sector participation in Nigeria

  - Infrastructure Concession Regulatory Commission (Establishment, etc) Act, 2005 ("the Infrastructure Act")

  - Some state legislations e.g. Lagos State Roads, Bridges and Highway Infrastructure (Private Sector Participation) Development Board Law

  - **Other Relevant Legislations and Regulations**
    - Federal Roads Maintenance Agency Act, 2002
    - Fiscal Responsibility Act, 2007
    - Foreign Exchange (Monitoring and Miscellaneous Provisions) Act, Cap. F34, LFN 2004

Legal and regulatory issues (Contd.)

    - Federal Highways Act, Cap. F13, LFN 2004
    - Companies Income Tax Act Cap C21, LFN 2004
    - CBN Regulations and Policies
    - National Inland Waterways Authority Act, Cap. N47, LFN 2004
    - Nigerian Investment Promotion Commission Act, Cap. N117, LFN 2004
    - Public Enterprises (Privatisation and Commercialisation) Act, 1999
    - Public Procurement Act, 2007

- 2 broad legal & regulatory challenges facing infrastructure finance in Nigeria:
    - Inadequacies of existing legislation & regulations
        - Deficiencies of the Infrastructure Act
        - Dearth of sector-specific legislation
    - Regulatory & institutional barriers

Inadequacies of existing legislation

Infrastructure Act

- Long Title: *"An Act to provide for **private sector participation** in the development financing, construction, operation or maintenance of **federal** infrastructure or development projects (by whatever name called) through **concessions** and **contractual arrangements.**"*
- Establishes the ICRC to monitor compliance and ensure efficient execution of the provisions of the Act
- ICRC empowered to issue its own regulations
- Provides for:
  - Authorization to enter into contracts with and grant concessions to private entities, subject to FEC approval.
  - Grant of guarantees, letters of comfort or undertakings to investors, subject to FEC approval.

Inadequacies of existing legislation (Contd.)

- **Deficiencies of Infrastructure Act**

Although enactment of the Act is laudable, it fails to provide statutory assurances in respect of certain matters which will be fundamental to private sector concessionaires. Whilst these can be addressed contractually, acknowledgment of same in the Act would buoy financial institutions and private investor confidence.

These matters relate to:

- payment of compensation upon changes in legislation or policies, which adversely affect concessionaires
- payment of compensation if contract is terminated by government otherwise than in accordance with contract terms
- takeover or appropriation of project by government

Inadequacies of existing legislation (Contd.)

- indicia for the evaluation of content or implementation of the concession contract, to limit political considerations
- substitution of concessionaires
- confirmation that where applicable, government will abide by governing law and dispute resolution mechanisms adopted.

o Presently, only one sector-specific federal legislation on infrastructure financing i.e. the EPSR Act which deals with IPPs

Regulatory & Institutional Barriers (Contd.)

- **Complex & costly regulatory processes**
  - E.g. existing statutory requirements (ISA & SEC Rules) for the issuance of corporate bonds are time-consuming & expensive (an Issuer will pay to regulators, approx 16%-18% of funds raised). Much “quicker” to obtain bank loans (but structuring and security requirements often complicated)

- **Nigeria’s debt capital market**
  - Nigeria’s debt capital market still evolving and not yet robust
  - Current ratio of equity to debt securities on the NSE is approximately 84:16
  - Market is yet to commence trading in sophisticated instruments such as derivatives, repurchase agreements (REPOs)

Regulatory & Institutional Barriers (Contd.)

- **Tax Regime**
  - Inadequate tax and other incentives for fund providers and investors. E.g. Interests on corporate debt instruments and bank financing are liable to withholding tax (WHT) at the rate of 10% (unlike FGN bonds which are exempted therefrom) & transaction documents assessed to stamp duties
  - Tax holidays where available are not particularly attractive to infrastructure investors who seek longer holidays
  - However WHT on interest payments on a foreign loan with the appropriate moratorium period may be reduced by between 40.0 per cent and 100.0 per cent (under Table 1 of the Third Schedule referred to in section 11 of CITA) depending on the moratorium and tenor of the loan, such tenor not being less than two years.

Regulatory & Institutional Barriers

- The Table provides for certain exemption on withholding tax payable, based on the repayment period and the moratorium granted under the terms of the loan. There is a controversy as to whether moratorium relates to interest alone or to both interest and principal. ***The Current FIRS position is that it relates to both.***

  (the Table is set out hereunder for ease of reference).

Repayment Period including Moratorium	Grace Period	Tax Exemption Allowed
Above 7 yrs	Not less than 2years	100%
5-7 yrs	Not less than 18 months	70%
2-4 yrs	Not les than 12 months	40%
Below 2 yrs	Nil	Nil

Regulatory & Institutional Barriers (Contd.)

Similar or better concessions should be provided for locally raised long term loans.

- **Unattractive project financing profiles**

  In many cases, no assurance is provided to private investors regarding future revenue stream constraints which limit return on investment e.g. possibility of government policy mandating reduction of rates for benefit of low-income consumers.

- **Country Risks**

  - Civil unrests e.g. Niger Delta
  - Unquantifiable social & environmental risks in addition to political risks
  - Premium payable procuring Political Risk Insurance is very expensive

Regulatory & Institutional Barriers (Contd.)

- Unstable, inconsistent and uncoordinated Government Policies, extreme policy flip-flops. E.g. ill advised review by Legislature of exemptions, guarantees and assurances granted to the NLNG project **by law** for 10 years. Done great damage to financial institution and investor perception of Nigeria

- **Weak domestic financial institutions**

  Regardless of recent reforms and regulations many of our financial institutions still inadequately or inappropriately capitalized to undertake big ticket long term projects

- **Public Sector Bureaucracy**

  Government ministries and agencies still plagued by bureaucracy, inadequate understanding& inefficiencies which hinder the effectiveness of PPPs and other infrastructure financing

Recommendations

- **Improving enabling legislation**
  - Review of existing legislation to address identified challenges
  - Enactment of industry-specific infrastructure development Laws & Regulations
  - Work should be concluded & reports submitted by policy committee set up to advise on revamping of the bond market, in addition to the work being done by the Bonds Sub-Committee of the Capital Markets Committee of SEC
- **Streamlining of regulatory processes**
  - SEC and the NSE should streamline & improve their review and approval processes to encourage the timeous completion of debt issuances.

Recommendations (Contd.)

- Powers, roles and functions of key ministries and government agencies (e.g. SEC, NSE, CBN, DMO, BPE, NERC, FERMA, Fiscal Responsibility Commission, ICRC, NPA, NCAA, PHCN, should be streamlined to tackle bureaucracy, eliminate conflicts & overlaps and improve efficiency. This should be replicated at states level.

- **Further reduction of regulatory fees**
  - There should be further reductions (in addition to recent reductions granted as part of efforts at "rescuing" the value of shares on the NSE) in regulatory fees payable to the SEC & NSE on security issuances and registration. (aware that efforts being made to substantially reduce fees on bond issuances)

- **Infrastructure development funds**
  - More attention should be paid to the administering of infrastructure development funds such as the Rural Electrification Fund, National Information Technology Development Fund, to attain the targeted growths objectives

Recommendations (Contd.)

- **Incentives**
  - Extensive/enhanced tax and other incentives, suitably attractive must be granted to infrastructure financiers
- **Political Will**
  - All tiers of Governments must commit to the task with sincerity.
  - Government must coordinate policies and show resolve to assure an enabling environment, avoid inconsistencies and flip-flops and enhance confidence
  - Government must focus on and improve security
- **Private Sector**
  - Enhance in house capacities for assessing and financing projects
  - Change mindset from quick turn around, quick returns projects
  - Financial institutions must deepen their financial base, be more accessible, better disciplined and take a longer term view
  - Positively support and honestly advise on Government efforts

THANK YOU

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