

Mobilizing Institutional Investments into Emerging Market Infrastructure

The infrastructure financing gap remains a critical global challenge for sustainable development. New thinking and innovative financial models are needed in order to mobilize more private capital to infrastructure investments. IFC's new Managed Co-Lending Portfolio Program for Infrastructure seeks to address numerous infrastructure financing challenges that inhibit the flow of resources to emerging markets. The program provides an innovative model for mobilizing financing for infrastructure projects that combines financing from insurance companies, project origination and credit enhancement from IFC, and support from public sector donors.

Infrastructure investment plays a crucial role in fostering economic growth and has been proven to promote other development priorities such as improved economic opportunities and life outcomes for the very poor, reduced inequality and increased labor force participation by women. However, infrastructure continues to face numerous financing challenges that have resulted in a wide and persistent infrastructure gap, particularly in developing countries.

The Managed Co-Lending Portfolio Program (MCP) for Infrastructure was developed to address these challenges. As an innovative debt product it is designed to leverage IFC's experience and expertise in emerging market investments, as well as IFC's track record in structuring and managing a globally diversified infrastructure portfolio, in order to unlock institutional investor financing for infrastructure in emerging market economies.

Untapped Institutional Investor Financing

Emerging markets will require a significant increase in infrastructure investment in coming years to facilitate economic growth, to respond to demographic and urbanization pressures, and to meet sustainable development goals. Current infrastructure investment amounts to approximately \$1 trillion per year, an amount that will need to triple annually over the next decade to meet the unmet demand for infrastructure.

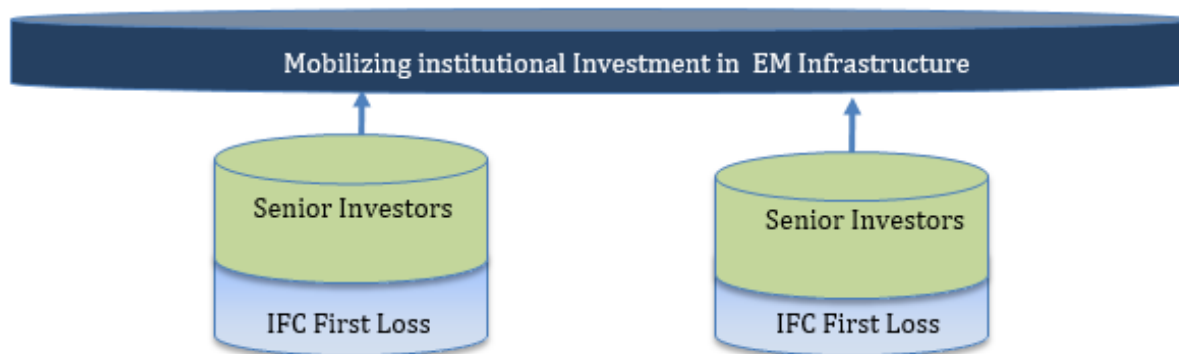
Public finance remains a significant lending source for infrastructure, yet many governments are facing fiscal pressure and are looking to reduce, rather than expand, their balance

sheets. At the same time, new liquidity rules and a narrower focus on core markets has led to a reduction in long-term lending from large international commercial banks that were previously active in this market. Local capital markets, meanwhile, face high costs of capital, unsophisticated actors, limited scale, and low financial depth. As a result, there is a dwindling supply of financing to meet an ever-expanding demand for infrastructure.

Historically, the primary platform for mobilizing third-party financing into IFC loans has been through syndicated lending. Since inception this method has managed to mobilize over \$50 billion, with approximately half of those funds flowing to infrastructure. Given the increasing demand, however, this traditional approach will not suffice to satisfy future needs, and additional sources of financing are required.

One large, untapped source of debt financing for infrastructure investment in emerging markets comes from institutional investors that control deep and rapidly growing pools of assets with enormous potential to transform the infrastructure financing landscape. In OECD countries, total assets under management by "traditional" institutional investors more than doubled from 2000 to 2011, from \$36 trillion to \$73.4 trillion.¹

This potential, however, has largely not translated to significant investments in emerging markets infrastructure, even though institutional investors are active participants in infrastructure financing in advanced economies. The exceptions to this trend have been very large scale projects in upper middle-income countries (China, Turkey, and Brazil, for example), where the



scale justified developing a tailored credit reviewing expertise, and where the risk profile was in line with the risk–return appetite of institutional investors, in particular their preference for investment-grade assets.

Issues such as regulatory uncertainty, project bankability, the lack of data about asset performance, and the institutional capacity of procuring governments are gating constraints that, while complex, can be overcome through use of appropriate policy levers. A steeper challenge is to convince investors to participate in a broad range of projects across sectors and countries. The absence of a track record makes it difficult for investors to decide on target return and asset allocation, while the risk profile is usually sub-investment grade, and therefore outside the risk appetite that dominates the bulk of institutional balance sheets. In addition, the absence of local expertise in smaller markets makes individual credit review impossible or excessively onerous for projects outside of a few large middle-income countries.

MCPP Infrastructure

The MCPP Infrastructure initiative was specifically developed in close collaboration with leading insurance companies and other development partners to address these challenges. The approach follows from, and builds on, an established IFC syndicated loans platform—the original Managed Co-Lending Portfolio Program that was launched in 2013. In the original program, IFC received an allocation of \$3 billion from China’s State Administration of Foreign Exchange, SAFE, in a “blind pool” approach. SAFE co-invested with IFC in every loan committed by IFC for its own balance sheet over a period of five years, subject to concentration limits.

The MCPP platform essentially provides investors with a diversified portfolio of loans that mirrors IFC’s own, similar to that of an index fund. This allows investors to benefit from IFC’s unique diversification across countries and sectors.

The newest iteration, MCPP Infrastructure, adapts the MCPP model to the needs of institutional investors with an explicit interest in investing in infrastructure. In addition, in order to provide investors with an investment-grade profile, IFC provides credit-enhancement through a first-loss tranche.

It is estimated that IFC will be able to leverage ten dollars of institutional financing for each dollar of IFC money invested in the first-loss tranche.

The first phase of the MCPP infrastructure initiative will involve partnerships with two to four investors, with a goal of raising between \$1.5 billion and \$2 billion, with a subsequent scaling up of the model to mobilize additional volumes. Up to \$5 billion is expected over the next three to five years.

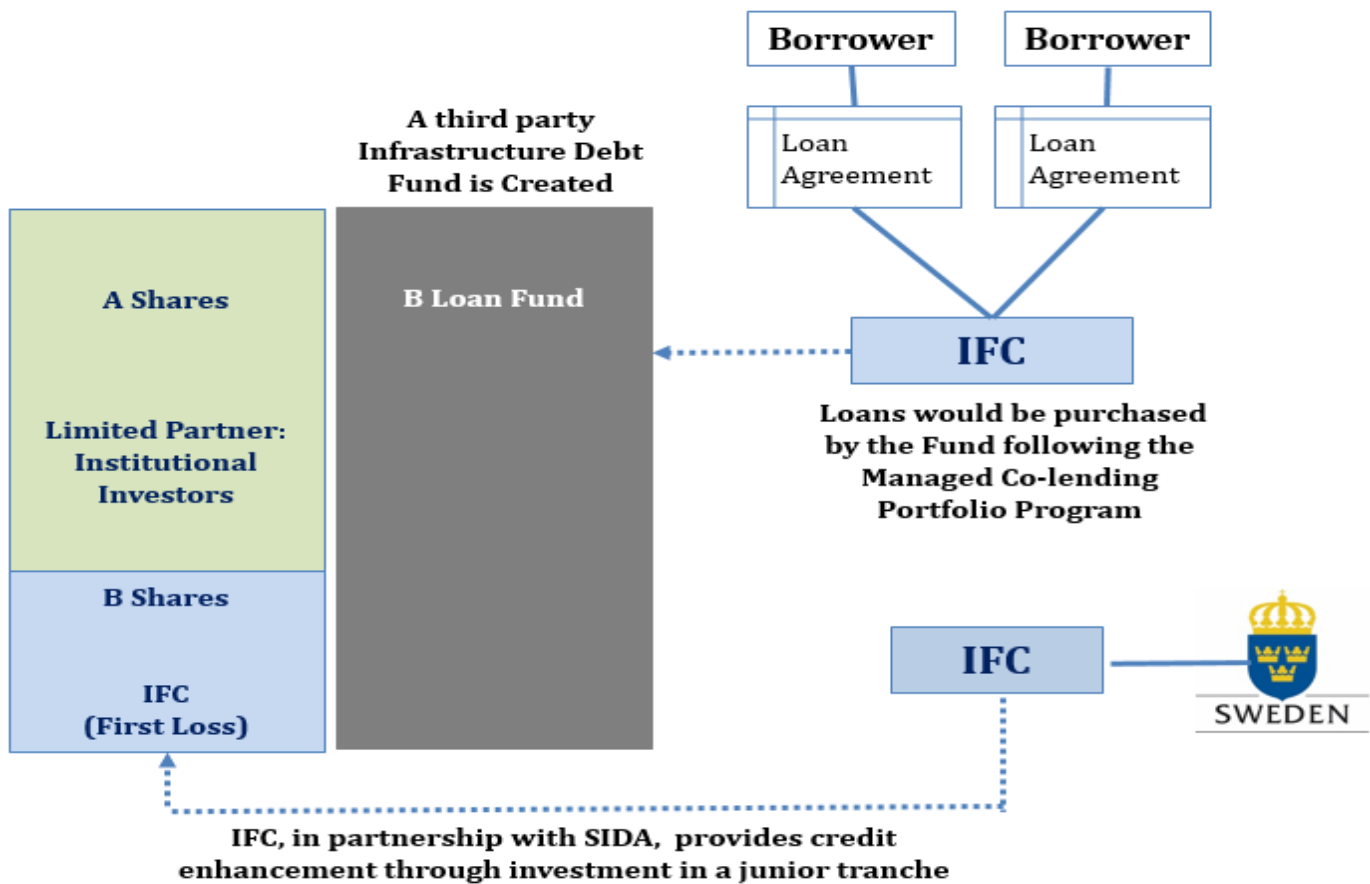
How it works

Through MCPP Infrastructure, external investors will be able to deploy additional debt financing to support infrastructure projects that IFC originates and approves for investment. The process is objective, largely mechanized and transparent, and was designed to maximize efficiency.

Investors commit a certain amount of money in advance, to be invested alongside IFC funds within certain country and sector limits. In exchange, IFC shares with MCPP investors its full pipeline of infrastructure projects, without the ability to cherry-pick projects. As a result, IFC and the borrower get certainty of financing upfront, while investors get to benefit from IFC’s 60-year track record of investing in emerging markets around the world, from IFC’s global infrastructure expertise, and from IFC’s local knowledge and presence in over 100 countries.

The eligible infrastructure projects will be in the power, water, transportation, and telecoms sectors, all of which provide the stable, long-term cash flows that investors demand. Crowding in a new pool of institutional investors and funneling them toward these projects will create a powerful demonstration

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model that, when scaled, can help close critical infrastructure gaps in emerging markets.

Key Partnerships

IFC has developed the MCPP Infrastructure approach in collaboration with institutional investors who have devoted significant time and resources to creating the structure. In addition to meeting the risk-return requirements of the investment itself, these first movers also require additional return to compensate them for bearing these first-mover costs.

In setting up this first phase of the MCPP Infrastructure initiative, IFC was able to benefit from the partnership and support of the Swedish international Development Cooperation Agency (Sida) which provides a guarantee on a portion of IFC's first loss position in exchange for a guarantee premium. This helps to mitigate some of the volatility and improve the risk-return profile of IFC's investment. In turn, IFC provides a more attractive return to the private sector investors, ensuring their cost recovery and further encouraging their participation as first movers under this structure. In addition to improving the risk-

return profile of IFC's investment, the Sida guarantee also significantly reduces IFC's capital requirement for the first-loss tranche, thereby freeing up capital that can be used to replicate and scale up the model.

The Sida team has actively participated in the design of the guarantee to ensure that it covers only investments that fit with Sida's own strategic priorities. This arrangement of sharing the risk on a subset of assets in the portfolio means that further variations on the model could see the use of donor support for high-priority strategic portfolios, such as the world's poorest countries, fragile and conflict states, or climate financing. With greater cooperation between multilateral and bilateral development finance institutions, in structures similar to the IFC-Sida arrangement, new and innovative solutions can be scaled up and expanded in high developmental priority areas or more challenging markets.

Value Add and Impact

The main impact of the MCPP Infrastructure initiative is to establish a new model to mobilize financing for infrastructure

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projects, one that combines financing from private sector investors, origination and credit enhancement from IFC, and support from public sector donors.

The successful implementation of the model will provide developmental benefits in two ways. First, directly through the financing of critical infrastructure projects in emerging markets and low-income countries, enabling these projects to reach financial close on shorter lead times and at much lower transaction costs. This will accelerate the development of sustainable infrastructure in emerging market economies and low-income countries.

Second, indirect benefits can be expected through a demonstration effect. The possibility of scaling up a structure

that is proven to work and stand on its own would be extremely valuable from a developmental standpoint, in view of the overwhelming financing requirements—with institutional capital in a critical role—for developing sustainable infrastructure on a global basis.■

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¹ Celik, Serdar, and Mats Isaksson. 2014. "Institutional Investors and Ownership Engagement." Organization of Economic Co-operation and Development.