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NOTE 53 • APRIL 2018

# Crowding-In Capital Attracts Institutional Investors to Emerging Market Infrastructure Through Co-Lending Platform

Financing infrastructure in emerging markets is a critical global challenge for sustainable development. Through a new IFC program, private institutional investors can directly participate in the evolving infrastructure asset class in emerging markets. The program, IFC's Managed Co-Lending Portfolio Program for Infrastructure, creates a structure that overcomes several hurdles that have inhibited the flow of private capital to emerging market infrastructure projects. It provides an innovative model to mobilize financing for development that combines financing from insurance companies, project origination and credit enhancement from IFC, and support from public sector donors.

Infrastructure investment plays a critical role in fostering economic growth. It has been proven to promote other development priorities as well, including 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.

According to a recent study, the world will need to invest an average of $3.7 trillion in infrastructure every year through 2035 to keep pace with projected GDP growth. This amount would need to increase further, by up to $1 trillion annually, to meet the United Nations Sustainable Development Goals.[1]

Public finance remains a significant lending source for infrastructure, yet many governments face fiscal pressures 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 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 limited supply of financing to meet an ever-expanding demand for infrastructure, and mobilizing and scaling private investments will be necessary to reduce the infrastructure financing gap.[2]

## Untapped Institutional Investor Financing

One large, untapped source of private debt financing for infrastructure investment in emerging markets comes from institutional investors that control deep and 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 trillion.[3]

This potential, however, has not translated to significant investments in emerging market 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, where the scale justifies a tailored credit-review, and where the risk profile is in line with the risk–return appetite of institutional investors.





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Issues such as regulatory uncertainty, project bankability, the lack of data about asset performance, and the institutional capacity of procuring governments are constraints that, while complex, can be overcome through the 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 in many emerging markets makes it difficult for investors to decide on target return and asset allocation. And because the risk profile is usually sub-investment grade, it lies outside the risk appetite that dominates 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.

IFC's Managed Co-Lending Portfolio Program (MCPP) 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. The objective of the program is to unlock institutional investor financing for infrastructure in emerging market economies.

Historically, the primary platform used by IFC to mobilize third-party financing into emerging market loans has been syndicated lending. Since IFC's inception, this method has managed to mobilize over $50 billion, with approximately half of this total flowing to infrastructure. However, these funds came largely from commercial banks and development finance institutions. The MCPP offers a solution to syndicate loans to institutional investors, enabling them to participate for the first time as a source of financing to meet the growing infrastructure needs.

## MCPP Infrastructure

The MCPP Infrastructure initiative was developed in close collaboration with leading insurance companies and other development partners. The approach follows from and builds on the original MCPP that was launched in 2013 with an initial allocation from China's State Administration of Foreign Exchange.

In MCPP Infrastructure, IFC has entered into separate partnerships with three of the world's leading insurers—Allianz, AXA, and Prudential—mobilizing a total of $1.6 billion in funding. In each partnership, a private-sector investment vehicle has been created by the investment management arm of each insurer to raise money from related-party entities of the investment manager and from IFC. Each vehicle has been structured to meet the specific needs of each insurance group, and the financial and legal structures differ accordingly across partnerships.

There are two key components of each MCPP Infrastructure facility. First, a portfolio syndication process provides investors with a diversified portfolio of loans that mirrors IFC's portfolio, allowing them to benefit from IFC's unique diversification across countries and sectors. Second, an IFC investment in a first-loss tranche that provides the private investors with an investment-grade profile. It is estimated that IFC will be able to leverage nine dollars of institutional financing for each dollar of IFC money invested in the first-loss tranche.

## The MCPP Process

IFC and each investor sign an agreement that sets the syndication arrangements between the investment vehicle and IFC. MCPP investors are offered the opportunity to co-lend in every new loan that IFC originates that fits the investor's criteria. Objective criteria are laid out in the facility agreement, and any project that meets them must be offered to the investors. Each investor has slightly different criteria to meet their own investment strategy and mandate. To create a diversified portfolio for third-party investors, portfolio concentration limits have been established to ensure that the portfolio is not overly concentrated in any individual project, country, or sector.

The share of MCPP investor participation in any given project is determined on a case-by-case basis, though IFC always keeps a share for its own account to ensure an alignment of interests between IFC and investors. The allocation follows a rules-based methodology and is a function of the size of the project, the number of eligible investors, their respective headroom, their matching percentage to IFC, and IFC's risk appetite for exposure to retain on its own books. The key allocation driver is for IFC and MCPP investors to invest in equal amounts, unless the investor hits a concentration or single-name limit. All allocation between MCPP investors is pro rata.

Operationally, the process has been designed to front-load all interactions and decision points with the investors prior to the signing of a mandate with the borrower. Once IFC decides to make a loan for its own account, it will automatically create a parallel tranche for the MCPP

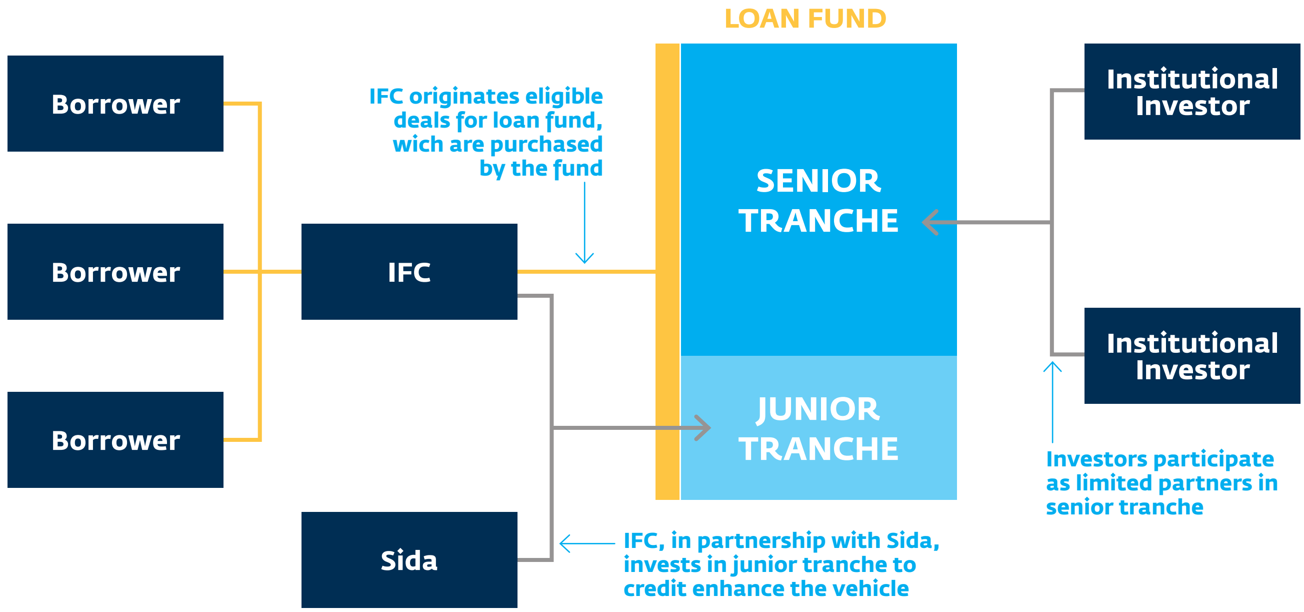


**FIGURE 1** MCPP Infrastructure—How a Facility is Structured

*Source: IFC*

investor on the same terms and conditions as its own loan. IFC signs a single loan document with the borrower, in which the MCPP participation is included in the form of an "MCPP B Loan." IFC acts as lender of record for the entire financing. There are no additional layers of decision making, resulting in minimal additional costs for IFC and relatively low fees for investors.

For IFC and IFC borrowers, this "pre-mobilized" money provides certainty of financing, enabling IFC to provide larger loans and, in some cases, accelerating business development and project preparation. It also ensures that the mobilized financing follows IFC loans across all countries and sectors, introducing investors to a range of new markets, including in low-income and fragile countries.

## IFC's Investment

IFC has agreed to provide credit enhancement to each of the partnerships through a 10 percent first-loss investment. This level of first-loss protection was calibrated to provide investors with a risk-profile similar to an investment-grade asset. The first-loss investment works by splitting the cash flows from the portfolio of loans between the institutional investors and IFC.

All of the loan income is received by the investment vehicle, and then is distributed: first to pay a share of the income to the senior investor, with the residual paid to IFC. Principal repayments received from the borrower are allocated first to the institutional investors. IFC will receive principal repayments only after senior investors have been fully repaid.

While this structure utilizes some established structured finance techniques, significant innovation was required to adapt these to work within the context of an emerging market infrastructure loan portfolio. This required significant creativity and flexibility on the part of IFC and the first-mover MCPP partners.

## 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 the MCPP Infrastructure initiative, IFC benefited 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.

## Value Add and Impact

The main impact of the MCPP Infrastructure initiative is to establish a new model to mobilize financing for infrastructure 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 can stand on its own would be extremely valuable from a development standpoint, in view of the overwhelming financing requirements—with institutional capital in a critical role—for developing sustainable infrastructure on a global basis.

IFC's innovative investment model helps match institutional capital with emerging market infrastructure investment. This matchmaking is key to supporting the ongoing transformation of infrastructure in emerging markets. Leveraging private investment in this way is critical to realizing the United Nations Sustainable Development Goals. ■

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## ABOUT THIS EM COMPASS NOTE

This EM Compass Note builds on the previously published EM Compass Note Mobilizing Institutional Investments into Emerging Markets (Note 36).

## ADDITIONAL EM COMPASS NOTES ABOUT MOBILIZING CAPITAL

Please also refer to the following EM Compass Notes: *Crowding-In Capital: How Insurance Companies Can Expand Access to Finance* (Note 52); *Masala Bond Program–Nurturing a Local Currency Bond Market* (Note 30); and *Mobilizing Private Climate Finance—Green Bonds and Beyond* (Note 25).

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1 McKinsey. 2017. "Bridging Infrastructure Gaps: Has the World made Progress?"

2 IMF Working Paper. 2017. "Trends and Challenges in Infrastructure Investment in Low-Income Developing Countries."

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