



Programme Management Unit of the Regional Trade Facilitation Programme

Final Report

**INPUT FOR THE DESIGN OF THE IMPLEMENTATION
ARRANGEMENTS OF THE PROPOSED COMESA REGIONAL
INFRASTRUCTURE FUND**

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1. Executive Summary

This report aims to inform COMESA's *internal dialogue* on the design of implementation arrangements of the proposed Infrastructure Fund. It highlights the issues that require addressing as well as the *resource mobilisation and implementation* approaches. The report outlines the next steps that are critical and of interest to the COMESA Secretariat.

There is no doubt that modern and effective infrastructure is vital to the promotion of regional trade and closer integration amongst COMESA member states. New approaches to financing infrastructure development have provided *alternatives* to purely public sector financing. Similarly, the availability of a new generation of powerful tools is assisting in simulating risks involved and improving risk mitigation strategies making investment in infrastructure an attractive proposition.

Key findings/Recommendations

- Donor countries and WTO members maintain that whilst funding for infrastructure projects that facilitate trade is available, *a suitable vehicle* through which such resources can be channelled needs to be further developed.
- Finance for investment in infrastructure projects *can be secured from the private sector* if such projects are *bankable* i.e. have commercial rates of return and political risks mitigated.
- There are several infrastructure funds operating in Africa, but none of them have the same degree of focus that would be built into COMESA's Regional Infrastructure Fund, *namely trade and integration*. This focus on regional integration will *differentiate* the Regional Fund from other DFIs that invest in infrastructure.
- The Regional Infrastructure Fund *should act as a catalyst for viable integration focused infrastructure projects*. It will assume the lead role in funding projects (through taking up equity and debt) in the Special Purpose Vehicles ("SPVs") established to develop various projects.
- Investors can *invest at both the Fund level as well as the Project level*. Investing at Project level would ensure that they benefit from the high returns generated by direct investment in selected high return projects. Investing at Fund level would mitigate single project risk and provide a consistent annual return on the Regional Infrastructure Fund's pool of projects or assets.
- The starting point for resource mobilisation is contribution or subscription to the Regional Fund by *member states*. This base fund will demonstrate to (other) potential investors/stakeholders the member states' commitment to the Regional Infrastructure Fund.
- Establishing the Regional Fund as a Limited Liability Company ("LLC") would be *simpler*. Company law is well codified in all member states. The relationships between shareholders, directors, and management are clearly understood. Similarly,



the rights, obligations, and responsibilities of the officers of the company can be embodied in the Articles of Association of the LLC.

- To address the concerns of private sector investors with respect to *commercial operations* of the Fund and COMESA's concerns on the potential risk of being out-voted on strategic issues COMESA could own a "golden" share. The share could be retained for a defined period to allow the Regional Infrastructure Fund to become *accustomed* to operating in a public environment.
- To assess the magnitude of resources required to fund infrastructure projects there is need to identify infrastructure projects that have a *high potential for both trade facilitation and fostering closer integration* in the COMESA region. This inventory of projects should underpin and justify the creation of the Regional Infrastructure Fund.
- As a minimum an *engineering needs, assessment* should be undertaken for each project. Engineering needs assessment is a technical method, based on engineering studies of the conditions and need, for development of, and investment, in infrastructure projects.
- PPPs are *effective financing mechanisms* for both national and regional development activities, especially infrastructure projects. COMESA member states should develop and implement policies and strategies on PPPs and market these to key stakeholders including potential investors. *Legislative frameworks* conducive for the development of PPPs need to be developed and *harmonised* in the COMESA region.
- Structuring PPPs acceptable to both the public and private sectors *involves bridging the preference of both sides to assume minimum risk* in projects. Extensive negotiations will be required in order to address all the issues equitably and to develop a sense of partnership and trust between the public and private sector players. *Inter-alia*, these negotiations will tackle these extremes *equitably* in order to mitigate the risks that each side fears.
- To attract private sector funding to the Regional Infrastructure Fund there is need to develop clearly defined and acceptable exit strategies and mechanisms. Ambiguities would deter investors.
- Given the amount of *time and effort* involved in establishing a fully operational Regional Infrastructure Fund, activities should be phased. During the *Pilot/Phase I* priority, projects (such as projects along the North-South Corridor) could be developed through SPVs created by successful bidders. The *objective* during this phase would be to develop specific projects put to tender by COMESA before the Regional Infrastructure Fund becomes fully operational.
- In *parallel* with Phase I, Phase II activities aimed at establishing the *Regional Fund and achieving financial close* should continue. Once fully operational Regional Fund's investments in project SPVs during Phase I would be *absorbed* under the "Umbrella Fund".



- Not all the infrastructure projects in COMESA’s inventory will yield superior returns -some will yield higher returns than others will. Lower yielding projects will be less attractive to private sector investors and will therefore require incentives. The provision of grant funding to marginal projects will reduce the cost of funds as well as the overall project development costs thus making marginal projects more attractive for private sector investors.
- There are *several* Project Preparation Facilities (“PPFs”) in existence and the establishment of a COMESA Regional Infrastructure Fund specific *PPF risks* dissipation of effort and interest away from the Regional Infrastructure Fund. The Regional Infrastructure Fund should facilitate *access* by developers to the *existing PPFs*.
- The management of infrastructure *funds require specialist skills* and they are either managed by sponsor banks or institutions related to banks or by independent fund managers. The appointment of a fund manager *would add credibility* and *appeal* to potential investors. Such an appointment must be based on an international competitive bidding and open and transparent evaluation processes.
- The infrastructure fund model is an *attractive source of fees* for the Manager of the fund –fees that are derived from a wide range of management, advisory and financial services. The COMESA should be aware of these fees and *should be ready to contest* the fees in negotiations leading to the appointment of the Fund Manager.
- The critical next steps are to invest time developing the Regional Infrastructure Fund’s *project brief* and appoint a Transaction Advisory Team as these steps will have *the greatest impact* on delivering the Regional Infrastructure Fund project to a *realistic* timetable.

Conclusion

Rapidly changing trading patterns and infrastructure technology is simultaneously creating challenges and opportunities for COMESA. The challenge is to develop new infrastructure in response to demand for more efficient business support services in the region, maintain, and rehabilitate existing infrastructure that has depreciated over many years due to under investment. The opportunity to catalyze the development of new infrastructure that will reduce cost of production and distribution, and foster closer integration exists. The challenges and opportunities must be addressed by an integrated strategy and with a suitable vehicle such, as is contemplated by the creation of the COMESA Regional Infrastructure Fund.



Introduction

Infrastructure is one of the most critical components of economic growth. Inadequate investment in transportation, water, communications, and electricity will almost guarantee that an emerging economy's prospects remain forever emerging.

COMESA's main function is to strengthen regional integration through the implementation of preferential trading between member states. The COMESA Secretariat has been working on operationalising *Aid for Trade* as a regional integration mechanism through the establishment of the COMESA Regional Infrastructure Fund ("CRIF"). It is now actively pursuing the establishment of this infrastructure fund, which is in consonance with World Trade Organisation's ("WTO") trade facilitation activities. The CRIF would be used to provide resources for investment in infrastructure projects that would promote regional integration between member states.



2. Assessment of Need for the CRIF

Overview of infrastructure funds

Historically governments using public funds developed infrastructure projects (including utilities). Most public utilities were subsidised. With increasing emphasis on cost recovery and economic pricing in recent years, private investors are now investing in infrastructure projects. The increasing pressure on the public purse has meant that governments do not have the resources required to invest in infrastructure projects. Private investor involvement in infrastructure projects began with investment of funds dedicated to developing real estate. Traditionally private investors have invested in the more familiar stocks and shares.

Typically, infrastructure funds invest directly in power, water treatment and reticulation, transport and communications. Private investment in infrastructure development began in earnest in the nineties, which saw the first surge in private infrastructure funds. The largest being Macquarie Bank with US\$22 billion diversified across many countries and sectors.

Governments embracing privatisation and Public Private Partnerships (“PPPs”) in response to fiscal constraints and economic trends are spurring the boom in infrastructure funds. Demographic changes (growth in populations, improved mortality and the growing middle class in developing countries) too have contributed to the boom is creating further demand for new infrastructure. In addition, there is China’s expansion and the growth expectations of developing countries with capital resources.

Another reason for the surge is increasing interest from institutional investors. Institutional investors with readily available resources and low returns on alternative (traditional) investments are also fuelling growth of the sector. They prefer long duration fixed income and as such, their return profile dovetails with their longer term obligations. Returns on infrastructure funds provide a good match with their obligations.

Over the last fifteen years private infrastructure investment that has shied away from Africa and accounts for a meagre 4% of all private investment in developing countries. This notwithstanding, governments with the assistance of multilateral institutions and development finance institutions are investing in infrastructure projects. Governments are pressured by increasing population, public demand, and economic growth to invest in infrastructure.

The current power deficit is a case in point –several new-generation power projects are being planned and implemented to address the demand for power. However governments on their own can not garner the required resources to implement projects and are looking to the private sector and development finance institutions to partner with and jointly develop infrastructure projects. Most African governments are adopting variants of the PPP model to develop infrastructure projects.

Private investors too have recognised the potential opportunities and are now investing in African infrastructure. Citigroup, Royal Bank of Scotland, Barclays and others are active in project finance in Africa. Private funds will invest in projects with the following characteristics:

- credible sponsors (in this case CRIF backed),



- governments' policy predictability (COMESA would have some role),
- governments' technical capacity in initiating projects (CRIF can assist fill this gap),
- management of vested interests (COMESA and relevant governments could address these),
- legal constraints (COMESA can assist through harmonisation), and
- affordability (the end users should be able to pay for the service -this is critical for CRIF funded projects).

Where the above characteristics are not addressed, private investors will look to mitigating potential resultant risks.

DFIs such as the African Development Bank (“AfDB”) and the Development Bank of Southern Africa (“DBSA”) and International Financial Institutions (“IFIs”) have been active in Africa and will consider assuming some level of risk. Whilst these institutions are not dedicated to developing infrastructure they have, and continue to invest, in viable infrastructure projects.

Poor infrastructure reduces the competitiveness of countries and increases costs of production and distribution. Investment in cross-border transit corridor infrastructure and other integration focussed infrastructure assets would reduce these costs, increase trade, and further strengthen cooperation in the COMESA region.

Donor countries, (including United Kingdom, Unites States of America -through the AGOA arrangements, European Union, Scandinavians, China and Japan) and WTO members maintain that whilst funding for trade-facilitation infrastructure projects is available, a suitable vehicle through which such resources can be channelled needs to be further developed. These funds, combined with funds from member states, when channelled through an appropriate vehicle could be further augmented with funds from other financial institutions such as development banks, sovereign funds, private equity funds, commercial banks and thereby provide the critical mass required to launch a vehicle to develop infrastructure projects that would enhance integration. In order to attract donor resources COMESA's policy organs decided to establish the CRIF as this would be the vehicle dedicated to the accelerating the execution or development of regional infrastructure projects.

In addition to traditional sources, finance for investment in infrastructure projects can be secured from the private sector if such projects are bankable i.e. they have commercial rates of return and inherent political risks mitigated. There are an increasing number of examples of successful infrastructure funds involving the pooling of public funds and privately sourced funds in other parts of the developed and the developing world.

Significant progress has been made in both the “soft” aspect of trade in the region (harmonisation of tariffs and regulations) as well as on the development of the “hard” aspects, (infrastructure), much of which has been undertaken on an individual country basis, usually funded by borrowing from “IFIs”.

The *need for the CRIF* is becoming more evident with the passage of time. Infrastructure in the region is inadequate. Many member states have undertaken fundamental economic reforms that have put their economies on the path of growth. These reforms have made members states attractive investment destinations for investors -private, donors and IFIs such as the International Finance Corporation (“IFC”) and the World Bank.



There are several infrastructure funds operating in Africa, but none of them has the same degree of focus that will be built into the CRIF, *namely trade and integration*. This focus on regional integration will *differentiate* the CRIF from DFIs that invest in infrastructure. The CRIF would become the focal point or “*clearing house*” for trade and integration related infrastructure projects in the COMESA region. It will become a source of funding for such projects, without excluding other funds also operating in the region. In fact, it will be desirable for these other funds to participate in syndications and co-finance projects.

Given that a significant proportion of the seed capital of the fund will be made available as grants or sub economic (soft) funding, the cost of capital of projects funded by CRIF will be lower and the overall cost of development will be lower. This will be of benefit to all stakeholders. In order to attract private funds, the CRIF should yield reasonable and/or competitive returns. Contribution from member states should give the fund greater credibility.



3. Approaches to Collaboration with Other Institutions

Infrastructure projects are characterised by their size/magnitude, complexity, the time it takes to develop them and the inherent risks. Institutions that fund infrastructure projects therefore require the *resources and professionals* expertise (in-house or bought-in) to analyse the risks and returns, and if these are acceptable, fund the projects. Collaboration with other institutions is necessary, as it is not prudent for any one DFI or IFI to fund infrastructure projects on its own.

The CRIF, when established, should act as a catalyst for *viable* integration focused infrastructure projects. It will take the lead role in funding projects (through taking up equity and debt in the Special Purpose Vehicles (“SPVs”) established to develop various projects. Other DFIs will be more willing to invest in infrastructure projects in which the CRIF takes the lead role.

Similarly other DFIs and promoters will present projects with integration components for consideration by CRIF, either as the *lead institution* or as a *participant* in a syndicate, resulting in a steady flow of proposals as well as retaining COMESA’s “oversight” of developments in the region. This will assist with planning and with *linkages* with other institutions in sub-Saharan Africa, such as SADC and ECOWAS. The net result will be a mix of participants in various projects with diversified portfolios of investments in infrastructure projects in the region.

The development of infrastructure projects (from concept stage to commissioning) is an involving process. CRIF will have the financial and professional resources to evaluate projects. This evaluation would provide other DFIs the opportunity to invest in infrastructure projects without the need to perform detailed preparatory work.

One of the key risks that investors (including DFIs and IFIs) tend to avoid is “concentration” risk. That is committing funds to a particular project or a particular sector. Investing in the CRIF and/CRIF led projects would enable investors manage this risk.

The CRIF would exchange information on the broader developmental impact of infrastructure projects with other DFIs and other regional bodies.

The CRIF provides potential investors and financiers the opportunity to invest at two levels:

- invest at the fund level by taking up equity and/or providing debt to CRIF and that way benefit from the returns on broad portfolio of infrastructure assets. This would mitigate single project risk and provide a consistent annual return on the Regional Infrastructure Fund’s pool of projects or assets, or
- invest (directly) at the project level by taking up equity and/or extending loans to the SPVs set up to develop specific infrastructure projects. Investing at Project level would ensure that they benefit from the high returns generated by direct investment in selected high return projects.



Investors can also invest at both the fund level as well as the project level. This would ensure that they benefit from the high returns generated by certain projects and benefit from the “risk-mitigated return” on the CRIF’s pool of assets.

There are several other funds involved in infrastructure development in Africa, including the COMESA region. This includes the AfDB, the DBSA, the PTA Bank and the Afri-Exim Bank.



4. Mobilising Resources for the CRIF

The World Trade Organization (“WTO”) advocates the removal of trade barriers and restrictions. In recent years, WTO has been working on initiatives aimed at free and fair trade based on encouraging developing countries to pursue trade based development policies to improve standards of living. In 2006, WTO’s Aid for Trade Task Force identified five areas that would be considered under its Aid for Trade mandate, viz:

- Trade policy regulation;
- Trade development;
- Productive capacity building;
- Development of trade-related infrastructure and;
- Trade related adjustments.

In order to increase regional integration and benefit from WTO’s Aid for Trade mandate COMESA has made significant strides in all areas save for *Development of Trade-related Infrastructure*. To this end, it is necessary for COMESA to work on establishing a vehicle through which WTO and other resources can be channelled for the development of infrastructure.

Studies have shown that full benefits of regional integration can be only be realised if the impediments to integration are removed. In the wake of economic liberalisation, improving standards of living and increasing populations it has become apparent that the existing infrastructure is inadequate. Member countries are actively developing in-country infrastructure projects to meet the needs of their respective populations. However, there is currently little investment in new bi-lateral/regional infrastructure projects that would benefit COMESA member states. Hence, the justification for a *dedicated regional infrastructure fund focussed on trade and integration*.

Whilst several IFIs and DFIs do have resources to fund viable infrastructure projects they have hitherto mostly funded in-country projects and a few projects that would benefit two or more member states. The Maputo Corridor project is one example. The *rationale* for setting up an infrastructure fund is COMESA’s focus on regional integration. COMESA has identified several projects that would promote further integration in the COMESA region. It now wishes to catalyse and initiate processes that would enable it to implement these projects.

The CRIF will be similar in many respects to other infrastructure funds. It will be modelled on the basis of existing funds. The major *difference* will be its dedicated focus on infrastructure projects within the COMESA region that would increase regional trade and thereby strengthen further integration.

To make the CRIF operational requires significant resources and involves taking the steps necessary to mobilise the resources. The CRIF must be “*packaged*” as an attractive investment opportunity to potential interested parties –donors, DFIs, IFIs, the private sector and COMESA member states.



Mobilisation of resources for the CRIF will necessitate COMESA making a *compelling* case. Potential stakeholders may well argue that there a number of existing DFIs and IFIs and that could provide the funding required to develop infrastructure projects.

Garnering support for the CRIF from stakeholders is essential. The fact that COMESA is promoting the CRIF with the support of WTO, certain donors and multi-lateral agencies should help in getting the support of other potential stakeholders.

Mobilising resources for the CRIF will require the issuance of a *prospectus and/or Project Information Memorandum (“PIM”)*. The prospectus/PIM will provide detailed information about the CRIF (its structure, operation, management, focus, etc) and projected financial statements. The prospectus/PIM will be used by the targeted investors to make investment decisions. This critical document and should be based on a credible *feasibility study*.

The prospectus or information memorandum will be used as the selling tool at “*road shows*” in the region and internationally. It is critical that the potential sources of finance are well documented, noting the *pledged contributions* of donors and *subscription of shares* by member states.

An essential step will be to undertake a *feasibility study* that demonstrates the *viability* of the proposed CRIF. The feasibility study will focus on the financial aspects of the CRIF including profitability, return on investment, capitalisation, and cash flows. As the feasibility study, will underpin the prospectus/PIM an independent, credible, and experienced firm or professionals should conduct it.

Funds and support for the CRIF can be mobilized from the following potential stakeholders:

- Member states,
- Donors,
- World Bank and AfDB,
- DFIs, IFIs and sovereign funds,
- Other “infrastructure focused” funds
- Institutional investors and banks, and
- Governments.

The starting point for resource mobilisation is contribution or subscription to the CRIF by *member states*. This will form the base of funds and would demonstrate their commitment to other stakeholders. Grants and soft loans from *donors* are also a good source of “permanent capital”. Contributions from member states as well as grants and soft loans will comprise the “seed capital” which could be used to launch operations.

Another potential source is the World Bank’s *International Development Association (“IDA”)* and the *African Development Bank (“AfDB”)*. There is need to engage both the IDA as well as the AfDB an early stage to sensitise them of COMESA’s initiative and suggest that they *consider allowing* countries to use of *Special Drawing Rights (“SDRs”)* in the case of IDA and the funds “enveloped” for “*multilateral*” projects by AfDB. The AfDB is considering funding power transmission lines from this envelope. Convincing the IDA to change its rules will require the presentation of a well-argued and robust case.



IFIs, DFIs, and *sovereign funds* have long-term resources at their disposal, and should be approached to assess the extent of their interest in investing in the CRIF. IFIs by their very nature consider competing opportunities and focus on returns on investment that exceed returns on other opportunities open to them. DFIs have a “developmental” focus and are likely to invest in the CRIF. Lately, sovereign funds have been in the spotlight because of the significant resources they have at their disposal and the way governments use and/or channel these funds. Most oil exporting countries and high-growth economies are looking for opportunities to invest. With numerous infrastructure projects being developed around the world, the proposed CRIF will be competing for these investment funds with other large infrastructure projects.

Dedicated “infrastructure funds” could invest in the CRIF. They understand the long gestations period, risks, and returns and may take up significant equity and provide debt (loans) to the CRIF.

Regional and international institutional investors and banks are another source of funds. Institutional investors would include collective investment schemes and contractual savings institutions (mutual funds, trusts, pension funds, and insurance companies).

Infrastructure projects appeal to *institutional investors* including *private equity* because of the potential for long-term, relatively predictable, and steady cash flows. This is particularly attractive to *pension and insurance funds* as they seek steadier returns than the returns volatile stock markets have delivered over the last decade. They have long-term liabilities to which they need to match income-producing assets. Generally, infrastructure projects, such as power plants and roads, are long-lived assets, typically generating income for more than 30 years. Long asset lives also permit long-term debt amortisation, which have the potential of generating larger cash flows. Against other types of investments, high-tech, health care, consumer goods, etc., infrastructure projects are much less vulnerable to obsolescence or competitive threats from changing technologies. Cash flows tend to be predictable because demand for infrastructure, especially power, water, and transportation grows steadily at close to the GDP rate.

Many large international banks manage the wealth of *high net worth individuals* and could invest in the CRIF. Funds from this type of institutions would be mobilised through the issuance of bonds on the regional as well as the international markets. Bonds would allow the bondholders to dispose the bonds in cases where they do not want to hold the bond to maturity.

Finally, and perhaps most important, *governments* typically participate in some form in most infrastructure projects. Their participation support can be *explicit/direct*, such as a government entity contracting the project developer to provide a service and therefore is the ultimate source of payment. Alternatively, the support may be more *indirect* where the government or a regulatory body creates a monopoly, such as with a franchise electric utility or toll road, and then establishes the tariff or toll that customers must pay. This, of course, may also be where the *greatest risk lies* for the infrastructure investor. For as much support and confidence as a government may provide, a *change in political winds or fiscal regime* can quickly turn support into a *liability*.

Oftentimes, the fortunes of infrastructure investments have been seen to change in a flash as the rules of the game change. In some cases, a promised toll increase was *denied*, in other



cases, taxes and royalty rates unexpectedly *increased*, and in extreme instances, concessions were *terminated*.

A considerable amount of *time and effort can be saved by making preliminary contacts and meeting with potential investors* (equity and debt) to make them aware of the investment or development opportunity and to understand their investment policies or “rules of engagement” as well as their concerns. This will ensure that the CRIF’s prospectus/PIM “dovetails” with the rules and addresses the concerns of potential investors. These meetings should be scheduled well ahead of “Road-Shows” to “*showcase*” the CRIF.

The road shows proper should be *targeted* at private sector funds, sovereign funds, DFIs and commercial banks who will be invited to subscribe for a mix of equity and debt. In addition to undertaking road shows, representatives of COMESA and (if appointed) the Fund Manager, should visit donors as well as selected capital markets. Considerable use should be made of the *internet* by placing “*teasers*” on the COMESA web site to begin stimulating interest. Such teasers contain reasons as to why investors should consider investing in particular projects, and outline facts about the CRIF.



5. Legal Structure & Institutional Arrangements

The legal structure of the CRIF should *support* the operations of the CRIF. The structure should be *flexible* enough to enable *efficient* operations and *robust* enough to engender the *confidence* of the stakeholders in the CRIF. Without a sound legal structure the CRIF as a vehicle for mobilizing funds would be ineffective.

The CRIF's main purposes will include:

- Providing the *vehicle* through which resources from donors and DFIs can be channelled to fund priority infrastructure assets in the region;
- Securing *resources* to finance priority regional infrastructure projects;
- Encouraging regional *integration* through COMESA countries having ownership of, or an equity stake in, infrastructure projects in the region;
- Permitting *public-private partnerships* in the ownership and management of infrastructure assets.

It is necessary to establish the CRIF as a *separate legal entity* to support the operations of the CRIF. In order to attract the type of funding required for the fund, the legal framework must be open and transparent. The entity should be able to protect the interests of shareholders/investors and should therefore have a *legal persona separate* from the COMESA Secretariat. This would enable the CRIF to sue in its own right.

Infrastructure funds can be formed using configurations that include companies and trusts. There is *no standard* configuration for infrastructure funds; the legal structure of each fund is based on the consideration of:

- Existing *legal and regulatory requirements* of the fund's domicile (location) and jurisdiction;
- The *instruments* the fund intends to use to mobilise resources;
- The *nature of the investments* of the fund.

Whilst there are several legal forms CRIF as an entity could adopt, the three that warrant consideration are:

- Granting the CRIF a *charter* under the COMESA treaty;
- Registering the CRIF as *trust*;
- Incorporating the CRIF as a limited liability *company* ("LLC").

Establishing CRIF by Charter under the COMESA Treaty: whilst the CRIF can take this legal form, the disadvantages include:

- The CRIF being perceived to be *insufficiently independent* of COMESA and could ergo be an *impediment* to the attraction of investors.
- Risk of including the COMESA Secretariat in *potential litigation* against the CRIF.
- *Attachment of assets* belonging to the COMESA Secretariat and other COMESA institutions established under the COMESA Treaty in *litigations* against the CRIF.



- *Restraint* of COMESA Secretariat officers from carrying out certain acts.

Registration of the CRIF as a trust: It is not uncommon to find funds established as trusts. Some of the disadvantages of establishing CRIF as a trust are:

- Definition of the investors (beneficiaries) and their rights
- Choosing a jurisdiction whose laws would apply to the formation and operation of the trust. Trust law *varies* from country to country.
- Assets are controlled and held in trust by trustees for investors.
- Trustee's obligations are not extensively defined.
- Could potentially complicate the process and lead to delays and disputes relating to the establishment of the Trust and the appointment of Trustees.

Incorporation of the CRIF as a Limited Liability Company ("LLC"): LLCs are *widely* used as vehicles to mobilise funds. Establishing the CRIF as a LLC would be simpler and straightforward. Company law is *well defined* in all member states and the *relationships* between shareholders, directors, and management are clearly *understood*. Similarly, the rights, obligations, and responsibilities of the officers of the company can be embodied in the *Articles of Association* of the LLC. The Articles will have clauses dealing with policy and management issues. The LLC could be publicly listed when it is ready, to mobilise savings or seek investment from other sources by issuing bonds on the international capital markets. The advantages of establishing the CRIF as a LLC include:

- Broad understanding of the principles of Company law that are defined and codified in most jurisdictions.
- Marketing of shares and mobilising loans for LLCs is easier.
- Rights and obligations of policy organs and the executive are well defined.

Other issues that will be of interest to potential investors with respect to the LLC are:

Domicile: The CRIF's location or address of both the (legal) *registered office* as well as the well as the location of the *management and operations*. In order to make investment in instruments issued by the CRIF more marketable it may be prudent for the CRIF to have legal *domicilium* in an international financial services centre that offers the best incentives and locate the management and operations in a city that is in close proximity to member states. This would reduce logistical challenges.

Classes of shares and voting rights: The CRIF may issue different classes of shares and ordinary shares with or without voting rights. It can also issue preference shares.

Article 25 of the COMESA Fund Protocol proposes that Member States should have fifty per cent of the votes and "*representatives of cooperating partners* should have the other fifty per cent of the votes, apportioned equal to their proportionate contributions to the *General Fund*." To this should be added other equity investors in the fund. Clearly, this presents the *prospect* of Member States being *out-voted* on strategic issues. One way of *ensuring control* is for Member States to own a "*golden share*".

A **golden share** is a share that has extraordinary or *special powers* over the company, e.g. power of veto over a merger. This share gives Members States the *right of decisive vote*, thus



to veto all other shares, in a shareholders' meeting. The golden share is *implemented* through clauses in a company's *Articles of Association*, and can be designed to give Member States veto powers over any *major corporate action*, such as the sale of a major asset or special purpose vehicle or of the CRIF as a whole.

This share could be retained for a *defined period of time* to allow the CRIF to become accustomed to operating in a public environment, *unless ownership* of the CRIF is deemed to be of ongoing importance to Member States' *strategic* interests. The golden share can be used to:

- Prevent the takeover of COMESA backed SPVs which COMESA considers against the public interest;
- Restrict the issue of new voting shares;
- Place constraints on the disposal of SPVs and assets;
- Impose limits on winding up or dissolution of the CRIF and related SPVs;
- Guarantee the place of COMESA appointed directors on the board.

Golden shares are *not designed* to be a form of disguised Member States' control over the CRIF. They are a means of protecting key regional interests, and are limited to certain specified provisions in the company's *Articles of Association*, and do not confer any right to interfere on other issues.

Representation on the Board of Directors: The subscribers to the shares will appoint directors to represent their interests on the CRIF's Board. The number of directors to appoint will be specified in the Articles of Association and Board members would be appointed by the shareholders in proportion to the number of shares held.

Chairperson: At the inaugural meeting, the Board will elect one of the directors to chair the Board. The Chairman oversees the business of the Board and the Board is responsible for policy formulation (including dividend policy).

Appointment of the Fund Manager: Most companies appoint a Managing Director or Chief Executive Officer to manage the business of the company. However, in the case of the CRIF, executive management and responsibility will be *assigned* to a Fund Manager. The Fund Manager will be responsible for the day-to-day operations of the CRIF. The specific terms of reference of the Fund Manager including obligations and responsibilities should be *clearly defined*. In order to engender the confidence of potential investors in the CRIF the appointment of the Fund Manager should be based on international competitive bidding.

The process should commence with a call for "Expression of Interest" as soon as possible. A short list of suitable candidates would then be drawn up and invitations to submit bids would be sent to short-listed candidates. This would be followed by a *bid evaluation process* and submission of recommendations to the Board. The CRIF Board would consider the recommendations or *adjudicate* the bids and appoint the Fund Manager.



6. CRIF Operations & Project Development

There is a widening infrastructure gap between member states and this is costing countries in terms of lower productivity, high transport and logistics costs, reduced competitiveness, and slower growth. The dearth of new infrastructure and its impact on economic development is widely acknowledged. To bridge this gap, remain competitive, and address the infrastructure deficiency requires overcoming several challenges. These include:

- *High investment costs:* For a country to benefit from cross-border infrastructure, *seamless integration* must be achieved between networks. This will require expensive programs of shared support and investments.
- *Uneven distribution of benefits:* The costs and benefits of regional projects are likely to be *unevenly distributed* between countries and could lead to decisions based on *national* costs and benefits rather than *regional* costs and benefits, resulting in cross-border infrastructure receiving less attention.
- *Funding constraints:* The *public sector* is often *unable to fund infrastructure* because of its *weak* finances, usually marked by underdeveloped long-term capital markets and fiscal/budgetary concerns. International financial markets also remain *inaccessible* to varying degrees because of the higher rates of return markets expect from risks associated with investments in the public sector.
- *Varying regulatory response:* The different strengths, weakness and variations of *regulatory regimes* between countries makes regional infrastructure projects difficult to coordinate and develop, particularly in securing private sector financing as that would require strong “*common regulations*” to mitigate risks.

COMESA to some extent has *overcome* a number of the above *challenges* with respect to the *North-South Corridor* and is now looking to “fast track” the *development* of these projects. Most stakeholders recognise the benefits of the project and are keen to move forward. Clearly, COMESA cannot wait to *execute priority projects* such as the North-South Corridor Project until the CRIF is adequately funded and becomes operational

Identification of a regional infrastructure projects

In order to assess the magnitude of resources required to fund infrastructure projects there is need to identify infrastructure projects that have a *high potential for fostering closer integration* in the COMESA region. This portfolio or inventory of projects will underpin the CRIF.

This *initial* project identification activity should be carried out by a *Projects Division* within the COMESA Secretariat or an *independent firm*, or *both*. The projects selected should have all or some of the following characteristics. They should be:

- *beneficial to more than one country* in the COMESA region;
- *economically feasible and viable*, with a public sector component;
- *able to deliver a positive economic rate of return*;
- *able to satisfy the requirements of environmental and social impact regulations*;



- able to clearly demonstrate an improvement in the *regional investment climate*;
- able to facilitate *increased production and trade*; and
- able to be *financed*, at least in part, by *the private sector*.

As a minimum an engineering needs assessment should be undertaken for each project. *Engineering needs assessment* is a technical method based on engineering studies of the conditions and needs for the development of projects. Engineering needs studies attempt to satisfy technical engineering specifications and quality of service standards but provide no assessment based on economic performance. This requires undertaking pre-feasibility and feasibility studies.

Study of the *results of political votes* is a method used particularly in the United States, where states and local governments are required to use referenda to obtain approval of all new major construction projects.

On a more concrete level, both the State of Victoria in Australia and the City of Edmonton in Canada use the *gap analysis* method to assess their infrastructure needs. The State of Victoria produced a report presenting the State's vision as well as infrastructure needs for the year 2020. The method used in the report consists of four steps:

- a) identifying the *forces* that have an impact on future demand;
- b) determining the *condition* of the existing infrastructure stock;
- c) identifying future infrastructure *needs*; and
- d) analysing the *gaps* between the existing stock and future needs.

While the Victoria example focused on the *gap between the existing stock and future needs*, the City of Edmonton interpreted gap analysis differently in its infrastructure strategy. The study focused instead on the *gap between projected costs for infrastructure projects and the funds available to finance them*.

There is no doubt that, despite the complexity of the task, it is possible to use methods that provide rigorous analyses of infrastructure needs. The examples that seem to be most promising focus on defining a *development vision*, as was the case with Australia and New Jersey, as well as *analysing trends and future demand*. Although the results of the analyses are subject to interpretation, it is nonetheless essential for the development of medium-term and long-term policies that a *rigorous methodology* be used to *identify* infrastructure needs.

Each member state could undertake a *gap analysis* exercise focussed on increasing trade and strengthening integration. This can be undertaken with the assistance of either the COMESA Secretariat or other “project preparation funds”. The prioritised lists of projects, which conform to COMESA “parameters”, would then be analysed by COMESA and a portfolio of region-wide projects could then be adopted for development.

Following identification of this project portfolio, it will be necessary to develop *concept papers* or perform *pre-feasibility studies* outlining the justification, costs, and benefits of projects.

These activities (identification of projects, related concept papers and/or pre-feasibility studies and “packaging”) as stated above could be carried out either by:



- A *Projects Division* within the COMESA Secretariat. The advantage of housing this Division within the COMESA would ensure that it benefits from the close *oversight* of COMESA. It also creates a *focal point* that would deal with all matters relating to regional infrastructure projects, or
- Engaging *external* “specialist” firms. It may be more appropriate to engage external firms. Such firms would have the expertise required in: identifying regional projects, managing relationships with the private sector, and negotiating with potential developers or projects promoters.

Investment of CRIF funds in infrastructure projects

Tenders or Request for Proposals (“RFPs”) for the development of projects identified as (see above) *priority projects* would be invited from developers or bidders which would include the CRIF. Responses to RFPs would be detailed and would require information on all aspects critical to development of the infrastructure project including:

- Bidders’ corporate information
- Bidders’ proposal guarantee
- Development plan and time schedule
- Proposed tariffs and royalty payments
- Proposed capital expenditure
- Operations and maintenance plan and costs
- Required Internal Rate of Return
- Funding arrangements
- Financial model with built in sensitivities showing impact on tariffs/tolls
- Project site areas
- Project layout drawings
- Technical data sheets and project specifications
- Design and engineering specification
- Experience of contractors
- Mechanical equipment
- Use of regional labour and resources
- Comments on Draft Implementation Agreement
- Issues arising from bidder’s due diligence.

Potential developers (including the CRIF) would respond to the RFPs. The responses would be evaluated by an *Evaluation Committee* nominated by COMESA with authority to evaluate proposals and *recommend* the Preferred Bidder. Proposals would be evaluated for their development plan, estimated throughput, costs, price, service charge (tolls, tariffs, etc), technical factors, and comments on the Draft Implementation or Concession Agreement provided with the RFP.

On conclusion of the assessment of the Proposals with respect to the completeness of the submission, the primary areas of detailed evaluation would include:

- *Capital Structure*: The capital structure would be evaluated for its *acceptability* in the following areas: appropriate level of gearing, certainty of cash flow generated during construction and acceptable debt coverage ratios.



- *Debt Terms:* All debt terms would be evaluated with respect to current market conditions. In the event the lenders are export credit agencies or multilateral agencies, the indicative terms would be evaluated with respect to those agencies' published policies. The proposal would be evaluated for the *reasonableness of the debt terms* assumed, including the following: interest rates, fees, lenders' insurance premiums, foreign exchange risks assumed by the Project, and debt repayment profile.
- *Lenders:* The proposed lenders to the Project would be evaluated with respect to; *experience* of the proposed lenders, strength of expressions of *interest*, and *amounts* of funds committed by lenders.
- *Equity Participants:* The financial strength of the equity investors would be judged based on the *Developer's ability* to internally generate, or obtain from external sources, the necessary equity funds for the Project. The Proposals would also be evaluated for the indicated *level of commitment* to provide equity, in addition to the commitment to provide any *contingent equity* to complete the Project.
- *Technical:* The technical criteria that would be considered in relation to the design, performance, operability, availability and reliability of the proposed plant include:
 - *Plant Equipment with special emphasis on:* the proven reliability of major equipment, completeness of the equipment, overall layout of the plant, design of the individual equipment, redundancies built into the plant, and references (operating records of similar equipment) for major equipment.
 - *Manufacturers and Suppliers of Main Equipment:* references from manufacture and supplier of similar equipment.
 - *Operation and Maintenance ("O&M") of the Plant:* experience of the O&M contractor, O&M philosophy, and stock of spare parts.

On completion of the evaluation the Evaluation Committee, assisted by experts, would make recommendations on the *developers* to the COMESA Secretariat or decide in its behalf. The decision would be communicated to the successful bidder who would then begin the implementation phase. In most cases, the developer would incorporate a *Special Purpose Vehicle* ("SPV") to develop the project.

In the case of *trans-regional* projects, this may involve *several* developers with each developer developing a segment or component of the project. For example on the North-South Corridor Project, the developers of *bridges* may not be the same as the developer of *roads*.



Application for and disbursements of funds

The SPVs set up by *developers* (including the CRIF if it was the selected bidder) would approach *potential equity partners and lenders* to participate in the development of the project.

The CRIF would evaluate the *investment opportunity* and if were *not* the developer would carry out detailed evaluation and *due diligence* to assure itself of the *viability* of the project. In so doing, it would evaluate the *risks* and ensure that the potential *risks are adequately mitigated*. CRIF would invest in or lend to projects that satisfied its criteria and investment guidelines.

Once the developer/SPV has *mobilised* the funds it would engage contractors and suppliers (after an international competitive bidding process). All *payments* to contractors and suppliers would be made by *lenders* to the project or by the *SPV*.

To ensure that the SPV makes progress in terms of project implementation the CRIF Fund Manager would seek to have *representation* on the Boards of the projects' SPVs. This would provide the forum for intervention by the CRIF at the policy level. The *loan* agreement and *shareholder* agreement between the SPV and CRIF would allow for *intervention* by the Fund Manager at the *operational* level.

Structure of funding packages

In assessing investment opportunities, the CRIF Fund Manger would consider the following:

Project size: the Fund Manager would not *over-commit resources* to one project. Most infrastructure projects would be funded by *several* financiers and DFIs. This helps the financiers balance *their portfolios* and avoid *over concentrating resources* in a particular sector.

Nature and characteristics of project: Infrastructure projects have long gestation periods and financiers would like to ensure that the projected income streams *dovetail* with their *cash-flow* cycles.

Risks involved: There is a whole array of risks that the Fund Manger should be aware off in assessing investing in the project SPV. The risks (*country* and *project* specific) are outlined below:

Country Risks

Country Political Risks

- Political Support
- Taxation
- Expropriation/Nationalization
- Forced Buy-out
- Cancellation of Concession
- Import/export restrictions
- Failure to obtain or renew approval of concession
- Non payment



- War and civil disturbance
- Breach of contract.

Country Commercial Risks

- Currency inconvertibility
- Foreign exchange availability
- Currency devaluation
- Inflation
- Interest Rate.

Country Legal Risks

- Changes in laws and regulations
- Law enforcement
- Delays in calculating compensation.

Project Specific Risks

Development Risks

- Bidding
- Planning delay
- Approval
- Transnational or cross-border.

Construction/Completion Risks

- Delay
- Cost overruns
- Performance
- Completion
- Force Majeure
- Loss or damage to work and structures.

Operating Risks

- Associated Infrastructure
- Technical
- Demand (volume and price)
- Supply (volume and cost)
- Cost Escalation
- Management
- Force Majeure
- Loss or damage to Project Facilities.

In analysing the risks, the Fund Manager will also ensure that the risks are *mitigated* by the developer (SPV). This is done by the developer obtaining performance guarantees, bonds, and appropriate insurances. All of these would *affect project costs*.

To maximise resources at its disposal the CRIF's *financial interventions* in individual infrastructure projects should be based on *extensive leveraging of funds* (from donors, investors and lenders). This will assist both in *resource mobilisation* for infrastructure projects (from other co-investors and co-lenders) and also ensure that the CRIF's "*catalytic*" role impacts positively on a larger number of projects. In summary, CRIF should not "fully



fund” infrastructure projects. It must participate to the extent *necessary to kick-start* infrastructure projects and in so doing *lend* credibility to the projects.

Public Private Partnerships (“PPPs”)

PPP describes a public sector (government) service or private business venture that is funded and operated through a *partnership* of the public sector (governments) and one or more private sector companies. These arrangements are also called *PPP or P3*. In recent years, PPPs have emerged as strong investment opportunities. In most cases, infrastructure development initiatives require the participation of private companies because governments alone cannot finance them.

The British Computer Society describes a PPP as “*a marriage of mutual convenience, with pre-nuptial agreements...*” between the Public Sector and a private company or companies, with shared or *common goals*. If the partners respect and understand each other's goals the arrangement creates synergy, the relationship is for the long term (in excess of five years). Both partners *actively manage the risks and share in the rewards*. The partnership will *only* be successful if *both* partners derive *benefit* from the relationship.

In certain types of PPP, the government uses tax revenue to provide capital for investment, with operations run jointly with the private sector or under contract. In other types of PPP such as the *Private Finance Initiative*, capital investment is made by the private sector on the *strength of contracts* with the public sector or government owned entities to provide agreed services. Good examples are Power Purchase Agreements (“PPAs”) with off-takers in the case of Hydroelectric/Power Projects. These PPAs also provide the security that potential lenders require to secure their lending. Public sector contributions to a PPP are normally in *kind* such as *the transfer of existing assets* by way of concessions.

With increasing resources at its disposal, the private sector in recent years has begun to invest in infrastructure projects. The CRIF alone will not have all the required resources to develop regional infrastructure and will rely on tapping resources from both the public and private sectors.

It is common for a private sector consortium to form a special propose company or SPV to build and maintain the asset. The consortium usually comprises a contractor, a maintenance company, and lenders. The SPV signs the *contract* with the *public sector* and with subcontractors to develop the facility and then *maintain* it.

PPPs are effective financing mechanisms for both national and regional development activities, especially *infrastructure projects*. COMESA member States should develop and implement policies and strategies on PPPs and market these to key stakeholders including potential investors. *Legislative frameworks* conducive for the development of PPPs need to be developed and harmonised.

A *transparent* regulatory framework on PPPs is essential. This should include the *pricing* of services and *exit* regulations for the private sector. Harmonisation of such regulatory frameworks, policies, and strategies at the regional level will create a *larger PPP market space* and attract PPP oriented investments.



There are a variety of ways in which PPP options can be structured, depending on the specific project under consideration. The options and types of risks inherent in PPPs are outlined below:

- *Lease Contracts:* A private company *rents* facilities from a government(s) and assumes responsibility for the *operation and maintenance* of the facility. The lessee *finances* working capital and replacement of capital components with limited economic life and *fixed assets* remain the *responsibility of the public sector partner(s)*.
- *Concessions:* A private company handles operations and maintenance, and finances investments in addition to working capital of a public partner. The *public sector partner exercises* a regulatory and oversight role and receives a concession fee for this arrangement.
- *Build-Operate-Transfer or Build-Own-Transfer (BOT):* A form of concession with *emphasis* on construction of new, stand-alone systems and comes in several variations.
- *Corporatisation:* The public sector forms a separate legal entity to manage service provision. Often referred to as "*utilities*", it involves *partnerships* in the sense that government creates a separate, contractual "partner".

Types of Risks in Public-Private Partnerships	
Risk	Explanation
<i>Completion risk</i>	The possibility that a project's construction or installation will be <i>delayed</i> , with additional cost or other implications.
<i>Cost overrun risk</i>	The possibility that during the design and construction phase, the actual project costs will <i>exceed</i> projected costs.
<i>Design risk</i>	The possibility that the private party's <i>design may not</i> achieve the required specifications.
<i>Exchange rate/forex risk</i>	The possibility that <i>exchange rate fluctuations</i> will affect the costs of imported inputs or the project's debt or equity.
<i>Force majeure</i>	The occurrence of certain <i>unexpected events that are beyond the control of the parties</i> , whether natural or man-made, that affects the project.
<i>Interest rate</i>	Fluctuations in the <i>rate</i> at which the project borrows money.
<i>Market/demand risk</i>	The demand for the services generated may be less than projected.
<i>Operating risk</i>	Factors <i>other than Force Majeure</i> such as projected operating expenditure, skills requirements, labour disputes, and employee fraud.
<i>Political risk</i>	Unforeseeable <i>conduct</i> by a government institution that <i>materially and adversely</i> affects the expected return on equity, debt service, or costs of the project. This includes expropriation and nationalisation.
<i>Regulatory risk</i>	Consents required from government authorities or independent regulatory agencies are not obtained or result in additional costs.
<i>Utilities risk</i>	The utilities (water, electricity, gas) for the project are not available.
Source: South African National Treasury's PPP Manual, pp. 63-66.	



Risk Transfer/Risk Mitigation

All PPP initiated projects involve risks and these risks must be *identified*, transferred where possible, and managed. The *public sector* prefer PPPs arrangements where the *private sector partner* would *bear all the costs and associated risks* (such as less than anticipated demand, regulation and currency fluctuation) for a minor cost and low profit. The private sector partner would be loath to accept the arrangements. From the *private sector partner's perspective*, the *ultimate PPP* would involve *very high profits, no risk, government subsidies, and monopoly control*. These governments would decline. Structuring PPPs *acceptable* to both parties would involve bridging these extremes *equitably* to mitigate the risks that each side fears. The above table lists types of risks involved in PPPs.

The prerequisites for a *receptive PPP Debt Market* include the following:

- relatively stable *macroeconomic environment*.
- *developed legal framework* for concessions, contract enforcement, bankruptcy, and lender remedies.
- relatively *reliable* regulatory framework that *recognises the lifecycle needs* of the projects.
- developed domestic debt market.

Only a few countries have truly stable macroeconomic environments, and most are susceptible to the contagion effect of a financial and economic crisis. Nevertheless, countries that have taken steps to control inflation and external debt, increase official international reserves and use trading partnerships often provide fertile ground for domestic and foreign private investment. For *infrastructure projects*, a national and economic *crisis* creates not only *risk for the financial performance* of the infrastructure transaction (i.e. its ability to generate sufficient revenues to cover operating costs and service debt) but also *added uncertainty as to the range of political responses* that might affect its operations during a crisis.

Notwithstanding the *efforts required* (harmonisation of regulation, common legislation on PPPs, etc.) in setting the stage for PPPs to operate, they have a critical role to play in the development of infrastructure in the region.

Phased Implementation of CRIF

It will take a considerable amount of time and effort to establish the CRIF. It will involve, discussion of terms for participation by member states, satisfying the requirements of donor countries and organisations, addressing investors' interest, and mobilising resources for the fund. Given the foregoing, it is proposed that activities related to the CRIF be phased as follows:

Phase I: Development of infrastructure projects through creation of SPVs

In order to expedite the development of *priority* infrastructure projects (the projects identified as priority projects such as projects along the North-South Corridor) should be *developed whilst work* on establishing the CRIF *continues*. These priority projects would be developed by developers creating SPVs whose *objective* would be to build/construct specific projects put to tender by COMESA.



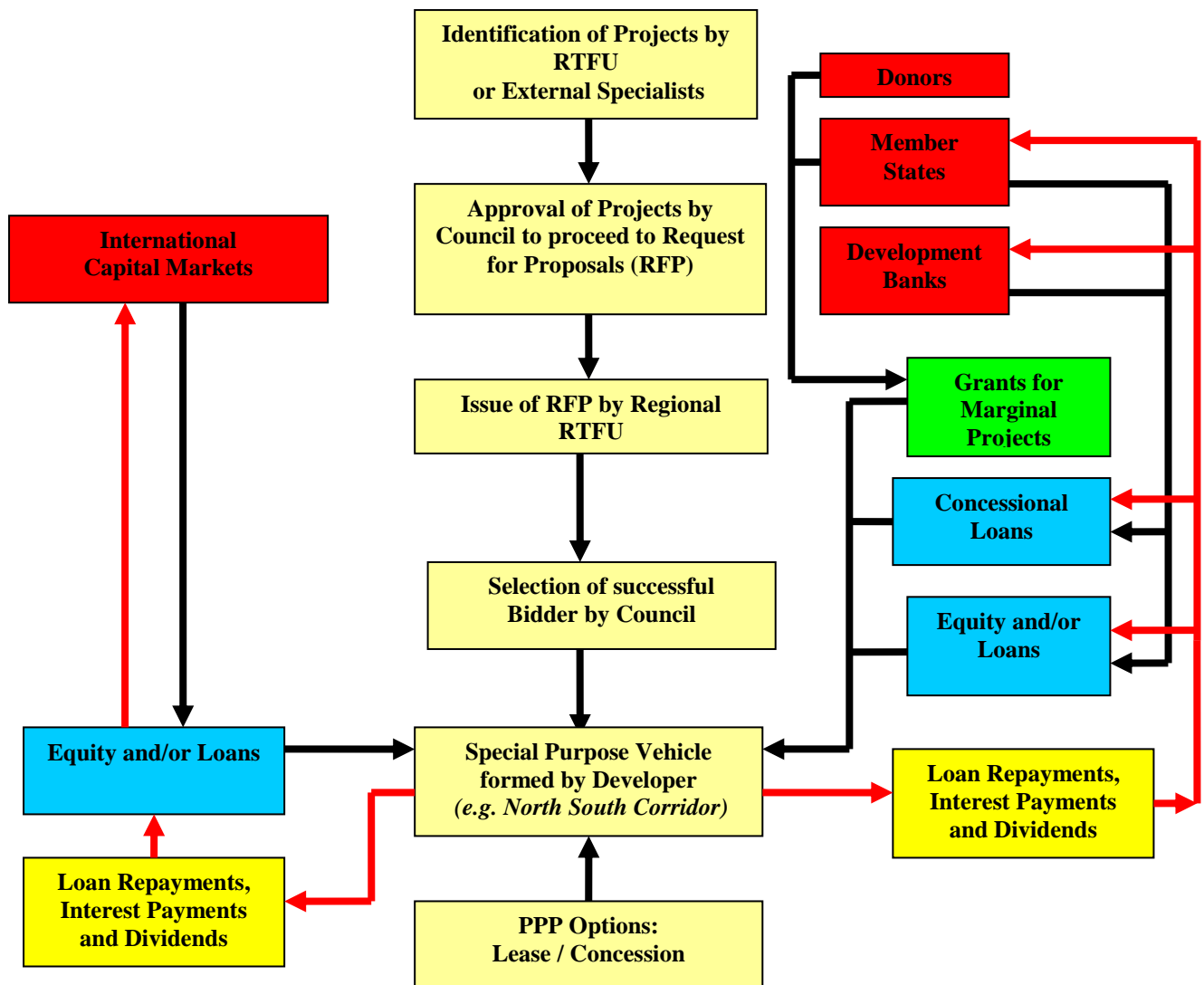
The North-South Corridor Initiative, which has been approved by the COMESA-SADC-EAC Task Force, is at pilot project phase. The initiative brings together all ongoing schemes along the North-South corridor under one umbrella, to ensure that reforms to customs, border management, infrastructure, and transport regulation are mutually reinforcing and properly sequenced. The aim is to maximize synergies and ensure that *improvements* in one area are not *nullified* by bottlenecks in another.¹

The financial structuring for infrastructure projects can be very complex. An assessment of the project financial structure will include identification of the *risks* involved, recognition of the *political sensitivities* of the host governments, understanding the *regulatory regimes* of the host countries and examining the *possibilities* of creating a Public Private Partnership (PPP).

Once the infrastructure projects are identified, advertised and RFPs issued, bidders would be selected. The winning bidders or developers would establish SPVs and commence the processes to reach project completion. The schematic below (also see Appendix I) highlights the essential elements involved in the development of infrastructure projects during the Pilot Phase/Phase I.



CRIF Pilot/Phase I: Set-up and Operation of the CRIF (Prior to capitalisation of CRIF)



The solicitation processes typically involve:

a. Technical/Investment Partners and Contractors

- Project road shows
- Request for proposals
- Draft Concession or Implementation Agreement
- Document preparation: Feasibility study
- Project Information Memorandum/prospectus
- Evaluation and selection of strategic or technical investor
- Contractor bidding and selection
- Signing of concession or implementation agreement
- Commencement of project implementation (should be synchronised with solicitation of lenders).



b. Lenders

- Identification of potential lenders to the SPV
- Document preparation (as above)
- Road shows to potential lenders
- Indicative term sheets
- Proposal evaluation
- Selection of preferred lenders (including CRIF)
- Loan negotiations
- Financial close
- Execution of loan agreements
- Commencement of project implementation.

Although the processes are involving, they are necessary and if they are ignored or circumvented key *stakeholders* (investors, lenders, contractors etc) are *unlikely* to engage with the projects' SPVs.

The time required to complete the above processes for infrastructure projects would normally take between 12 and 18 months. With increasing pressure from Member States to commence expeditiously, project development there is the *hazard* of *underestimating* the time required to complete the processes with the attendant *risks* in terms of *securing, funding, and project completion*.

One of the key challenges in the project implementation process is *securing funding*. The private sector developer will seek to raise funds (equity and debt) to develop the project. The developer or SPV would mobilise funds from sovereign funds, DFIs (including the CRIF), banks, and private investors. In common with other lenders and/or, investors, the CRIF will conduct a *detailed due diligence of the project* and if it satisfies the investment and lending criteria funding (debt and/or equity) would be provided.

The diagram at Appendix I show a *generic* PPP project development model. In the CRIF's case, COMESA will *liaise* with Governments' and either *negotiate* on their behalf or *facilitate negotiations* between the infrastructure project developers and the relevant Governments.

Phase II: Work on establishing CRIF & on achieving financial closure and absorb SPVs created during Phase I into CRIF ("Umbrella Fund")

Activities aimed at setting up the CRIF would focus on achieving financial close. Financial close would signal the completion of the fund mobilisation process in readiness for commencement of operations. There are several critical activities or tasks that need to be completed before financial close can be achieved. These activities include:

Preparation for the CRIF Project

- Garner support of stakeholders (WTO, donors, and multi-lateral and bi-lateral agencies).
- Lobby the World Bank and AfDB to *allow the use* by Member States of specific *soft loans and Special Drawing Rights* to fund the CRIF.



- Prepare RFPs for a Transaction Advisory Team to work with COMESA on establishing the CRIF
- Select and appoint a Transaction Advisory Team
- Incorporate the CRIF as a LLC
- Build capacity by (COMESA) up-skilling staff, hire additional staff with requisite skills and/or engage specialists and experts
- Formulate policies
- Draft operating procedures
- Commence “search” for potential fund managers.

Document preparation

- Preparation of feasibility study demonstrating viability of the CRIF
- Preparation of Project Information Memorandum or prospectus for potential lenders and investors
- Draft Placement Memorandum for bond issue.

Development of financing strategy

- Review existing portfolio of infrastructure projects in the COMESA region
- Develop assumptions for financial model (CIF costs, revenues, inflation, exchange rates, etc)
- Develop financial model
- Develop financing options (quantum, financial instruments, tenors and sources)
- Assesses appetite for investment in the CRIF through preliminary contacts with potential funding institutions
- Develop financing strategy.

Risk Mitigation

- Develop inventory of risks
- Develop risk mitigation strategies.

Financial Marketing Strategy

- Identify and short-list potential investors and lenders
- Make preliminary contact with potential investors and lenders
- Undertake “road shows”
- Obtain indicative term sheets from investors and lenders
- Prepare draft funding documentation (equity, bonds and loans)
- Constantly review and update of processes
- COMESA to take leadership in the entire process with advisors providing technical back up.

Funding negotiations

- Prepare inventory of deal breakers and deal makers (i.e. issues critical to each party) and develop negotiations strategy
- Develop “lender” and “investor” specific negotiating strategies
- COMESA team to “speak” with one voice during negotiations.



Financial and Legal Close

- Link all elements from *preparation* to funding *negotiations* to successful *financial close*
- Achieve *legal close* (i.e. completion and execution of legal documentation)
- Satisfy *conditions precedent* to investment and disbursement of funds to CRIF.

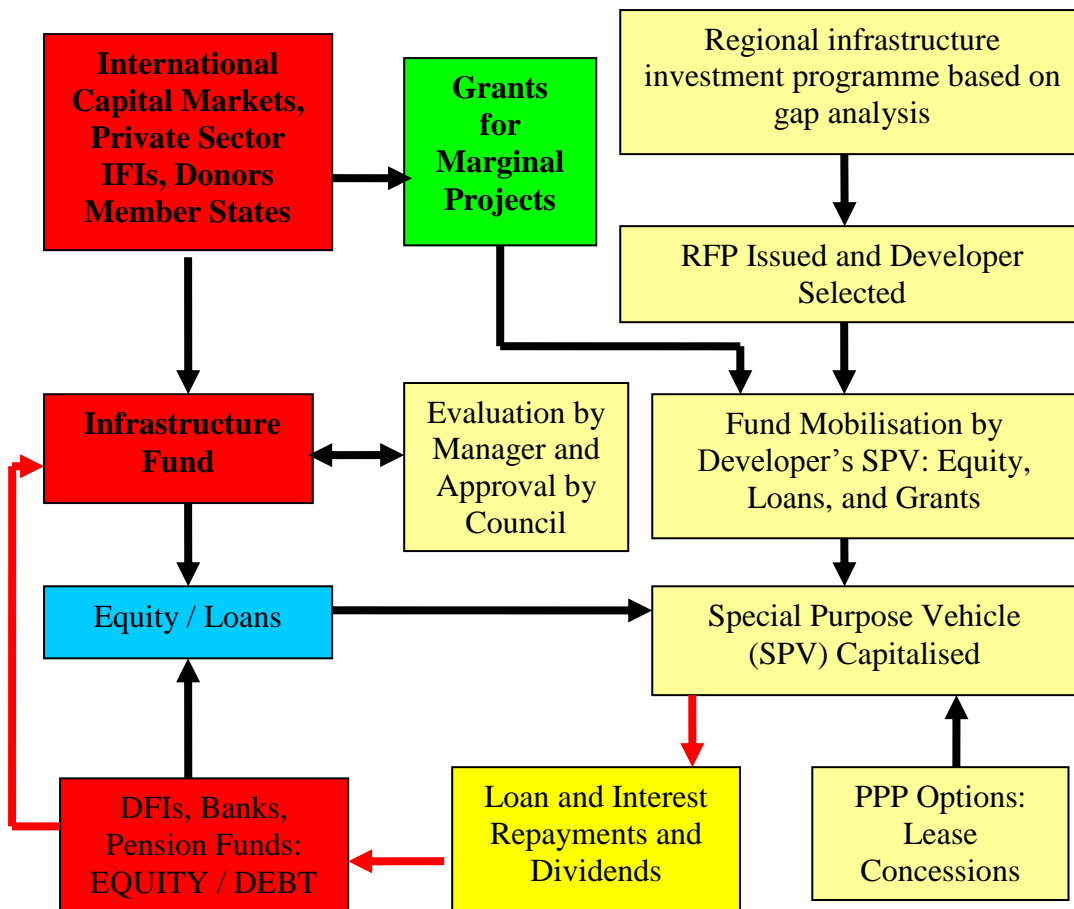
Appointment of Fund Manager

- Request expressions of interest
- Shortlist institutions
- Send RFPs to short listed institutions
- Evaluate responses to RFPs
- Appoint fund manager.

Once the funds have been mobilised the CRIF would “pool” all investments made in project SPVs (during Phase I/Pilot Phase) under the CRIF. This pool of investments would *comprise the portfolio of investment* from which the *investors* in the CRIF would expect *returns* by way of dividends. The schematic below identifies relevant operational issues.



CRIF Phase II: Full Operational Status (*post capitalisation of CRIF*)



Marginal Projects

Clearly not all infrastructure projects in the COMESA portfolio will yield the same return on investment. Some will yield higher returns than others will and lower yielding projects are unlikely to be attractive to the private sector investors. Cases in point are the projects along the North-South Corridor. Some of these projects will be less profitable than other projects. However, these less profitable projects are a critical link/part of the corridor and if they are not developed, could cause bottlenecks on other more “profitable” segments of the Corridor.

Marginal projects could be made *attractive* to potential developers/investors by making available *grant funding*. Grant funding would *reduce the cost of funds* and therefore the overall project development costs. Although the CRIF will attract grant funds, these funds would *not be managed* by the Fund Manager. The pool of grant funds would be *administered by the CRIF Board* as opposed to the Fund Manager. This will preclude the possibility of the Fund Manager making decisions on the regional priority projects to develop.



Project Preparation Facility (“PPF”)

The *complexities* inherent in the development of infrastructure projects have been acknowledged and recognised by cooperating partners and institutions. To this end, *several funds* dedicated for the *preparation* of infrastructure projects have been established. These are either “self managed” or managed under the aegis of DFIs. Examples of existing PPFs follow:

- The NEPAD Infrastructure Project Preparation Facility (“*NEPAD-IPPF*”) is managed and disbursed through the AfDB and the DBSA.
- The NEPAD Business Foundation (“*NEB*”) is actively involved in assisting project developers. To this end, they have established a Project Management Office to identify, evaluate, develop, and facilitate implementation of bankable infrastructure projects. *NEB* is also working on setting up a “Catalyst Fund” to catalyse projects.
- The Infrastructure Consortium for Africa (“*ICA*”) is managed and funded by a grant from the Private-Public Infrastructure Advisory Facility (“*PPIAF*”), a multi-donor technical assistance facility designed to assist developing countries improve the *quality of their infrastructure through private sector involvement*. *ICA* also provides grants for project preparation.

The CRIF should *not* establish a “CRIF dedicated” PPF, as there are in existence a number of PPFs (which disburse grants or partial loans). The creation of a CRIF specific PPF could dissipate effort and interest from the CRIF. This notwithstanding, COMESA *could* through its good offices assist project developers/SPVs access funds from existing PPFs.



7. Terms of Reference for the CRIF Manager

Corporate governance issues should be *addressed* in the *early* stages of establishing the CRIF. The framework should provide for the management of potential *conflicts of interest* in the operation and management of the CRIF. The *best practice* principles to adopt should include:

- Laying solid foundations for management and oversight
- Structuring a Board that adds value
- Promoting ethical and responsible decision making
- Safeguarding integrity in financial reporting
- Making timely and balanced disclosure
- Recognising and respecting the rights of all stakeholders
- Recognising and managing risks
- Ensuring enhanced performance.

Managing infrastructure funds requires specialist skills. Reputable infrastructure funds are managed either by sponsor banks or by institutions related to banks or by independent fund managers. The appointment of fund managers would lend credibility to the CRIF and ensure that it is professionally managed.

Investors' *raison-d'être* of investing in a fund is to *leave* the investment management and operations function to *professionals*. Therefore, the quality/calibre of the fund manager is one of the key factors that investors and lenders consider when analysing the investment opportunity.

The Fund Manager's team must have a high level of educational and professional credentials, and infrastructure fund management experience to qualify for appointment. COMESA should consider appointing an experienced Manager with a record of accomplishment of managing funds over the long-term and consistently improving funds' performance.

The Fund Manager would be responsible for implementing the CRIF's *investment strategy* and *managing its investment portfolio*. The CRIF can be managed by one entity or by two entities as co-managers.

The appointment of the fund manager is essential for the success of the CRIF. The function should be *advertised internationally* and international competitive bidding processes should be used in identifying a suitable Fund Manager. The final *appointment* should be ratified by the COMESA Council. The *quality and reputation* of the fund manager will be major factors that would be taken into consideration by potential investors in the CRIF.

The Fund Manager's terms of reference would include the following:

- Be accountable and responsible to the Board
- Manage the fund on behalf on the owners/shareholders
- Ensure sustainable and growing long-term cash flows to support increasing debt
- Utilise financial structuring and capital optimisation strategies to enhance shareholder returns



- Appraise infrastructure projects being developed by SPVs and recommend investing in the projects if they qualify or satisfy CRIF's investment criteria.
- Evaluate competing "opportunities"/projects
- Undertake or commission due diligence studies
- Maintain a diversified portfolio of projects (by sector and geography)
- Identify potential co-investors in each project
- Limit over-exposure to individual projects
- Limit over-exposure to one sector
- Oversee project development (through representation on the Boards of SPVs)
- Optimise returns on liquid resources
- Identify and mobilise additional grant and concessionary funding
- Ensure cost effectiveness of activities
- Fund viable projects that promote trade and are consistent with regional priorities designed to support integration
- Be transparent and accountable to stakeholders
- Maintain contact with development finance institutions, commercial banks and other sources of private sector investment.
- Adopt a flexible approach and introduce modifications as the need arises.

At the core of the infrastructure fund model is an attractive source of fees for the sponsor or manager of the fund –fees that are derived from a wide range of *management, advisory and financial services*. In essence, Fund Managers charge a *base fees* and performance fees.

Base fees, which are based primarily on the *market capitalisation* of the fund, and *related party fees* (fees for advisory, underwriting and debt arranging) are *open to influence* by the Fund Manager, as it is the Fund Manager that would initiate investment, acquisitions, restructurings and disposals, all of which have an *influence* on assets under management and hence *market capitalisation*.

Performance fees are linked to *pre-agreed* benchmarks or out-performing broad market indices. They are significantly harder for the Fund Manager to influence.

The total fees (management, advisory, etc) of infrastructure funds are expressed as a management expense ratio ("MER"). High MERs are indicative of the *front-end loading* effect that happens when assets/projects are first transferred into a *newly created fund*, with a range of accompanying fees.

The CRIF should be aware of current practice on fund management fees and fee levels, and must be prepared to *contest fees in negotiations* leading to the appointment of the Fund Manager.



8. Summary of Challenges & Next Steps

The processes involved in creating a credible infrastructure fund are complex and involving. It is *unlikely* that COMESA will have in-house skills and competences to undertake the project and should therefore seek the assistance of experts as it works on actualising the CRIF initiative. It is important to note that *investment in time* at the start of the process, specifically in *developing the CRIF project brief*, will have the greatest impact on *delivering* a successful project to a *realistic* timetable. The challenges, critical next steps, and success factors are outlined below.

Challenges

The key challenges that need to be addressed in establishing the CRIF are:

- The noticeable absence of a “*champion*” within COMESA supported by appropriate resources.
- The lack of a *feasibility study* demonstrating the viability of the CRIF as well as the benefits to potential investors (returns in the case of the private sector and developmental impact in the case of donors).
- Given COMESA’s *voluntary* approach to Member States’ *participation*, achieving harmonised standards and regulations in all member states could be a constraint. An example of this is the planned power inter-connector between Zambia, Tanzania, and Kenya where only Zambia’s legislation permits the ownership of transmission lines by private sector entities. In the absence of common legislation, what was planned to be a project with both public and private participation has now evolved into a purely public sector venture.
- Canvassing the benefits of CRIF with a view to garnering the support of all Member States leading to subscription for shares in the Fund.
- Building capacity within COMESA to facilitate the development of infrastructure projects and to spearhead (with the assistance of external advisors) the establishment of the CRIF.

Success Factors

- Creation of first SPV(s) to develop projects along the North South Corridor.
- Finalisation and acceptance of the CRIF Feasibility Study by the COMESA Council.
- Incorporation of the CRIF as a LLC and funded as planned.

Next steps

As is the case with all successful projects, it is necessary to *consider* the next steps and ensure that the magnitudes of the tasks at hand are not *underrated*. The next steps will to a large extent determine the success and speed with which the CRIF could be established and meet



the expectations of all stakeholders (see Appendix II: Key Tasks to be undertaken during Phase I).

- *Terms of Reference (“ToR”) for CRIF Feasibility Study:* the ToR should be drafted as soon as possible and RFPs sent out to professional firms and infrastructure fund managers. Their responses should be evaluated and a firm commissioned to perform the feasibility study. The feasibility study should include a comprehensive, and accurate *financial model* showing:
 - all costs
 - project/shareholder returns
 - lender coverage ratios
 - conservative assumptions.
- The study should include *Sensitivity Analysis* demonstrating the CRIF’s *viability* under different scenarios
- *Incorporation of the proposed CRIF as a Limited Liability Company:* it is now necessary to register or incorporate the CRIF as a separate legal entity.
- *COMESA & Other Regional Bodies Conference on the CRIF:* COMESA’s initiative is a bold one and COMESA has thus far invested considerable resources on the process. A conference with other regional bodies in attendance would be informed of the progress made towards creating the CRIF. This would *persuade* other regional bodies to join or work with COMESA on the initiative and *pre-empt* them from embarking on setting up similar “groupings-based” infrastructure funds thus detracting from the interest the proposed CRIF has generated.
- *Appoint Transaction Advisory Team:* It is advisable to engage a Transaction Advisory Team that would work with COMESA in the implementation of the proposed CRIF. The team will comprise finance, legal, engineering, environmental and integration experts. These experts are typically *managed* by a Lead Advisor who is also the client’s *principal* point of contact. The appointment of a credible and experienced advisory team would facilitate successful mobilisation of resources from the public and private sectors. The Transaction Advisor would implement the fund design and draw up documentation required to complete the processes.
- *Project Information Memorandum (“PIM”)/Prospectus:* This document would be based on the feasibility study and would be prepared by the Transaction Advisor. The PIM would provide details on the project and potential financing. It should be focussed on potential lenders and financiers. The PIM would be approved by COMESA before it was presented to interested parties.
- *International Competitive Bidding for Fund Manager:* The common perception is that funds managed by independent managers and *agencies are less likely to be influenced by governments or political interests*. It is therefore critical that the proposed CRIF’s Board appoints a *credible* Fund Manager through an international competitive bidding process.

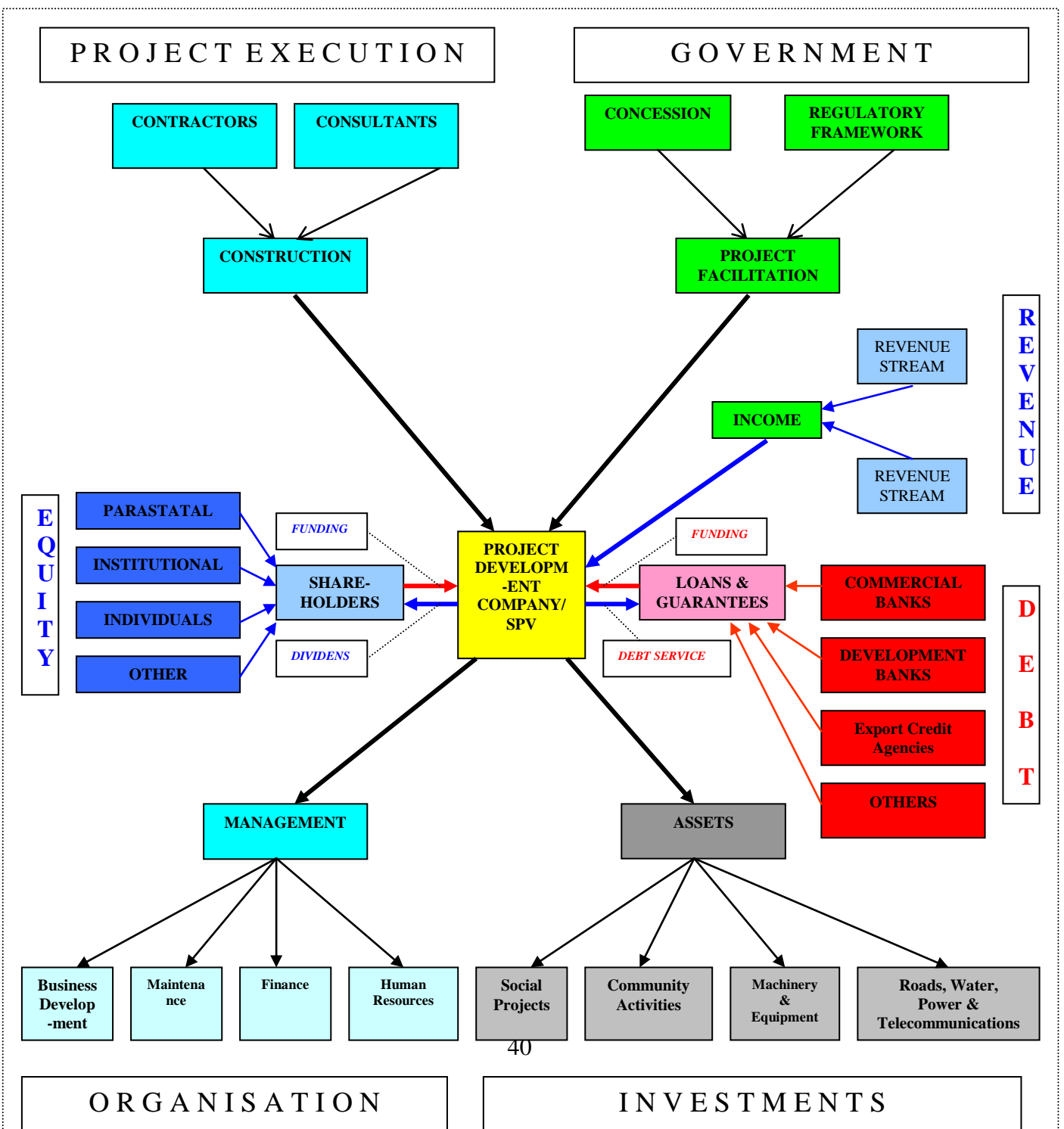


- *Road Shows for International Financial Institutions, Development Finance Institutions, Donors, and other interested Stake Holders:* Road shows are necessary for garnering the support of the investor community. The road shows will be at *two levels*: the initial or *preliminary* road shows will aim to sensitise the audience on the work COMESA is doing on *developing a framework for developing cross-border infrastructure* and the potential *investment opportunities*. The subsequent road shows will be aimed at *securing funding* for the CRIF.
- *Financial and legal Close:* this will be a key milestone and its achievement will result in the capitalisation of the CRIF. At this stage in the financial agreements all conditions precedent to draw down/investment will have been satisfied and documents executed thereby permitting drawdowns for the capitalisation of the fund.
- *Launch of CRIF:* The launch of the CRIF will mark the completion of the capitalisation process and the commencement of investments (debt and/or equity) in regional infrastructure projects.

Although the tasks involved in creating a Regional Infrastructure Fund appear daunting, they can be addressed. Embarking on the establishment of the CRIF will not only require resources but will also require continuing “high-level” commitment from COMESA.

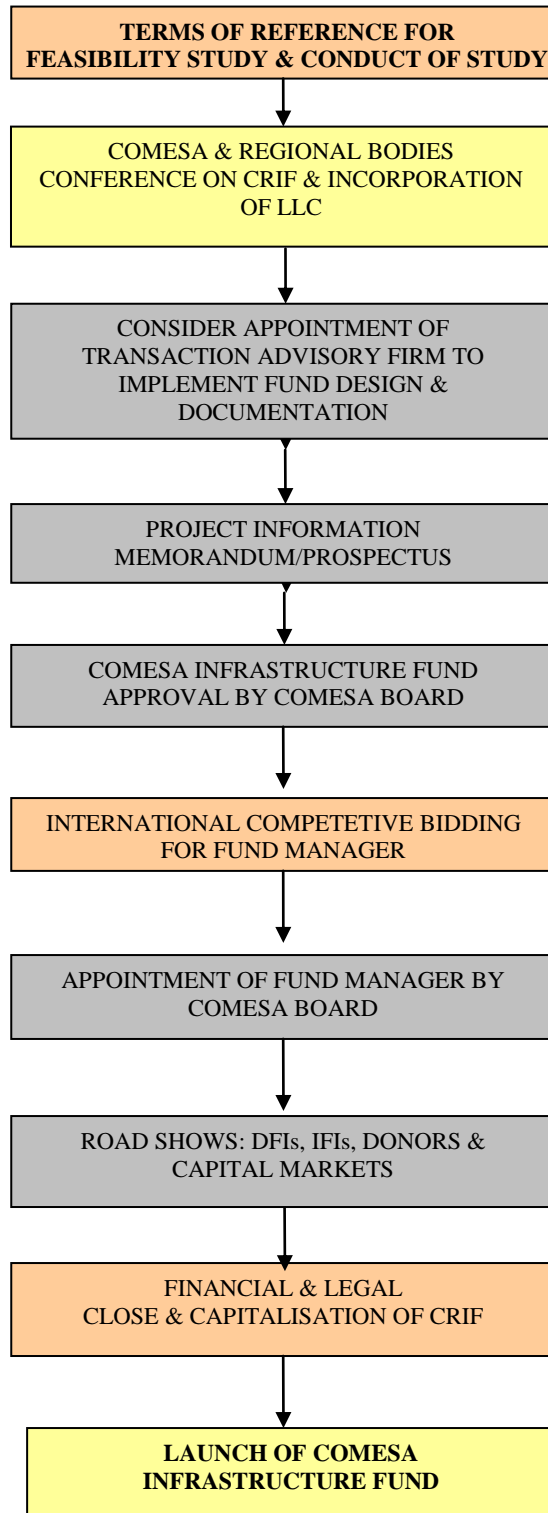


Appendix I: Project Development Model Private Financing of Infrastructure





Appendix II: Key Tasks to be undertaken on Phase II during Phase I





Appendix III: Documents Reviewed

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31. “World Bank Group Financing and Risk Mitigation Instruments”, World Bank
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33. “EC Infrastructure Programme in Mozambique”, Sergio Piazzardi, Head of Infrastructures Section, EC Delegation Maputo, February 2008
34. “Stock Taking and the Future - A DFI Perspective”, Emmanuel Kere, Country Manager, Mozambique, Development Bank of Southern Africa
35. “Public Private Partnerships in SADC” Juliet R. Kairuki, SADC Banking Group, January 2008



36. “Increasing Domestic Impact of Investments through Linkages,” Mazen Bouri, Private Sector Development Specialist, Africa Region, World Bank.
37. “Guidelines on Private Public Partnerships for Infrastructure Development” UN/ECE, December 2000
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40. “Infrastructure Funds, Issues to Consider”, Presentation by Brad Johnson, Resource Mobilization Advisors, January 2008
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Appendix IV: Terms of Reference

Introduction

Although there is an urgent requirement to improve the region's infrastructure, there is always the dilemma of how to finance such an improvement. One of the reasons why the region is underdeveloped is because it has poor infrastructure and it has poor infrastructure because it is underdeveloped. The levels of aid and concessionary financing provided by donors and International Financing Agencies (IFIs) have, on their own, never been high enough to meet the region's infrastructural needs. Owing to the small domestic capital base, the region's governments have also not been able to finance their infrastructural needs from the public budget. In addition, most COMESA countries already have a large, and sometimes unsustainable, public debt, so borrowing money on international markets is not an option. The challenges, therefore, are:

- i) to identify the priority infrastructural requirements of the region; and
- ii) design and implement a method of financing this priority infrastructural investment.

To identify the priority infrastructural requirements of the region the COMESA Secretariat (in conjunction with EAC, IOC and IGAD) have been working on a Transport and Communications Strategy (TCS) and Priority and Investment Plan (PIP) for Eastern and Southern Africa. The identified directions are intended to be in line with NEPAD's initiatives that offer solutions to regional and institutional bottlenecks to regional infrastructure activities. They are also intended to be in line with SADC's intentions towards regional development and integration, economic viability and environmental sustainability. In addition, they link up with Sub-Saharan African Transport Policy Programme's intentions to aim at sustainable service levels on road networks through commercialisation of financing and management of road maintenance.

The TCS and PIP are still being worked on so have not provided any input into the COMESA Infrastructure Fund in terms of projects that could be considered by the COMESA Infrastructure Fund when it becomes operational. The RTFP, in its capacity as the Secretariat for the COMESA-EAC-SADC Task Force, is implementing a Regional Aid for Trade (RAFT) project which is a multi-modal, multi-sectoral transport corridor from Dar es Salaam in Tanzania to South Africa, with the main corridor running through Tanzania, Zambia and Zimbabwe and into South Africa and secondary routes running through Botswana, Mozambique and Malawi, with implementation covering rules, regulations procedures and infrastructure development. It is expected that the RAFT project will be able to identify sub-projects, which can then be used as an input for the COMESA Infrastructural Fund and that these sub-projects will be identified by RAFT within the first half of 2008.

The COMESA Infrastructure is envisioned to work as follows:

Description of the implementation of the COMESA Infrastructure Fund

An Infrastructure Fund Committee could be established, comprising representatives of participating countries who have ratified the Protocol and paid their contributions into the Pooled Fund (see below for a description of the Pooled Fund) and donors and IFIs who have contributed to the Pooled Fund. Voting at the Infrastructure Fund Committee could be done on the basis of proportional voting. COMESA member countries participating in the



Infrastructure Fund would hold a block of 50% of the vote, which will be allocated equally to each participating COMESA country. The other 50% would be allocated to donors and IFIs who have contributed to the Pooled Fund and the number of votes given to each donor or IFI, within the 50% of the block vote given to donors and IFIs, would be proportional to their contributions made to the Pooled Fund. Therefore, if one funding agency has contributed half of the funds from all donors and IFIs in the Pooled Fund, that funding agency would control half of the 50% block vote allocated to donors and IFIs (i.e. 25% of the total vote).

The Infrastructure Fund Committee would appoint Fund Managers whose job it would be to establish a Special Purpose Vehicle (SPV) for each asset, or, possibly, a pool of assets, and assist to raise financing for the SPVs on international capital markets.

Pooled Fund

The Pooled Fund will serve four main purposes:

- i) it will be a source of revenue to be used to finance identified projects
- ii) it will promote regional integration through ESA countries having an equity stake in infrastructure all over the region;
- iii) it will allow a public-private partnership in ownership and management of capital assets of the region; and
- iv) it will be a vehicle through which donors and IFIs can contribute resources for the development of priority infrastructure projects in the region.

The Pooled Fund will be made up of contributions from ESA member States and contributions from donors and International Financing Institutions (IFIs).

The COMESA Policy Organs have determined that, at least initially, COMESA member States should contribute a pre-determined amount of US\$10m to the COMESA Infrastructure Fund. COMESA country payments to the Pool Fund will be calculated using the formula used to calculate country contributions to the COMESA Secretariat budget. The contribution for each country to the Pooled Fund will be fB where B, in this case, is US\$10m and f is the percentage contribution for each country. As the maximum any one country can contribute to the COMESA budget is 13% on the total and the minimum is 1% of the total, countries would contribute between US\$1.3m and US\$100,000.

Once the Pooled Fund is established through contributions from COMESA countries, selected donors and IFIs will be invited to contribute to the Pooled Fund on a leveraged basis, meaning that a donor or IFI would be expected to contribute a minimum of an agreed multiple of the total amount contributed by the member States themselves.

Discussions have been held with the World Bank on the possibility of financing regional programmes using concessionary loan financing. The World Bank has a scheme whereby if a country eligible to receive IDA credits is willing to use a proportion of its IDA credit allocation to finance a regional programme, the World Bank will match this allocation with an allocation which is 200% leveraged. For example, if a country is willing to contribute US\$5m of its IDA credits to a regional programme, the World Bank will provide US\$10m in IDA credits. Although this facility is not targeted to the COMESA Infrastructure Fund, it could be appropriate to try out this funding mechanism through the Infrastructure Fund.

If the money is provided through IFI concessional loans, the ultimate borrower (in this case the region) will, through the SPV, be provided with a mechanism through which both the loan repayments and capital repayments can be secured. Whether the international



community is contributing to the Pooled Fund through either grants or concessionary loan, the advantages to the donors and IFIs will be that:-

- they will be part of a structured financing system with transparent management systems in place;
- they will be assured that the funds they commit to the COMESA Infrastructure Fund are going to be used to address the major constraints faced by the region and by the countries themselves;
- they will be part of the decision-making process which allocates and manages finances;
- they will, in all cases, be part of a process which involves the COMESA member States and private sector investors in financing and implementing projects which are regarded as a priority for the integration of the region by COMESA member States themselves and which shows the commitment of COMESA to helping itself to reduce poverty; and
- it would be in support of NEPAD in that the Infrastructure Fund has been developed within the framework of NEPAD and promotes the aims and objectives of NEPAD.

The SPV will be managed by Fund Managers who will be responsible for selection of projects, due diligence, preparation of financing plans for projects, development of exit strategies, making and monitoring payments, assisting in project evaluation to ensure the project is viable, etc. Selection of a professional Fund Manager will be done by the Infrastructure Fund Board but using commercial considerations.

In all infrastructural projects, there is need for technical inputs. For example, specialist technical inputs are needed in the design of an infrastructure project, in preparation of tender documents, in the supervision of the implementation of the works and in the checking of interim payment certificates. A special grant facility will be requested from the donor agencies and the financial institutions to cover the cost of the technical inputs. Once a project is approved in principle, grant funds for technical inputs could be released by the Infrastructure Fund Committee to allow detailed project design, tendering and project supervision to take place.

Terms of Reference

These Terms of Reference focus on providing Input for the design of the proposed COMESA Infrastructure Fund and methods for financing priority infrastructural projects.

The Consultant will:

- 1) Assess the need for the COMESA Infrastructure Fund, given that there are a number of other funds in existence, which could finance infrastructure projects in the sub-region.
- 2) Suggest ways in which the COMESA Fund could work together with other funds and development banks.
- 3) Outline how the Fund could raise finances from international capital markets including development banks and sources of concessionary finances.



- 4) Propose an outline of a legal structure for the COMESA Fund.
- 5) Describe how the COMESA fund could operate in terms of identification of a regional portfolio, disbursement of funds and possible structuring of financing packages.
- 6) Develop possible Terms of Reference for the COMESA Fund Managers.

The results of this study will feed into a larger study on the COMESA Fund, which will finalise the design of the Fund.



NOTES