Filling the infrastructure financing gap

Attracting investors to emerging projects

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There is a sizeable gap between the world economy's infrastructure needs and available financing. The shortfall is especially pronounced in emerging markets.

Infrastructure investment has fallen short of what is needed to support potential growth. At the same time, financial resources in world markets have contended with low long-term interest rates, while opportunities for greater returns from potential infrastructure assets are missed.

The development of properly structured projects, with risks and returns distributed in accordance with stakeholders' incentives, will help to close the gap between private sector financing and infrastructure. Worldwide infrastructure investment, including from international financial institutions, public investment and public-private partnerships, amounts to around $1.7tn per year. This leaves a funding gap of more than $1tn.

Global infrastructure financing has fallen short of its potential, (see Chart). Institutional investors and other private sector players could increase allocations under appropriate conditions. Private sector investment and institutional investor capital are often raised as possible solutions for filling the infrastructure funding gap. According to data from the World Economic Forum, institutional investors managed assets exceeding $50tn in 2015, compared to $30tn in 2007.

Defining attractive opportunities

Institutional investors must consider their own incentives, constraints and objectives when it comes to selecting countries, types of projects and at what stage of the investment project cycle to invest in. Inadequate coverage of risks is one of the most common reasons projects do not reach financial close. Defining attractive investment opportunities and matching investors to these prospects in a more systematic manner is one key way in which the shortfall in infrastructure funding should be addressed.

Heterogeneity in the set-up of projects is often named as a key barrier to pushing greater allocations of capital towards infrastructure investment. A lack of data, varied contractual structures and differing regulatory environments are all part of this puzzle. However, focusing on improving the breadth of products tailored specifically for different types of institutional investors is likely to reap greater near-term rewards.

Currency risk is a major factor which international investors face in emerging markets. Export credit agencies can help with that challenge, although often only at great expense. Other challenges frequently named are the scarcity and complexity of financial instruments and their high cost. Fixed-income instruments such as bonds – including project bonds, sub-sovereign bonds, green bonds and sukuk – as well as loans are likely to be a better fit for the appetite of a broad range of institutional investors in emerging economies.

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Developing project pipelines

Development finance institutions are important catalysts for investment. They can draw private capital to long-term projects in countries and sectors in which, although the market may perceive higher risks, significant development results can be expected. Those institutions contribute their own funding and guarantees, providing improved creditor status. Bringing partners into specific deals through syndications can likewise generate additional financing. Furthermore, development finance institutions can support the advancement of longer pipelines of investable projects. Non-banking financial institutions frequently highlight the scarcity of such pipelines as an impediment to greater infrastructure investment.

Development banks are trialling various mechanisms which can distribute risk among third parties through risk transfer and credit enhancement instruments. These include guarantees, insurance policies and hedging mechanisms under which, for a fee, the provider will agree to compensate the concessionaire in case of default or loss due to some specified circumstance.

The contrast between the dearth of investments in infrastructure and the savings-liquidity glut in the global economy must be confronted. Lowering legal, regulatory and policy risks are essential steps. Improving the availability of sophisticated, developed financial markets and instruments will help facilitate partnerships between different financial agents. Increasing private investor involvement and designing rational financing structures will both boost funding and improve the efficiency of infrastructure projects. Building such bridges is well within reach for resourceful financial actors. ■

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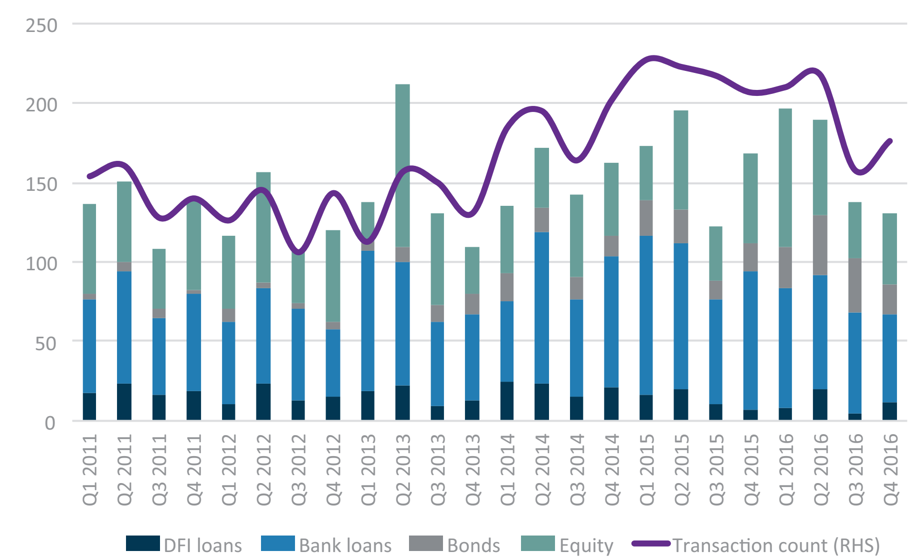
Global infrastructure finance falls in 2016

Global infrastructure finance including corporates, by source of funding, $bn and number of transactions



Source: Canuto and Liaplina, 'Matchmaking finance and infrastructure', Capital Finance International, 2017