actserv | Impacting Lives Positively

INVESTING IN INFRASTRUCTURE FOR PENSION SCHEMES

9th December, 2021

Pension schemes around the world are always looking for the best investment returns, and they're always looking for profitable and significant investment possibilities. The main aim of any pension scheme is to deliver good retirement security to its members through investment and management decisions. This article aims to inform various stakeholders on investing in infrastructure as an alternative asset class that offers unique and rewarding investment opportunities for pension schemes.

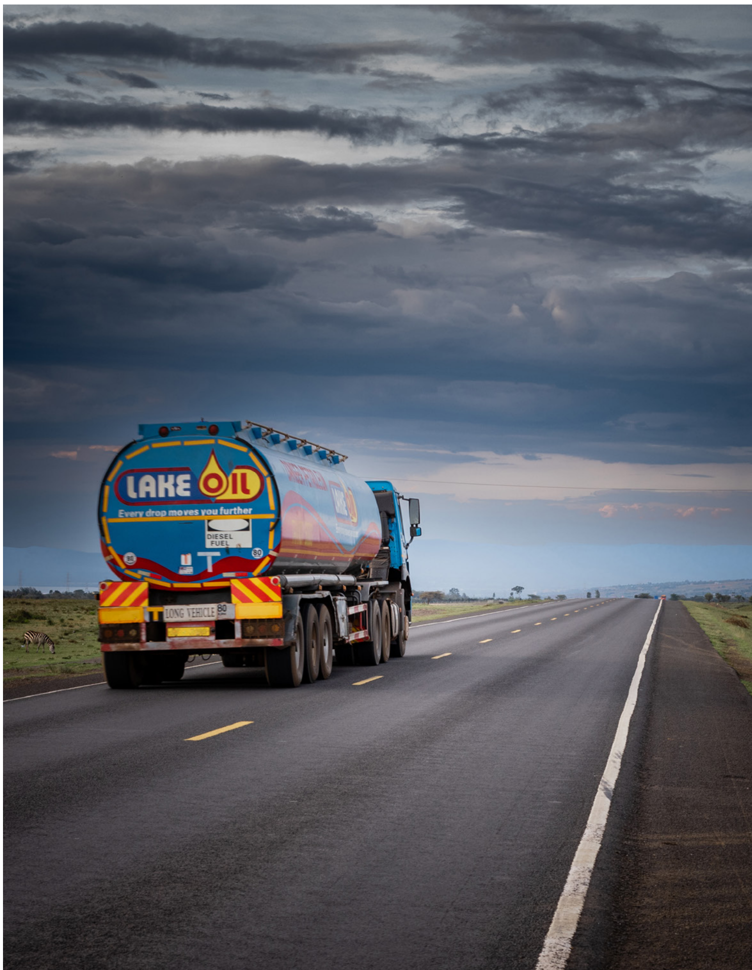
Background

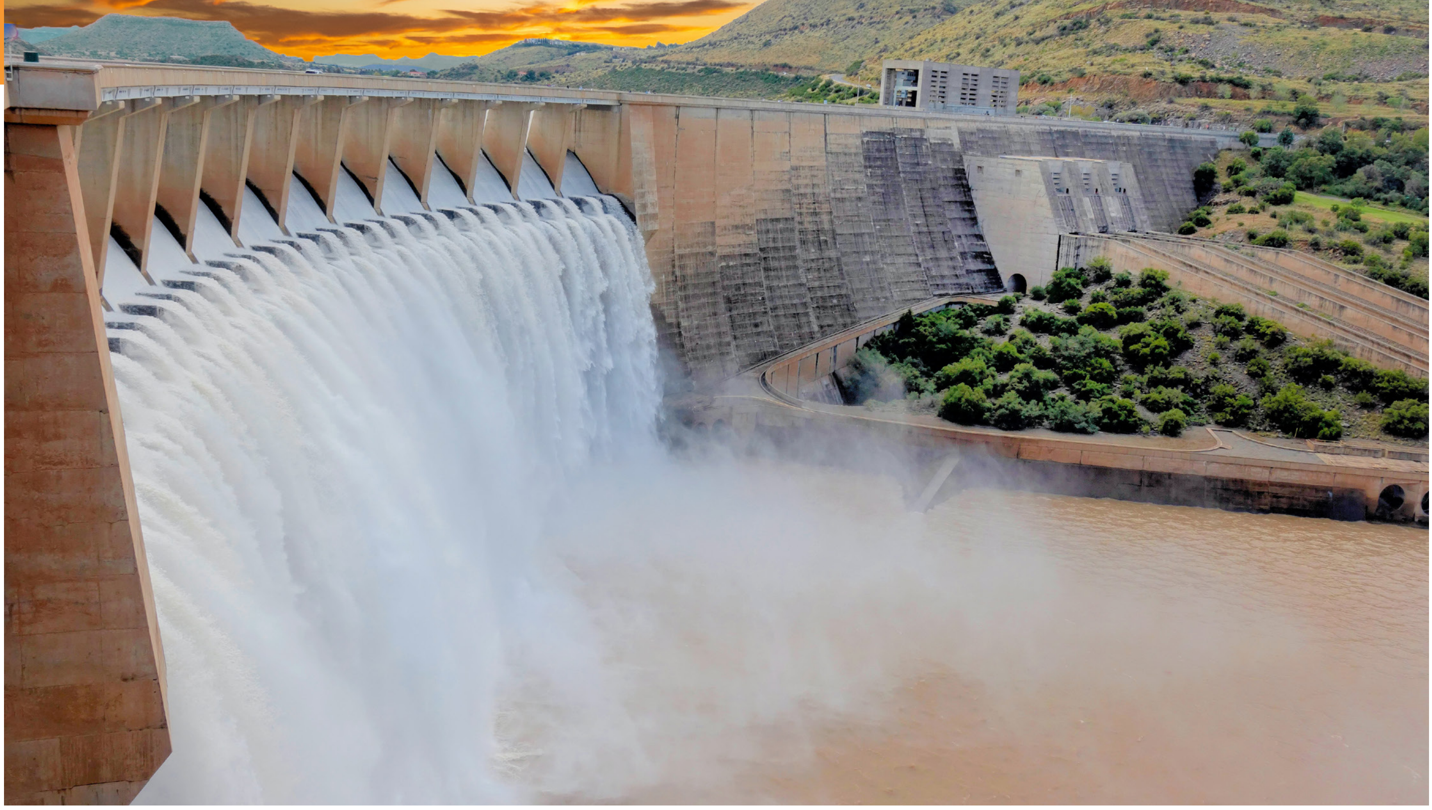
According to the World Bank, Kenya faces a widening infrastructure funding gap estimated at USD 2-3 billion annually. As with other countries in sub-Saharan Africa, the main source of infrastructure funding is the government. However, the government is confronted with growing budget deficits and competing priorities in healthcare, affordable housing, education, and food security. As a result of the fiscal budget constraints accrued in recent years, the government has become a limited source of infrastructure funding.

The assets under management for Kenyan pension sector has grown significantly from 80 billion shillings in early 2000 to KES 1.47 trillion at the end of June 2021. According to the Retirement Benefits Authority (RBA) industry report for June 2021, schemes have continued to invest heavily in government securities and quoted equities, accounting for 44.12% and 16.74% of the total assets under management respectively.

This is a challenge for schemes as there is a significant market risk when relying heavily on the two asset classes. Additionally, approximately 50% of the local equities market is represented by one listed company, elevating the market risk and emphasizing the need for diversification. The need for diversification has further been illustrated during the Covid-19 pandemic where institutional investors such as pension schemes have earned lower returns from their investments due to a significant drop in stock prices at the Nairobi Securities Exchange(NSE), a reduction in bond value and reduced returns from property.

To achieve enhanced returns and maintain a diversified portfolio schemes have to think outside the box and invest in alternative asset classes such as infrastructure. Infrastructure offers a return while matching the scheme's long-term liabilities.





Investing in Infrastructure

The infrastructure asset class is broadly categorized into economic and social infrastructure. The economic aspect incorporates commerce-supporting assets e.g. toll roads, power stations, airports, bridges, etc. in which a fee is typically charged. The social aspect, on the other hand, includes but is not limited to public healthcare, education and social housing and is mainly financed through public/private partnerships.

Why Pension Schemes should Invest in Infrastructure

The Infrastructure asset class has very unique characteristics that are suitable to schemes and help achieve the goal of offering a decent retirement income to its members. Some of the reasons schemes should invest in infrastructure include:

1. Competitive returns- Infrastructure offers a reliable stream of liquidity for schemes due to non-market competition.

2. Diversification- Infrastructure is a unique asset class whose return has a low correlation to other asset classes

3. Long term investment time horizon- this asset class allows the pension scheme to match their long term liabilities with a long term asset

4. Low volatility- Infrastructure is an essential service and therefore minimally affected by economic cycles

5. Inflation-linked return- the rate charged for usage (e.g toll stations) are typically linked to inflation and in the long run, protect the real return.

Challenges Facing Infrastructure Investing

- Limited awareness of the opportunity- investment in infrastructure has gained traction over the past years and schemes might have not gotten a chance to understand the opportunity. Trustees may also miss the opportunity as investing in infrastructure is long-term compared to their terms in office.

- Regulatory uncertainty- a consistent and predictable regulatory framework is required as the infrastructure asset will outlive a government that runs 5-10 years in Kenya.

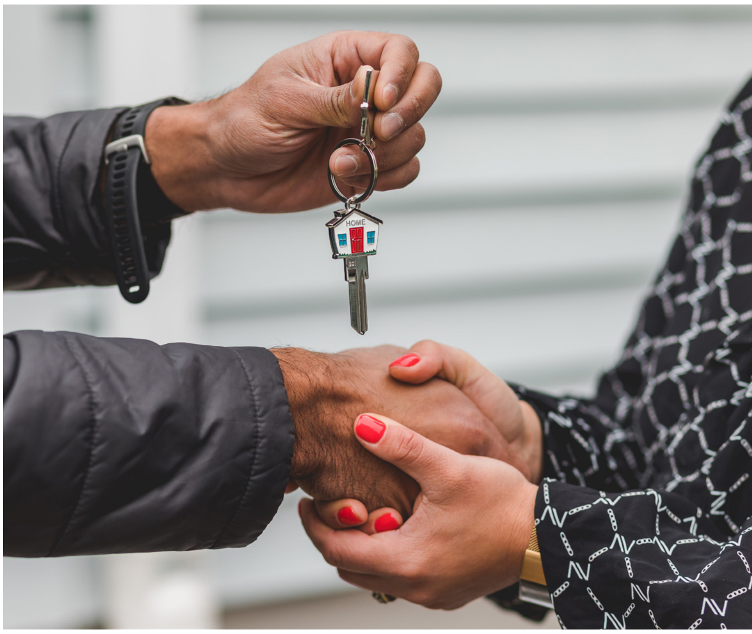
- Large investment size- Infrastructure investments have large ticket sizes which are beyond the capacities and regulatory limit for pension funds.

- Limited expertise- Infrastructure projects are often complex and require costly due diligence processes. Low investor expertise is one of the biggest barriers to increasing institutional investment in infrastructure, highlighting the need for a credible investor body.

Investment Consortiums

Infrastructure investments have large ticket sizes which are beyond the capacities and regulatory limit for pension funds as mentioned. Pension schemes can invest in infrastructure through an investment consortium.

Investment consortiums such as Kenya Pension Fund Investment Consortium (KEPFIC) in Kenya and Pensions Infrastructure Platform(PIP) in the UK provide investment expertise and asset management to pension funds investing in infrastructure.



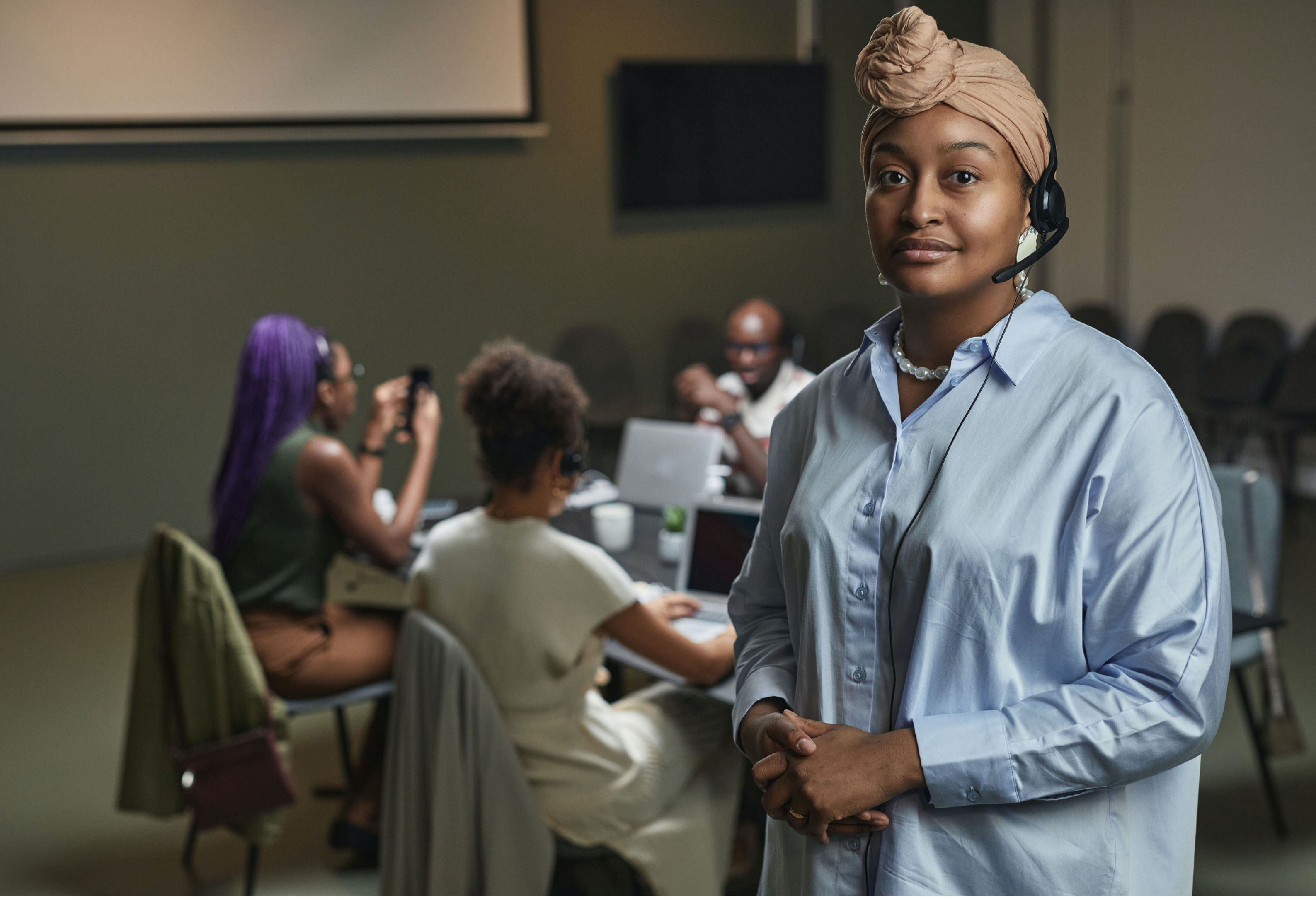
Investment consortiums such as Kenya Pension Fund Investment Consortium (KEPFIC) in Kenya and Pensions Infrastructure Platform(PIP) in the UK provide investment expertise and asset management to pension funds investing in infrastructure.

Kenya Pension Fund Investment Consortium (KEPFIC) was conceptualized and officially launched on 21st October 2020. KEPFIC is a consortium of Kenyan retirement benefits funds that have come together to make long-term infrastructure and alternative asset investments in the region. To do this, KEPFIC aims to identify suitable infrastructure opportunities, pool investment capital from local pension funds and co-investors, and build the technical and investment capacity of its member funds, to enable them to make informed infrastructure investment decisions.

Call to Action

Recently, the Kenyan government has increased borrowing to fund infrastructure leaving the country with high debt levels. Pension schemes account for approximately 30% of this debt through bills and bonds. The government has since shown it understands the key role that pension schemes can play. To support capital flows from pension schemes, the Retirement Benefits Authority (RBA) introduced two asset classes as investment options for pension schemes; Exchange Traded Funds (ETFs) and Public Private Partnership Debt instruments (PPPs).

Formerly, pension schemes exposure to infrastructure was only through listed companies, Real Estate Portfolios or Private Equity Funds. This introduction allows a 10.0% allocation of assets under management in PPPs to invest in Debt instruments for the financing of infrastructure or affordable housing projects. This potentially unlocks over KES 100 billion, as the industry had assets under management of KES 1.47 trillion as at the end of June 2021. As the need for investment in infrastructure grows, pension schemes can be part of the solution by moving into the available alternative asset classes. Through investment in infrastructure, trustees would give schemes a chance to invest in the real Kenyan economy and leave behind their legacy.



Pensions Research Team,
Actuarial Services E.A Limited
26th Floor, UAP Old Mutual Tower,
Upper Hill Road, Upper Hill
P.O Box 10472-00100
NAIROBI, KENYA
Tel: 0708710028/0786710028
Email: pensions_team@actserv.co.ke
Website: www.actserv.co.ke