

Mobilizing Private Capital at Scale: The Experience of U.S. Institutional Investors in Africa, 2017-2019

Achieving the Sustainable Development Goals will require closing an annual investment gap of \$2 to 3 trillion, an order of magnitude greater than the development budgets of all the world's donor countries combined. Attaining this level of scale will require harnessing the largest pools of capital in the world.

Worldwide, institutional investors—primarily pension funds and insurance companies—hold approximately \$70 trillion in assets under management. Mobilizing a mere one percent of these assets—\$700 billion—would equal more than four times the total official development assistance provided annually by all donor countries combined.

The vast majority of these institutional investor assets are invested in developed economies; however, that is beginning to change. Increasingly, investors are seeking both social and financial returns in faster growing developing countries, enabling them to diversify away from mainstream markets and their relatively expensive asset prices. Persistently low interest rates in these same mainstream markets have increasingly led institutional investors, particularly U.S. pension funds which are chronically underfunded, to search for higher returns in foreign markets to meet their obligations.

Institutional investors, however, still see Africa in particular as an investment destination fraught with risks—political, currency, regulatory—and often perceive these challenges as insurmountable, deterring them from considering the region.

Africa as an Investment Destination

KEY RISKS (PERCEIVED AND ACTUAL)

Currency Risk

Foreign exchange (FX) volatility and illiquidity can be a significant drag on returns. However, recent data suggests FX volatility is leveling, particularly for numerous African economies no longer dependent on the commodity cycle. Most African currencies depreciate at less than an 8.5 percent annualized pace while paying 15 percent yields or more for long term local currency bonds.¹

Liquidity

Africa is the most finance-constrained region in the world with a one percent share of global capital markets.² Average Market Capitalization to GDP (excluding South Africa) is 17 percent compared to 27 percent for frontier markets and 76 percent for emerging markets.³

Political Risk

From 1960 to 2000, the continent experienced an average of 40 coups a decade. From 2000 to 2019, it had an average of 10. Since 2009, only 12 of Africa's 54 countries have experienced coups.

THE AFRICAN GROWTH STORY

Economic Growth

In 2018, Africa was home to six of the world's 10 fastest growing economies. By 2050, the continent is expected to be a \$29 trillion economy.⁴

Diversification and Valuations

African capital markets are the least correlated with mainstream markets and have some of the most attractive price-earnings valuations on the globe.

Young and Growing Population

The continent's population will reach 2 billion by 2040 and will contain the largest workforce on the planet—1.1 billion people—surpassing China and India combined.

Urbanization

Africa currently has three megacities (10 million plus). That number is expected to jump to 15 megacities by 2040.

Africa Continental Free Trade Area

The African Continental Free Trade Agreement among 54 nations is the largest free-trade area in the world in terms of participating countries and will create a single market that is already estimated at \$3 trillion dollars in 2020.

While these challenges can create barriers to entry for international investors, Africa has the potential to generate significant returns for those who have the time and the resources to develop local expertise and relationships.

This rationale was the genesis of a program begun by USAID in 2017 to expose U.S. institutional investors to opportunities in Africa and help them navigate perceived and actual risks on the continent. The Mobilizing Institutional Investors to Develop Africa's Infrastructure (MiDA) initiative has focused on fostering long-term relationships between African and American institutional capital and their respective financial sectors. Through investor delegations, road shows, pitch sessions with credible African asset managers, site visits, and targeted transaction facilitation, **MiDA has mobilized \$1 billion in investment commitments over the last three years** (see Investment Spotlights).

In April 2019, the third annual MiDA investor delegation visited Kenya and South Africa, and it included 17 asset owners representing over \$1 trillion in assets under management. In cooperation with the World Bank, MiDA helped spur the formation of KEPFIC, a local consortium of a dozen Kenyan pension funds. Through KEPFIC, these local pension funds will collaborate with their U.S. counterparts to invest in their own infrastructure for the first time in the country's history. The upcoming fourth annual MiDA delegation will visit Ethiopia and Kenya in March 2020, at the invitation of the United Nations Economic Commission for Africa, which will convene a high-level meeting of African finance ministers in Addis Ababa.

By reducing the perception of risk and introducing U.S. asset owners to concrete opportunities for co-investment with their African counterparts, MiDA has accelerated capital flows into the continent and begun to address the scale required to close the SDG investment gap in one of the more challenging frontier market regions.

Now situated under the Prosper Africa mandate—a U.S. Government initiative to strengthen two-way trade and investment between the U.S. and Africa—MiDA will expand its work under USAID INVEST, a mechanism that mobilizes private capital for development goals. It will continue to build long-term U.S.-African investor relationships through delegations and road shows, and its new lines of effort will include an expanded ability to provide transaction facilitation as well as working more closely with the new U.S. International Development Finance Corporation on select transactions.

Moreover, as U.S. institutional investors have demonstrated a growing interest in entering African markets, the broader U.S. underwriting community—the city and local officials, investment banks, and advisory firms that make up the core financial infrastructure of the largest capital market in the world—has begun to take notice of opportunities on the continent. As relationships between the broader U.S. and African financial communities continue to deepen, new areas of collaboration, such as public financial management and accessing capital markets, will continue to emerge, helping to build Africa's organic capacity to finance its own development.

Investment Spotlights

Chicago Public Schools Teachers Pension and Retirement Fund

\$20 million investment in two Africa-focused private equity funds; first Africa-focused investment in pension's history

Alameda County Employees and Retirement Board

\$30 million investment in funds targeting real assets and natural resources in Africa and \$200 million for an emerging market fund targeting South Africa

The City and County of San Francisco Employees' Retirement System

\$100 million investment into a global infrastructure fund with investments throughout Africa

Prudential Investment Management

\$180 million investment in a West Africa-focused impact fund

Casey Foundation Family Programs

Over \$50 million in investments in private markets (equity and credit) and infrastructure

Teachers Retirement System of Texas

\$75 million in an emerging markets infrastructure fund that also specializes in projects in Africa, such as those with a regional focus

¹ Phumelele Mbiyo, "Constructive Medium Term Economic Outlook," Presentation at MiDA Investment Roadshow, Multiple locations, October 2019.

² Dr. Jan Dehn, "African Public Market Issues and Opportunities," Presentation at Africa Investment Summit, Abu Dhabi, November 2019.

³ James Johnstone, "The Africa Opportunity," Presentation at Africa Investment Summit, Abu Dhabi, November 2019.

⁴ Landry Singé and Ameenah Gurib-Fakim, "Six of the World's 10 Fastest-Growing Economies Are in Africa," World Economic Forum, August 6, 2019, <https://www.weforum.org/agenda/2019/08/afcfca-proof-that-africa-heading-for-substantial-growth/>.