STUDY ON PRIVATE DEBT MARKETS IN AFRICA

SEPTEMBER 2022

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Acronyms

AFD	Agence Française de Développement (French Development Agency)
AfDB	African Development Bank
AMMC	Autorité Marocaine du Marché des Capitaux (Morocco Capital Markets Authority)
AVCA	Africa Private Equity and Venture Capital Association
AUM	Assets Under Management
BESA	Bond Exchange of South Africa
BII	British International Investment (formerly CDC Group)
BIO	Belgian Investment Company for Developing Countries
COVID-19	Coronavirus disease
CRISA	Code for Responsible Investing in South Africa
DEG	Deutsche Investitions- und Entwicklungsgesellschaft (German Investment Corporation)
DFI	Development Finance Institution
EAC	East African Community
EIB	European Investment Bank
EM	Emerging Markets
EMPEA	Emerging Markets Private Equity Association
ESG	Environmental, Social, and Governance
EU	European Union
FMO	Dutch Entrepreneurial Development Bank
FSD Africa	Financial Sector Deepening Africa
GFC	Global Financial Crisis
GHC	Ghanaian Cedi
GPCA	Global Private Capital Association
HNWI	High Net Worth Individual
IDZ	Industrial Development Zone
IFC	International Finance Corporation
InfraCredit	Infrastructure Credit Guarantee Company Limited
IRA	Insurance Regulatory Authority
JSE	Johannesburg Stock Exchange
KEPFIC	Kenya Pension Funds Investment Consortium
KES	Kenya Shillings
KFW	Kreditanstalt für Wiederaufbau (Credit Institute for Reconstruction)
LHGP	Lion's Head Global Partners
MDB	Multilateral Development Bank
NGN	Nigerian Naira
NIDF	Nigeria Infrastructure Debt Fund
PE	Private Equity
PENCOM	National Pension Commission (Nigeria)
PenOP	Pension Fund Operators Association of Nigeria
PFA	Pension Fund Administrator
RBA	Retirement Benefits Authority
REPP	Renewable Energy Performance Platform
SEC	Securities and Exchange Commission
SME	Small and Medium Enterprises
USA	United States of America
USD	United States Dollars
VC	Venture Capital
ZAR	South African Rand

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Executive Summary

FSD Africa, in line with its mandate and capacity to build and strengthen financial markets across sub-Saharan Africa, engaged Lion's Head Global Partners ("LHGP" or "Lion's Head") to conduct a study on Private Debt markets in Africa. While keeping a pan-African perspective, the study focussed on Nigeria, Kenya, Ghana, and Morocco as markets of strategic importance. South Africa was used as a reference market, given the development of the financial sector and the size and scale of the South African institutional investor base.

In addition to desk research and data analysis, the outputs, analysis, and recommendations were driven by stakeholder consultations, workshops, and interviews to both reflect individual positions, but also generate buy-in from stakeholders.

The insights from the study will support FSD Africa's overarching strategic goal to mobilise long term finance in local currency to support Africa's development priorities and inform FSD Africa's transaction support, regulatory initiatives and knowledge and capacity building engagements under its Africa Private Equity and Private Debt programme. The study will also benefit stakeholders including institutional investors, borrowers, regulators and policymakers, who seek to improve the enabling environment.

1.1 Private Debt Overview

Private Debt is the investment of debt capital in a non-listed format. It sits between public debt and bank loans. This includes all forms of debt finance provided by non-bank lenders outside of public listed bonds. Commercial banks can participate in Private Debt, but to a lesser extent than specialist debt funds.

Globally, Private Debt originated in the US in the late 1980s as a format by which debt could be structured and sold directly to US insurance companies – it was also known as the private placement market. However, the market grew exponentially in the run-up to the Global Financial Crisis as Private Debt was structured and re-packaged via the securitisation market. Bank regulators were quick to clamp down on the lending activities of non-bank-financial institutions and the mechanisms of ratings arbitrage that had fuelled the initial expansion. A core market has however remained and has since re-grown, offering an alternative for institutional investors to the public credit markets (e.g., eurobonds, asset-backed securities and corporate bonds) where yields have been heavily compressed. Private Debt also offers a format for issuers to raise capital for specific needs not catered for by the public markets.

In the United States and European markets, Private Debt is a recognised asset class for institutional investors, providing potential for attractive risk-adjusted returns and portfolio diversification. In these markets, Private Debt comprises corporate debt, real estate debt, infrastructure debt, distressed debt, direct lending, bridge financing, and venture debt. These are structured as secured senior or unsecured subordinated/mezzanine loans.

In Emerging Markets, Private Debt represents a smaller market relative to the US and Europe. Asia represents the bulk of the Emerging Market Private Debt market while Central and Eastern Europe, Africa and the Middle East have much smaller, but growing markets.

1.2 Private Debt in Africa

In Africa, the Private Debt market has historically been dominated by Development Finance Institutions and Multilateral Development Banks as a proven instrument for direct investments in infrastructure financing through corporate loans and project finance structures. Increasingly, a pool of specialist funds is emerging building on the precedents set by the DFIs and MDBs, both in terms of track record and legal documentation. This pool could become an important supply of funds for Africa's financing needs. These funds can offer blended capital structures that are designed to accommodate the risk appetites of a diverse pool of funders to complement the MDBs and DFIs.

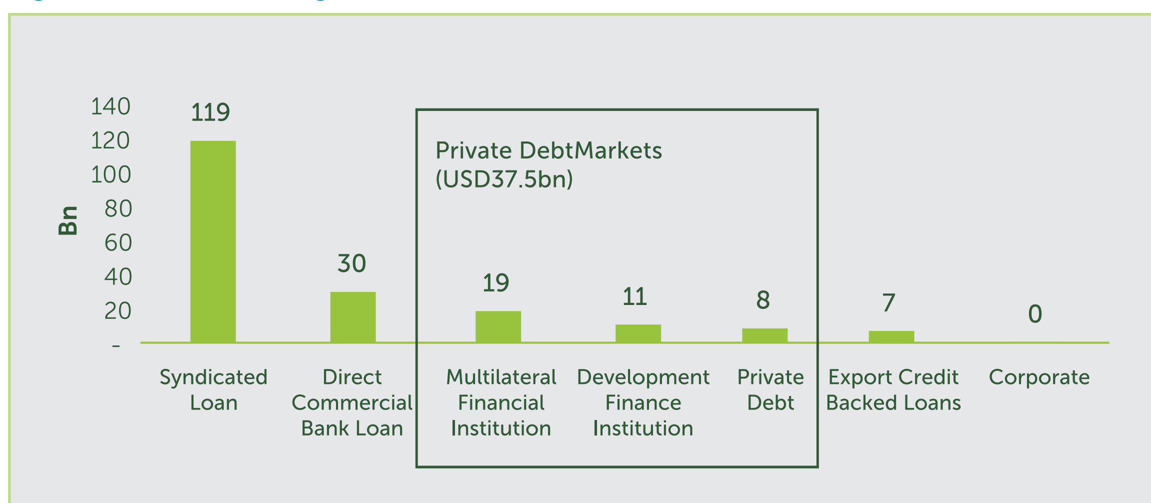
Local currency offerings are still in the minority, but this is also changing with both the establishment of domestic funds and specialist international funds that offer both local currency and foreign currency products through hedging mechanisms.

Analysis of Private Debt transactions in Africa showed that including MDB and DFI financing, the ratio of Private Debt to GDP is slightly lower than that of the US and Europe. The US and Europe have Private Debt to GDP ratios of 0.48% while South Africa has a Private Debt to GDP ratio of 0.42%, Nigeria's ratio stands at 0.22% and Ghana's is 0.20%. Kenya and Egypt have ratios of 0.67% and 0.56% respectively, demonstrating that Private Debt is already a key pillar of the financing landscape in these markets.

The comparison shows that Private Debt already plays an important role in several markets on the continent, however, there are limits to the use of these ratios to compare Africa and Developed Markets. Firstly, the African ratios include debt financing from MDB and DFI lenders while US and European ratios include only Private Debt fund financing, and secondly, there are wide disparities in the absolute Private Debt volumes and the sizes of the economies in question. When the MDBs and DFIs are excluded from the analysis, the Private Debt to GDP ratios in the focus markets would be 0.08% for South Africa, 0.10% for Nigeria, 0.11% for Kenya, 0.07% for Ghana and 0.01% for Morocco. These adjusted ratios are significantly lower than those in the US and Europe.

For this study, Lion's Head analysed disclosed Private Debt transactions across Africa from 2015 to H1 2021 and identified Private Debt transactions worth more than USD 193Bn. Excluding commercial bank and lender syndicate transactions, the total drops to USD 37.5Bn, and further drops to USD 8Bn excluding the MDB's/DFIs as illustrated in Figure 1.

Figure 1: Source of lending (USD Bn, 2015-H1 2021), Total=193Bn



***Source:** Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

Excluding the MDB/DFI capital invested into third party fund managers in Africa, the percentage of pure institutional capital dedicated to direct investments is currently very small – this is the growth opportunity where FSD Africa and other organisations with Africa focussed financial sector development mandates have a key role to play.

We note that the dominance of the MDBs and DFIs in Private Debt has led to the dominance of hard currency denominated transactions. This both crowds out domestic capital and results in increasing foreign exchange risk to enterprises and projects with hard currency funding while earning most, if not all, of their revenues in local currency.

In this study, we have sought to highlight the key impediments to the growth of Private Debt and steps that key stakeholders such as governments and institutional investors can take to catalyse the growth of the Private Debt market in Africa.

1.3 Findings From Stakeholder Interviews

The Lion's Head team engaged with a broad spectrum of stakeholders in the study's focus markets (Nigeria, Kenya, Ghana and Morocco) including pension funds, mutual funds, insurance companies, banks, regulators and policymakers. The needs identified by stakeholders in the focus countries are summarized below. Specific recommendations to address the identified constraints are covered in section 1.4.

1.3.1 Nigeria

- **Capacity constraints**: Private Debt investment requires a specialised skillset. New private debt funds might struggle initially given the importance of a demonstrable track record and ability to produce returns, especially in the view of institutional investors seeking reputable fund managers to diversify their assets.
- **The attractiveness of the Private Debt asset class**: The market for local private debt funds is growing (e.g., Chapel Hill Denham's Nigeria Infrastructure Debt Fund [NIDF] and Stanbic IBTC which also recently launched an infrastructure debt fund). Broadly, there is a desire for greater diversification of investment opportunities by institutional investors, for example, driven by the appetite for USD exposure to hedge against inflation.
- **Pension fund participation and ESG-driven investment**: While there has been much discussion around the improvement of governance and other specific issues, ESG factors as a whole are not key drivers of investment decisions for institutional investors. This is partly due to a lack of standardisation in practice, but also because these investors are still largely focused on managing risk and return. Nevertheless, some external players are driving change in this regard (e.g., international banks with established Nigeria operations) and the expectation is that this will gather pace, particularly with regulatory support.
- **Crowding-in investments**: Alongside tenor and pricing, institutional investors in Nigeria remain focused on the security and structure of potential transactions. There has been ongoing engagement among players such as PenCom, PenOP, InfraCredit, etc., leading to the exploration of innovative structures for non-traditional industries and sectors such as infrastructure, renewable energy and agriculture. There is potential for risk-sharing mechanisms that can help drive participation as well as a case for increased technical assistance, particularly to secure ratings and improve governance and financial reporting, increasing the pool of enterprises that are ready for Private Debt.

1.3.2 Kenya

- **The attractiveness of the Private Debt asset class to institutional investors**: While in more developed markets Private Debt offers a risk-adjusted diversification opportunity for institutional investors compared to traditional asset classes such as

stocks and bonds, government securities in Kenya are relatively high yielding (offering ~12% interest on the 10-year treasuries). There is therefore low appetite for riskier Private Debt by institutional investors who have access to attractive, relatively risk-free returns offered by government securities that are compliant with investment allocation guidelines by regulators.

- **Risk Management:** Risk protection is a key consideration for institutional investors to increase their allocations to Private Debt. Given other available investment options, Private Debt funds seeking institutional investor capital will need to incorporate capital protection measures such as guarantees, at least in the initial years, to give much-needed comfort.
- **Preference for local currency investments:** The lack of local currency investment options is a concern for institutional investors seeking access to diversified assets. Domestic investors felt there is not enough consideration paid to local currency capital and its advantages as compared to hard currency financing and would want access to Private Debt transactions structured with a local currency component to give more investment opportunities.
- **ESG factors as a driver of investment attractiveness:** For many institutional investors, ESG factors as seen as a "good to have" in addition to other characteristics of an attractive investment but are not necessarily a key driver for institutional investor decisions. Financial returns are seen as the key driver for investments with ESG considerations as secondary. Local institutional investors will not consider a project with high ESG scores if the returns do not meet their thresholds.
- **Regulatory concerns:** Regulators are supportive of market development and innovative products; however, they remain cautious given the history of previous commercial paper defaults that led to investor losses and damaged market confidence including causing criticism of the regulators.
- **Capacity constraints:** Capacity constraints impede the growth of institutional investor participation in Private Debt. These constraints exist along the whole investment spectrum from pipeline generation to transaction structuring and closing. Training and education would be required at several levels to create comfort and get the key decision makers aligned especially for pension funds – trustees, fund managers and boards. The training is viewed as a continuous process over time, rather than a one-off engagement with the institutional investors.
- **Potential for new Private Debt funds:** Investing in Private Debt through third party funds is a welcome option, but track record is critical. Institutional investors are open to a new asset class but would prefer to deal with established debt fund managers with a track record and not first-time fund managers. Institutional investors would not want to bear the costs of the learning curve and would prefer third-party guarantees to protect their capital.

1.3.3 Ghana

- **General attractiveness of Private Debt:** Institutional investors predominantly invest in fixed income and equities, heavily weighted towards government debt securities. There is a desire to diversify investment options, however, the major challenge with Private Debt would be to outperform government securities.
- **Credible Private Debt funds would be welcomed:** Having direct exposure to Private Debt instruments and setting up all the required systems to originate, approve and monitor the direct deals would be a challenge for institutional investors. The preference would be to outsource these functions to a specialist fund manager experienced in Private Debt. Investments in emerging Private Debt funds are being discussed by fund managers and pipeline transactions have been identified, providing a level of momentum for the nascent asset class.
- **Regulations remain central to market activity:** The country's financial and capital markets are recovering from the collapse of multiple financial institutions, including

non-bank financial institutions and commercial banks (the regulator revoked 9 bank licences in 2018), as well as several high-profile capital markets defaults. Government and regulators were blamed for the sector collapse, prompting calls for more stringent regulations, with regulators appropriately incentivised to avoid a recurrence of the situation. New regulations for pension funds and fund managers were issued in September 2021 to ensure the safety of assets, diversify investment options and increase institutional investor participation in the Ghanaian economy. Provisions for investment in Private Debt funds exist; investments in alternative investments are capped at 25% of AUM, however, investments outside Ghana cannot exceed 5%. Unregulated Private Debt continues to be a funding option for SMEs in Ghana, given their inability to access affordable, long-term debt from commercial banks, prompting them to seek alternative solutions. However, there is a level of risk that regulators and government bodies will be keen to define and ringfence such that innovation may continue, but not at the expense of systemic stability.

1.3.4 Morocco

- The desire for additional investment opportunities: There is a strong appetite among insurance companies, mutual funds and pension funds for senior corporate credit instruments in Morocco. This appetite is driven by higher potential returns compared to local government bonds and subsequent portfolio diversification benefits. Both institutional investors and the banking sector are well funded and looking to deploy liquidity into Private Debt; however, there are several constraints including the market structure and regulatory constraints explained below.
- Market structure: The supply of credit by traditional lenders is skewed toward large blue-chip corporates while the SME sector, which accounts for the majority of enterprises in Morocco, is underserved by local lenders and investors. Reasons include informality in governance, financial transparency concerns, and overall lack of investment readiness. Lenders also lack the frameworks and tools to assess SME credit risk. In response, the government has launched several thematic programmes for priority sectors to kick-start SME lending growth, financed by major DFIs/MDBs like the European Investment Bank (EIB). The financing offered by these thematic programmes can be subject to capped margins, in effect distorting the market risk-adjusted returns. In the capital markets, more stringent requirements to issue and list bonds represent a key barrier for many SME issuers. Local issuers access the bond market to raise junior (subordinated) or hybrid instruments, which do not match the standardised risk appetite of Moroccan investors. The combination of all these factors has translated into a credit market with supply concentrated towards large blue-chip companies, predominantly in the loan sector. As a result, this market segment is very price competitive while the SME sector remains underserved.
- Lack of "quality" issuers: As a result of the aforementioned structural constraints, there is a perceived lack of investment opportunities in the private sector. This is driven in part by a lack of frameworks and tools to assess non-standard credit risk, and in part by the overall low investment readiness of potential borrowers. Institutional investors would benefit from expert assistance in developing and implementing credit review frameworks and tools to evaluate and measure non-standard credit risk.
- Regulatory constraints: the regulatory framework currently does not allow the full spectrum of domestic investors to participate in the Private Debt market. For institutional investors, the regulatory framework sets constraints for asset allocation further restricting the scope of allocation to corporate credit. For example, local institutional investors can only invest in instruments denominated in local currency (for example, 95% of technical reserves of insurance companies must be denominated in Moroccan Dirhams). In addition, domestic investors must allocate a large portion of their AUMs (e.g., a minimum of 30% for insurance companies) to local government bonds that have been a low yielding asset in today's market context (for reference, 5-year government bonds are yielding approximately 2%).

- **Regulatory progress:** There is an appetite for the development of the Private Debt market in Morocco with mutual funds and local regulators working to create a framework to allow for additional asset classes. A securitisation law was passed in 2013, introducing the possibility for institutions managing securitised collective investment funds to grant loans to finance the acquisition or holding of eligible collateralised assets, which institutional investors can acquire. The existence of securitised products would allow institutional investors to tap the loan market or tailor the credit exposure across various issuers, tenors, or capital structures. However, the framework governing the operationalization still needs to be implemented, setting the conditions for prudential and supervisory rules and the procedures for carrying out these operations. A new securitisation framework is currently under development by the Ministry of Finance, the Morrocan Capital Markets Authority (AMMC) and other market participants to complement the existing law. There is a strong interest by the AMMC for this project to be implemented and the regulator expressed interest in receiving support to inform the development of this framework based on international benchmarks and best practices.
- **ESG factors:** The level of ESG considerations in investment decisions depends on the size and footprint of each institutional investor. International institutional investors are more advanced in implementing ESG into their investment thesis. Some institutions have developed internal frameworks for ESG scoring to supplement the credit risk analysis to make decisions. For local institutional investors, the concept of ESG remains nascent.

1.4 Key Recommendations

The recommendations below cover key aspects that need to be addressed to catalyse local institutional investor participation in Private Debt in the focus countries. Cross-cutting recommendations that apply to all the focus countries include:

- **Introduce credit enhancement facilities (monoline funds) in the focus markets specifically tailored for institutional investors to encourage them to invest in Private Debt.** Institutional investors cite risk protection as a key factor. That means new Private debt funds will need to demonstrate a successful track record. However, even the experienced fund managers may not demonstrate a track record in specific markets and therefore it is critical for the private debt funds to encompass some level of credit enhancement to encourage fund managers to consider investing in Private Debt. This could range from first-loss capital to partial guarantees to incentivise institutional investors to invest in Private Debt funds. Box 1 illustrates the role InfraCredit plays in risk-sharing and deepening institutional investment in infrastructure in Nigeria, a model that can be adopted to grow Private Debt in the focus countries.

Box 1: InfraCredit Nigeria

InfraCredit is a Nigerian specialised infrastructure credit guarantee institution, backed by the Nigeria Sovereign Investment Authority, GuarantCo (a Private Infrastructure Development Group company), KfW Development Bank, Africa Finance Corporation, InfraCo Africa and the African Development Bank. It provides local currency guarantees to enhance the credit quality of infrastructure asset debt instruments helping mobilise long term debt financing for infrastructure in Nigeria. The AAA-rated (Nigeria) institution's guarantees catalyse investment from pension funds, insurance firms and other long-term investors, deepening the Nigerian debt capital markets.

InfraCredit helps motivate investment in long term bonds by institutional investors to finance infrastructure assets. Eligible Sectors are gas to power, social infrastructure (housing, hospitals, education), inputs to infrastructure (goods, equipment, materials),

agriculture, power, renewable energy, ICT/telcom, waste management, transportation, and water distribution. InfraCredit has;

- mobilised NGN84Bn of domestic capital from pension funds;
- supported 7 first time issuers accessing the capital markets;
- created 2,302 jobs in Nigeria; and
- supported 8 infrastructure projects to reach financial close.

To expand its impact, InfraCredit recently signed a Technical Assistance Agreement with FSD Africa under which FSD Africa will provide TA funding for pre-feasibility studies as well as the pre-transaction and transaction costs, including the design of innovative financing solutions for eligible projects that can issue climate-aligned local currency infrastructure bonds.

Market Impact

InfraCredit provided a guarantee for a first-time issuer's Pan African Towers (PAT) issuance of NGN 10Bn 10-year Senior Guaranteed Fixed-Rate Series I Infrastructure Bonds Due 2032. On the strength of the guarantee, the PAT Series I Bonds were accorded a 'AAA' long term credit rating by Agusto and Co. and GCR. The Bond issue was oversubscribed by 127% by ten institutional investors, including the domestic pension funds and insurance companies. Proceeds will finance the acquisition of environmentally friendly tower sites to enhance telecommunication coverage and service quality and reduce carbon footprint in the sector by replacing diesel generators with renewable energy sources. The bonds were attractively priced, providing an avenue for pension fund managers to diversify their portfolios with risk-adjusted return yielding assets.

Source: *InfraCredit, FSD Africa*

- Increase data access: There is a dearth of data regarding Private Debt transactions in Africa illustrating a need for platforms linking lenders and borrowers and reporting closed deals for reference, education, and trend analysis. An initiative like the Climate Bonds Initiative[1] for Green Bonds tailored for Private Debt would increase awareness and encourage regulators to allow greater domestic investor participation and create greater pricing transparency.
- **Structure and seed local currency investment vehicles in the focus markets to provide exposure to local currency investments, and seek investments that allow local institutional investors to co-invest directly in Private Debt transactions or indirectly through investing in Private Debt vehicles.** The creation of local currency vehicles for specific markets would provide exposure to investment opportunities structured to fit institutional investor preferences and hurdle rates which vary from market to market. Institutional investors would then have the option to invest in Private Debt vehicles if they cannot invest directly in Private Debt deals. Given the predominance of hard currency Private Debt lending and the common failure to price in the expected depreciation of local currencies, most borrowers face rising debt service costs when local currencies depreciate making it more expensive to service hard currency loans. There is, therefore, a need to establish more local currency Private Debt investment vehicles that provide more price certainty for borrowers and serve as vehicles to mobilise investments from local institutional investors.

In addition to these cross-cutting recommendations, country-specific recommendations are provided below.

1 https://www.climatebonds.net/

1.4.1 Nigeria

- **Engage PenCom to increase investment avenues for pension funds by adding flexibility to invest in unlisted debt transactions.** Current pension fund investment guidelines restrict Pension Fund Administrators to investments in listed instruments, that are subject to a minimum BBB rating by two rating agencies.
- **Develop pension funds' individual capacities to evaluate transactions.** Pension funds indicated a willingness to increase the level of direct investment in non-listed instruments, given an appetite for higher-yielding instruments. Technical assistance support would be required to build internal capacity to assess and evaluate transactions.
- **Deploy targeted credit enhancement to encourage investment in early-stage infrastructure projects or smaller companies across sectors.** InfraCredit has demonstrated that there is investor appetite to invest in credit-enhanced infrastructure bonds - this model can be leveraged to support the financing of other sectors.
- **Provide support for the development of a standardised framework (structuring and documentation) for institutions to invest in Private Debt.** Potential borrowers (outside of the regulated bond markets) typically approach investors on an ad hoc or bilateral basis without fully understanding their structuring and documentation requirements. Establishing formalised and standardised requirements, together with funding for the requisite advisory support, would help increase the level of investment, especially in non-real estate transactions where the transaction structures and collateral arrangements are already well established.
- **Support creation of specialist local currency private credit vehicles.** For example, providing risk capital to funds that specialise in tailored working capital solutions for value chain businesses e.g., pharmaceuticals, agriculture, etc., that banks find difficult to finance due to non-traditional transaction structures.

1.4.2 Kenya

- **Increase the capacity of the pension funds to develop deal pipelines, structure and invest directly in Private Debt.** This could be through i). structuring local currency investment vehicles to provide investment avenues for institutional investors and ii). capacity creation for institutional investors to explore Private Debt investments. This involves the entire investment path from pipeline generation, credit assessment, deal structuring and pricing to enable local institutional investors to create and manage Private Debt portfolios.
    - o An example of an entity that would benefit from such support is the Kenya Pension Funds Investment Consortium (KEPFIC)[2] which brings together 27 pension funds looking to mobilize their institutional capital for infrastructure and alternative asset investments in East Africa.
- **Provide first-loss capital and credit enhancement facilities (monoline funds) to promote Private transactions perceived to be risky** to encourage additional institutional investor participation and particularly from first time institutional investors to gain experience and comfort in Private Debt investment.
- **Encourage public disclosures for institutional investors on asset allocations and performance per asset class.** This will allow institutional investor Trustees to be able to make informed judgements when awarding fund management mandates. Regulators would set the minimum thresholds for assets under management for these disclosures to avoid overburdening smaller institutional investors with additional reporting requirements.

2 https://kepfic.co.ke/

1.4.3 Ghana

- **Support precedent and demonstration transactions for Private Debt.** This could be through supporting fundraising efforts or investing in emerging Private Debt funds e.g., Ashfield Investment Managers. Support could also include underwriting institutional investor investments in the new funds.
- **Provide first-loss capital and credit enhancement facilities (monoline funds) to promote Private transactions perceived to be risky** to encourage additional institutional investor participation and particularly from first time institutional investors to gain experience and comfort in Private Debt investment.
- **Support capacity-building efforts to promote the participation of regulated investors in the Private Debt market.** Support could be through providing TA funding for workshops bringing together different stakeholders such as government regulators and institutional investors, and engagement with regulators to provide specific Private Debt guidance to institutional investors. Technical assistance to develop local rating methodologies may also help develop the market by enabling institutional investors to have a better understanding of risk and build confidence in the asset class. Support here would go towards the training of domestic rating agencies by providing TA funding and partnering with regional rating agencies (e.g., GCR and Agusto) to train local rating institutions to support the growth of local ratings. Finally, TA would assist prospective Private Debt issuers to prepare for credit ratings that would allow potential investors to objectively evaluate the risk of transactions against their investment guidelines.

1.4.4 Morocco

- **Support ongoing regulatory reforms that will set the course for the expansion of Private Debt investment opportunities in future.** The Capital Markets Regulator expressed interest in receiving support to develop frameworks that will enable institutional investors to increase their participation in debt markets. This involves supporting the dissemination of knowledge to regulators on existing regulatory frameworks and case studies on other jurisdictions. A new securitisation framework that would benefit from such support is currently under development by the Bank Al-Maghrib, the AMMC and other market participants to complement existing laws. Securitised debt will expand the portfolio of credit instruments available to local institutional investors and lay the foundation for future engagement to develop the Private Debt sector in Morocco.
- **In tandem with the regulatory reforms, it is essential to provide capacity building and support to develop risk assessment frameworks for institutional investors to invest in Private Debt.** This would support precedent and demonstration transactions.
- **Introduce credit enhancement facilities (monoline funds) specifically tailored for Moroccan institutional investors to encourage them to invest in Private Debt once regulations permit them to invest in Private Debt funds.** Facilities including first-loss capital and guarantees would incentivise institutional investors to invest in Private Debt funds to support precedent-setting and demonstration transactions.

2

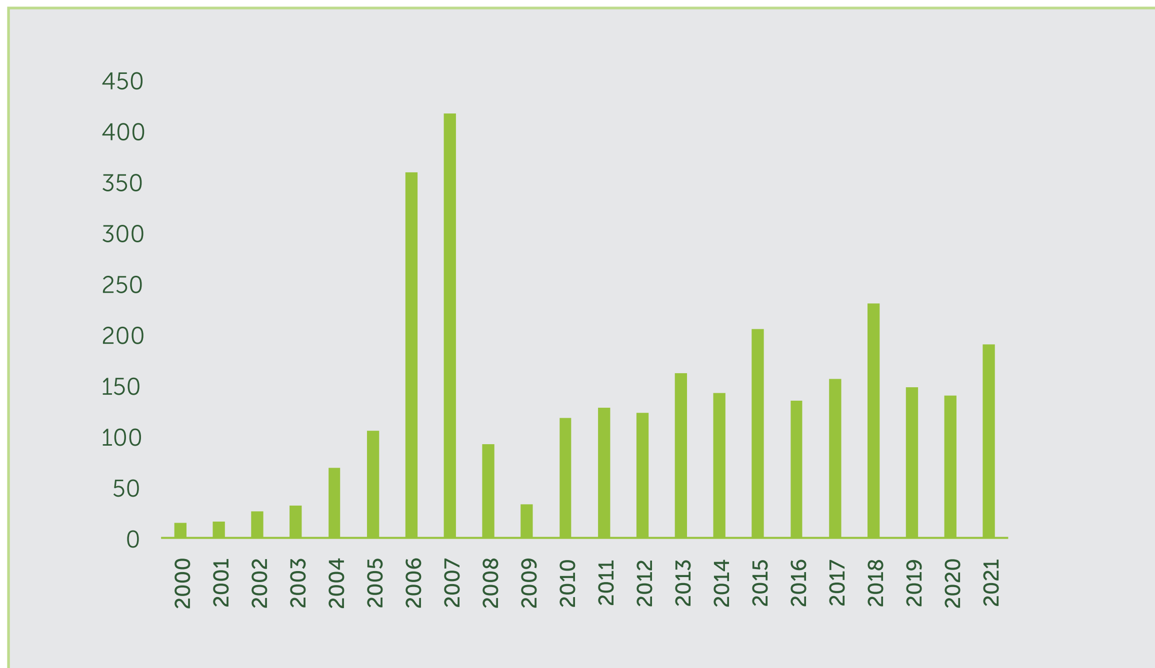
Introduction

Private Debt markets increasingly play an important role in various sectors of global economies and could play a strong role in infrastructure funding and financing the growth of high potential SMEs in Africa. Despite its potential, the Private Debt asset class represents only a fraction of the long-term finance in African economies. Domestic institutional investors in Africa hold significant assets under management, with most invested in traditional assets and are therefore a potential source of the private capital required for the development of the continent through increasing participation in Private Debt.

2.1 Classification of Private Debt

Private Debt is the investment of debt capital in companies in a non-listed format. In developed markets, this includes all forms of debt finance outside public markets, the syndicated bank loan markets and the direct bank loan markets. Commercial banks participate in Private Debt, but to a lesser extent than specialist debt funds. Private Debt or Private Credit is part of the "alternative investments" asset class and first came to prominence in the credit boom that preceded the Global Financial Crisis ("GFC"). Indeed, many would argue that the explosion of Private Debt which was then repackaged into listed rated bonds was one of the causes of the crisis.

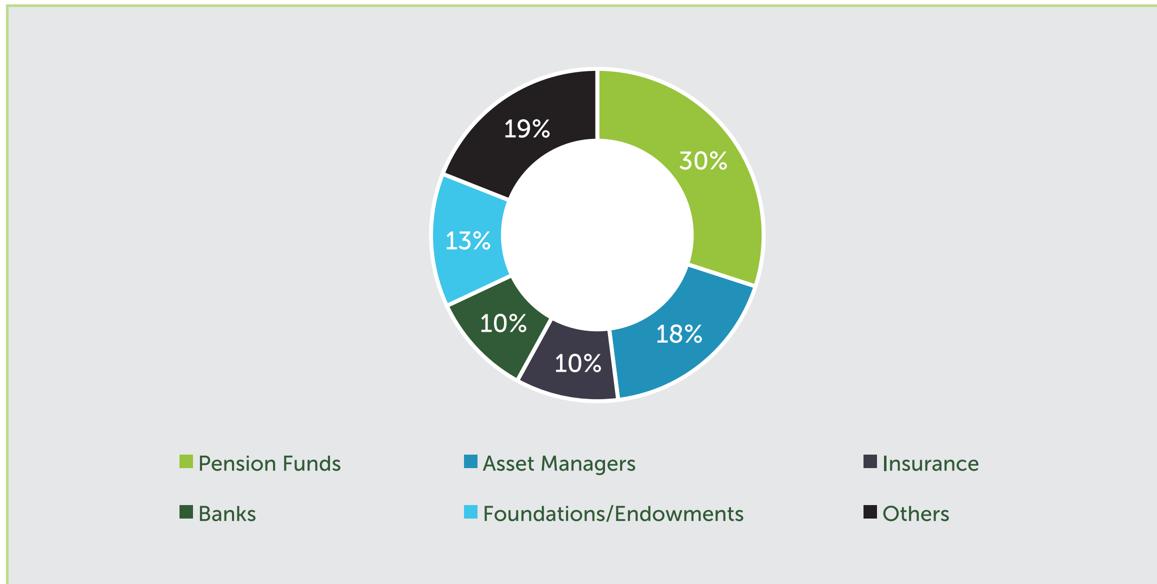
Figure 2: Global Private Debt Issuance (USD Bn)



Source: *Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

Since the GFC, however, Private Debt has continued to play a significant role in the overall capital market filling a gap left by the commercial banks and listed markets which have increasingly focused on larger transactions in the search for liquidity. In contrast, the illiquid Private Debt markets have offered a yield pick-up and have become an interesting asset class for buy-and-hold investors such as pension funds, insurance companies and endowments as illustrated in Figure 3.

Figure 3: Private Debt Investor Allocation



***Source:** Global Private Capital Association*

Private Debt has characteristics similar to commercial bank loans. The debt is usually secured and has various covenants in place to protect the investor, is not widely held, and is customised to the borrower's requirements, reducing its liquidity.[3] Strategies covered by Private Debt differ in tenor, capital structure and return profile. Key strategies employed are direct lending, mezzanine, distressed debt, and special situations.[4]

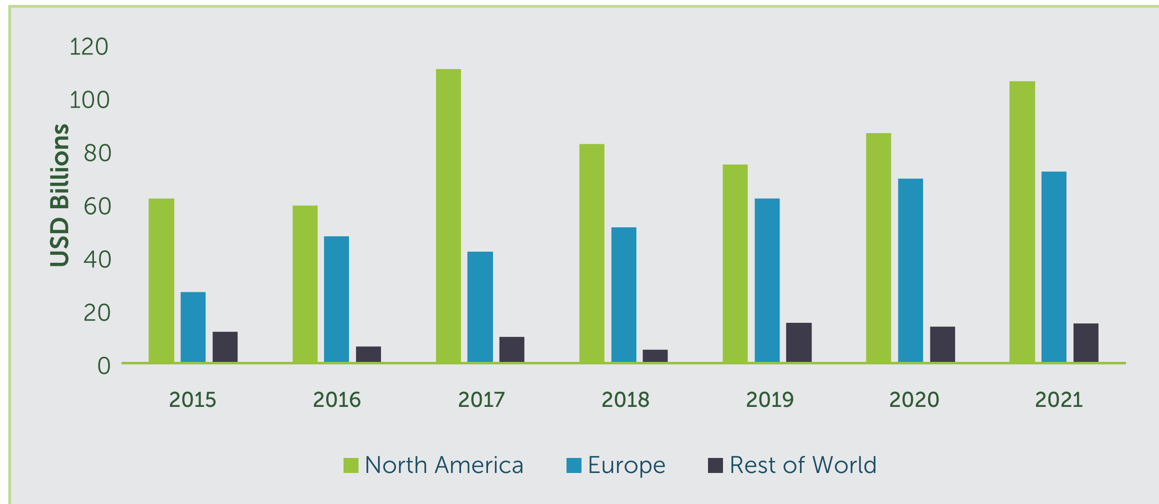
Table 1: Private Debt Strategies

STRATEGY	DESCRIPTION
Direct Lending (Senior Debt)	• Loans (frequently senior secured) that are issued directly to companies. • Contractual coupons may constitute the entirety or a portion of the investment's return.
Mezzanine	• Instruments sit between senior debt and common equity in a firm's capital structure. • Highly customisable with a blend of contractual and performance-based pay-outs.
Distressed Debt	• Discounted debt securities of operating companies or assets.
Special Situations (Credit Opportunities)	• Investments in a broad mix of distressed companies/assets, with potential for event-driven or restructuring opportunities, and rescue/turnaround situations.

3 Mercer (2017) Private Debt in an Institutional Portfolio
4 EMPEA (2019) Private Credit Solutions: A Closer Look at the Opportunity in Emerging Markets

The largest market for Private Debt is the United States, followed by Europe and to a lesser extent Asia. Currently, countries outside the US, Europe and Asia account for less than 2% of global Private Debt issuance annually. In the United States and European markets, Private Debt is a recognised asset class for institutional investors providing potential for attractive risk-adjusted returns and important for portfolio diversification. In these markets, Private Debt comprises corporate debt, real estate debt, infrastructure debt, distressed debt, direct lending, bridge financing, and venture debt, and could be senior or subordinated/mezzanine loans.

Figure 4: Global Private Debt fundraising by region (USD Bn)



Source: *Preqin*

Box 2: Private Debt Characteristics

Lender-Borrower Relationship	• Lending to private sector companies on a bilaterally negotiated basis • Lenders for direct relationships with borrowers to understand their businesses and may join company boards to provide additional expertise and direction • Involves tailored debt structures, not off the shelf lending products e.g. by banks • Can be extended to both listed and unlisted companies, as well as real assets such as infrastructure and real estate
Higher Risk	• Private debt providers can consider credits that are sub-investment grade with instruments that tend to have shorter tenors. The higher risk is priced into the expected returns
Limited Liquidity	• Private debt instruments have limited liquidity • However, lenders can compensate by applying a liquidity premium
Contractual Returns	• Transaction structure with predictable payments linked to interest rate and tenor • Potential for additional upside given flexible structure e.g. can include equity kicker to enhance returns
Credit Analysis	• Needed for thorough due diligence of privately held information • May require additional comfort in the form of parent company or shareholder guarantees and other collateral

Source: *Alternative Credit Council, Preqin, Global Private Capital Association, LHGP analysis*

2.2 Advantages and Disadvantages of Private Debt

Private debt provides advantages to both lenders and borrowers in terms of tailoring to fit borrower needs, visibility into cash flows over the life of an investment, flexibility in collateral and tenor as well as achieving intended returns. The asset class also has drawbacks including complexity in structuring and the need for proactive management of transactions to monitor covenants and other lender rights. These are summarised in Table 2.

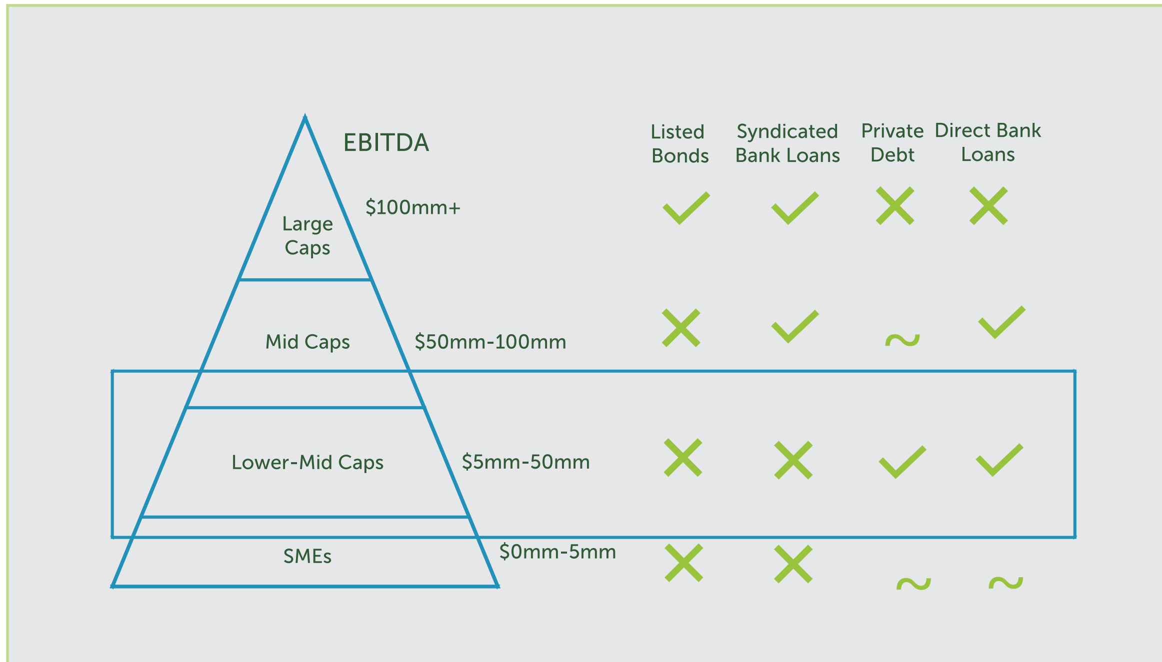
Table 2: Advantages and disadvantages of Private Debt

	ADVANTAGES	DISADVANTAGES
Borrowers	• A less costly alternative to equity as debt is for a fixed term. • Private debt funds are typically able to structure and disburse faster than other lenders; can structure products that suit businesses and sector-specific circumstances. • Private debt offers a range of tenors and repayment profiles taking into account different types of security, structure, collateral and seniority. • Opportunity to strengthen governance and ESG through lender board participation. • Benefit from safeguards and borrower protection rules.	• A less patient form of capital as compared to equity. • Borrowers may lack the internal capacity to negotiate complex structures with lenders. • Borrowers may lack the internal capacity to effectively manage and mitigate foreign exchange risks. • Increased board oversight due to lender participation can inconvenience borrowers.
Lenders	• Private Debt offers higher yields than traditional debt securities and fixed income securities. • Private debt offers diversification potential for capital providers. • Built-in liquidity premium and cash yield. • More predictable returns than equity given its contractual nature. • In the event of default, debt typically has priority over other claims. • Default risk can be mitigated with adequate monitoring and covenants.	• Limited information on borrowers. • Requires specialist expertise to analyse and price risk. • Requires investment pipeline development and due diligence - lenders typically only invest in a small percentage of businesses assessed. • Like commercial debt, requires proactive management of credit risk to ensure that covenants are not breached and deal with signs of distress.

Source: *Alternative Credit Council, Preqin, Global Private Capital Association, LHGP analysis*

As illustrated by Figure 5, globally, Private Debt occupies a niche between direct bank lending and the large-scale public bond and syndicated loan markets. It is especially attractive for the lower-mid-sized company sector but spans the full range from mid-sized to SME companies.

Figure 5: Taxonomy of Private Debt

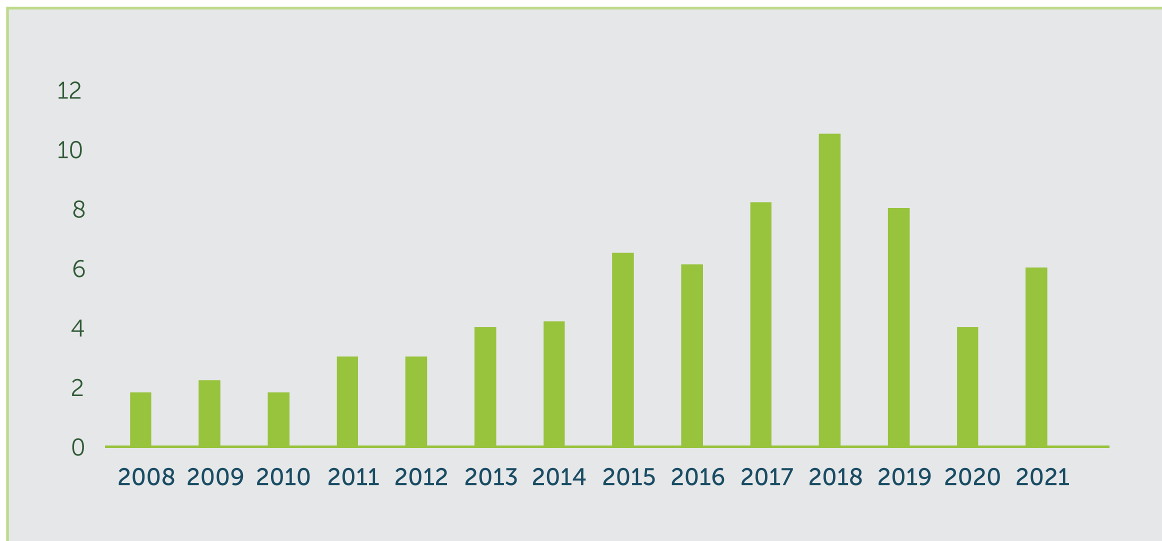


***Source:** LHGP & Campbell Lutyens*

2.3 Private debt in Emerging Markets

The Private Debt sector in Emerging Markets hit a peak of USD 10.5Bn in 2018, before slowing in 2019 due to the tightening of credit conditions in the US and then the COVID-19 pandemic in 2020. Activity picked up in the second half of 2020 with that momentum maintained into 2021, but still at a slower pace than pre-pandemic. Emerging Asia has captured the largest portion of Emerging Market private credit fundraising, representing over 80% of the total EM Private Debt funds. In contrast, the total number of firms operating in private credit in Central and Eastern Europe, Africa, and the Middle East remains limited.

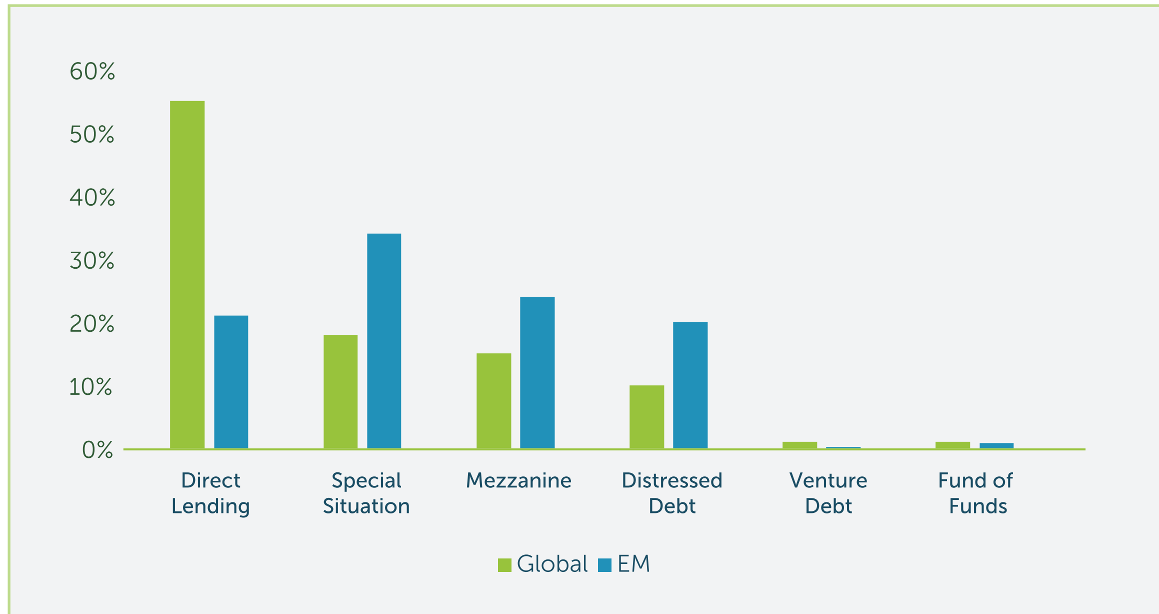
Figure 6: Emerging Market Private Debt fund volumes raised (USD Bn)



***Source:** Preqin, Global Private Capital Association, Financial Times*

The Emerging Market Private Debt strategies also differ somewhat from the global picture. The weighting is skewed to specific strategies – Special Situations, Mezzanine and Distressed as compared to the dominance of Direct Lending which reflects the relative disintermediation of banks that has occurred primarily in the US, but to a lesser extent in Europe also, but has yet to occur to the same degree in the emerging markets.

Figure 7: Market Share Comparison of Global vs EM Private Debt Strategies



***Source:** Preqin, Global Private Capital Association, Financial Times*

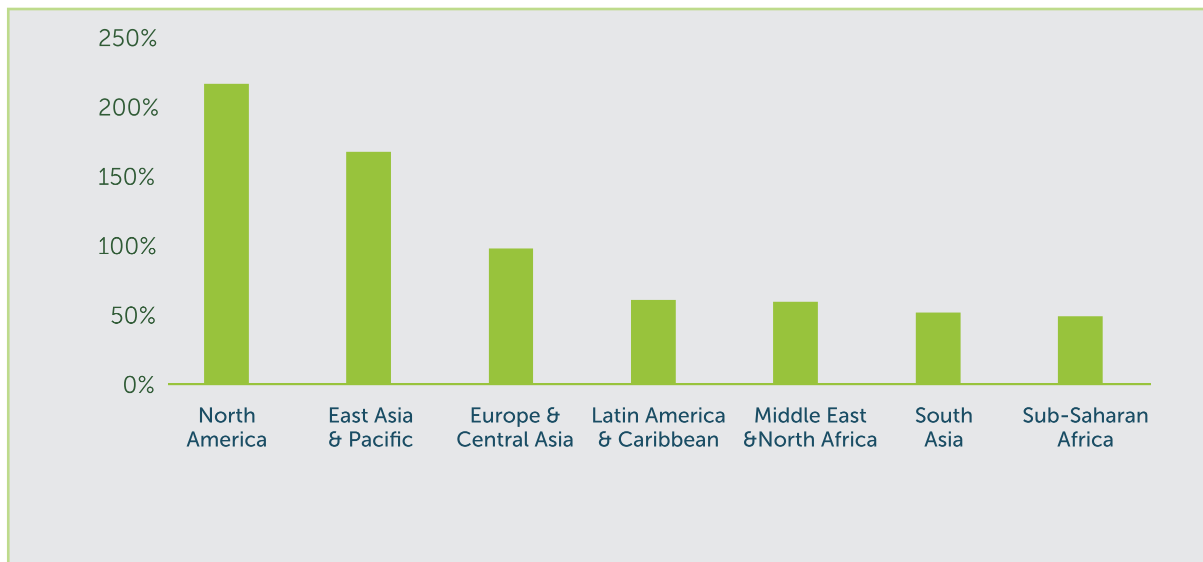
3

Private Debt activity in Africa

Sub-Saharan Africa lags other regions around the world in access to credit indicators as measured by credit provided to the private sector as a percentage of GDP.

In Africa, Private Debt is a small but growing sector of the market, attracting growing interest from international and African Investors. Historically, the leaders in Private Debt have been the Development Finance Institutions and Multilateral Development Banks, but direct Private Debt fund transactions are growing in importance.

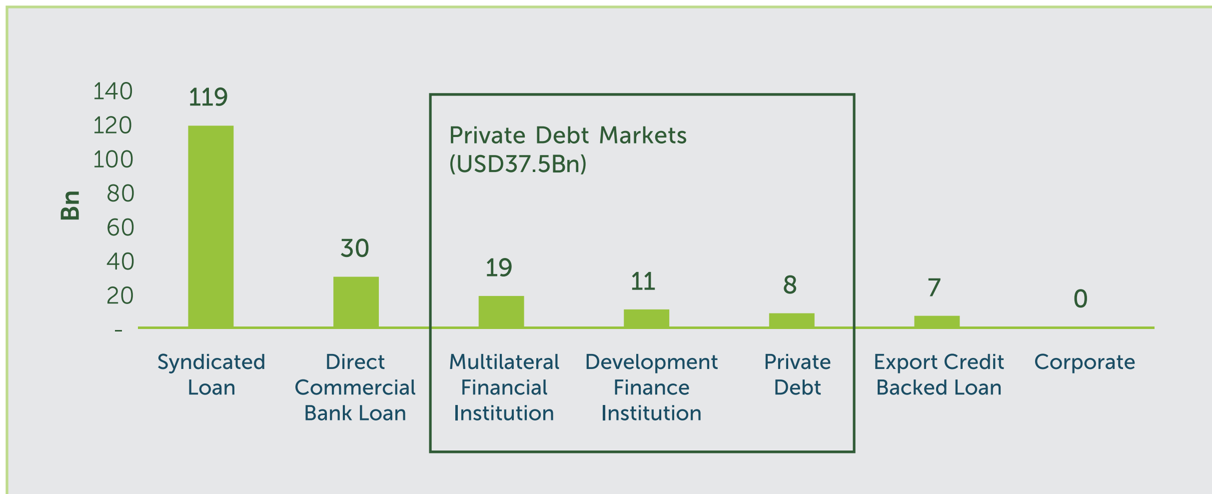
Figure 8: Credit to the Private Sector as a % of GDP



***Source:** World Bank Development Indicators*

For this study, Lion's Head collated a database of private sector transactions executed in Africa between 2015-H12021. This data set required collation from multiple sources, with the data then cleaned to eliminate duplication. In total, we identified USD 193Bn of transactions over this period. Of this, USD 37.5Bn could be classified as Private Debt transactions with USD 8Bn of non-DFI and MDB transactions. However, we note that the largest investors in the funds that make up the USD 8Bn of transactions are also currently the MDB and DFI communities.

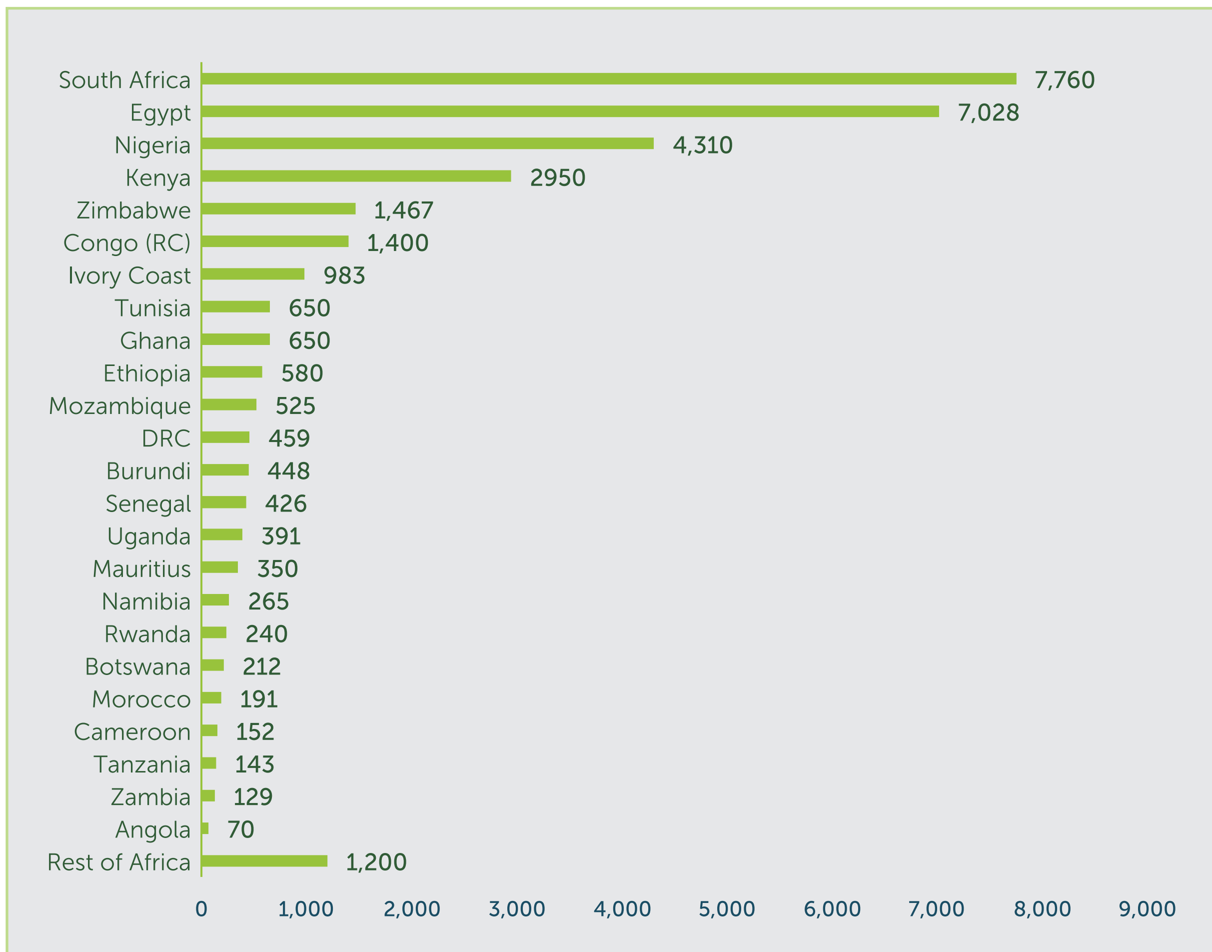
Figure 9: Source of lending (USD Bn, 2015-H1 2021), Total=193Bn



Source: *Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

Figure 10 illustrates the relatively small scale of the Private Debt market in Morocco compared to the rest of the focus countries.

Figure 10: DFI, Multilateral and Private Debt Fund lending by country (USD m, 2015-H1 2021, total transactions =USD 37.5Bn)



Source: *Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

Narrowing down to the focus markets, the relative importance of the Private Debt markets in Africa can be seen.

Figure 11: DFI/MDB vs non-DFI/MDB funding (USD Bn)

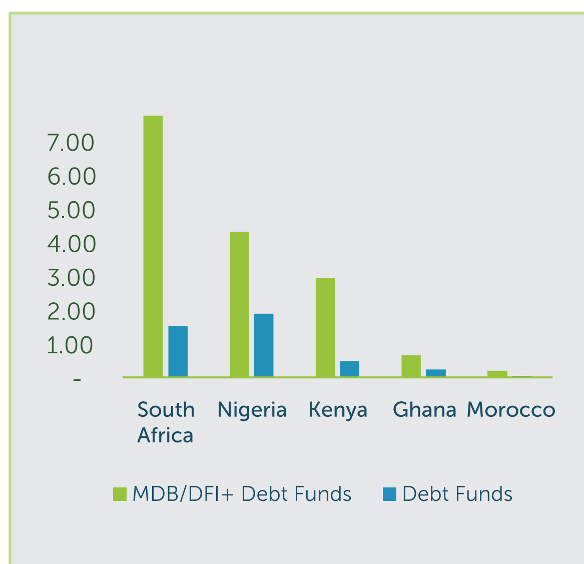
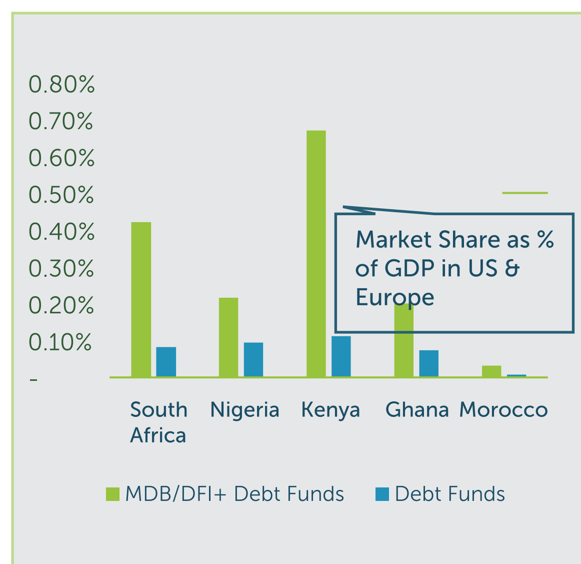


Figure 12: Private Debt as a percentage of GDP



***Source:** Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

Figure 11 illustrates that South Africa has the largest Private Debt market in Africa. Analysis of Private Debt transactions in Africa showed that including MDB and DFI financing, the ratio of Private Debt to GDP is slightly lower than that of the US and Europe. The US and Europe have Private Debt to GDP ratios of 0.48% while South Africa has a Private Debt to GDP ratio of 0.42%, Nigeria's ratio stands at 0.22% and Ghana's is 0.20%. Kenya and Egypt have ratios of 0.67% and 0.56% respectively, demonstrating that Private Debt is already a key pillar of the financing landscape in these markets.

The comparison shows that Private Debt already plays an important role in several markets on the continent, however, there are limits to the use of these ratios to compare Africa and developed markets. Firstly, the African ratios include debt financing from MDB and DFI lenders while US and European ratios include only Private Debt fund financing, and secondly, there are wide disparities in the absolute Private Debt volumes and the sizes of the economies in question. When the MDBs and DFIs are excluded from the analysis, the Private Debt to GDP ratios in the focus markets would be 0.08% for South Africa, 0.10% for Nigeria, 0.11% for Kenya, 0.07% for Ghana and 0.01% for Morocco. These adjusted ratios are significantly lower than those in the US and Europe.

3.1 African Private Debt Funds

Private Debt funds have a role to play where other lenders such as commercial banks face regulatory constraints or are limited in the amounts they can lend in specific markets. Because of their unregulated nature, Private Debt funds can take more risks, be more flexible, provide longer tenor and cover multiple markets. In developed markets, Private Debt funds play an important role in working hand in hand with banks as syndication partners, and buyers of risk or assets to relieve banks' balance sheets.

African Private Debt funds broadly fall into two categories: 1) those that operate in typical bank markets– but where commercial banks remain absent due to amongst other reasons, risk aversion (SME finance), limited access to foreign currency or inability

to provide long-term financing; and 2) event-driven financings (e.g., mezzanine loans and acquisition financing) that exceed their (or their regulators') risk tolerance.

Ordinarily one would expect local institutional investors to invest in debt funds for diversification and to access private credit. Having said that, other than in South Africa and Nigeria, the biggest markets with a larger proportion of the economy financed in local currency, single country, locally funded debt funds are rare.

The momentum for Private Debt funds is building, particularly in those sectors that are of interest to the international development finance community. Figure 13 illustrates selected African debt funds.

Figure 13: Examples of African Private Debt Funds

***Source:** LHGP analysis*

Thematically, access to energy (OGEF, Sunfunder, SIMA, Triple Jump, responsAbility, Oiko Credit etc.), renewable energy (EAIF, FEI, Crossboundary, ElectriFi etc.), access to finance (responsAbility, Blue Orchard, Symbiotics, Oiko Credit etc.) and transitioning to lower carbon economies (Africa Go Green) are key areas that have attracted considerable investor interest and are largely dominated by Private Debt funds or development finance institutions.

Another asset class that is reasonably well established is mezzanine finance (BluePeak, Ethos, Vantage, Helios etc.) which has been active for several years.

Recent fund closings include Africa Go Green launched in 2021, reaching a first close of USD 39.5m and anticipating a second close of 169m in 18 months; The Facility for Energy Inclusion Offgrid and On-grid funds which have raised a combined USD 307m since 2018; BluePeak which announced a USD110m first close in 2021; Ethos Mezzanine Partners III which reached USD70m first close in 2018 and Vantage Mezzanine Fund IV which announced a first close of USD207m in July 2021. Specialist lender Sunfunder is working on a USD500m energy access fund, SIMA is expected to start fund-raising for its successor fund imminently.

DFIs and MDBs have allocated significant amounts of capital to the private sector on competitive terms and have also been major participants in the funds raised to date for this purpose. Further, they have the reach across multiple markets and decades of experience operating on the African continent. They deploy patient capital across the financing spectrum including debt, private equity and mezzanine and several DFIs have specialist credit arms to address the opportunity in the Private Debt space, for example, the BII (British International Investment, formerly the CDC Group).

The scale of Private Debt transactions in Africa is growing in number and value, with key sectors being healthcare, fintech and infrastructure including traditional and renewable energy.

Most funds raised have been backed by DFIs or Impact Investors and are seeking to make USD denominated returns. The amount of truly private institutional investors

in these funds is still limited. This has been a source of for many practitioners in the sector– it can seem counter-intuitive that in an environment where developed market interest rates remained close to zero (or even negative), not more private institutional money from the US or Europe flowed to African debt funds – especially as many of them would meet the global demand for ESG and green assets.

Globally, asset allocation to frontier and emerging markets (except for China and India) has been in decline for years. This can be explained by the tremendous rally of the US stock market which diverted attention away from almost all alternative asset classes. Furthermore, rising stock markets in the US and Europe, coupled with a massive injection of liquidity led to a jump in mergers and acquisitions activity. When stock markets are rising by 20-30% p.a., acquisitions financed with debt can create significant shareholder value, even with leverage financed rates in high single or low double-digit territory.

Against that backdrop, African markets with perceived higher risk and much lower volumes don't offer an attractive risk/return trade-off. It remains to be seen how these dynamics change when the stock market rally comes to an end. Until then, DFIs and Impact Investors will remain the principal international funders of African Debt Funds.

Africa Go Green and the Facility for Energy Inclusion funds are rare in the sector in that they can offer both hard and local currency financing, having developed the infrastructure for foreign exchange hedging. The demand for local currency financing is steadily increasing. The emergence of fully domestic funds that can offer an investment option for the local pension funds is the critical next step for the development of the Private Debt market in Africa. Currently, only South Africa and Nigeria have local currency Private Debt funds. In the case of Nigeria, the Nigeria Infrastructure Debt Fund managed by Chapel Hill Denham has been a stand-out success (see Box 3). The majority of investors in this fund are the local Nigerian pension funds.

Box 3: Chapel Hill Denham Nigeria Infrastructure Debt Fund (NIDF)

The NIDF is a local currency infrastructure debt fund domiciled in Nigeria. The fund registered a program for issuance worth N 200Bn listed on the FMDQ OTC Securities Exchange. In 2020, NIDF closed its 6th capital raise raising a total of N 58Bn (USD 190m) from 22 pension funds.

NIDF is sponsored by the Chapel Hill Denham group and Chapel Hill Denham Management Limited acts as the Fund Manager. The fund will invest in loans, securities and securitized debt instruments of infrastructure companies or projects or special purpose vehicles which are created to facilitate or promote investment in infrastructure. Target projects will be selected based on providing essential economic and social services, having long-term predictable cash flows and having asset bases with long useful lives. Target sectors are electricity generation, transportation and logistics, utilities and waste management, social infrastructure, telecommunications infrastructure, storage and transport for hydrocarbons, water treatment, transmission, and distribution.

The Fund's investment portfolio of infrastructure loans and other securities targets a gross return of 3.00% to 4.50% above the comparable federal government bond yields. At least 80% of the Fund's assets will be invested in senior debt, securitized debt or loans to government agencies. Not more than 20% will be invested in working capital loans, subordinated debt, preferred shares or warrants.

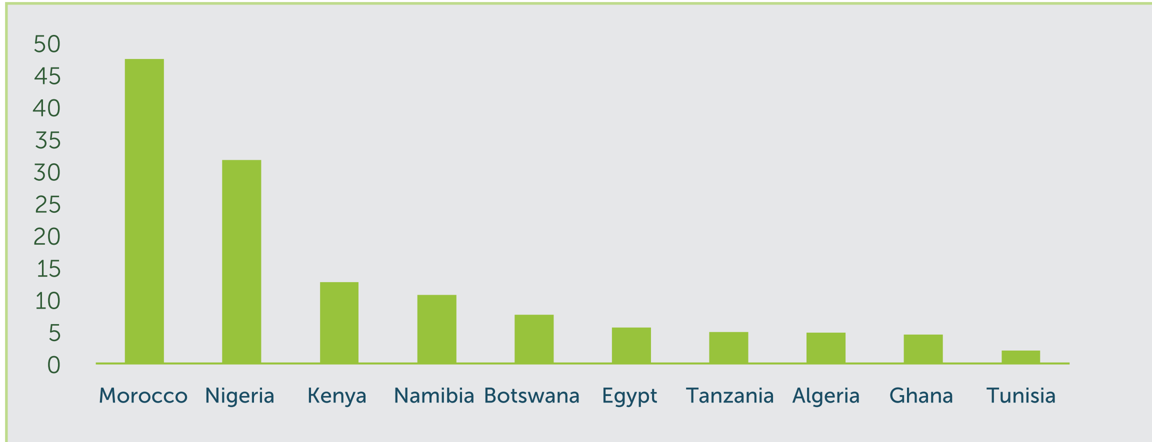
An example of an investment by the fund is USD 4.6m in the local currency equivalent investment in solar mini-grid supplier Havenhill Synergy, for the development of 22 solar mini-grids in rural Nigeria.

***Source:** Nigeria Infrastructure Debt Fund, FMDQ*

In South Africa, there are many Private Debt investors, most notably in the infrastructure sector combining specialist fund managers such as Futuregrowth, the Emerging Africa Infrastructure Fund, Old Mutual Specialist Finance, and Sanlam Infrastructure, with the strong bank sector in the form of ABSA, Investec, Nedbank, RMB/FNB and Standard Bank all of whom offer highly competitive domestic ZAR debt offerings.

The next challenge will be to encourage the pension funds of the smaller markets such as Kenya and Ghana to increase investment into domestic Private Debt vehicles. Figure 14 illustrates pension assets in selected African markets (South Africa has the largest pension asset base at c.USD 300Bn but has been excluded for scale).

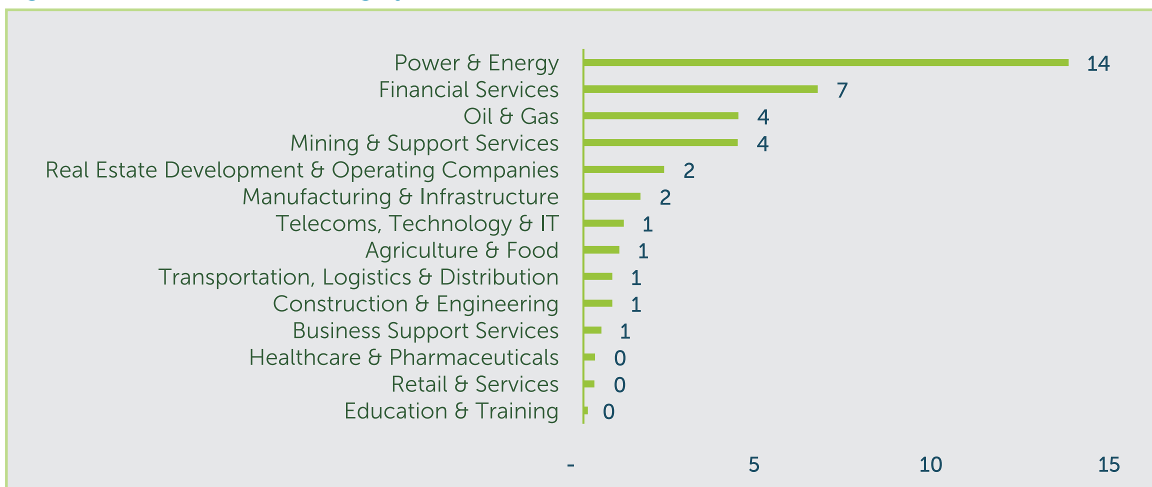
Figure 14: Pension Assets in Selected Countries (USD Bn)



***Source:** FSD Africa analysis based on respective country pension regulators; OECD, AVCA, Riscura, IFC, SFW Institute*

Although Private Debt is permitted in the focus markets, their pension funds have been slow to shift their asset allocations, not least because of the attractive domestic yields offered by government bonds. In Kenya where regulations allow for up to 10% of assets under management to be invested in Private Equity and Venture Capital, investments grew from KES 969 million (USD 8.47m) in December 2019 to KES 1.17 Bn (USD 10.22m) in June 2020. In Nigeria, at the end of 2020, pension funds had committed NGN 35.4Bn of assets (USD 92m) of assets or 0.29% of assets to Private Equity as compared to the 5% ceiling allowed by regulations.[5]

Figure 15: Private Debt Funding by Sector (USD Bn, 2015-H1 2021), total transactions = USD 37.5Bn



***Source:** Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

5 AVCA 2021 Pension Funds and Private Equity in Nigeria

Sectors receiving financing

The largest funding recipient sectors of Private Debt financing (from DFI, MDB and Private Debt funds) in Africa were power and energy, oil and gas, financial services and mining support services accounting for 77% of the total transaction value.

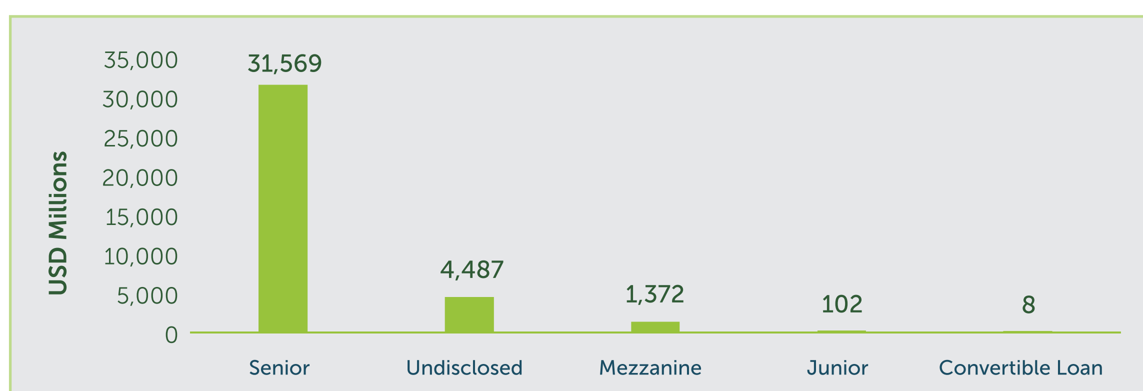
Sources of financing

Multilateral finance institutions and DFIs provided the largest proportion of Private Debt to the continent (78% of Private Debt transactions) while Private Debt funds accounted for 22% of transactions.

Lending structures

Senior debt was the predominant lending structure in Private Debt transactions (accounting for 84% of Private Debt transactions).

Figure 16: Private Debt transaction structures (USD m 2015-H1 2021), total transactions = USD 37.5Bn



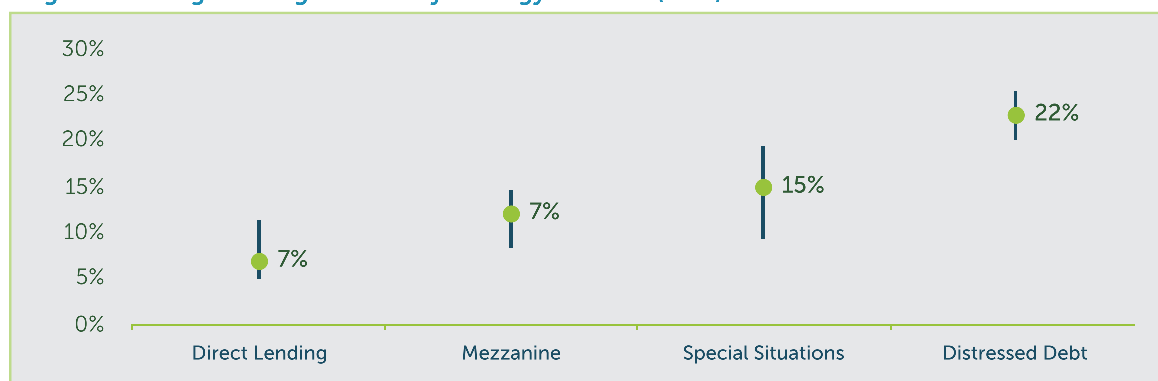
Source: *Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

3.2 Yields, Tenors and Default Rates

Private Debt yields vary across geographies and by the strategy adopted to deal with various transaction types and risk levels. Factors that reduce returns for Private Debt include credit losses, trading costs, foreign exchange hedging costs and management fees as they all eat into the realised yields. In Africa, the dominance of the DFI/MDBs has kept transaction pricing at the lower end relative to other developing markets, with strong private sector transactions attracting DFI pricing of 5-6% for USD debt. As more Private Debt transactions are executed and a greater track record develops, we anticipate that transaction pricing will become more predictable across issuer types and strategies.

Yield ranges are illustrated in Figure 17. Loan tenors are typically 7-12 years, though there is a wide range of tenors depending on the specific transaction structure for example working capital loans would range from 1-3 years.

Figure 17: Range of Target Yields by strategy in Africa (USD)



Source: *Global Private Capital Association, LHGP analysis*

Private Debt funds typically do not publicly report their realised returns, however, target returns for debt funds typically range from 7%-12% for senior debt and 12-16% for mezzanine debt.[6] For MDBs, lending rates are typically benchmarked to a market rate plus a target margin as illustrated in Table 3:

Table 3: MDB and concessional funder lending rates

CONCESSIONAL FUNDER	PRICING RANGE (USD)
African Development Bank	0.15%+project risk-specific lending spread
Asian Development Fund [7]	1-2%
Green Climate Fund [8]	0-0.75%
International Development Association [9]	3.125-6.8%
Inter-American Development Bank [10]	0.25% - LIBOR-based rate

Default rates for the investments also vary significantly depending on country risk, the strategy employed, and the stage of growth of the investee. In the Infrastructure and Project Finance sectors, Moody's analysis of default rates globally between 1983-2015 is presented in Table 4 for illustration (these rates cannot be generalized to Private Debt lending across African markets).

6 LHGP Analysis

7 Asian Development Bank (2021) Public Sector (Sovereign) Financing https://www.adb.org/what-we-do/public-sector-financing/lending-policies-rates

8 Green Climate Fund. (n.d) Financial Terms and Conditions of Grants and Concessional Loans https://www.greenclimate.fund/sites/default/files/document/financial-terms-conditions-grants-loans.pdf

9 World Bank (2021) IDA Financial Products Lending Rates and Fees https://treasury.worldbank.org/en/about/unit/treasury/ida-financial-products/lending-rates-and-fees

10 Inter-American Development Bank (n.d) Concessional Financing Terms and Conditions of Investment (INV) and Policy Based (PBL) Blended Loans: https://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=35770512

Table 4: Average Default Rates per Region

		BASEL II DEFINITION OF DEFAULT		MOODY'S DEFINITION OF DEFAULT	
REGION	PROJECTS	DEFAULTS	AVERAGE DEFAULT RATE %	DEFAULTS	AVERAGE DEFAULT RATE %
Africa	257	10	3.9%	7	2.7%
Asia	624	57	9.1%	52	8.3%
Eastern Europe	148	8	5.4%	7	4.7%
Latin America	408	55	13.5%	52	12.7%
Middle East	298	6	2.0%	5	1.7%
North America	1,669	138	8.3%	118	7.1%
Oceania	405	27	6.7%	24	5.9%
Western Europe	2,580	159	6.2%	98	3.8%
TOTAL	6,389	460	7.2%	363	5.7%

Source: *Moody's Analytics Project Finance Data Consortium*

Africa, despite having a higher perceived risk than other more developed regions of the world, had a lower average default rate. This could be because there were fewer projects in the region, potentially selected more carefully and with stronger project sponsors to attract commercial financing in the first place.

In markets where more data is available, particularly the US, Private Debt borrowers tend to be smaller and have weaker credit profiles than speculative-grade companies, more highly concentrated in the lower credit profiles.[11] This aspect of borrowers is likely to be replicated in African markets where stronger borrowers typically can access commercial bank lending at competitive rates while smaller and earlier stage borrowers that may need more tailored financing structures need to rely on alternative sources of financing.

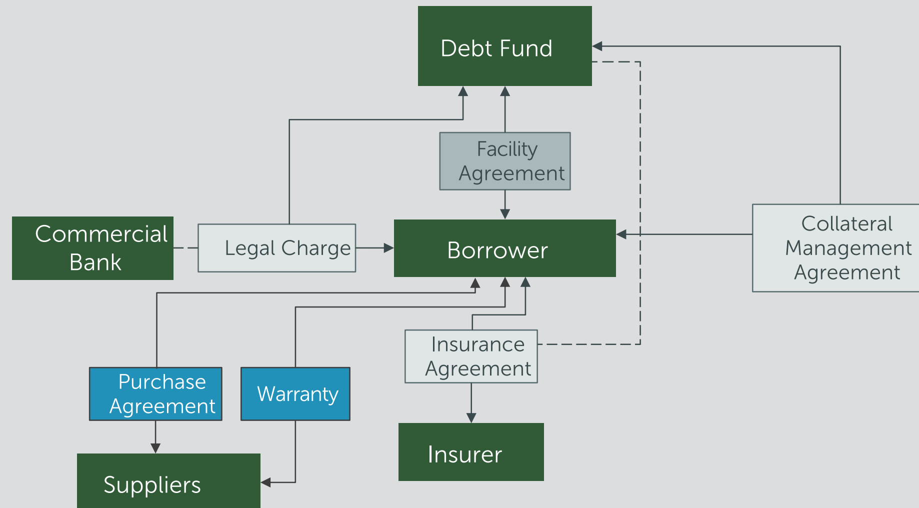
Two illustrative private debt case studies are shown in Box 4, a short tenor loan and a long-term loan.[12]

11 https://www.spglobal.com/en/research-insights/featured/private-debt

12 LHGP analysis based on fund manager interviews

Box 4: Case Study of Private Debt Transactions

The borrower, a renewable energy company providing commercial and consumer solar appliances on a lease to own model, required financing for inventory and approached a specialist lender to structure a working capital facility. Structuring the facility required the lender to have in-depth knowledge of the borrower's business model and cash flow cycles. The transaction structure is illustrated below.



Key terms:

- **Facility USD**: 2.5m
- **Currency**: USD
- **Tenor**: 2 years
- **Structure**: Senior Debt
- **Pricing**: 9% p.a.(separate from commitment and origination fees)
- **Security**: Inventory

The borrower had existing bank lenders financing other aspects of the business; however, the bank could not structure the working capital facility secured against inventory, requiring the participation of a specialist lender.

Example 2: Long term loan

An established company required financing to build out infrastructure and secured a syndicated lending facility from a specialist Private Debt fund and multiple DFIs to finance the operations of multiple subsidiaries. The transaction required a specialist Private Debt fund to create a tailored lending structure and bring in DFIs as co-investors given the fact that financing was to multiple subsidiaries without guarantees from the parent, a feature that made it hard for the company to secure an appropriate financing solution. Transaction details are as below:

- **Facility**: USD 65m
- **Currency**: USD
- **Structure**: Senior Debt
- **Tenor**: 7.5 years
- **Pricing**: LIBOR+ 7-7.5% interest rate (separate from commitment and origination fees)
- **Security**: Partially secured against subsidiaries' assets

Both transactions illustrate a key benefit of Private Debt – the ability to tailor transactions to borrowers' business models and cash flows.

3.3 Demand for Private Debt in Africa

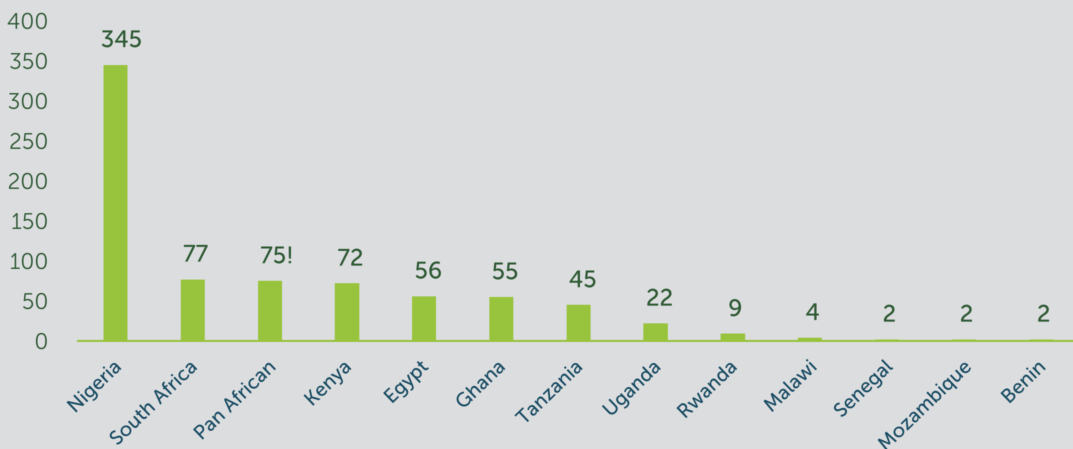
Demand for private debt is emerging driven by economic growth and the emergence of new business models that don't lend themselves to the traditional commercial debt. This study analysed demand through business life cycle stages:

Early-stage or start-up companies: These are companies that need financing to rapidly scale up their operations but have outgrown early-stage equity or venture capital financing. These start-ups would be past Series B or C and growth capital in the form of equity funding would be very dilutive to founders and venture capital investors. Such enterprises, however, lack the financial and operating track record required by traditional lenders, for instance, 3-year historical financials, adequate revenues, cash flows and assets to provide collateral for traditional debt. As such, they provide growing demand for Venture Debt and Private Debt funds with instruments that are flexible and open to taking on risks at this stage. Venture debt is a nascent but growing space in Africa as illustrated in Box 5.

Box 5: Venture Debt in Africa

Research by Partech Partners showed that in 2021, 37 tech start-ups raised USD 767m in debt across 43 funding rounds. This funding was low compared to USD 5.2Bn in equity raised by African tech start-ups in the same period. The majority of the investment (45%) was to Nigerian start-ups. Fintech start-ups accounted for more than 54% of debt raised followed by cleantech (products and services that reduce negative environmental impacts) start-ups which accounted for 23% of the debt funding raised.

Figure 18: Debt funding for tech start-ups per Country in Africa (USD M)



In 2020, Digital Africa and Propacro, launched a USD 5.4m Bridge fund to support digital entrepreneurs between fundraising rounds. Financing will be for a term of 24 months and amounts of USD 216,000 – 648,000 that must be co-financed by investors already active in Africa. The financing is available for African digital companies that have operated for at least 18 months, have at least USD 216,000 in revenue, have a demonstrated business model and completed the first round of fundraising.

***Source:** Partech Partners 2021 Africa Tech VC Report, VC4 Africa, Africa Venture Capital Association*

Growth stage companies: these companies have proved their business model and are on a growth trajectory, conquering new markets or introducing new product and service lines. These companies have assets that could be collateralized for debt and most with a verifiable track record seek financing from the traditional debt market. However, there is an emerging class of new business models such as in the solar Home system space adopting PAYG business models that struggle with traditional debt financing.

Banks, for example, struggle to charge collateral or inventories managed by these companies for example Mkopa, BBOXX, d.light, and Azuri Technologies. This pushes these businesses to seek Private Debt structures such as structured debt (e.g., securitisations). These growth companies continue to be a source of demand for the various specialist private debt funds in Africa.

Mature companies: These are established companies that typically have long-term banking relationships but need additional lines of credit that would see them exceed single obligor limits for banks. This means they have to seek additional external sources of financing such as syndicated loans or establish off-balance sheet structures that banks may shy away from. These companies have existing operations and cashflows that can sustain debt repayments. Such companies could be private companies such as Bidco Africa (a fast-moving consumer goods company) that received debt financing from the IFC for expansion, or public companies like Kenya Power or Kengen that have access to multiple funding lines including banks and capital markets. They may however want to diversify their funding sources and may approach private debt funds to increase their funding lines.

Another key demand driver for Private Debt in Africa is projects that require **project finance** type funding. Infrastructure financing in Africa remains a key priority for African governments, development partners and Africa focused MDBs. The majority of the planned infrastructure projects in SSA involve the construction and upgrading of transport infrastructure, mainly roads, aviation, ports, railways and electricity transmission, pipelines, Information and Communication Technology (ICT) infrastructure, trade inland ports and waterways (IPW), and refineries. While there is no comprehensive public central depository of infrastructure projects under conception or development, several sources indicate the scale of financing required. According to Fitch Solutions, SSA has a pipeline of 870 energy and utility infrastructure projects worth USD 236Bn at various stages from pre-construction to construction.[13] Capital intensive power plants and energy grids account for the bulk of the value of projects at USD 200.3Bn.[14]

The number of projects for which financing has been obtained is much smaller than that of projects at the feasibility study stage. This is because projects are frequently shown to be commercially non-viable without significant viability gap funding (VGF) from governments. While the majority of the infrastructure projects will be financed through public finances, a subset will be financed through project financing or a mix of public and private finances, requiring structured project financing through Private Debt. These deals, especially in the power sector, are predominantly structured in hard currency to attract international capital given the scale of financing required. The hard currency contracts give rise to significant foreign currency risks as project revenues are in local currencies while debt payments are in hard currencies.

13 Fitch Solutions 2021 https://www.fitchsolutions.com/infrastructure/sub-saharan-africa-energy-utilities-infrastructure-project-pipeline-renewable-power-projects-promise-opportunities-07-05-2021

14 Ibid

4

Private Debt in the Focus Markets

The study focused on - Nigeria, Ghana, Kenya and Morocco while South Africa was used as a comparative market given it is a larger, more active, and more developed financial market with the potential to offer learning points for the focus markets.

4.1 South Africa

4.1.1 Background and Overview of the Economy

COUNTRY OVERVIEW	
Population (million)	59.3 million
GDP current (USD Bn)	301.9 Bn
Sovereign rating Long-Term Foreign Currency (Moody's/Fitch/S&P)	Ba2 (negative)/BB (negative)/ BB- (stable)

***Source:** Moody's Analytics Project Finance Data Consortium*

South Africa has the most industrialised and diversified economy in Africa. Key sectors are manufacturing, retail, finance, transport, mining, and tourism. The economy was hard hit by the COVID-19 pandemic following several years of low growth caused in part by the unstable power supply, a consequence of the financial and operational difficulties at the national power utility (Eskom). Recurring waves of COVID-19 including the rise of new variants, and subsequent restrictions continued to constrain economic recovery in 2021. Modest recovery is expected with growth driven by low-interest rates, exports and strong commodity prices; however, unemployment, skills deficits and power shortages will weigh on short term activity. The Johannesburg Securities Exchange (JSE) is a mature, efficient and secure market with world-class regulation, trading clearing, settlement assurance and risk management, currently ranked 17th in the world in market capitalisation.

Key strengths of South Africa include:

- A deep capital market and strong financial service credentials, supported by a strong savings to GDP ratio.
- The country has a developed banking sector with competitive investment banking, mature capital markets and a growing fintech sector. On the legal and regulatory front, South Africa is regarded as having high regulatory standards and international best practices.
- Developed human capital and quality of life with a high concentration of finance professionals supported by high-quality service providers.
- Quality physical and digital infrastructure supported by one of Africa's largest and most sophisticated ICT markets.

Several drawbacks are present, however, including:

- **Macroeconomic and financial factors:** Political and economic uncertainty, high unemployment and corruption have resulted in low business confidence.
- **Legal and regulatory factors:** Exchange controls limit the volume of capital that local institutional investors can invest outside South Africa meaning that South African savings play a weaker role in the pan-African growth story than they could.
- Cumbersome work permit and visa processes act as a significant barrier.

South Africa has the most developed fixed income market in Africa. The country also issues efficiently priced long-term foreign currency debt, offering offshore investors a prime opportunity to gain exposure via relatively liquid instruments. South Africa's local bond market is one of the deepest and most sophisticated in the developing world, with a significant amount of participation by foreign investors. Secondary market trading in the corporate bond market remains limited.

4.1.2 Institutional Investor Regulatory Overview

The pension sector is the largest in Africa and holds approximately 40% of the assets on the Johannesburg Stock Exchange. The country's pension industry is also a leader in best practices in sustainable investment regulatory policy.[15] Characteristics of the investment landscape include:

- Institutional investor awareness of Environmental, Social, and Governance (ESG) factor investing remains low in South Africa. Where it exists, uptake is focused on thematic/impact space more than "sustainable development." This includes green and BEE investments.
- Infrastructure is a major theme, driven by policymakers and linked to economic recovery. Regulatory changes aim to accelerate pension capital participation, whether in listed (preferred) or unlisted instruments.

Box 6 summarizes the regulatory landscape for institutional investors introduced to ensure that the investments made by these vehicles minimise risk.

Box 6: Summary of Regulatory Landscape in South Africa

Regulation 28: ESG

- Regulation 28 (Reg 28) to the Pension Funds Act supports prudent long-term investing practices: sustainable, risk-aligned, and liability-driven.
- As of 2011, Reg 28 requires pension funds to address all factors that affect long-term performance including ESG factors.
- FSCA Guidance Note 1, 2019 requires that investment policy statements reflect approaches to ESG factor integration and active ownership, flowing down to investment mandates.
- Funds are requested to comply with the Guidance Note: no penalties for non-compliance.
- Previously, trustee capacity has been noted as a barrier to ESG integration.

Regulation 28: Asset limits

- To avoid undue risk-taking by pension funds, Reg 28 prescribes limits for investing in individual asset classes.
- Existing limits are heavily tilted towards domestic assets and listed instruments.
- Limits on alternative assets have been challenged considering the current administration's infrastructure-led growth focus.
- Draft amendments allow up to 45% allocation to SA infrastructure across all financial instruments, and an additional 10% to the rest of Africa..

15 IFC, "Sustainable Finance Practices in South African Retirement Funds", 2020

Box 6: Summary of Regulatory Landscape in South Africa

CRISA: ESG

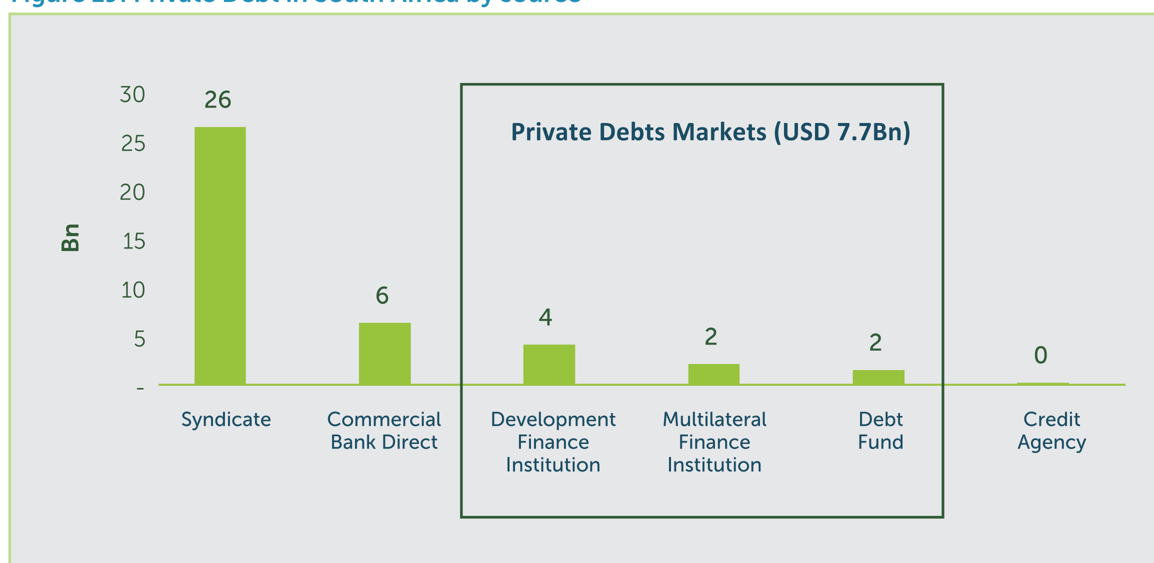
- A total foreign investment limit of 25% still applies.
- The Code for Responsible Investing in South Africa (CRISA) applies voluntarily to asset owners (e.g., pension funds, insurers) and their service providers (investment managers, asset consultants)
- 2020 Draft Version positions investors as actively supporting sustainable development:
  - o Stewardship emphasized.
  - o Integration of sustainable finance practices (i.e., material ESG factors as these relate to risks and opportunities).
  - o Transparency, disclosure and sound governance are required.
- Intended to apply to all investors (being asset owners and managers) on a proportionate basis, i.e., larger investors face greater implementation requirements.

The regulations are expected to put a ceiling on pension fund investments in infrastructure and other asset classes, however, this is unlikely to limit pension fund investment in such asset classes due to their large size and various instruments they can utilize for infrastructure investment including equity, bonds, loans, and private equity.

4.1.3 Private Debt Activity in South Africa

The Private Debt market in South Africa had the most activity across the continent with a total of USD 7.7Bn in transactions between 2015-H1 2021. Examples of investors include the International Finance Corporation, Industrial Development Corporation of South Africa, the Green Climate Fund, FMO, Finnfund, the Export-Import Bank of China, the Africa Finance Corporation, the European Investment Bank, the African Development Bank, EEP Africa, the Development Finance Corporation and the Emerging Africa Infrastructure Fund.

Figure 19: Private Debt in South Africa by source

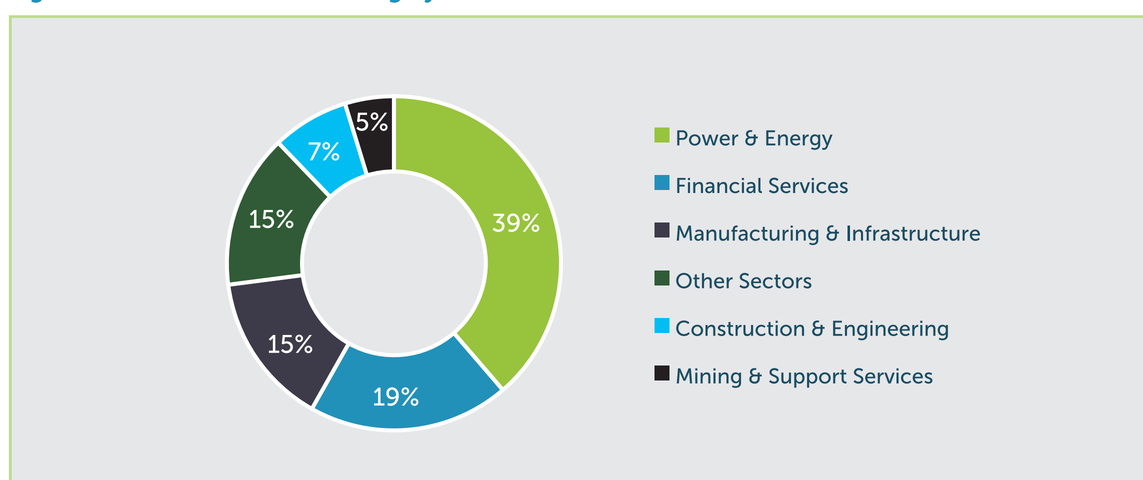


Source: *Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

Sectors Receiving Private Debt Financing in South Africa

Key sectors receiving Private Debt financing were Power and Energy (USD 3Bn or 39% of financing), Financial Services (USD 1.5Bn or 19% of financing), Manufacturing and Infrastructure (USD 1.1Bn or 15% of total Private Debt funding).

Figure 20: Private Debt Financing by sector in South Africa



Source: *Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

4.2 Nigeria

4.2.1 Background and Overview of the Economy

COUNTRY OVERVIEW	
Population	206.1 million
GDP current (USD)	432.3 Bn
Sovereign rating Long-Term Foreign Currency (Moody's/Fitch/S&P)	--/B (stable)/B-(negative)

Source: *World Bank, Economist Intelligence Unit, Trading Economics*

Nigeria is Africa's largest economy with a GDP of USD 432.3 Bn.[16] A major revenue and foreign exchange earner, crude oil is the mainstay of the economy and Nigeria is the biggest oil producer in SSA, producing an estimated 1.5 million barrels per day. Key issues expected to affect the economy in 2022 include insecurity, power supply issues and high inflation and monetary tightening. Nigeria has a relatively active non-bank Private Debt market with an investor base comprising insurance companies, asset managers and HNWIs.

4.2.2 Institutional Investor Regulatory Overview

The Securities and Exchange Commission (SEC) is the main regulatory organ of the Nigerian capital market while the pension sector is regulated by the National Pension Commission (PenCom). Nigeria has detailed investment limits for pension funds based on their Multi-Fund Structure. The rules state that no more than 10% of the total pension assets under management in all RSAs can be invested in all securities (debt, equity, and the money market) issued by a corporate entity. Ordinary shares are a permissible investment option by any one of the Funds given the maximum value limit of 7.5% of the issued share capital. Critically, the cumulative value cannot exceed more than 20% of the issued share capital in listed companies by the six Funds under the Multi-fund Structure. A high-level overview of the Multi-Fund Structure is stated in Table 5.

16 Nigeria, IMF (2021) https://data.worldbank.org/country/nigeria

Table 5: Nigerian Pension Multi-Fund Structure Asset Global Allocation Limits and Policies

CATEGORIES OF ASSETS	FUND 1	FUND 2	FUND 3	FUND 4*	FUND 5*	FUND 6*
Government Securities (incl. sovereign, municipals)	60%	70%	80%	80%	60%	70%
Corporate Debt (incl. ABS, MBS, Sukuk, Eurobonds)	35%	40%	45%	45%	35%	40%
Supra-national bonds	20%	20%	20%	20%	0%	20%
Money Market (CPs, CDs, Bas)	30%	30%	35%	35%	60%	30%
Ordinary shares	35%	25%	10%	5%	5%	25%
Infrastructure Funds	10%	5%	0%	0%	0%	5%
Private Equity Funds	10%	5%	0%	0%	0%	5%
Open, Closed, Hybrid Funds (incl. RE-ITS, ETFs)	25%	20%	10%	5%	0%	5%

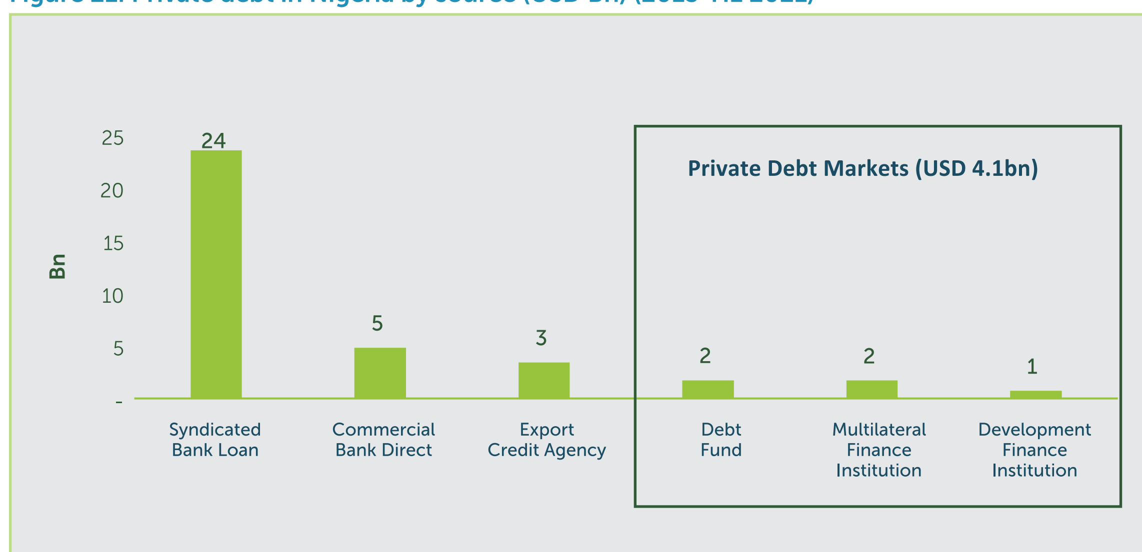
*Fund 4 is the Retiree Fund; Fund 5 is a Micro-Pension Fund; Fund 6 is a non-interest fund required to be Shariah Compliant

Source: *World Bank, Economist Intelligence Unit, Trading Economics*

4.2.3 Private Debt Activity in Nigeria

In the period between 2015-H1 2021, Private Debt transactions in Nigeria reached USD 4.1Bn, comprising lending by Development Finance Institutions (USD2.1Bn), Private Debt Funds (USD 1.7Bn) and Multilateral Finance Institutions (USD 230m). Examples of DFIs that were active in Private Debt include FMO, Proparco, DEG, BII (formerly CDC Group) and BIO. Debt Funds included Vantage Capital, TLG Capital, Helios, and the Renewable Energy Performance Platform (REPP). Multilateral lenders included the World Bank, the IFC and the European Investment Bank.

Figure 21: Private debt in Nigeria by source (USD Bn) (2015-H1 2021)

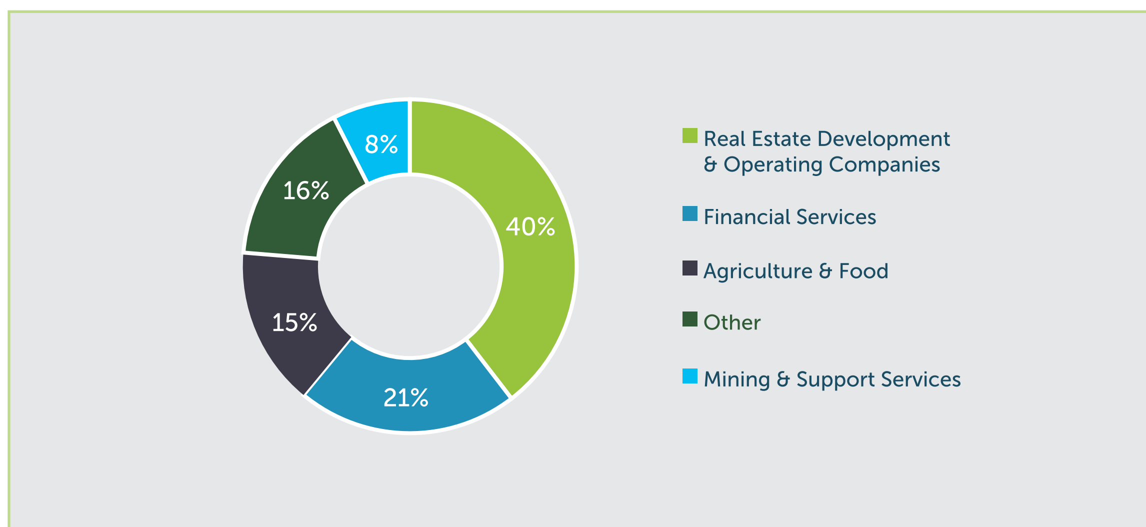


Source: *Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

Sectors receiving Private Debt Financing in Nigeria

Key sectors that received Private Debt financing were Real Estate (accounting for 40% or USD 1.6Bn), Financial Services accounting for 21% (USD 0.9Bn) Agriculture and Food (15% or USD 0.6Bn) and Mining and Support Services receiving 8% (USD 0.3Bn).

Figure 22: Private Debt Financing by sector in Nigeria



Source: *Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

4.2.4 Feedback from Stakeholder Engagement in Nigeria

- **Capacity constraints:** Private Debt investment requires a specialised skillset. New private debt funds might struggle initially given the importance of a demonstrable track record and ability to produce returns, especially in the view of institutional investors seeking reputable fund managers to diversify their assets.
- **The attractiveness of the Private Debt asset class:** The market for local private debt funds is growing (e.g., Chapel Hill Denham's Nigeria Infrastructure Debt Fund [NIDF] and Stanbic IBTC which also recently launched an infrastructure debt fund). Broadly, there is a desire for greater diversification of investment opportunities by institutional investors, for example, driven by the appetite for USD exposure to hedge against inflation.
- **Pension fund participation and ESG-driven investment:** While there has been much discussion around the improvement of governance and other specific issues, ESG factors as a whole are not key drivers of investment decisions for institutional investors. This is partly due to a lack of standardisation in practice, but also because these investors are still largely focused on managing risk and return. Nevertheless, some external players are driving change in this regard (e.g international banks with established Nigeria operations) and the expectation is that this will gather pace, particularly with regulatory support.
- **Crowding-in investments:** Alongside tenor and pricing, institutional investors in Nigeria remain focused on the security and structure of potential transactions. There has been ongoing engagement among players such as PenCom, PenOP, InfraCredit, etc., leading to the exploration of innovative structures for non-traditional industries and sectors such as infrastructure, renewable energy and agriculture. There is potential for risk-sharing mechanisms that can help drive participation as well as a case for increased technical assistance, particularly to secure ratings and improve governance and financial reporting, increasing the pool of enterprises that are ready for Private Debt.

4.2.5 Recommendations

- **Engage PenCom to increase investment avenues for pension funds by adding flexibility to invest in unlisted debt transactions.** Current pension fund investment guidelines restrict Pension Fund Administrators to investments in listed instruments, that are subject to a minimum BBB rating by two rating agencies.
- **Develop Pension Funds' individual capacities to evaluate transactions.** Pension Funds indicated a willingness to increase the level of direct investment in non-listed instruments, given an appetite for higher-yielding instruments. Technical assistance support would be required to build internal capacity to assess and evaluate transactions.
- **Deploy targeted credit enhancement to encourage investment in early-stage infrastructure projects or smaller companies across sectors.** InfraCredit has demonstrated that there is investor appetite to invest in credit-enhanced infrastructure bonds - this model can be leveraged to support the financing of other sectors.
- **Provide support for the development of a standardised framework (structuring and documentation) for institutions to invest in Private Debt.** Potential borrowers (outside of the regulated bond markets) typically approach investors on an ad hoc or bilateral basis without fully understanding their structuring and documentation requirements. Establishing formalised and standardised requirements, together with funding for the requisite advisory support, would help increase the level of investment, especially in non-real estate transactions where the transaction structures and collateral arrangements are already well established.
- **Support creation of specialist local currency private credit vehicles.** For example, providing risk capital to funds that specialise in tailored working capital solutions for value chain businesses e.g., pharmaceuticals, agriculture, etc., that banks find difficult to finance due to non-traditional transaction structures.

4.3 Kenya

4.3.1 Background and Overview of the Economy

COUNTRY OVERVIEW	
Population	52.5 million
GDP current (USD)	95.5 Bn
Sovereign rating Long-Term Foreign Currency (Moody's/Fitch)	B2(negative)/B+(negative)

Source: *World Bank, Economist Intelligence Unit, Trading Economics*

Kenya is a lower-middle-income economy with a GDP of USD 101Bn[17] making it the largest economy in East Africa. Key sectors are agriculture, manufacturing, tourism and financial services. the economy has undergone a period of rapid transformation over the past 20 years becoming a diversified economy.

4.3.2 Institutional Investor Regulatory Overview

The pension sector is regulated by the Retirement Benefits Authority (RBA) and has seen growth in pension assets with pension funds as key investors in government and corporate debt markets. Other investors are insurance companies, regulated by the Insurance Regulatory Authority (IRA), and retail investors both directly and through mutual funds.

17 The World Bank Data Kenya https://data.worldbank.org/country/kenya

Regulatory changes have allowed pension funds to change their asset allocations to diversify returns while protecting assets, and there have been increased allocations to non-traditional asset classes like PE and VC, however, the pension funds have been known to be reluctant to shift their risk preferences, which would be required to grow their participation in Private Debt transactions

Table 6: Kenya Pension Fund Asset Allocation Investment Regulations and Policies[18]

CATEGORIES OF ASSETS	MAX % OF TOTAL ASSETS
• Cash and demand deposits in institutions licensed under the Banking Act of the Republic of Kenya.	5%
• Fixed Deposits. • Time Deposits and Certificate of Deposits in Institutions Licensed Under the Banking Act of the Republic of Kenya.	30%
• Listed Corporate Bonds, Mortgage Bonds and Fixed Income Instruments. • Loan stocks approved by the Capital Markets Authority. • Collective investment schemes incorporated in Kenya and approved by the Capital Markets Authority reflecting this category; and • Global depository receipts.	20%
• Commercial Paper. Non-listed bonds and other debt instruments issued by private companies provided that the bond or the instrument has been given an investment-grade rating by a credit rating agency registered by the Capital Markets Authority, and collective investment schemes incorporated in Kenya and approved by the Capital Markets Authority reflecting this category.	10%
• East African Community Government Securities and infrastructure bonds issued by public institutions and collective investment schemes incorporated in East African Community (EAC) and approved by an EAC Capital Markets regulator reflecting this category.	90%, or 100% in the case of schemes receiving statutory contributions
• Preference shares and ordinary shares of companies listed in a securities exchange in the East African Community and collective investment schemes incorporated in Kenya and approved by the Capital Markets Authority reflecting this category. • Exchange-Traded Funds and global depositary receipts.	70%
• Unlisted shares and equity instruments of companies incorporated in Kenya and collective investment schemes incorporated in Kenya and approved by the Capital Markets Authority reflecting this category.	5%
• Offshore investments in bank deposits government securities, listed equities and rated corporate bonds and offshore collective investment schemes reflecting these assets.	15%
• Immovable property in Kenya.	30%
• Guaranteed Funds.	100%
• All exchange-traded derivatives contracts approved by the Capital Markets Authority.	5%
• All listed Real Estate Investment Trusts incorporated in Kenya and approved by the Capital Markets Authority.	30%
• Private Equity & Venture Capital.	10%
• Any other assets.	10%

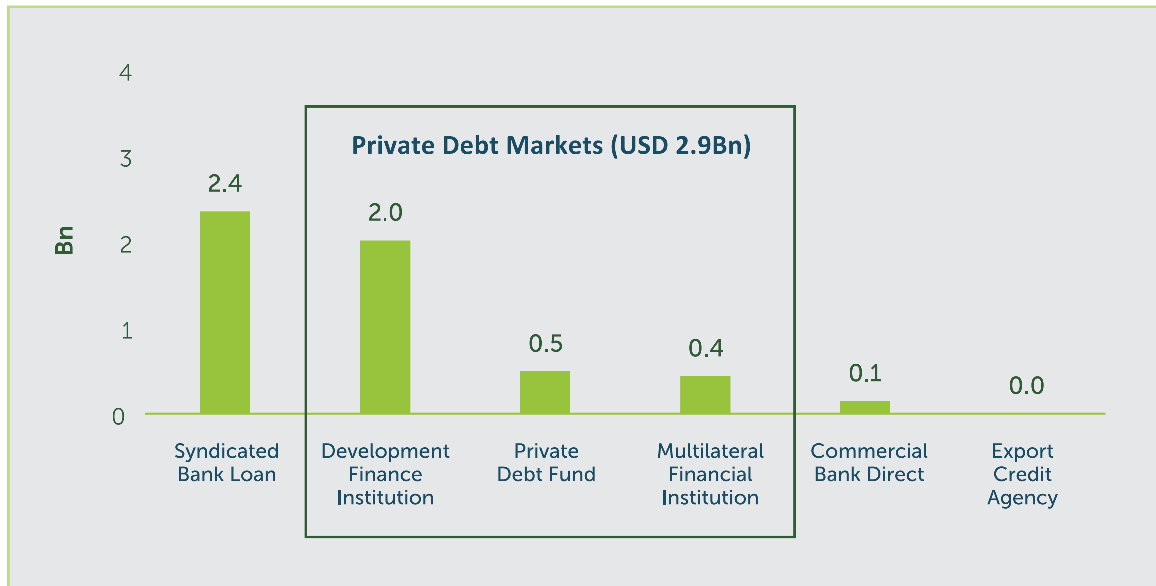
Source: *Retirement Benefits Authority*

18 Retirement Benefits Authority, "Investment Regulations and Policies", 2016

4.3.3 Private Debt Activity in Kenya

A review of transactions in the period between 2015 to H1 2021 showed Private Debt transactions of USD 2.9Bn. Private debt sources were Development Finance Institutions (USD 2Bn), Private Debt funds (USD 491m) and Multilateral Finance Institutions (USD 437m). Examples of DFIs that were active in the Private Debt markets were the DFC, DEG, BII (formerly CDC Group), Proparco, AFD and the FMO. Private Debt Funds included Vantage Capital, the Offgrid Energy Access Fund, Sunfunder and EEP Africa. Multilateral lenders included the Afrexim Bank, the AfDB, and the IFC.

Figure 23: Private debt lending by source in Kenya (USD Bn) (2015-H1 2021)

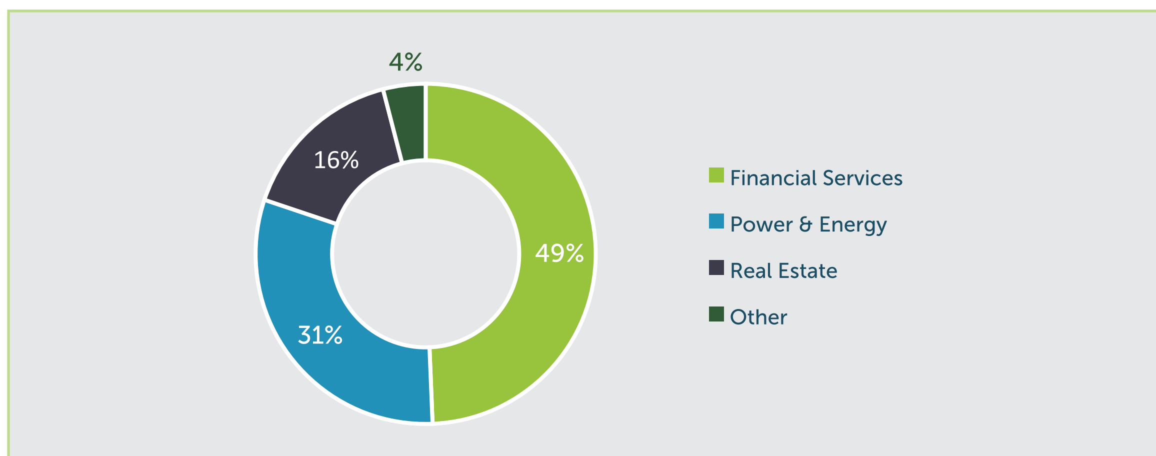


***Source:** Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

Private Debt Lending by Sector in Kenya

Sectors that attracted the largest amount of Private Debt were Financial Services accounting for USD 1.4Bn or 49% of Private Debt transactions, Power and Energy accounting for USD 0.9Bn or 31% of financing and Real Estate (USD 0.46Bn or 16% of financing).

Figure 24: Private Debt transactions by sector in Kenya



***Source:** Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

4.3.4 Feedback from Stakeholder Engagement in Kenya

- **The attractiveness of the Private Debt asset class to institutional investors:** While in more developed markets Private Debt offers a risk-adjusted diversification opportunity for institutional investors compared to traditional asset classes such as stocks and bonds, government securities in Kenya are relatively high yielding (offering ~12% interest on the 10-year treasuries). There is therefore low appetite for riskier Private Debt by institutional investors who have access to attractive, relatively risk-free returns offered by government securities that are compliant with investment allocation guidelines by regulators.
- **Risk Management:** Risk protection is a key consideration for institutional investors to increase their allocations to Private Debt. Given other available investment options, Private Debt funds seeking institutional investor capital will need to incorporate capital protection measures such as guarantees, at least in the initial years, to give much-needed comfort.
- **Preference for local currency investments**: The lack of local currency investment options is a concern for institutional investors seeking access to diversified assets. Domestic investors felt there is not enough consideration paid to local currency capital and its advantages as compared to hard currency financing and would want access to Private Debt transactions structured with a local currency component to give more investment opportunities.
- **ESG factors as a driver of investment attractiveness:** For many institutional investors, ESG factors as seen as a "good to have" in addition to other characteristics of an attractive investment but are not necessarily a key driver for institutional investor decisions. Financial returns are seen as the key driver for investments with ESG considerations as secondary. Local institutional investors will not consider a project with high ESG scores if the returns do not meet their thresholds.
- **Regulatory concerns:** Regulators are supportive of market development and innovative products; however, they remain cautious given the history of previous commercial paper defaults that led to investor losses and damaged market confidence including causing criticism of the regulators.
- **Capacity constraints:** Capacity constraints impede the growth of institutional investor participation in Private Debt. These constraints exist along the whole investment spectrum from pipeline generation to transaction structuring and closing. Training and education would be required at several levels to create comfort and get the key decision makers aligned especially for pension funds – trustees, fund managers and boards. The training is viewed as a continuous process over time, rather than a one-off engagement with the institutional investors.
- **Potential for new Private Debt funds:** Investing in Private Debt through third party funds is a welcome option, but track record is critical. Institutional investors are open to a new asset class but would prefer to deal with established debt fund managers with a track record and not first-time fund managers. Institutional investors would not want to bear the costs of the learning curve and would prefer third-party guarantees to protect their capital.

4.3.5 Recommendations

- **Increase the capacity of the pension funds to develop deal pipelines, structure and invest directly in Private Debt.** This could be through i). structuring local currency investment vehicles to provide investment avenues for institutional investors and ii). capacity creation for institutional investors to explore Private Debt investments. This involves the entire investment path from pipeline generation,

19 https://kepfic.co.ke/

credit assessment, deal structuring and pricing to enable local institutional investors to create and manage Private Debt portfolios.

  - An example of an entity that would benefit from such support is the Kenya Pension Funds Investment Consortium (KEPFIC) which brings together 27 pension funds looking to mobilize their institutional capital for infrastructure and alternative asset investments in East Africa.

- **Provide first-loss capital and credit enhancement facilities (monoline funds) to promote Private transactions perceived to be risky** to encourage additional institutional investor participation and particularly from first time institutional investors to gain experience and comfort in Private Debt investment.
- **Encourage public disclosures for institutional investors on asset allocations and performance per asset class.** This will allow institutional investor Trustees to be able to make informed judgements when awarding fund management mandates. Regulators would set the minimum thresholds for assets under management for these disclosures to avoid overburdening smaller institutional investors with additional reporting requirements.

4.4 Ghana

4.3.1 Background and Overview of the Economy

COUNTRY OVERVIEW	
Population	31 million
GDP current (USD)	67.2 Bn
Sovereign rating Long-Term Foreign Currency (Moody's/Fitch/S&P)	B3(negative)/--/B(negative)

Source: *World Bank, Economist Intelligence Unit, Trading Economics*

Ghana is a lower-middle-income country with a GDP of USD 67.2 Bn.[20] Key sectors are agriculture, forestry and fishing, infrastructure, manufacturing and the financial sector. The country is the second-largest global producer of cocoa and is an exporter of gold and oil. The Ghanaian economy has seen a rapid transformation in recent years as the country begins to reap the benefit of the discovery of oil and gas resources. Whilst Ghana's oil fields are modest by international standards, before the COVID-19 pandemic, exports enabled the current account to move to a sustainable balance according to the IMF.

4.4.2 Institutional Investor Regulatory Overview

The Ghana Securities and Exchange Commission (SEC) has overall regulatory responsibility for the Ghanaian Capital Markets. In May 2021, the SEC in conjunction with the MoF launched its 10-year capital markets master plan (CMMP) as a blueprint for market development. Produced in conjunction with a range of critical stakeholders, the expectation is that the plan will help grow Ghana's financial sector, by diversifying its instrument offerings and by improving access to markets, particularly for SMEs and new companies. The plan is in 3 phases focussed on increasing market attractiveness, liquidity and introducing more sophisticated products and consolidating gains made.

While Private Debt issuances are not subject to the same strict Securities and Exchange Commission regulations as public debt, the Private Debt market is nascent and restricted by inflation, currency depreciation, competing government funding costs, financial literacy, and valuation issues. There is a need to broaden the availability and flexibility of investment products, widening the use of Private Debt, to address the gap for enterprises with smaller financing needs.

20 Ghana, IMF (2021) https://data.worldbank.org/country/GH

Ghanaian pension funds are the dominant buyers of debt securities in the country. The local guidelines and regulations are especially conservative mirroring that of other institutional investors across sub-Saharan Africa, hence local asset managers tend to focus on financing government debt and high-quality assets, which reduces the appetite for higher risk assets and local corporate debt.

The National Pension Regulatory Authority oversees both private and public pension schemes. The National Insurance Commission provides oversight to the insurance sector. Table 7 shows the pension allocation guidelines for Ghanaian pension assets.

Table 7 Ghana Pension Investment Assets Allocation Guidelines

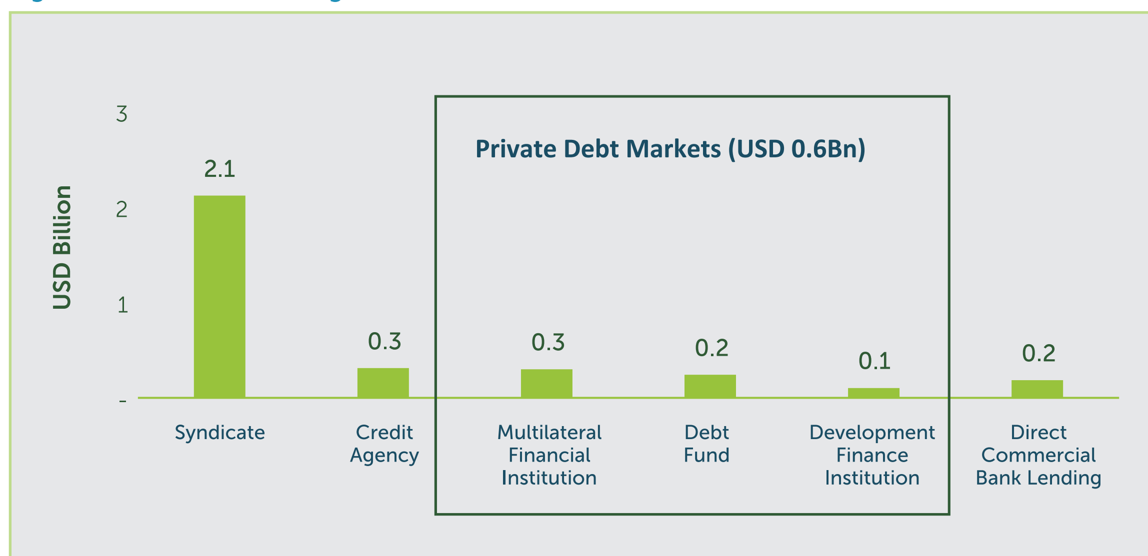
ASSET CLASS	MAX ALLOCATION	PER ISSUER	PER ISSUE
Government of Ghana Securities: a) Treasury Bills b) Treasury Notes c) Treasury Bonds (Including Infrastructure Bonds & Eurobonds)	60%		Min. of 35% in long-dated securities applicable
Local Government and Statutory Agency Securities a) Municipal and Local Governments Bonds b) Infrastructure Bonds c) Cocoa Bonds/Bills	15%	Max. 5%	Max. 5%
Corporate Debt Securities a) Debentures b) Notes c) Redeemable Cumulative Preference Shares d) Mortgage-Backed Securities e) Commercial Paper f) Infrastructure Bonds	35%	Max. 5%*	Max 5%* Rated investment grade if unlisted
Ordinary Shares/Non-Redeemable Preference Shares	20%	Max 5%	Max of 10% if shareholders' funds of any one corporate entity
Bank Securities and Other Money Market Securities a) Fixed Deposits b) Negotiable Certificates of Deposits (NCDs) c) Bankers Acceptance	35%	Max. 5%	Max. of 10% of the shareholders' funds of the issuer Bank Rollover permitted once. One week "cooling off" period is required
Collective Investment Schemes (CIS): a) Unit Trusts b) Mutual Funds c) Exchange-Traded Funds	15%	Max. 5%	
Alternative Investments* a) Real Estate Investment Trusts/Funds b) Private Equity Funds c) External Investment in Securities ***NB:** Each sub-asset class is restricted to a maximum of 10% except for External Investment which shall be limited to a maximum of 5%.	15%		

***Source:** National Pensions Regulatory Authority*

4.4.3 Private Debt Activity in Ghana

A review of transactions in the period between 2015 to H1 2021 showed Private Debt transactions of USD 0.6Bn from Multilateral Finance Institutions (USD 300m), Private Debt funds (USD 240m) and Development Finance Institutions (USD 100m). The IFC was the only multilateral lender with a reported transaction. Debt Funds included Vantage Capital, Milost Global, Helios, Credit and Renewable Energy Performance Platform (REPP). DFIs were the Belgian Investment Company for Developing Countries and the AFD.

Figure 25: Source of lending in Ghana (USD Bn, 2015-H1 2021)

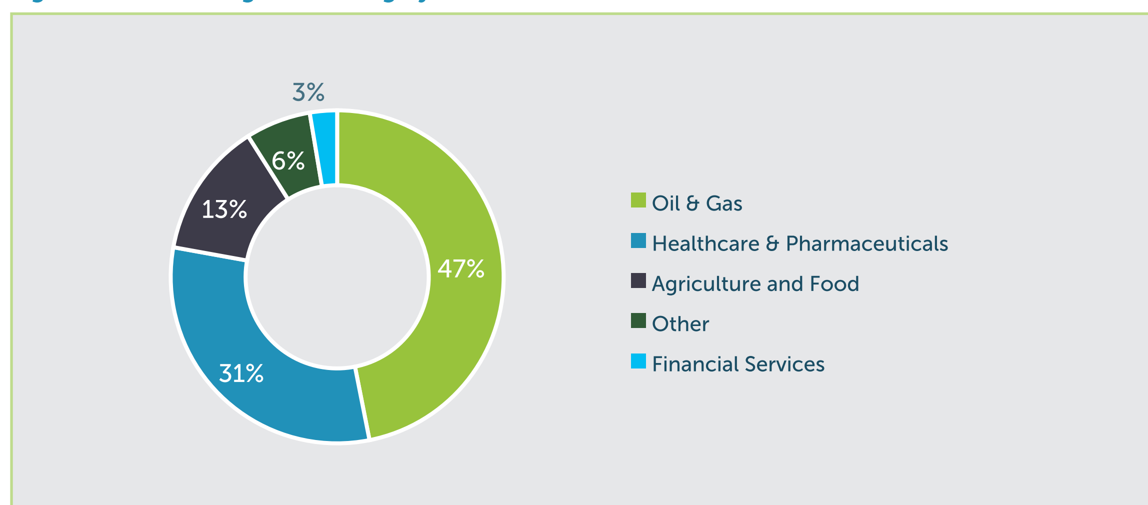


Source: *Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

Sectors Receiving Private Debt Financing in Ghana

The Oil and Gas sector received the bulk of financing (USD 302m or 47%) followed by the Healthcare and Pharmaceuticals sector (USD 200m or 31%), the two sectors accounting for 79% of the total financing received. The third-largest funding recipient was the Agriculture and Food Sector receiving 13% of the financing (USD 85m).

Figure 26: Percentage of lending by sector in Ghana (2015-2021)



Source: *Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

4.4.4 Feedback from Stakeholder Engagement in Ghana

Market engagement with Ghana capital market stakeholders was largely positive as regards the receptiveness of Private Debt. Key themes were:

- **General attractiveness of Private Debt:** Institutional investors predominantly invest in fixed income and equities, heavily weighted towards government debt securities. There is a desire to diversify investment options, however, the major challenge with Private Debt would be to outperform government securities.
- **Credible Private Debt funds would be welcomed:** Having direct exposure to Private Debt instruments and setting up all the required systems to originate, approve and monitor the direct deals would be a challenge for institutional investors. The preference would be to outsource these functions to a specialist fund manager experienced in Private Debt. Investments in emerging Private Debt funds are being discussed by fund managers and pipeline transactions have been identified, providing a level of momentum for the nascent asset class.
- **Regulations remain central to market activity:** The country's financial and capital markets are recovering from the collapse of multiple financial institutions, including non-bank financial institutions and commercial banks (the regulator revoked 9 bank licences in 2018), as well as several high-profile capital markets defaults. Government and regulators were blamed for the sector collapse, prompting calls for more stringent regulations, with regulators appropriately incentivised to avoid a recurrence of the situation. New regulations for pension funds and fund managers were issued in September 2021 to ensure the safety of assets, diversify investment options and increase institutional investor participation in the Ghanaian economy. Provisions for investment in Private Debt funds exist; investments in alternative investments are capped at 25% of AUM, however, investments outside Ghana cannot exceed 5%. Unregulated Private Debt continues to be a funding option for SMEs in Ghana, given their inability to access affordable, long-term debt from commercial banks, prompting them to seek alternative solutions. However, there is a level of risk that regulators and government bodies will be keen to define and ringfence such that innovation may continue, but not at the expense of systemic stability.

4.4.5 Recommendations

- **Support precedent and demonstration transactions for Private Debt.** This could be through supporting fundraising efforts or investing in emerging Private Debt funds e.g., Ashfield Investment Managers. Support could also include underwriting institutional investor investments in the new funds.
- **Provide first-loss capital and credit enhancement facilities (monoline funds) to promote private transactions perceived to be risky** to encourage additional institutional investor participation and particularly from first time institutional investors to gain experience and comfort in Private Debt investment.
- **Support capacity-building efforts to promote the participation of regulated investors in the Private Debt market.** Support could be through providing TA funding for workshops bringing together different stakeholders such as government regulators and institutional investors, and engagement with regulators to provide specific Private Debt guidance to institutional investors. Technical assistance to develop local rating methodologies may also help develop the market by enabling institutional investors to have a better understanding of risk and build confidence in the asset class. Support here would go towards the training of domestic rating agencies by providing TA funding and partnering with regional rating agencies (e.g., GCR and Agusto) to train local rating institutions to support the growth of local ratings. Finally, TA would assist prospective Private Debt issuers to prepare for credit ratings that would allow potential investors to objectively evaluate the risk of transactions against their investment guidelines.

4.5 Morocco

4.5.1 Background and Overview of the Economy

COUNTRY OVERVIEW	
Population	36.9 million
GDP current (USD)	112.8 Bn
Sovereign rating Long-Term Foreign Currency (Moody's/Fitch/S&P)	Ba1 (negative)/BB+ (stable)/ BB+(positive)

***Source:** World Bank, Economist Intelligence Unit, Trading Economics*

Morocco's GDP was close to USD 112 Bn in 2019, making it the 5th largest economy in Africa. The country is ranked among the most competitive economies in North Africa, considered relatively open to the outside world, especially Europe. Key sectors of the economy are services, industry (including manufacturing, mining and construction), and agriculture. The country has privatised key sectors of the economy since the early 1990s with further reforms more recently including financial sector reforms and liberalisation of the telecommunications sector. The reforms have earned the country investment-grade status. However, the country faces challenges in volatility in key exports, particularly phosphates where the country is a key global supplier, over-reliance on agriculture, high import costs for petroleum, high unemployment, high-income inequality and high national debt levels. Despite the challenges, the reforms in legal and institutional changes are expected to have positive economic and social results.

4.5.2 Institutional Investor Regulatory Overview

The Autorité Marocaine du Marché des Capitaux (AMMC) is a financially independent public institution that acts as the market watchdog authorised by the Ministry of Finance and Privatisation. Its roles include[21]:

- Guaranteeing compliance with the various legal and regulatory provisions governing financial markets.
- Ensuring equal treatment of investors, transparency and integrity of the capital market and the investor's information.
- Protecting investors in transferable securities or any other investment available to the public.
- Assisting the government in the regulation of the capital market.

Institutional investors have limited investment options and there is interest in diversifying assets through international investments and investing directly in unlisted companies, currently not possible under the asset allocation regulations.

The available options have left institutional investors with unattractive returns given a low-interest-rate environment and a declining stock market. Table 8 shows investment allocation guidelines for one of the largest pension funds in Morocco, the CMR (la Caisse Marocaine de Retraites).

Table 8: Asset allocation guidelines for la Caisse Marocaine de Retraites (CMR)

ASSET CLASS	ALLOCATION
Treasury bills	50% minimum
Listed equities	30% maximum
Real estate	15% maximum
Private Equity	5% maximum

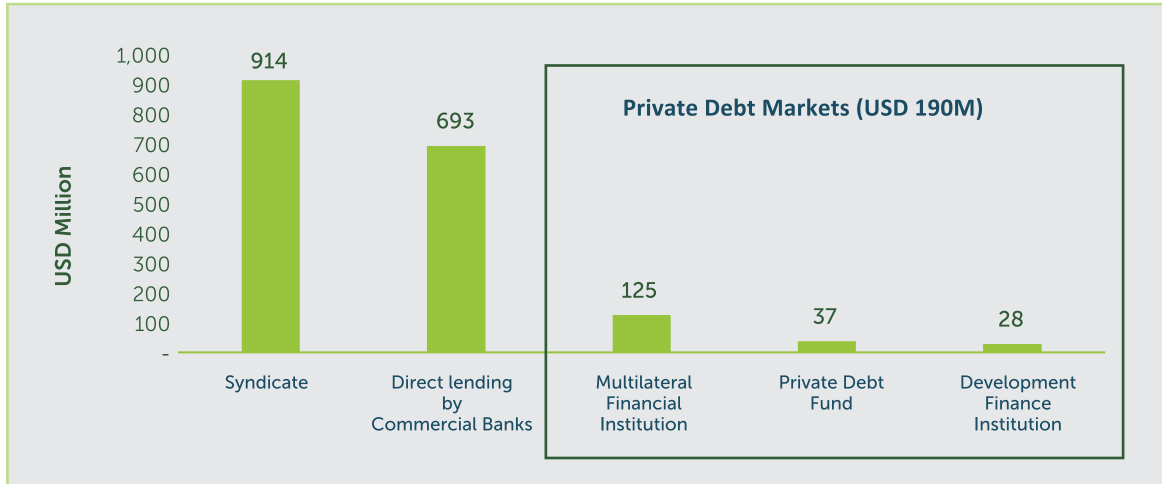
***Source:** O. Chiboub, S. Benjelloun (2020) ACRN Journal of Finance and Risk Perspectives 9*

21 Investing in the Stock Market, Casablanca Stock Exchange (2020) http://www.casablanca-bourse.com/bourseweb/en/content.aspx?IdLink=242&Cat=6

4.5.3 Private Debt Activity in Morocco

In the period between 2015-H12021, Private Debt transactions in Morocco were USD 190m from Multilateral Finance Institutions (USD 125m), Private Debt Funds (USD 37m) and Development Finance Institutions (USD 28m). Examples of lenders were the World Bank, Vantage Capital and the Japan Bank for International Cooperation.

Figure 27: Private debt in Morocco by sources (USD million 2015-H1 2021)

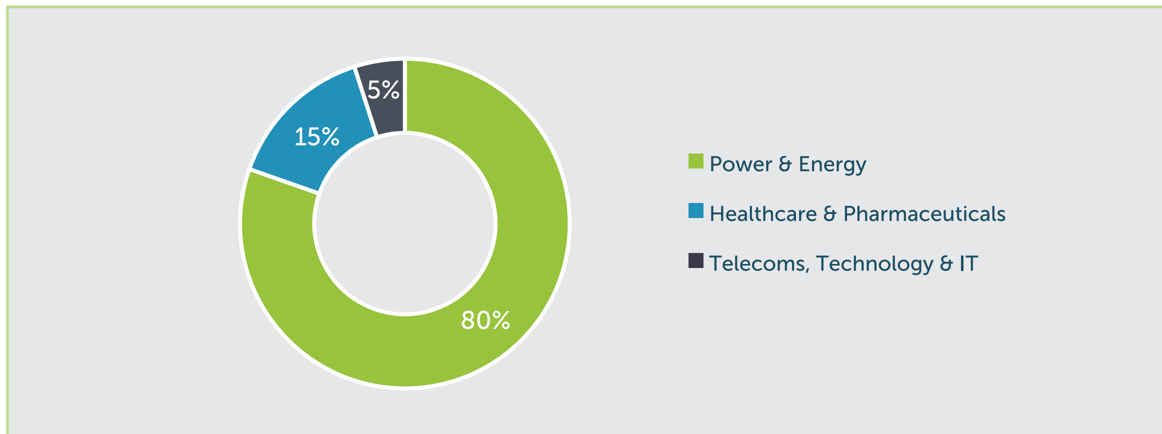


***Source:** Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

Sectors Receiving Private Debt Financing in Morocco

The Power and Energy sector received 80% of the funding (USD 153m). Other sectors receiving financing were Healthcare and Pharmaceuticals (15% or USD 28m) and Telecoms, Technology and IT (5% or USD 9.4m).

Figure 28: Financing by sector in Morocco



***Source:** Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios*

4.5.4 Feedback from Stakeholder Engagement in Morocco

Throughout our engagement, the market responded positively to this study and expressed a strong interest in developing the Private Debt market as a new type of asset class that would complement the existing product offering on the market. Key themes were:

- **The desire for additional investment opportunities:** There is a strong appetite among insurance companies, mutual funds and pension funds for senior corporate credit instruments in Morocco. This appetite is driven by higher potential returns compared to local government bonds and subsequent portfolio diversification benefits. Both institutional investors and the banking sector are well funded and looking to deploy liquidity into Private Debt; however, there are several constraints including the market structure and regulatory constraints explained below.
- **Market structure:** The supply of credit by traditional lenders is skewed toward large blue-chip corporates while the SME sector, which accounts for the majority of enterprises in Morocco, is underserved by local lenders and investors. Reasons include informality in governance, financial transparency concerns, and overall lack of investment readiness. Lenders also lack the frameworks and tools to assess SME credit risk. In response, the government has launched several thematic programmes for priority sectors to kick-start SME lending growth, financed by major DFI/MDBs like the European Investment Bank (EIB). The financing offered by these thematic programmes can be subject to capped margins, in effect distorting the market risk-adjusted returns. In the capital markets, more stringent requirements to issue and list bonds represent a key barrier for many SME issuers. Local issuers access the bond market to raise junior (subordinated) or hybrid instruments, which do not match the standardised risk appetite of Moroccan investors. The combination of all these factors has translated into a credit market with supply concentrated towards large blue-chip companies, predominantly in the loan sector. As a result, this market segment is very price competitive while the SME sector remains underserved.
- **Lack of "quality" issuers:** As a result of the aforementioned structural constraints, there is a perceived lack of investment opportunities in the private sector. This is driven in part by a lack of frameworks and tools to assess non-standard credit risk, and in part by the overall low investment readiness of potential borrowers. Institutional investors would benefit from expert assistance in developing and implementing credit review frameworks and tools to evaluate and measure non-standard credit risk.
- **Regulatory constraints:** the regulatory framework currently does not allow the full spectrum of domestic investors to participate in the Private Debt market. For institutional investors, the regulatory framework sets constraints for asset allocation further restricting the scope of allocation to corporate credit. For example, local institutional investors can only invest in instruments denominated in local currency (for example, 95% of technical reserves of insurance companies must be denominated in Moroccan Dirhams). In addition, domestic investors must allocate a large portion of their AUMs (e.g., a minimum of 30% for insurance companies) to local government bonds that have been a low yielding asset in today's market context (for reference, 5-year government bonds are yielding approximately 2%).
- **Regulatory progress:** There is an appetite for the development of the Private Debt market in Morocco with mutual funds and local regulators working to create a framework to allow for additional asset classes. A securitisation law was passed in 2013, introducing the possibility for institutions managing securitised collective investment funds to grant loans to finance the acquisition or holding of eligible collateralised assets, which institutional investors can acquire. The existence of securitised products would allow institutional investors to tap the loan market or tailor the credit exposure across various issuers, tenors, or capital structures. However, the framework governing the operationalisation still needs to be implemented, setting the conditions for prudential and supervisory rules and the procedures for carrying out these operations. A new securitisation framework is currently under development by the Ministry of Finance, the Morrocan Capital Markets Authority

(AMMC) and other market participants to complement the existing law. There is a strong interest by the AMMC for this project to be implemented and the regulator expressed interest in receiving support to inform the development of this framework based on international benchmarks and best practices.

- **ESG factors:** The level of ESG considerations in investment decisions depends on the size and footprint of each institutional investor. International institutional investors are more advanced in implementing ESG into their investment thesis. Some institutions have developed internal frameworks for ESG scoring to supplement the credit risk analysis to make decisions. For local institutional investors, the concept of ESG remains nascent.

4.5.5 Recommendations

- **Support ongoing regulatory reforms that will set the course for the expansion of Private Debt investment opportunities in future.** The Capital Markets Regulator expressed interest in receiving support to develop frameworks that will enable institutional investors to increase their participation in debt markets. This involves supporting the dissemination of knowledge to regulators on existing regulatory frameworks and case studies on other jurisdictions. A new securitisation framework that would benefit from such support is currently under development by the Bank Al-Maghrib, the AMMC and other market participants to complement existing laws. Securitised debt will expand the portfolio of credit instruments available to local institutional investors and lay the foundation for future engagement to develop the Private Debt sector in Morocco.
- **In tandem with the regulatory reforms, it is essential to provide capacity building and support to develop risk assessment frameworks for institutional investors to invest in Private Debt.** This would support precedent and demonstration transactions.
- **Introduce credit enhancement facilities (monoline funds) specifically tailored for Moroccan institutional investors to encourage them to invest in Private Debt once regulations permit them to invest in Private Debt funds.** Facilities including first-loss capital and guarantees would incentivise institutional investors to invest in Private Debt funds to support precedent-setting and demonstration transactions.

4.6 Overarching Recommendations

The recommendations below cover key aspects that need to be addressed to catalyse local institutional investor participation in Private Debt in the focus countries. In addition to the country-specific recommendations in sections 4.2.5, 4.3.5, 4.4.5 and 4.5.5, cross-cutting recommendations that apply to all the focus countries are:

- **Introduce credit enhancement facilities (monoline funds) in the focus markets specifically tailored for institutional investors to encourage them to invest in Private Debt.** Institutional investors cite risk protection as a key factor. That means new Private debt funds will need to demonstrate a successful track record. However, even the experienced fund managers may not demonstrate a track record in specific markets. It is therefore critical for the private debt funds to encompass some level of credit enhancement to encourage fund managers to consider investing in Private Debt. This could range from first-loss capital to partial guarantees to incentivise institutional investors to invest in Private Debt funds. Box 7 illustrates the role InfraCredit plays in risk-sharing and deepening institutional investment in infrastructure in Nigeria, a model that can be adopted in other markets to grow Private Debt in the focus countries.

Box 7: InfraCredit Nigeria

InfraCredit is a Nigerian specialised infrastructure credit guarantee institution, backed by the Nigeria Sovereign Investment Authority, GuarantCo (a Private Infrastructure Development Group company), KfW Development Bank, Africa Finance Corporation, InfraCo Africa and the African Development Bank. It provides local currency guarantees to enhance the credit quality of infrastructure asset debt instruments helping mobilise long term debt financing for infrastructure in Nigeria. The AAA-rated (Nigeria) institution's guarantees catalyse investment from pension funds, insurance firms and other long-term investors, deepening the Nigerian debt capital markets.

InfraCredit helps motivate investment in long term bonds by institutional investors to finance infrastructure assets. Eligible Sectors are gas to power, social infrastructure (housing, hospitals, education), inputs to infrastructure (goods, equipment, materials), agriculture, power, renewable energy, ICT/Telcom, waste management, transportation, and water distribution. InfraCredit has;

- mobilised NGN84Bn of domestic capital from pension funds;
- supported 7 first time issuers accessing the capital markets;
- created 2,302 jobs in Nigeria; and
- supported 8 infrastructure projects to reach financial close.

To expand its impact, InfraCredit recently signed a Technical Assistance Agreement with FSD Africa under which FSD Africa will provide TA funding for pre-feasibility studies as well as the pre-transaction and transaction costs, including the design of innovative financing solutions for eligible projects that can issue climate-aligned local currency infrastructure bonds.

Market Impact

InfraCredit provided a guarantee for a first-time issuer's Pan African Towers (PAT) issuance of NGN 10Bn 10-year Senior Guaranteed Fixed-Rate Series I Infrastructure Bonds Due 2032. On the strength of the guarantee, the PAT Series I Bonds were accorded a 'AAA' long term credit rating by Agusto & Co. and GCR. The Bond issue was oversubscribed by 127% by ten institutional investors, including the domestic pension funds and insurance companies. Proceeds will finance the acquisition of environmentally friendly tower sites to enhance telecommunication coverage and service quality and reduce carbon footprint in the sector by replacing diesel generators with renewable energy sources. The bonds were attractively priced, providing an avenue for pension fund managers to diversify their portfolios with risk-adjusted return yielding assets.

Source: *InfraCredit, FSD Africa*

- **Increase data access:** There is a dearth of data regarding Private Debt transactions in Africa illustrating a need for platforms linking lenders and borrowers and reporting closed deals for reference, education, and trend analysis. An initiative like the Climate Bonds[22] Initiative for Green Bonds tailored for Private Debt would increase awareness and encourage regulators to allow greater domestic investor participation and create greater pricing transparency.
- **Structure and seed local currency investment vehicles in the focus markets to provide exposure to local currency investments and seek investments that allow local institutional investors to co-invest directly in Private Debt transactions or indirectly through investing in Private Debt vehicles.** The creation of local currency vehicles for specific markets would provide exposure to investment opportunities

22 https://www.climatebonds.net/

structured to fit institutional investor preferences and hurdle rates which vary from market to market. Institutional investors would then have the option to invest in Private Debt vehicles if they cannot invest directly in Private Debt deals. Given the predominance of hard currency Private Debt lending and the common failure to price in the expected depreciation of local currencies, most borrowers face rising debt service costs when local currencies depreciate making it more expensive to service hard currency loans. There is, therefore, a need to establish more local currency Private Debt investment vehicles that provide more price certainty for borrowers and serve as vehicles to mobilise investments from local institutional investors.

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