

SOUTH AFRICA - DEVELOPMENT BANK OF SOUTHERN AFRICA (DBSA)

Background and Establishment

The DBSA was established in 1983 and, despite its regional name, is solely owned by the Government of South Africa. Its original focus was radically changed in 1994 with the transition to democracy, and its current mandate, statutes and regulatory controls date from the DBSA Act No. 13 of 1997 plus the Public Finance Management Act No. 1 of 1999 and the King IV Code of Principles for governance. It now has a very strong focus on basic infrastructure – both economic and social – at the sub-national level in South Africa. To a much lesser extent, it also operates in the 14-member Southern Africa Development Community (SADC) and Africa more generally. This municipal commitment reflects the policy consensus that access to finance was a major constraint on the local delivery of basic services and hence equity, job creation and growth. Municipal loans and bonds were also recognised as having strong potential for capital markets deepening and the attraction of foreign investment. Finally, there was also the legacy of the inequalities and vulnerabilities of the homelands policy of the pre-democracy era.

Not a large bank in the South African financial sector context, the DBSA has pursued an aggressive balance sheet growth strategy, but its performance weakened over 2011-2013 and it required a total ZAR 11.7 billion (USD 900 million) of new equity in two tranches during 2015-2016. It has since restructured and improved the quality of its loan portfolio in an attempt to become more of a market leader and diversify its own funding sources, particularly through credit lines and partnerships with international DFIs. Its main development instrument remains senior loans with limited equity and investment in bonds; all non-transactional services are priced at full cost recovery. As it does not take deposits, it is mainly reliant on the domestic capital market for funding, and is strictly regulated. The latter market, although relatively well-developed and with long-term tenors, is volatile and relatively high-cost. Currently, the South African economy is in recession, with the Rand depreciating over 15 percent in 2018.

The DBSA seeks to play a more catalytic role in overall infrastructure investment mobilisation, and to enhance development impact and its own value proposition, while at the same time trying to increase its competitiveness compared to other DFIs and commercial banks, given its small ZAR 80 billion (USD 6 billion) balance sheet and strict statutory sustainability requirements. Recent years have seen some progress on crowding-in investment, but project preparation (and disbursed loans) dipped sharply in 2016/17. National economic and political issues also directly impact its domestic public sector client base. It has a single head office in Midrand, and at the end of 2016/17, it had some 491 permanent employees, plus 97 contracted staff in municipal infrastructure delivery¹.

Mandate

Based on the latest Integrated Annual Report 2016/17, the DBSA's vision is: "a prosperous and integrated resource efficient region, progressively free of poverty and dependency"². This vision centres on financial and development interventions in energy, water, transport and communications, but with secondary support in health, housing and education. The corresponding mission is to advance the development impact in the region by expanding access to development finance and effectively integrating and implementing sustainable development solutions so as to:

- improve the quality of life of people through the development of social infrastructure;
- support economic growth through the investment in economic infrastructure;
- support regional integration; and
- promote sustainable use of scarce resources.

¹ No public financial or operating information was available for 2017/2018 at the time of writing.

² DBSA. Annual Report. (2016-17). [Online]. <<https://www.dbsa.org/EN/About-Us/Publications/Annual%20Reports/DBSA%20Integrated%20Annual%20Report%202016-17.pdf>>

Over the last three years, the DBSA has modified its strategy to become an organisation that will enable the mobilisation of ZAR 100 billion (USD 7.5 billion) in infrastructure annually by 2020. Achieving this target will require considerable leverage of other financial sources, mainly private³. Emphasis is now placed on substantial growth in development impact, and providing integrated infrastructure solutions throughout the value chain, as well as maintaining the DBSA's financial sustainability. In summary, the DBSA aspires to be a trusted third-party between public and private sectors, catalytic throughout the value chain but particularly taking early stage risks (and rewards), as well as remaining active in the management and improvement of infrastructure assets. Innovation is also stressed, but there is limited specific evidence to date of what this means in practice.

The 2020 corporate targets are highly challenging. As well as the annual investment value, others refer to preparation of a gross value bankable project pipeline of ZAR 25 billion (USD 1.9 billion) and nearly ZAR 18 billion (USD 1.3 billion) of funds under management. For 2016/17, the actuals for project preparation/ approval and funds management, respectively, were ZAR 600 million (USD 40 million) and ZAR 3.3 billion (USD 200 million).

Institutional Structure

The DBSA is a South African government-owned DFI with a specific legal and regulatory status, and is integrated within the public sector financial management system. There is no intent to widen or divest ownership. The institutional structure of the DBSA continues to evolve in line with its statutory and market positioning. At the same time, it is still a key development platform for the South African Government, and its activities in municipal social and economic infrastructure – particularly basic service delivery at full cost recovery – retain a public sector character.

Recent institutional and other changes have been driven by funding constraints, domestic and international competition, and cyclical performance. There is also a heavy client concentration, with seven loans accounting for some 55 percent of the loan portfolio⁴. Institutional restructuring has tended to

follow rather than lead market drivers; it is also clear that more systematic change in scale is inevitable if the 2020 strategic infrastructure objectives are to be met.

Governance Structure

The Minister of Finance is the Governor of the DBSA and is responsible for the appointment of a 14-member Board of Directors, including the Company Secretary. There are 10 independent non-executives, which include union, academic and NGO representatives. The DBSA CEO and CFO are also members, as is a Director nominated by the Treasury. The Chairman is an independent non-executive.

Below the Board, day-to-day control is by a senior management team and four-person steering committees on asset liability and supply chain; investment; infrastructure delivery; knowledge management; and corporate services. No executive directors serve on the Board audit and risk or HR/ remuneration committees.

Based on the Association of African DFIs governance rating system, the DBSA was awarded an A plus in 2016/17.

The DBSA is closely regulated, and its annual investment/borrowing plan is formally approved by the Treasury. Legislation restricts borrowing to a maximum of 2.5 times equity plus capitalisation minimum ratio (equity/loans) at 28.6 percent. It also has 4.5 percent target rate of return and is required to be financially sustainable. Lending outside South Africa cannot exceed one third of the portfolio. Under the DBSA Amended Act No. 41 of 2014, its authorised share capital was increased to ZAR 20.2 billion (USD 1.5 billion).

The Board operates a balanced scorecard methodology and publishes a suite of reports on an annual basis that include the Integrated Annual Report, Financial Statements and a Sustainability Review. There is no dividend policy. The authorised share capital can only be increased by the Treasury, and is divided into 2.02 million shares of ZAR 10,000 each. As of 31 March 2017, DBSA assets totalled ZAR 83.7 billion (USD 6.25 billion); the main components being: development loans at 85 percent, equity investments at seven percent and development bonds at one percent⁵. The dominance of loans varies only marginally across clients, sectors and geographies.

3 It was criticised for straying from its tight infrastructure mandate, particularly via equity investments in productive sectors. It also administered the now curtailed national Jobs Fund and is active in black empowerment financing.

4 The top 10 clients in 2016/17 accounted for 60 percent of the loan book and the top 20 some 71 percent.

5 These are all South African municipal bonds and are held to maturity.

The DBSA historically operated four reporting segments based on the underlying business units: South African financing, international financing, infrastructure delivery and treasury. However, from April 2016, it has adjusted its market-facing divisions to fit its new catalytic, integrated solutions and sustainability strategy⁶. These provide focus for new business development in terms of client coverage, transactions and project preparation. These are supported by finance, HR and infrastructure delivery and management units. The Board delegates specialist oversight to four main committees: Audit and Risk; Credit and Investment; HR, Remuneration, Nominations, Social and Ethics; and Infrastructure Delivery and Knowledge Management.

Project origination varies by client type, sector and geography (national or international). Across the 283 municipalities in South Africa, there is a wide divergence in creditworthiness and capacity, and DBSA project preparation activities reflect this. DFIs or private or provincial governments have higher capability, but tend to want financing and technical expertise support in the higher-risk early stages; the DBSA has its own limited project preparation resources, but it has also convened a portfolio of facilities, funds, partnerships and credit lines that assist the DBSA to boost project pipelines and gain early access to transactions.

The DBSA managed the innovative Renewable Energy Independent Power Producer Procurement (REIPPPP) Programme, which included ZAR 80 million (USD 6 million) of DBSA loan finance but unlocked some ZAR 200 billion (USD 14.9 billion) of mainly private investment and added 6,000MW of renewable energy. As program manager, the DBSA also helped create local Community Trusts, which became part of the ownership structures and accelerated take-up⁷.

The REIPPPP Programme is credited with opening up the South African renewables market; as well as being the program manager to the sponsoring Department of Energy (DOE) and Treasury, the DBSA was the joint-mandated lead arranger and underwriter; it also provided debt finance to Black Economic Empowerment groups and Community Trusts for purchase of equity. The DBSA operates a standardised pricing model for loans to deliver a risk-adjusted return on capital, Net Present Value and a sustainable profit on an economic basis. It has extensive risk management procedures and systems; it reports monthly and quarterly to management. Despite a collapse in project preparation and a one quarter fall in development loans distributed in 2016/17, it still reported a net profit of ZAR 2.8 billion (USD 200 million). This was achieved primarily by an increase in non-interest income and a fall in operating expenses.

Apart from the statutory and corporate investment criteria detailed above, the infrastructure mandate is the main driver, with increasing importance given to development impact in terms of total funds mobilised or household and community outcomes. Problems of attribution or measurement of outputs/outcomes over the longer term are not reported; there is also preference given to aggregate results over projects or programs⁸. It is not clear if systematic, independent evaluations are undertaken or how time lags are dealt with. There has also been some criticism that sustainability has been largely interpreted as financial and has not sufficiently included environmental or social dimensions⁹. But the DBSA can argue that its appraisal systems and partners reflect good practice and that they are becoming a major domestic hub for green finance. The DBSA reports itself as: "Bigger than its Balance Sheet."

6 DBSA. Financial Mail Infrastructure Special Report. (June 2018). [Online]. <<https://www.dbsa.org/EN/DBSA-in-the-News/NEWS/Pages/Financial-Mail-Infrastructure-Report-2018.aspx/>>.

7 Community Trusts provide local residents and community stakeholders with a legal instrument to invest in the equity of a renewable energy generation project. This facilitates local involvement and community voice.

8 For example, all financial and development impacts are based on committed or ex ante investments not actual and households are simply referred to as "impacted."

9 Danny Bradlow and Chris Humphrey. Boston University Global Economic Governance Initiative, Working Paper No 4/ 2016, "Sustainable Infrastructure Investment: Development Banks in Africa,"

Capital Structure and Sources of Finance

Liabilities, at a total of ZAR 51.6 billion (USD 3.9 billion), are mainly financial market debt at ZAR 36.4 billion (USD 2.7 billion). Lines of credit add another ZAR 14.0 billion (USD 1 billion). For short- to medium-term financing, the DBSA held five auctions on the Johannesburg Stock Exchange in 2016/17; all were reported as oversubscribed. The DBSA also has a revolving credit facility, as well as foreign exchange funding through DFI credit lines. Total equity was ZAR 32 billion (USD 6.2 billion).

The DBSA reports a number of standard financial indicators, such as total capital and reserves relative to development loans at 45 percent. The long-term debt to equity ratio at end 2016/17 was 158 percent (excluding callable capital of ZAR 20 billion (USD 1.5 billion)). With callable capital, the rate was 97 percent and the overall return on assets was 3.4 percent. The majority of the net cash generated is from operations, and roughly 60 percent of operating income is from within South Africa. The recent injections of equity from the South Africa Treasury were designed to give more headroom in gearing, and the DBSA still has an aggressive growth strategy for its balance sheet, but remains constrained by its business and funding model, plus the statutory regulations that govern it as a fully government-owned DFI.

The DBSA has credibility with other international DFIs and green investment facilities operating in the South African and the wider Southern African region. The extension to include all of Africa was clearly designed to help this partnership/cooperation position. As noted above, the DBSA has partnerships, fund management and agency relationships with a number of internal and external environmental and development actors¹⁰. These include grants, technical assistance, guarantees, bridging finance and reimbursable fees, as well as loans and equity instruments. The DBSA can offer loans in SADC countries without sovereign guarantees. It also provides capacity development, project preparation and master planning to vulnerable or under-resourced municipalities, as well as the delivery of basic services and asset management.

Moody's reviewed the DBSA credit rating in March 2018, and assessed it Baa3 for long-term foreign currency issues with a stable outlook. This is the same as the national government. It noted the DBSA had high capital buffers but also high credit concentration and an aggressive growth strategy that will require new funding sources during a period of capital market volatility. In line with the main credit rating agencies' methodology for government-owned entities, the DBSA's credit rating is correlated to the sovereign outlook.

Table I-1 – DBSA ratings as of 28 March 2018

Agency	Issuer rating type	Short-term	Long-term	Outlook
Fitch	National scale	F1+ (zaf)	AA+	Stable
Moody's	Foreign currency	Prime-3	Baa3	Stable
	National scale	P-1.za	Aa1.za	Stable
	Foreign currency	B	BB	Stable
Standard & Poor's	Local currency	B	BB+	Stable

The DBSA does not report on its cost of capital or the terms on which other credit lines or co-financing are provided.

¹⁰ In mid-2017, a USD 200 million infrastructure investment facility with African coverage was announced for the DBSA through Standard Chartered, with political risk guarantees provided by MIGA. The aim is to provide competitive foreign exchange financing for both project development and investment.

Financing Activities

Of the total development loan portfolio, some 58 percent is in electricity; 18 percent in roads and drainage; and seven percent in social infrastructure. Water is currently at four percent, but it is recognised that water security may be a future growth area. By geography, South Africa accounts for three quarters of the portfolio – mainly Gauteng and Western Cape – and the rest of Africa the remaining 25 percent. By clients, local government (27 percent), public utilities (25 percent) and private sector intermediaries (19 percent) are the largest; all other types are less than two percent.

There is no reporting of the breakdown of financial products or their tenure by sector, client or geography. Pricing is based on commercial terms except where the DBSA manages or has access to a specific external fund or facility that can offer concessional terms¹¹.

Looking at 2016/17 annual disbursements, the total DBSA spend of ZAR 12.4 billion (USD 900 million) was distributed as follows: South Africa ZAR 8.7 billion (USD 600 million), with the rest of Africa at ZAR 3.7 billion (USD 300 million).

Apart from the REIPPP Programme, the DBSA was also a lead player in the post-2006 IPP programs, principally the Avon and Dedisa plants, with a combined 1,005MW capacity, both of which are now operational. It provided both senior debt and financed broad-based Black Empowerment groups. The DBSA has now been displaced in the IPP market by commercial banks, but can claim to have been one of the key initial market-making stakeholders.

The current DBSA strategy emphasises its claim to additionality through its tight infrastructure focus, trusted advisor and convenor status, project preparation capacity and expertise, and integrated infrastructure solutions approach. However, there is minimal published evidence on how this catalytic role is currently being discharged, either in projects or programs or through innovative, relatively high-risk initiatives.

Project performance is heavily influenced by political and economic factors, both domestically and in the region. The delays and operating problems faced by the light-rail Gautrain Project, in both Phases 1 and 2 of the project, are good examples¹².

Examples of DBSA involvement in municipal infrastructure projects include the 100MW Ka Xu concentrated solar project in Northern Cape, a number of urban rapid transit schemes and the Durban University Student Village. It has also acted to restore storm- and flood-damaged social infrastructure in the Limpopo Province, built health clinics and accelerated school construction.

DBSA project and program information for investments in SADC or elsewhere in Africa is only published at a headline level, mainly in aggregate totals and some, partly dated, case studies¹³. Examples include senior debt to hydro-power expansion in Zambia (Ithezi – Thezi project; USD 23 million); senior debt to the Cenpower Kpone IPP in Ghana (USD 53 million); the Kenya Pipeline extension (USD 35 million); and rehabilitation of road networks in Angola and Zambia.

11 Consultation should examine the argument that the DBSA is a relatively high cost provider; also that its public status means that it is slower and more bureaucratic than competitive private sector commercial banks.

12 These include political opposition to fares and service levels, disputes with trade unions and financial accountability problems in municipalities.

13 DBSA. Société Nationale Des Pétroles Du Congo (SNPC). [Online]. <<https://www.dbsa.org/EN/About-Us/Projects-2017/Pages/SNPC.aspx>>.

Green Finance

A number of the DBSA's DFI credit lines include green projects, particularly in renewables or energy efficiency. Examples include the Nordic Investment Bank USD 100 million facility announced in February 2018. Also, the New Development Bank USD 300 million loan to the DBSA for the Greenhouse Gas Emissions Reduction and Energy Sector Development Project. In 2016/17, the DBSA became accredited to the Global Climate Fund.

Within its Project Preparation Division, the DBSA has recently announced the creation of a Climate Finance Unit as an initial step towards establishing a green bank capability, and is actively looking for partners to supply development and capital support. This will lead to a new USD 160 million fund, typically with high gearing and targeted to Rand-based economies connected to the Southern Africa Power Pool (the Republic of South Africa, Namibia, Lesotho and Swaziland). The DBSA is looking to attract Climate Investment Funds, GEF and other global facility support. There was no report of DBSA participation in the issue of Cape Town or Johannesburg development bonds or the first green bond on the JSE for Growthpoint Properties in 2018, the latter being a 10-year ZAR 1.1 billion (USD 82 million) bond for green buildings and urban infrastructure. It was linked to the African Local Currency Bond Fund sponsored by KfW.

The DBSA reports a renewable energy portfolio worth ZAR 13 billion (USD 1 billion), with a total capacity of 1,550MW, with most of the projects being in Northern Cape. The 100MW Kathu Concentrated Solar Project closed in mid-2016 and should be operational by the end of 2018. In this instance, the DBSA worked with Absa Bank, Investec, Nedbank and Rand Merchant Bank for a total project investment value of ZAR 13.6 billion (USD 1 billion). The DBSA provided ZAR 1.7 billion (USD 127 million) of senior debt and ZAR 368 million (USD 27 million) for an equity stake by broad-based Black Empowerment groups.

Only 20MW of renewable energy solar projects were linked to DBSA financing activity in 2016/17, with none reported for gas or coal. The DBSA continues to try to accelerate investment in the renewable energy sector. For example, the South Africa Department of Energy is struggling to complete the first two rounds of a small-scale independent power producer program aimed at plants of 1MW to 5MW and, in response, the DBSA is trying to design a Global Environment Facility/Infrastructure Investment Program for South Africa (IIPSA) to accelerate sponsors' access to equity and debt markets. As well as an interest rate subsidy, this includes Black Empowerment finance.

Project Preparation and Technical Assistance Activities

The DBSA preparation activities focus on de-risking individual projects, partnerships, cooperation and programs. DFI credit lines or partnerships include project preparation and technical assistance components, such as the 2017 DBSA/AFD USD 100 million infrastructure loan facility; the DBSA/United States Trade and Development Agency Infrastructure Cooperation Agreement (which aims to accelerate large-scale projects through feasibility studies, technical assistance and pilots); the joint EU and SA Government Infrastructure Investment Program for Southern Africa (IIPSA); and the administration of the SADC Project Development and Preparation Facility, with technical assistance also provided by the EU and KfW.

The DBSA is also the implementing agent of the SA Department of Environmental Affairs Green Fund, this is an initiative to provide catalytic support to the transition to a green economy through three windows: green cities and towns; low carbon energy; and environmental and natural resource management. Priority areas and sectors are listed in annual calls for projects; financing can be grants (including recoverable), loans and equity.

Except through the execution of external programs, the DBSA has neither the staff nor the financial resources necessary to undertake a major scale-up of the development of infrastructure pipelines in South Africa or regionally. In 2017, the project preparation department had total staff of 16, up from 11 in 2016¹⁴. In 2017, total funding mobilised for project preparation, including co-financing, was ZAR 163 million (USD 12.2 million). Technical assistance activities are not separately reported in the accounts or statements.

The Financial Sustainability Review for 2016 /17 details a number of case studies covering the last five-year period¹⁵. The eThekweni Municipality Aqueducts Project involves bulk water supply for a catchment population of over 1 million people; here DBSA/AFD provided a 15-year loan of ZAR 700 million (USD 52 million) and supported a IIPSA ZAR 93 million (USD 7 million) grant within the overall

¹⁴ Other project preparation staff may be in other departments but such skills should be concentrated here. With the increased emphasis on project preparation in the 2017 strategy, this resource may grow.

¹⁵ DBSA. Integrated Annual Report. (2017-2018). [Online]. <<https://www.dbsa.org/EN/InvestorRelations/Pages/DBSA-Annual-Reports.aspx>>.

ZAR 3 billion (USD 0.2 billion) program. The DBSA has also supported the South African Government's public transport policy with PPP preparation in the difficult area of bus rapid transit. Transactions included 10-year loans with flexible tenors, grace periods and interest rates. Successful projects include the Tshwana and Ekurhuleni Bus Rapid Transit projects, plus Phases 1 and 2 of the Gautrain Project. The latter Phase 2 extension is currently stalled, but Phase 1 issues included municipal risk and loan tenors across different concession periods. IIPSA provided a ZAR 40 million (USD 3 million) project preparation grant. An aggregate of some 224,000 households were reported as positively impacted by municipal infrastructure delivery programs, social and economic, in 2016 /17.

Performance Monitoring

The DBSA does not publicly report by project or programs, but by business unit or segment and then higher-level aggregates; it has a comprehensive risk management policy and systems, and generates monthly and quarterly internal management statistics and profiles. There are clear processes for independent and executive investment, pricing and exit or refinancing, but loan instruments dominate and there is some evidence that international activities are more profitable (and dominated by the private sector or its intermediaries) relative to the DBSA's domestic activities.

As noted above, the DBSA is now emphasising its development impact both by crowding-in investment and economic benefits to households, job creation and the use of MSME supply chains. This appears to be monitored and measured at the transaction approval or commitment stage and not through de facto independent evaluations or surveys. Attribution and hence additionality are only addressed on a very high level.

Key Lessons Learned

The DBSA has the reputation of being a public sector 'safe pair of hands' for the administration and implementation of programs and projects funded by external stakeholders. However, more evidence is needed on the extent to which it adds value by expertise or targeted local technical assistance/ equity. The main DBSA successes in South Africa are its role in the REIPPP Programme, IPP start-ups and municipal energy and transport. Its funding of broad-based Black Empowerment and community trusts to enable them to gain equity shares in local projects has been catalytic. However, the DBSA's financing program and regulatory constraints would seem to suggest that the DBSA is less nimble and more risk-averse on the use of its own borrowed or generated resources than larger banks or DFI competitors.

The DBSA has largely maintained its tight strategic focus on municipalities and infrastructure, and has been proactive in trying to convene additional concessional or foreign exchange funds through administration or partnering arrangements. This has included arrangements with the Green Climate Fund, the Climate Investment Fund and the GEF, as well as KfW, AFD and domestic public sources. To date, the DBSA has not sponsored or initiated any green bond or similar activity. It is closely regulated and required to be financially sustainable; except when it can use concessional external funds, this means commercial pricing and full cost recovery. This has forced some innovation in reimbursable grants or refundable technical assistance for poorer municipalities. Financial activities are dominated by loans, mainly senior debt.

The DBSA is reported in the South African financial press to be at a "tipping point" in terms of value added and relevancy; additionality seems higher in South Africa than in SADC or the rest of Africa. It will continue to face strong competition from DFIs, plus larger commercial and investment banks, and its main effectiveness seems to be at the smaller, more programmatic end of projects, where its local knowledge, convening power and expertise is greatest and there is evidence of best practice. To maintain its niche, it will need to increase its project preparation capacity and funding.