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Commentary

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IFC Report Advances Debate on Mining Infrastructure

International Finance Corporation evaluates alternative models for ownership, operation and financing of rail and port components of integrated projects in Sub-Saharan Africa

The International Finance Corporation (IFC), a subsidiary of the World Bank Group, has recently published a report aimed at furthering the on-going debate concerning the appropriate model for owning, operating and financing critical "pit-to-port" infrastructure (mainly, rail and port) necessary to unlock world-class greenfield mining projects in Sub-Saharan Africa (SSA). The Report, "Fostering the Development of Greenfield Mining-Related Infrastructure Through Project Financing," addresses a large-scale challenge. A major international bank recently highlighted the scale, estimating that $50 billion worth of infrastructure investment is required to exploit SSA's pending iron ore projects alone.

The debate over mining infrastructure has arisen due to the sometimes conflicting goals of the various stakeholders in these projects, including:

- Major mining companies, which are often reluctant or unable to underwrite the entire infrastructure cost (which can vastly exceed the mine construction cost) but who would prefer to control such infrastructure for reasons of operational efficiency and flexibility;

- SSA governments, which are seeking to ensure that new infrastructure supports planned "transportation corridors," is accessible to other industries (including agri-businesses) and is able to support the efficient development of other viable mineral deposits; and

- Sponsors of small-to-intermediate mining projects, which are seeking long-term access to any existing or future infrastructure on fair and non-discriminatory terms.

The Report's Main Conclusions

The IFC's following conclusions likely will be of interest to our clients who are engaged in mining, infrastructure construction/operation and/or project financing activities in Africa:

1. SSA countries that IFC categorizes as "frontier" jurisdictions (including Republic of Guinea, Mozambique and Sierra Leone) do not, in IFC's view, have the capacity to undertake the financing or construction of major mining infrastructure projects themselves.
2. A "bankable" private-sector model for mining infrastructure will need to involve an investment grade "anchor" mining client, which owns the infrastructure directly or provides a "take-or-pay" (TOP) commitment to a special purpose vehicle (SPV) that owns the infrastructure. A TOP commitment would need to guarantee sufficient cash flow to meet the SPV's debt service obligations.

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3. IFC reasons that the level of usage needed to support a bankable TOP commitment on a major infrastructure project inevitably will be quite high. IFC concludes, therefore, that its anchor client model will work best when a single client develops a very large mining project, or possibly a "pool" of clients with smaller projects are able to "achieve a similar outcome."
4. IFC believes that an anchor mining client will demand, and should be granted, certain "founder rights" in exchange for funding, or supporting the financing of, mining infrastructure. IFC offers that such rights might include: (i) secured priority access, (ii) rights over infrastructure expansions, (iii) preferential tariffs, (iv) operational control and (v) dedicated handling facilities.
5. IFC is concerned that the level of political risk in frontier SSA countries may, in any event, severely limit the amount of third party debt capital available for infrastructure projects (assuming a debt-to-equity ratio of 50:50).
6. IFC acknowledges that mining companies have in the past shown "limited interest" in sharing mining infrastructure with third parties. However, IFC believes (in principle) that new mining infrastructure in SSA should be made available to competing mining projects and other users (including passenger rail). IFC focuses on the need to align the interests of an anchor mining client and the host government, which can only be achieved through an appropriate access regime.
7. IFC considers various access models, and states its preference for a "haulage model" in which the anchor mining client provides transportation services to all users, rather than a more traditional "open access" arrangement in which all permitted users own and operate their own rolling stock. A haulage model (although not commonly used within the mining industry) will, IFC believes, minimize operational risks (*e.g.*, rolling stock failure) in the SSA context.
8. IFC recommends that the terms and conditions of access should, whenever possible, be settled up-front between a host government and an anchor mining client (typically within a mining concession agreement). Such terms and conditions should, it suggests, guarantee: (i) a right of third party access if spare capacity is available and (ii) access charges that are fair and non-discriminatory. IFC also suggests that any negotiated mining royalties might be made subject to adjustment if the anchor mining client's operating costs increase unexpectedly (*e.g.*, due to third-party access demands).
9. IFC accepts that third party access will need to be secondary to the anchor mining client's operational and financial priorities, as well as to any project lender-imposed restrictions.
10. When considering the appropriate timing for granting third party access to infrastructure, IFC highlights the "unique sets of challenges" associated with mining infrastructure projects, the cyclical nature of commodities markets, and the benefits to a country of establishing a positive "track record" with international investors. The Report suggests that, in some cases, third party access rights may need to be implemented further "down the road."

What Next?

The Report has been published at a critical time for the mining industry. Weakening commodity prices and an uncertain global economic outlook have called into question the viability of developing certain SSA mining projects (which have already experienced significant delays) in the near term. SSA governments, which are seeking rapid economic development, are obviously frustrated, which has led some countries to strike ground-breaking (but controversial) "resource-for-infrastructure" (R4I) deals with Chinese and other state-owned entities.

The Report appears designed to build a consensus around a private sector solution to this challenging and urgent issue. However, the Report's conclusions will inevitably spark further debate, including on the following questions:

- The concept of an investment-grade anchor mining client supporting a greenfield mining infrastructure project is generally sound. However, will mining companies want to have direct ownership of the infrastructure, given the funding obligations that such ownership would normally imply?
- The idea of an SPV owning mining infrastructure is also sensible, but will mining companies want to fund all or a substantial portion of the SPV's equity, and can fair access ever be achieved if the anchor mining client controls the SPV?
- Might a well-structured infrastructure project benefitting from a strong contractual TOP commitment achieve a debt-to-equity ratio higher than 50:50?
- Will anchor mining clients be attracted to IFC's "haulage model," with the potential liability and operational complexity it could entail?
- What regulatory models will support a fair and effective access regime, and is there a role for international bodies such as the World Bank?
- What practical steps can SSA governments take to resolve the cross-border issues that have, to date, prevented more efficient transportation solutions from being realised (an issue that the Report touches on only briefly)?

The Report can be obtained online by searching for "IFC mining infra report."

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