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Infrastructure opportunities

Africa: a new port of call for international operators

In order for Africa to fully achieve its economic growth potential, a significant improvement in the quality and scale of its infrastructure is required. Without this, coupled with other reforms and further investment, Africa's potential will remain just that.

The need to upgrade and expand infrastructure does, however, represent a significant opportunity for international investors looking to develop and finance infrastructure in Africa and share in the benefits this can bring.

In this briefing, we analyse some of the opportunities and issues that international investors are likely to encounter in the context of African port projects.

African potential

Africa is among the world's most rapidly growing regional economies, with one-third of African countries having gross domestic profit (GDP) growth rates of more than 6 per cent[i]. The continent's middle class is also emerging at a rapid rate; income for almost 350m Africans now stands at between $2 and $20 a day[ii]. Africa's collective GDP of around $2trn is now roughly the size of Brazil or Russia's[iii] and the resources sector now accounts for a third of the recent wave of economic growth.

In order for Africa to maintain this growth and to fully achieve its economic potential, however, there is an urgent need to address a continuing shortage of adequate physical infrastructure on the continent. This is particularly the case in the context of the port sector, which plays a crucial role in stimulating economic growth and facilitating trade.

Case study – development of a multi-purpose terminal at Lagos, Nigeria

Ashurst is currently advising a major Nigerian conglomerate on the development, project financing, operation and maintenance of a multipurpose terminal at Apapa port in Lagos, Nigeria.

The project involves (i) the expansion of an existing berth; (ii) the development of a new terminal which will import and export, amongst other things, general cargo, containers, bulk cargo, roll on/roll off vehicles and liquid bulk cargo; and (iii) the development of an inland container depot which will be used for the storage of containers, vehicles and cargoes related to the terminal.

The Ashurst team is being led by partners Joss Dare and David Charlier from our Dubai office.

Inefficiency in the port sector

The challenges facing the port sector in Africa are well publicised. Africa has a low concentration of ports by world standards. There are a number of significant small to medium-sized ports on the continent but Durban remains the only location that ranks in the 50 largest container ports in the world.

Due to a lack of investment and outdated operating techniques, Africa's ports have also traditionally suffered from inadequate physical capacity, poor information technology, cumbersome cargo clearing systems and insufficient overland transportation links which are crucial to delivering goods to market in a timely manner.

The inefficiency of Africa's ports, when looked at in comparison to global standards, is highlighted in the following figures:

- the number of container moves per crane hour averages 10 to 20 on the African continent, in comparison with 25 to 30 moves globally;
- general cargo handling in Africa averages 7 to 25 tonnes per crane hour, as opposed to more than 30 tonnes for global ports;
- average container dwell times are 6 days in Southern Africa, 12 days in East Africa and 15 days or more in West Africa. The widely accepted international standard is 7 days or less, with the world's leading ports, such as Hong Kong and Singapore, achieving much less; and
- average cycle times for trucks dropping off and picking up containers at a terminal are 4 hours in Southern Africa, 5-6 hours in East Africa and 10 hours or more in West Africa. The accepted standard for an efficient cycle is 1 hour[iv].

In the last decade there has been a far greater number of large African container terminals let on a concession basis to international operators, as African governments have begun to shift towards privatisation of the port sector. Examples include:

- French operator Bolloré Africa Logistics has 14 port concessions in Africa;
- Dubai-based DP World operates terminals in Algeria, Djibouti, Mozambique, Senegal and South Africa;
- In West Africa, APM Terminals (a division of A.P. Moller Maersk Group) has operations across nine ports in eight countries, with several facilities currently undergoing expansion and a new second container terminal under construction at Abidjan, Ivory Coast; and
- Terminal Link, jointly owned by CMA CGM and China Merchants Holdings International, operates terminals in Ivory Coast and Morocco and has entered an agreement to construct a deep water port in São Tome and Principé.

While, therefore, progress has been made in attracting more international investment, it is clear based on the still relatively low figures of foreign investment (the largest global operators handle around 20 per cent of throughput in Africa, compared to nearly 70 per cent globally)[v] that there remains significant opportunities for operators and lenders to invest into the African port sector.

Success stories

Despite the challenges facing the port sector in Africa, in recent years international operators have been awarded concessions for a number of ports around Africa and this trend looks set to continue.

Port at Douala, Cameroon

A good example of this is the TICTS container terminal at the port of Dar es Salaam which was taken over by Hutchison Port Holdings in 2000 and has since become a far more efficient operation. Major improvements include the addition of a fourth berth in 2009, the development and installation of a sophisticated terminal software operating system, and a $20m investment in five new cranes at the end of 2013[vi]. Each of these improvements may not have been possible without the presence of an international operator.

Port management models

There are three main port management models which differ according to the level of responsibility assumed by each of the public and private sectors. These are commonly known as the **service model**, the **tool model** and the **landlord model**:

- **Service model**: infrastructure, superstructure and services are all managed by a port authority, which could be public or private. An example of this type of model is the **Port of Mombasa in Kenya**, which is owned and managed by the Kenyan Port Authority;
- **Tool model**: the port authority owns the superstructure and equipment while the private sector operates the facilities through licenses or management contracts. An example of this type of model is the **Port of Chittagong in Bangladesh**, which is owned by the Chittagong Port Authority and which contracts out labour services to the private sector;
- **Landlord model**: the port authority owns the facilities and either rents or awards a concession for these facilities to the private operator. An example of this type of model is the **Apapa Container Terminal in Nigeria**, which is operated on a concession basis by APM Terminals.

From the public sector viewpoint, the service model offers the greatest level of control (assuming the port authority is a public entity), followed by the tool model and then the landlord model.

The service model has traditionally been the dominant management model in Africa and, together with direct government involvement in the provision of port services, is widely seen as being responsible for the inefficiency of ports in Africa.

However, as noted above, African governments are beginning to shift towards privatisation of the port sector. The landlord model is increasingly being adopted, either wholly or partially, by certain African countries, for example Nigeria and Ghana.

Port concessions

While privatisation of ports can be realised through a number of alternative modes of privatisation, as mentioned above, the trend in Africa has seen the increasing use of the landlord model, involving the grant of a concession by a port authority to an operator.

A number of port developments in Africa are setting the scene for future port projects on the continent and demonstrate the increasing role of international operators.

Concessions can be granted by port authorities in a number of circumstances, including:

- for the operation of an existing public terminal;
- for the operation of an existing terminal that must undergo large-scale reconstruction and be re-equipped; or
- for the construction and operation of an entirely new terminal.

We have set out below some of the more common issues and considerations in respect of port concessions.

Duration

The term of the concession will vary from country to country, but should generally be of sufficient duration to reflect the high-cost and long-term nature of port infrastructure and allow the relevant investors/operators sufficient time in which to earn a return and, if relevant, repay and financing provided to fund improvements. By way of example, concessions awarded during the Nigerian port privatisation process between 2003 and 2006 had terms of between 10 and 25 years and a new greenfield port project near Lagos has recently been awarded a concession with a term of 45 years.

Many concessions will also provide rights of renewal which, from an operator's perspective, allows the operator to renew or extend the term of the concession and, from a port authority's perspective, avoids lost time and expertise that would otherwise occur if a new operator had to be found.

Rights and obligations of the operator

Operators will typically be granted broad rights under a concession in order to develop the port and associated business. If the host government/port authority is serious about improving efficiency and benefiting from international expertise, then the granting of broad rights gives the private sector the opportunity to manage the port as they see fit, subject to any particular parameters set out in the concession agreement. Parameters often include the operator confining its operations to a defined area and carrying out those operations exclusively for port purposes. Depending on the business model for the particular port, operators will need to ensure their rights are not unduly fettered by restrictions on the types of cargo they can handle.

Other matters that operators should have regard to include:

- the right of the operator to transfer its rights under the concession to third parties;
- any share transfer restrictions imposed in the concession agreements. Often the port authority, when awarding the concession agreement, places great emphasis on the experience and ability of the operator to maximise the throughput and efficiency at the port. As a result it will often look to "lock in" the key shareholder(s) at particular shareholding levels for particular periods; and
- the delineation between ownership of infrastructure (which will typically remain with the

port authority) and moveable equipment (which will typically remain with the operator) and how this is dealt with at the end of the concession period (e.g. does the moveable equipment necessary for the continued operation of the port transfer to the port authority in return for payment?).

Each of these can impact the extent to which operators can grant security to lenders, if relevant. For example, it could be problematic for the operator to grant security over infrastructure if it is required under the terms of the concession to transfer ownership of that infrastructure to the port authority. The relevant local law regime as regards security and property ownership (which is, of course, very diverse across Africa) will be relevant.

Rights and obligations of the port authority
Regulatory functions are, by and large, still carried out in Africa by port authorities. Other than South Africa, there are no independent regulators to monitor the performance of port authorities or the setting of tariffs, for example. Therefore, operators should expect that port authorities will retain rights under the concession to exercise regulatory functions. Any exercise of regulatory functions by the port authority should, where possible, be in line with the operational plans and schedules of the operator and will very much depend on the particular jurisdiction and level of involvement of the port authority.

Matters that operators (and lenders) will be keen to: ensure fall within the remit of the port authority include provision and maintenance of: (i) necessary supporting infrastructure; for example, breakwaters, turning circles and access roads; and (ii) marine and security services. Depending on the particular location, dredging may also be an issue, as the increasing size of container vessels means increased draught requirements which can be an issue if the particular port is subject to silting etc. The availability of dredging vessels also needs to be considered.

Operators may seek to limit the extent to which the port authority can award a concession for, promote or commence construction of another competing terminal at the port or in a nearby port area. Likewise, port authorities may seek to control the extent to which operators can compete with other terminal operators for particular types of traffic, within defined geographical areas and/or for stated time periods.

Payment and performance
Unlike many other types of concession, in a port concession the operator may be required to pay fees (or rent) to the port authority rather than vice versa. Fees will typically be a function of a fixed fee and/or a variable fee based on a percentage of throughput (i.e. revenue share). The port authority may also insist on a throughput guarantee or lesser form of assurance from the operator. In the case of the former, given the market risk assumed by the operator, it is important to set this at a level that allows for significant throughput downside (e.g. a post global financial crisis type scenario). The fee should ideally be expressed in US dollars or some other form of hard currency (matching the currency of revenues) and is often subject to adjustment for inflation.

Port authorities may also impose performance criteria backed with a financial incentive/penalty regime in order to encourage extra traffic and throughput at the port. Performance can be measured against, among other things, the number of container movements per crane working hour, the number of container movements per ship working hour, the equipment availability time or the truck turn-around time from entry to exit in the terminal area. What is appropriate will depend on the characteristics of the particular port.

Waterfront Port at Cape Town, South Africa

Land rights
It is likely that lease/licence conditions will form part of the concession agreement or be the subject of a separate lease or licence agreement. As noted above, port authorities will typically retain ownership of infrastructure and will lease or licence that infrastructure, together with the land on which it is located, to the operator. Responsibilities and liabilities that are imposed under the concession or lease/licence will need to be carefully considered, particularly with respect to environmental contamination and any obligations to return the leased/licensed land in a particular state. Any separate lease/licence will need to match the terms of the concession agreement in terms of duration.

Force majeure and relief events

Consideration should also be given to the extent to which an operator is entitled to relief from its financial obligations and/or an extension to the term of the concession upon the occurrence of a *force majeure* or similar event; for example, war, terrorism, embargoes or blockades. In any case, operators should evaluate to what extent they are able to obtain insurance to cover the risks of these events.

Termination

Port authorities will typically require rights to terminate the concession due to default of the operator and likewise the operator will also want a right to terminate for port authority termination events. Operators should be given a reasonable period in order to remedy an event of default before the port authority is entitled to terminate. There may also be mutual rights to terminate as a result of a continuing *force majeure* event.

Upon termination or expiry, in order for the port to continue to operate, all fixed and moveable assets of the operator will need to be transferred back to the port authority. Termination payments will typically be payable on termination of the concession and will need to take into account the value of these fixed and moveable assets, whether by reference to market value or some other appropriate formula. Any lenders will also evaluate closely to what extent termination payments will be sufficient to cover repayment of senior debt. In each concession agreement the level of termination payment offered in the different termination scenarios will need to be carefully evaluated in light of the level of investment, the expected return made by the operator and its shareholders, the role shareholders or third party financing will play in the development of the port, and the type and value of equipment to be transferred to the port authority following termination.

Port at Casablanca

Expiration

Upon expiry of the concession, the infrastructure and moveable assets will need to be transferred back to the port authority. The condition in which the facilities are handed back and, as mentioned above, the extent of any compensation payable by the port authority to the operator for those facilities will vary depending on the concession.

For example, the port site may need to be handed back in its original condition or it may simply need to be handed back on an "as is, where is" basis. In the case of the former, the likely level of expenditure required to reinstate will need to be evaluated.

Arbitration and governing law

Arbitration is likely to be the preferred form of resolution in the event of a dispute between the port authority and the operator. From an international operator's point of view, arbitration under internationally recognised rules (e.g. ICC) in a neutral venue (e.g. London or, for francophone Africa, Paris) is preferred where possible.

The governing law is likely to be the law of the country in which the concession is granted. International lenders may have a preference for UK or US law as the governing law if this is a realistic option, but it must be remembered that the range of legal systems that operate in Africa is diverse and can be common law or civil law based, depending on the history of the particular country.

Other issues

Above we have highlighted some of the main issues to be considered in the context of port concession agreements. In the interests of keeping this briefing concise, the issues described above are not exhaustive and other issues common to concession agreements, such as conditions precedent to commencement, the precise nature and timing of any construction obligations, change in law and local content requirements, events entitling the operates to compensation, standard of operation required, indemnity arrangements, insurance and subcontracting arrangements will also need to be considered. In general, the operator will also need to consider its subcontracting strategy (if relevant).

Those ports which have attracted international operators have, on the whole, been able to increase handling rates over time and lower charges to customers.

Conclusion

There has been a shift in outlook by many African governments towards attracting international port operators to improve the efficiency and profitability of ports. This represents a significant source of opportunity for international operators, investors and lenders.

Geographically, we are seeing increased interest from Asian clients in port opportunities in East Africa in particular, as the East Coast ports potentially offer a route to market for products and resources from Africa destined for Asia. The increase in Chinese, Japanese and Korean investment in Africa over the last few years, particularly in sectors such as resources, means that for a number of investors investment in port operations results in substantial synergies with other investments.

The issues associated with investing in port projects in Africa are, to a certain extent, similar to the issues associated with investing in port projects elsewhere in the world, though the developing legal systems in Africa, many of which are still playing "catch up" with the increased levels of investment, add a degree of complexity to these transactions. Operators, investors and financiers will, therefore, need to consider issues on a country-by-country basis in order to properly evaluate the opportunities.

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[i] African Development Bank Group. "Annual Development Effectiveness Review, 2013. (3rd Edition)", Page 1

[ii] African Development Bank Group. "Annual Development Effectiveness Review, 2013. (3rd Edition)", Page 1

[iii] McKinsey Global Institute. "Lions on the Move: The Progress and Potential of African Economies", Page 1

[iv] Vivien Foster and Cecilia Briceño-Garmendia for World Bank Publications. "Africa's Infrastructure: A Time for Transformation", Page 253

[v] Vivien Foster and Cecilia Briceño-Garmendia for World Bank Publications. "Africa's Infrastructure: A Time for Transformation", Page 254

[vi] www.ticts.net

Further information

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