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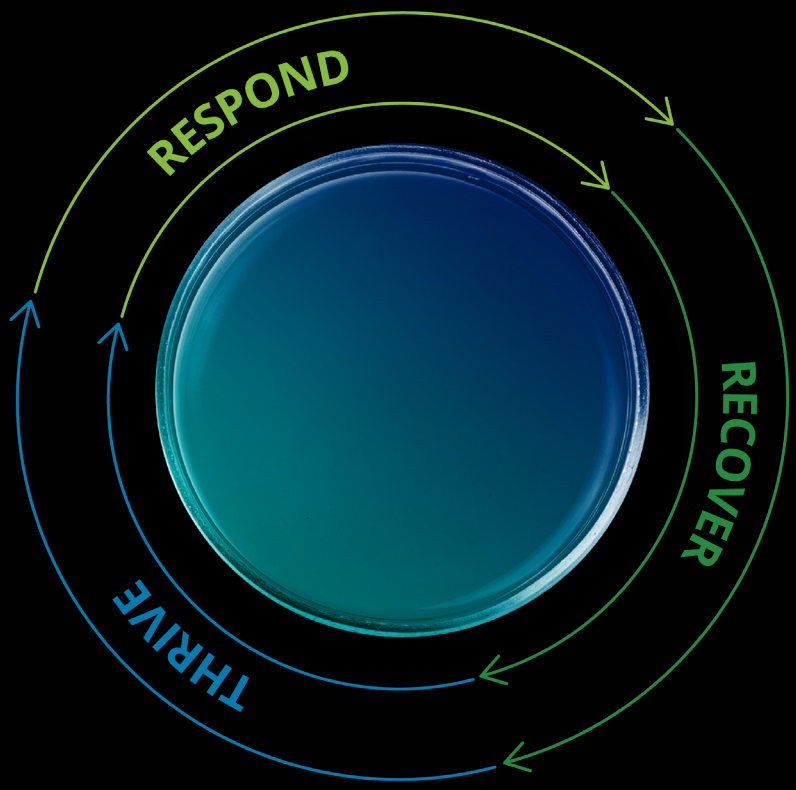

The Impact of COVID-19 on infrastructure projects and assets

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Introduction

The novel coronavirus ("COVID-19") pandemic is unprecedented and its impact continues to threaten economies globally. The pandemic is affecting various industries and sectors, some more than others. The impact on infrastructure companies can be assessed during any of the following phases: development, construction and operations. EPC contractors are declaring force majeure and/or off-takers are defaulting. This is creating liquidity challenges resulting in funding gaps.

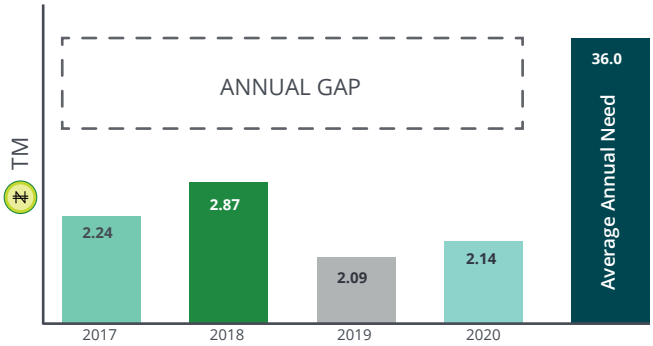
In this article, we highlight the impact of COVID-19 on infrastructure projects and assets and share key considerations for responding to the adverse effects of the pandemic.

Current state assessment

A notable adverse impact of the pandemic is the plunge in oil prices as a result of the sharp decline in crude oil products globally. Oil prices have plummeted to an all-time low of US$25 per barrel, pushing economies into potentially huge budget deficits with some advance economies heading towards a recession. To compound the situation, there have been capital flights.

The Government might prioritize its spending commitment in light of the pandemic, with a revised budget for 2020 focused more on recurrent expenditure, this could impact the annual gap in infrastructure investment in the short to medium term, except with interventions.

Annual Capex budget vs Infrastructure need



Source: Budget office, National Integrated Infrastructure Master Plan and Deloitte Analysis

We equally envisage a high possibility of stranded assets due to the inability of sponsors and/or investors to finance such assets, thereby creating a pipeline of opportunities for financing.

In what appears to sound gloomy lies the opportunity for infrastructure investors to acquire valuable hard assets from a valuation perspective (which is typical during an economic downtown) and reposition for the longer term when various initiatives have stabilised and there is an economic rebound.

Key questions to ask during Covid-19

1. Are projects in the development phase still viable and bankable given changes in the economic and social environment?
2. How much will project planning pre-financial close be affected? Will the assets generate enough revenue to cover the costs and risk of the investments?
3. How will the pandemic affect private sector involvement in infrastructure development and financing going forward?
4. For assets in operations, will investors be able to recoup funds invested as well as expected returns?
5. How long can the public sector honour signed agreement(s)?

Key considerations

1. The infrastructure sector utilises people and equipment (largely fixed costs), thus compa nies and contractors with high levels of debt and low cash reserves may face a liquidity crisis.
2. Supply chain interruptions will likely continue, affecting the availability of parts and equip ment, and eventually impact projects.
3. Counterparty risk leading to the liquidation of existing assets over the inability to continue operations.
4. Insurance settlements may be triggered if insurance policies were taken on such assets.
5. There has been a downward spiral in demand and usage of major infrastructure assets like transportation, due to the lock down. This may continue to affect demand even post COVID-19, as well as revenue generated.
6. Projects initially executed in foreign currency face the risk of exchange rate fluctuations, and such existing assets may take a toll for the worse, if not previously hedged or structured.
7. Force Majeure clauses may be triggered, where it is established that the clause mentions specific relevant events and also depending on whether the list of events is exhaustive or non-exhaustive.
8. Possibility of lawsuits arising as a result of failure to keep to the terms of the agreement by relevant participating parties.

Scaling the crisis

One can expect that infrastructure financing will take a downward plunge in the short to medium term. However, once the pandemic is successfully contained, the focus will need to shift from crisis management to assisting to adequately invest in infrastructure for development, as well as preventing and mitigating the impact of future outbreaks contractually.

Possible impact

- Investment contracts may be halted given the large initial outlay required and this will likely lead to liquidity problems during and after the pandemic.
- Projects expected to commence may not see the light of day, as they may take a back seat and linger even after the pandemic, as investors try to manage the existing portfolio.
- Lenders who typically have leveraged exposure are more likely to be affected by the pandemic, with defaults in repayment obligations by the investee companies.
- We expect to see infrastructure funds and investors diversify their portfolios from traditional infrastructure assets to telecommunications, data centres and utilities, as most of the aforementioned can be considered essentials.

Key questions to ask in responding adequately to the pandemic

1. How will liquidity and future cash flows be impacted, given that capital is tied down in infrastructure projects?
2. How do parties-negotiate already signed contracts, given the uncertainty involved and potential capital tie down?
3. How stable and secure are cash flows from debt structured investments given the possible liquidity challenges? Will there be possible debt tenure extensions to weather the storm?
4. Will aspens clause be triggered if embedded in the contract? How should contracts be structured going forward and who should bear the risk in the event of another pandemic? To what extent can a pandemic be a force majeure?
5. Will the current situation affect investors who have bid for contracts and what their bids were estimated on in terms of their long term projections?
6. Will it be most beneficial to proactively approach all the investee companies for a revised forecast of cash projections, to quickly identify possible defaults?

Practical next steps to navigate the distress

1. Taking advantage of the current crisis as a catalyst to rethink how infrastructure assets and investments should be structured.
2. Project planning and management for ongoing projects. This will include assessing the impact of supply delays on project completion.
3. Contract review and re-evaluation with consideration given to incorporating certain key clauses (force majeure clause, aspens clause) to mitigate against risks caused by unforeseen circumstances in the future. Also explore the use of derivative contracts to match the risks associated with investments e.g. Interest rate swaps.
4. Securing credit guarantees for infrastructure investments and ensuring that infrastructure investments are part of a well-diversified portfolio.
5. Deliberately diversify the portfolio and create triggers around prudential guidelines governing the same.

How Deloitte can help

- **Project re-assessment and review of any existing financial models** on which infrastructure investment decisions were based given that certain key assumptions may have changed.
- **Restructuring of existing debt facilities** and special situation advisory by bringing debt advisory, cash management, line by line cost analysis and accelerated solutions to distressed businesses and stakeholders.
- **Buy-side and sell-side advisory support**, more specifically financial due diligence and/or valuation of a target or investee company.

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