Asia project bonds: ready for take-off

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31/08/2016

A plentiful supply of cheap bank debt in Asia Pacific has meant the region has had little need for a project bond market. Until now. Commercial banks are expected to scale back their long-term lending to comply with impending Basel III rules, while multilateral banks, led by the Asian Development Bank, are stepping in to back emerging Asian issuers. The time for projects bonds in Asia may finally be here.

Swimming in liquidity

Until recently, project bond issuance in the Asia Pacific region had run into two major obstacles in almost every country: banks solid enough to offer cut-throat spreads on project finance loans, and keep the loans on their balance sheets.

A case in point has been the major banks in Australia and Japan, the region's most mature capital markets. The so-called Japanese mega banks, Mizuho, MUFG and SMBC, as well as Australia's four majors, ANZ, CBA, NBA and Westpac, continue to dominate their domestic project finance markets.

"Historically, bank financing in the Asia-Pacific region has been so plentiful and so cheap there was no need for the capital markets to step in," said Mark Austen, chief executive of the Asia Securities Industry & Financial Markets Association (ASIFMA) which has just published a Guide to Infrastructure Financing in Asia.

Indeed, the abundance of liquidity at local banks is not unique to the developed markets. In the Philippines foreign banks have struggled to make inroads in the face of local banks' ability to fund infrastructure projects on their own.

Banks reduce long term lending

With the deadline to comply with Basel III looming banks are starting to consider reducing their long term exposure.

"Bank funding will be more restricted as they [banks] seek to comply with Basel III," Austen said.

Even Japan's so-called mega banks, who have been aggressively expanding across the globe, are seeking to move their huge project finance loans off their balance sheets.

In July, Mizuho Bank, widely seen as the most capital-fragile of Japan's three biggest banks, launched a new fund that will sell on its overseas project finance loans to institutional investors. In mid-March rival SMBC launched Japan's first project finance loan securitisation notes.

In Australia and China the banks have taken to issuing green bonds, which will diversify their exposure at least to renewables infrastructure financing. In June, Westpac issued an A$500 million ($377 million) green bond and in early July, Bank of China printed a super-sized $3 billion green bond in three currencies.

Banks in countries with solid credit ratings such as Australia and China may be able to partly finance infrastructure projects by issuing bonds themselves.

For those - whether banks or sponsors - that cannot because their credit ratings are capped by the sub or barely investment grade sovereign ratings of their governments, the multilateral banks are stepping in.

The multilaterals' crucial role

One multilateral bank that has been actively promoting projects bonds in the region is the Asian Development Bank (ADB).

So far, the ADB has been providing credit enhancement, most recently this February when the bank backed Aboitiz subsidiary AP Renewables'

Ps10.7 billion ($231 million) project bond to refinance the 676MW Tiwi-MakBan geothermal plants in the Philippines.

One major obstacles for potential issuers is the generally low credit ratings in emerging Asian countries. For example, the Philippines' sovereign rating, despite robust economic growth of over 6% since 2012, is a barely investment grade BBB.

"An ADB credit enhancement can lift an issuer's credit rating to levels that are attractive to international investors, typically to at least investment grade," points out Frédéric Thomas, senior investment specialist at the infrastructure finance division of the ADB's private sector operations department.

"Similarly, an ADB credit enhancement could help local currency investors mitigate risk exposure to the underlying project, and in the case of local bank investors, manage their single borrower limit exposure to a constrained universe of local sponsors," he added.

Local currency lending

Local banks in several emerging markets are as dominant in their home countries as their counterparts in more developed economies. Similarly project bonds in Asia are expected to be issued mostly in local currencies.

How quickly and broadly project bond issuance will take off is dependent on how large and deep the base of local institutional investors is. Some emerging markets, such as Malaysia, are pioneers in project bond issuance with around a third of Malaysia's infrastructure projects financed with Islamic sukuk bonds. In contrast India is a country with a much narrower investor base and a *burgeoning* project bond market may not be as viable.

"Some countries have larger domestic investor bases than others, and in some cases, the domestic capital markets remain relatively undeveloped," ASIFMA's Austen said.