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Rates Strategy

Getting Excited About Singapore Infrastructure Bonds

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- In line with rising long term public expenditure needs, Singapore government is looking at issuing Infrastructure Bonds to help finance some of the growing list of long term public infrastructure construction.
- This new class of longer dated Singapore denominated bonds will be a welcomed addition to existing Singapore Government Bonds and Statutory Board bonds. Investors with long term Singapore dollar liabilities are likely to be keen to subscribe.
- Details are sparse at the moment in terms of potential issuance size and pricing specifics. Given the proposed explicit government guarantee, we can expect Infrastructure Bonds to trade at a narrower yield spread compared to existing Statutory Board bonds.

At the Singapore Budget 2018 announcement, Finance Minister Heng Swee Keat alluded to the government's plan to introduce Infrastructure Bonds. Specifically, he said that "we are looking at borrowing by Statutory Boards and Government-owned companies which build infrastructure. This will help spread the cost of certain large investments over more years. These infrastructure projects, once completed, will generate economic returns over many years. The borrowing arrangements for these projects will hence help distribute the share of funding more equitably across generations."

The announcement generated a fair amount of excitement amongst investors. While details are sparse at the moment, here are some of our initial thoughts.

Why Issue Infrastructure Bonds?

Singapore Budget 2018 has already alluded to the longer term future challenge of rapidly rising expenditure. On top of rising public healthcare expenditure due to a rapidly aging population, Singapore's public infrastructure related expenditure has more than doubled from SGD 8.5 bn in 2011 to a projected SGD 20 bn in 2018.

Minister Heng said that Infrastructure Bonds are needed to lower the long term financing costs for such infrastructure related expenditure. At the same time, issuing Infrastructure Bonds will ensure Singapore does not draw directly onto its reserved to fund the upcoming major infrastructure spending. Singapore's reserves can then remain invested to continue to generate meaningful returns for future budgets.

Broadly speaking, just as introducing carbon tax is a way of diversifying the government's revenue stream, Infrastructure Bonds is a prudent step towards diversifying the nation's longer term funding sources.

Which Infrastructure Projects Require Funding?

The Singapore Budget 2018 statement lists 3 specific projects that may be funded by Infrastructure Bonds are, i.e. the National Environment Agency (NEA) will look at borrowing to finance the upcoming Integrated Waste Management Facility, the Land Transport Authority (LTA) will also look at borrowing for upcoming projects such as the KL-Singapore High Speed Rail and the JB-Singapore Rapid Transit System Link and Changi Airport Group (CAG) will look at borrowing for construction of Changi Airport Terminal 5 (T5).

Bear in mind that the above three highlighted projects is by no means exhaustive. Furthermore, projects to be funded via bonds need not just be of “marquee” undertaking. Thus even upgrades to existing infrastructure may also be included and thereby ensuring a continuous supply of Infrastructure Bonds. Potential infrastructure spending over the next decade also include, redevelopment of different parts of Singapore e.g. Jurong Lake District, Punggol Digital District and Woodlands North Coast etc and rejuvenation of other public infrastructure in mature HDB estates.

Why Not Just Issue More Singapore Government Bonds (SGS)?

There are three key objectives that guide the issuance of Singapore Government Bonds, i.e. providing a liquid investment alternative with little or no risk of default for individual and institutional investors; establishing a liquid government bond market, which serves as a benchmark for the corporate debt securities market; and encouraging the development of skills relating to fixed income financial services available in Singapore.

In addition, since the Singapore government has generally operated on a balanced budget, there is no need to borrow funds through the issuance of government bonds and add onto national debt to finance its expenditure.

More importantly, pursuant to the Government Securities Act and Local Treasury Bills Act, SGS issuance proceeds are paid into a Government Securities Fund, and outward payments from this fund are generally limited to the paying of interest and repayment of principal associated with SGS issuance only. In other words, the existing laws and regulations do not allow the government to spend the proceeds nor returns from SGS issuance.

As such, an alternative avenue of funding has been identified and the proposal to issue Infrastructure Bonds instead of issuing more Singapore Government Bonds will increase the variety of bonds in the local market as well as increasing the transparency and accountability of such infrastructure projects.

How Confident Will Investors Be On The Singapore Government Guarantee?

Minister Heng also added that to lower the financing costs, the Singapore government will also consider providing guarantee for some of these long term infrastructure bonds. He added that a government guarantee will enhance the confidence of creditors.

There should not be any uncertainty surrounding the Singapore government’s guarantee since Singapore’s has AAA credit rating accorded by various international credit ratings agencies. Specifically, there are now less than 10 countries globally that have long term AAA credit rating across all three major rating agencies Moody’s, S&P and Fitch. In fact, outside of the developed markets like Canada, Germany, Luxembourg, etc, Singapore is the only AAA rated country in Asia across all three major rating agencies (Standard and Poor’s, Moody’s and Fitch). Singapore’s AAA rating is backed by robust foreign exchange reserves, strong current account surplus and consistently prudent fiscal policy.

Will There Be Demand For These Infrastructure Bonds?

Over the years, there has been consistent demand from life insurance companies and asset management companies for high quality Singapore dollar denominated local bonds for them to invest in. The proposed Infrastructure Bonds will help provide a new set of Singapore dollar assets for them to invest in, so as to match their longer term Singapore dollar liabilities.

The new issuing names will also provide a welcomed diverse pool of credits to choose from, other than the usual Singapore Government Bonds and various statutory board bonds like Housing Development Board (HDB) and Land Transport Authority (LTA). So the market is definitely excited about this and looking forward to the new issues.

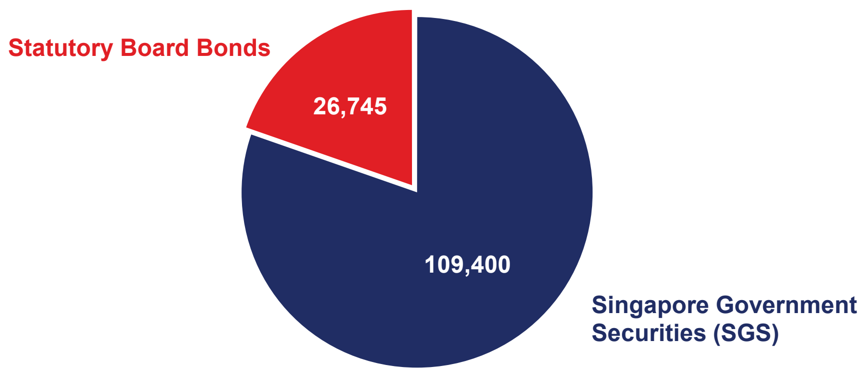
What Potential Issuance Sizes Are We Talking About?

To reiterate, concrete numbers are no yet made available, but Singapore Budget 2018 anticipates SGD 20 bn of infrastructure spending in FY2018 of which SGD 5 bn will be injected into the new Rail Infrastructure Fund and we know that SGD 4 bn has already been ring fenced for Changi T5 in 2015. Assuming a 50:50 public private partnership, then it is possible that the initial targets might possibly be up to SGD 24 bn (FY 2018 spending + T5 allocation) to be achieved over a number of years.

For comparison, the average SGS annual supply between 2010 and 2017 is around SGD 16 bn and the outstanding SGS issuance at the moment is about SGD 109.4 bn (as of 01 Feb 2018). In terms of statutory board bonds, their outstanding bonds currently on the market total about SGD 26.7 bn. These include, in order of amount of bonds outstanding: Housing and Development Board (HDB) at SGD 21.8 bn, Land Transport Authority (LTA) at SGD 3.5 bn and Public Utilities Board at SGD 1.4 bn.

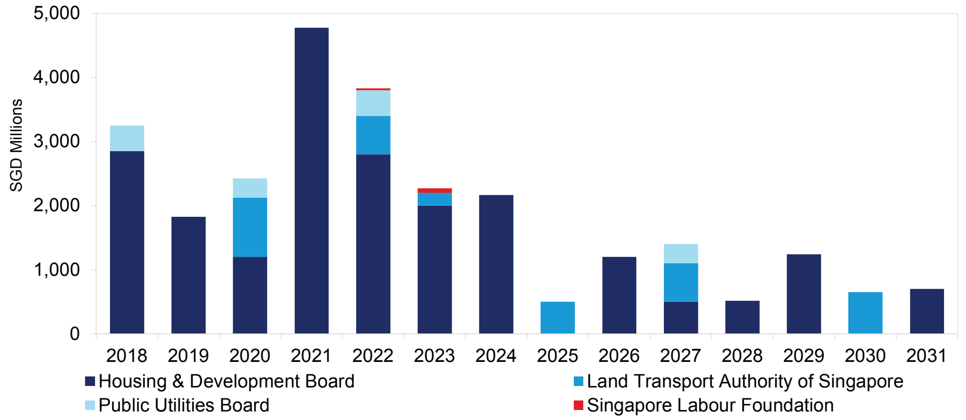
Outstanding SGD Denominated Bonds (SGD mio)

Source: Bloomberg, UOB Global Economics & Markets Research



Maturity Profile of Statutory Board Bonds

Source: Bloomberg, UOB Global Economics & Markets Research



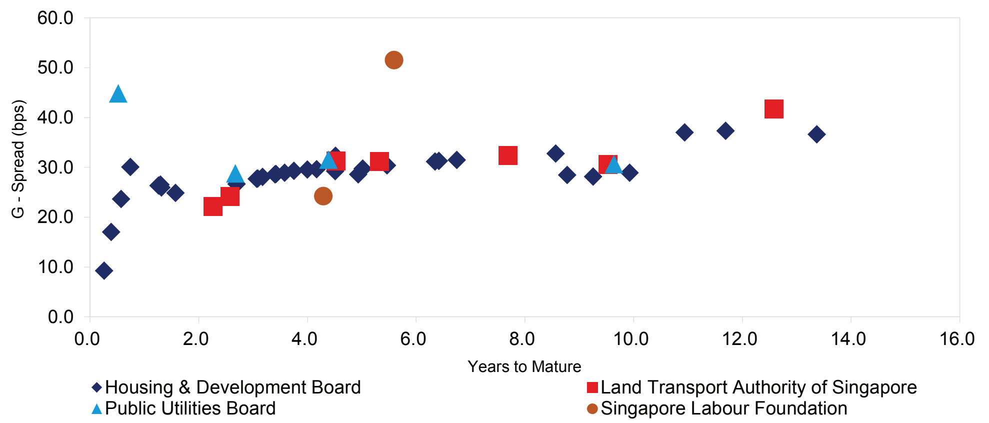
How Will Infrastructure Bonds Be Priced?

Currently, Statutory Board bonds trade at an average yield premium of about 30 bps above SGS of equivalent duration. It is worth noting that the outstanding vintages of Statutory Board bonds do not carry an explicit Singapore government guarantee. This is one of the key reasons why they are all trading with a positive yield spread over SGS.

With the explicit Singapore government guarantee, it is likely that Infrastructure Bonds will trade with a more compressed yield spread, possibly into the low teens over equivalent SGS bonds. However, it is worth noting that adequate liquidity and risk premium still needs to be accounted for, given that infrastructure projects have long gestation periods before they are operational and can generate consistent and predictable revenue stream. For now, pricing details are sparse for Infrastructure Bonds.

Statutory Board Bonds Yield Spread To SGS

Source: Bloomberg, UOB Global Economics & Markets Research



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