Institutional Investors and Infrastructure Financing

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UNITED NATIONS ESCAP
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Background

- Traditionally, infrastructure investments have been financed with public funds, given the inherent public good nature of infrastructure.
- Public deficits and increased public debt to GDP ratios have led to reduction in the level of public funds for infrastructure.
- The banking sector has traditionally played a major role in financing infrastructure projects in the region. However, bank dominant system increase the risk of an overexposed banking system.
- Capital markets would reduce the pressure on the banking system while also making available fresh equity to finance / refinance infrastructure projects.
- Much attention is being focused on the institutional investor, given the long-term nature of the liabilities.

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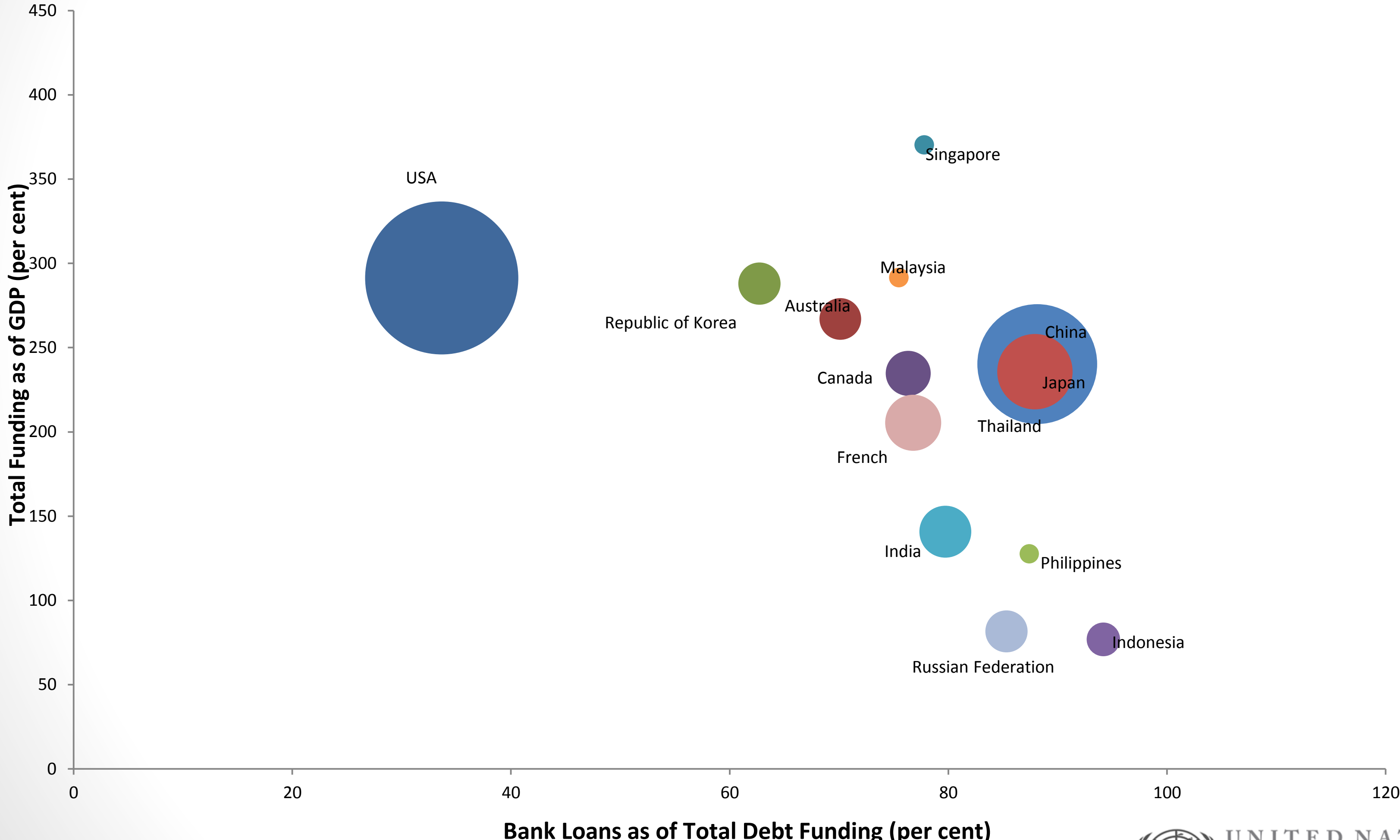
Challenges

- Large international commercial banks, which had previously provided a significant portion of infrastructure financing have been deleveraging since the global financial crisis.
- Institutional investors at present allocate a very small fraction of their investments to infrastructure assets in both developed and developing countries.
- Most institutional investors, even those with long-term liabilities such as pension funds, life insurance companies continue to invest in liquid assets, often with a short-term investment horizon.

Bank dominant financial system



Source: Authors' calculation based on data from BIS, ADB, World Bank.

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Limitations of Bank-Based Financial System

- Refinancing risks, Single borrower limits, etc.
- These limitations illustrate why bonds are a useful alternative to loans for infrastructure financing.
- Bank financing should nevertheless continue to play a key role in the initial phase of an infrastructure project.

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State of Capital Markets (1)

- Asia is home to diverse financial systems that vary in depth and sophistication, ranging from developed countries with sophisticated financial markets to emerging markets and low-income economies where markets are still in its infancy.

- The map in the next slide provides a snapshot of the depth of financial market development in the region based on the index developed by the International Monetary Fund (IMF).

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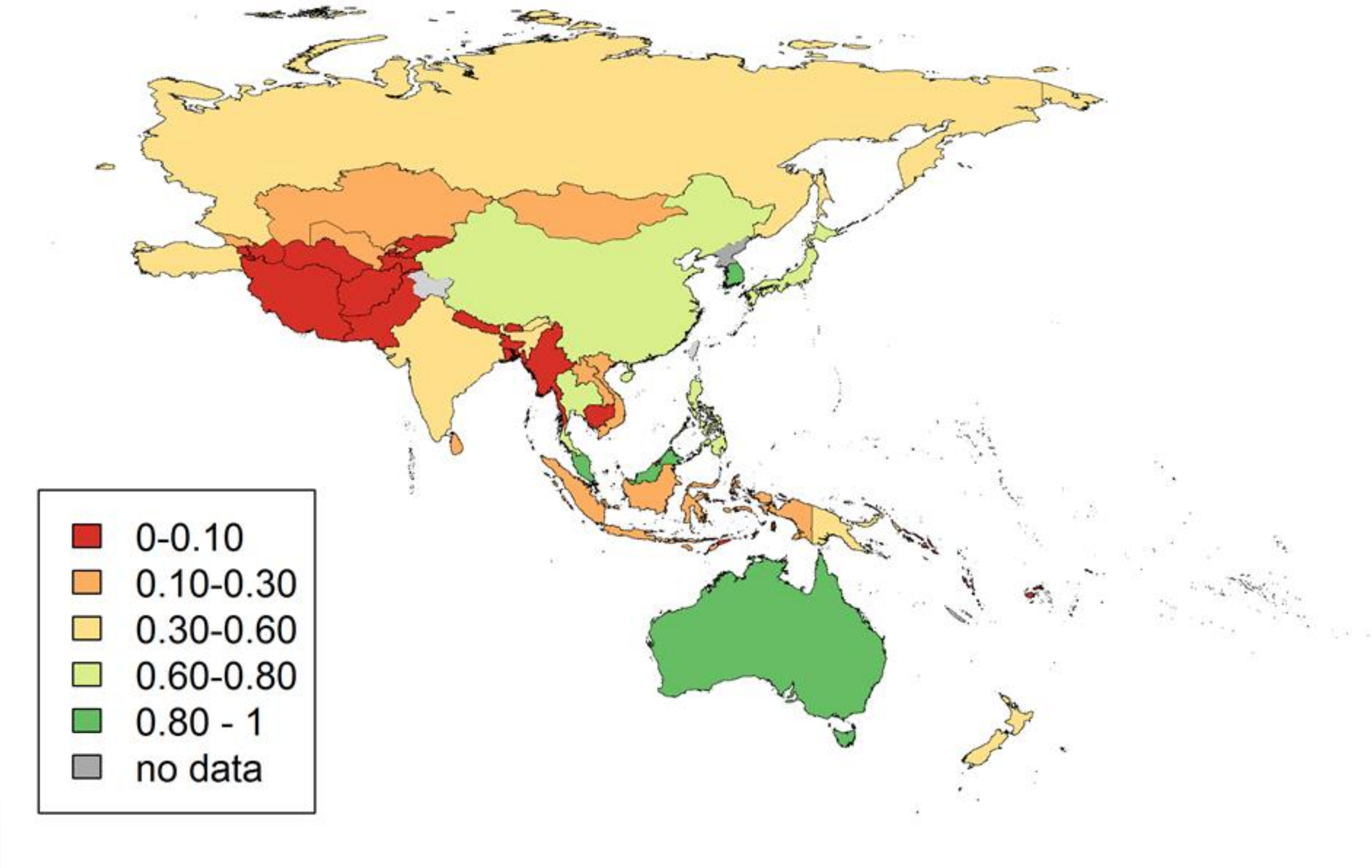
State of Capital Markets



Source: IMF

State of Capital Markets (2)

- Capital markets in the region are at different level of development, from Financial Hub (Singapore) to Nascent markets (Brunei, Cambodia, Laos, Myanmar, Viet Nam)

- Capital markets need to be further developed in some of the countries in the region before they can play a significant role for infrastructure development.

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Institutional Investors

- The long-term nature of infrastructure projects matches the long-term liabilities of institutional investors.
- There is a high correlation between the size of the institutional investor base and the size of capital markets.
- Underdeveloped equity and bond markets prevent institutional investors to finance infrastructure investment.
- The region has diverse structure in terms of the size of its institutional investors.

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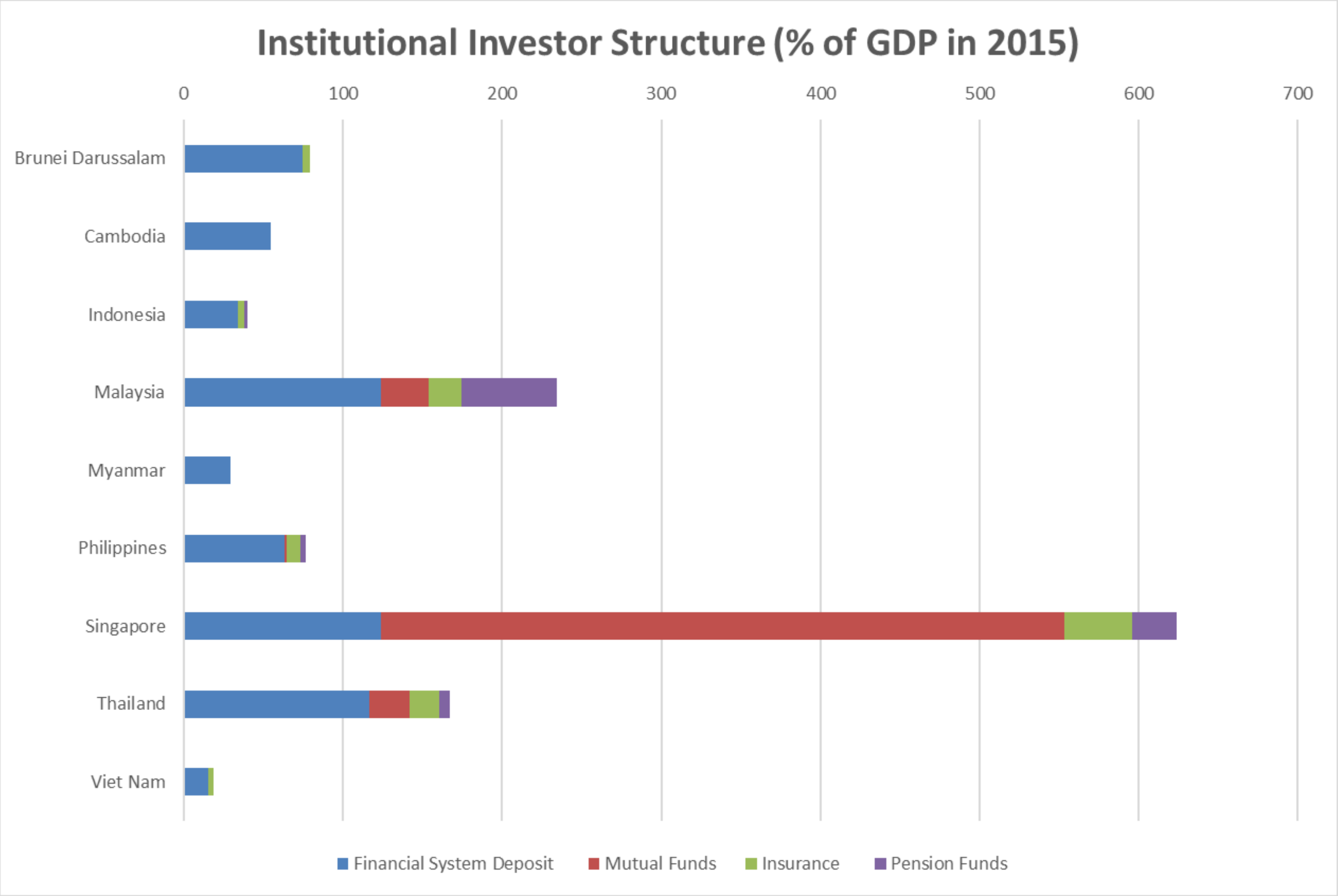

Source: World Bank, 2017, Global Financial Database
Note: The insurance data of Brunei Darussalam and Indonesia represents 2014; the insurance data of Thailand and Viet Nam represents 2013; the mutual fund data of Singapore represents 2013; the pension fund data of Indonesia represents 2011.

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Investment Modalities

Infrastructure Companies

- Stock market
- Corporate Bond

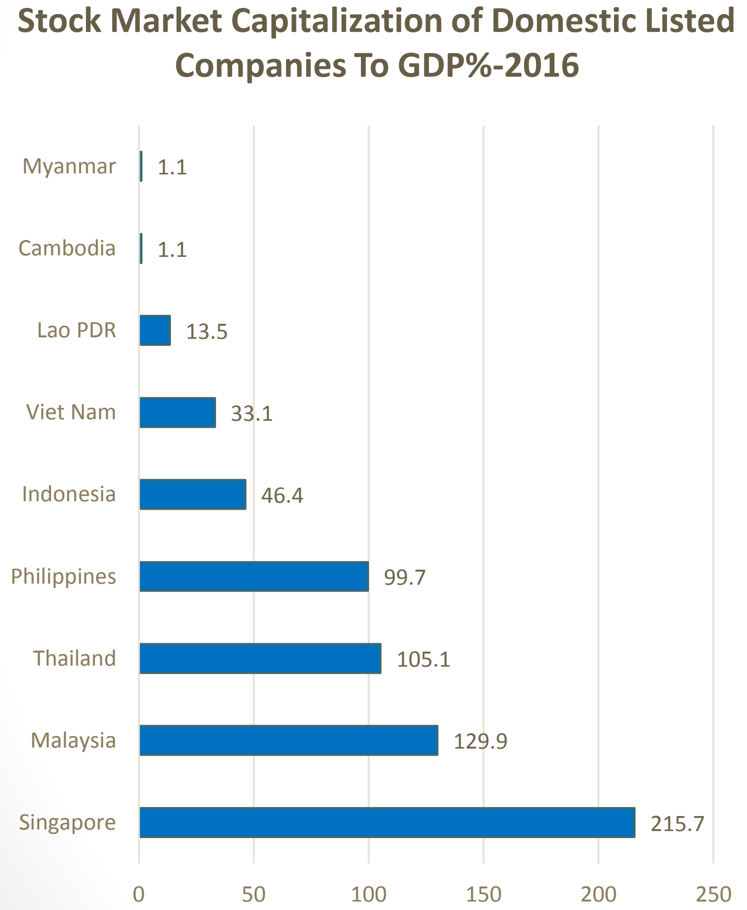
Infrastructure Projects

- SPV Listing
- Project Bond

Infrastructure Funds

Municipal Bonds

Investment Modalities (Infrastructure Companies-Stock Market)

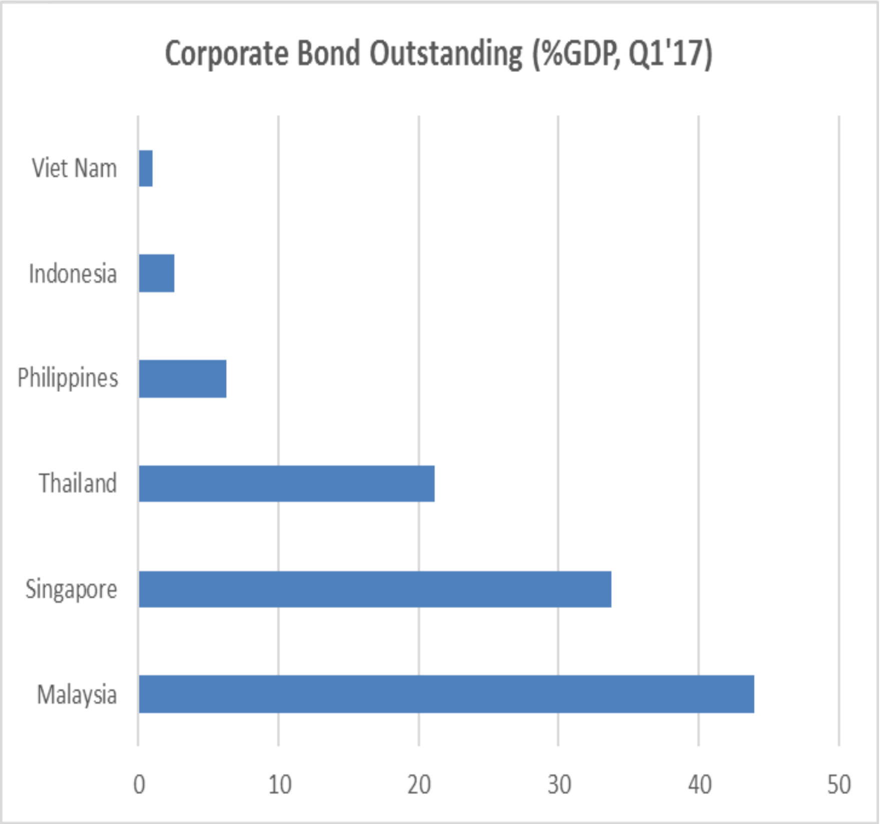


Source: CEIC and OECD issue paper on the corporate governance landscape and capital market development in Lao PDR
Note: Market capitalization of Cambodia, Lao PDR and Myanmar as of May 2016; GDP as of 2015.

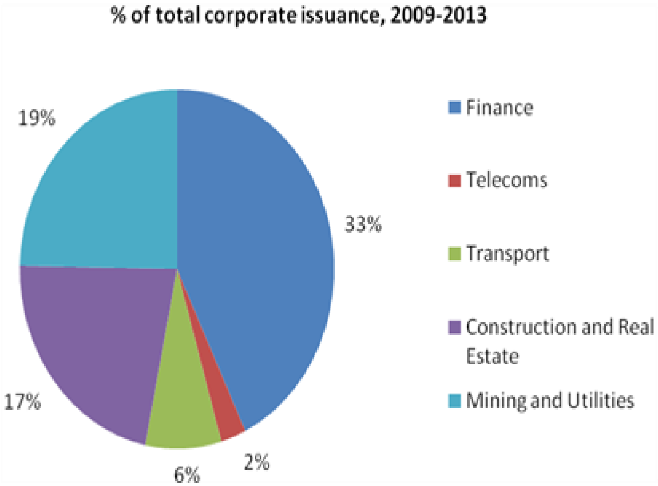
Country	Stock Market Turnover Ratio (2015)
Cambodia	..
Indonesia	20.72
Lao PDR	..
Malaysia	29.17
Myanmar	..
Philippines	15.54
Singapore	29.71
Thailand	71.63
Viet Nam	38.65

Source: World Bank, 2016, Global Financial Database

Investment Modalities (Infrastructure Companies-Bond Market)



Percentage of total corporate bond issuance in Asia



Source: Asia Bond Monitor, ADB, 2017.
Note: There is no corporate bonds issuance in Cambodia, Lao PDR and Myanmar; no data available for Brunei Darussalam.

Infrastructure Projects

SPV Listing	Project Bond
• Establish a dedicated project company known as a “Special Purpose Vehicle (SPV) to acquire financing and implement project activities. • This legally isolates the parent organization from direct exposure to the financial risks associated with a project. • If the SPV is listed on the stock exchange, investors can invest directly in the project	• Project bonds are a debt instrument used for financing stand-alone infrastructure projects, issued by SPV. • The creditworthiness of this bond depends on the cash flow performance of the underlying infrastructure project. • The volume of project bonds is \$36 billion in world (2013). In Asia, the volume ranged between \$1 billion and \$ 3 billion. • Average maturity of the bonds is 8 years in Asia, compared to 15 years in advanced economies.

Infrastructure Funds

- Another intermediary mechanism between investors and infrastructure projects.
- Serve as a vehicle to pool resources, skills and experiences from different investors while achieving economies of scale.
- Specialized skills are required for structuring and assessing infrastructure investments.
- Rail Mass Transit Growth Infrastructure Fund (BTSGIF-Thailand) and the ASEAN Infrastructure Fund are examples of this funds.

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Municipal Infrastructure Bonds

- With rapid urbanization, municipalities are under strong pressure to deliver infrastructure services.
- Municipal bonds are debt instruments issued by local governments to finance infrastructure projects.
- These bonds normally attract funding at low cost given the implicit government guarantee and are subject to less stringent level of oversight than the corporate bond market.

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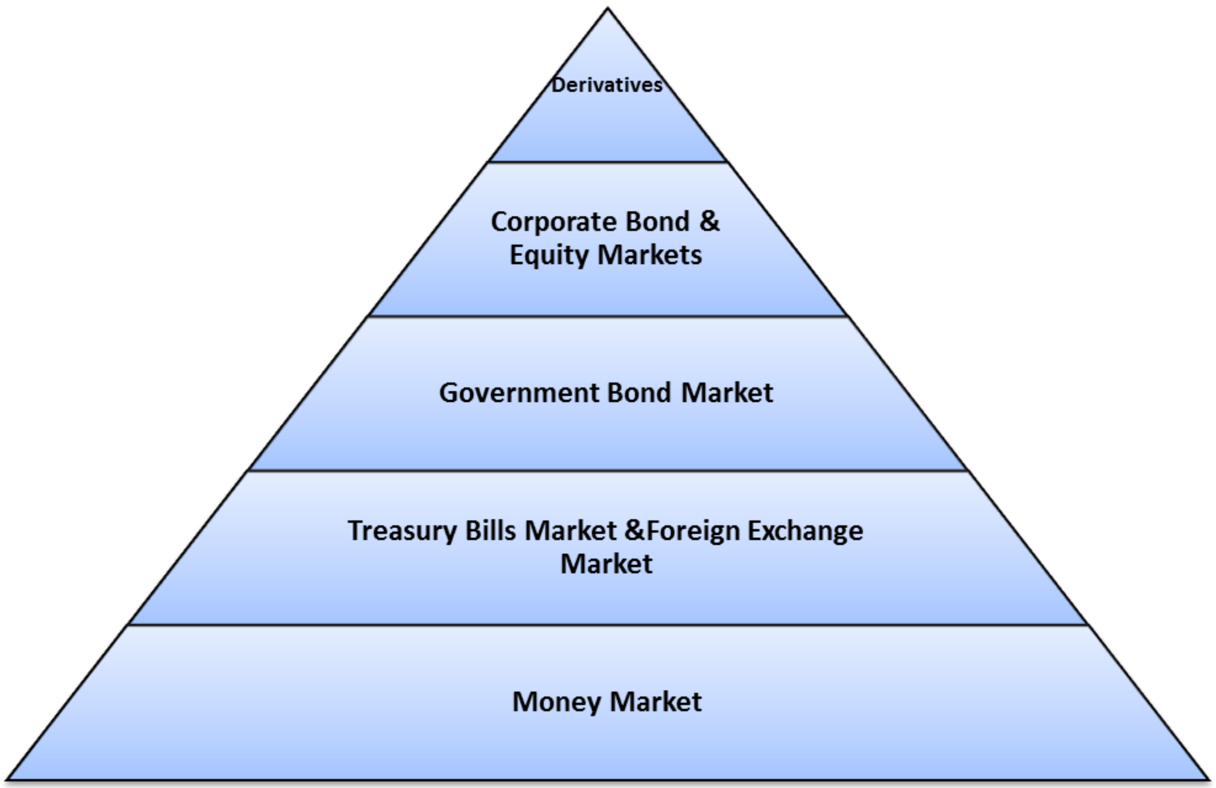
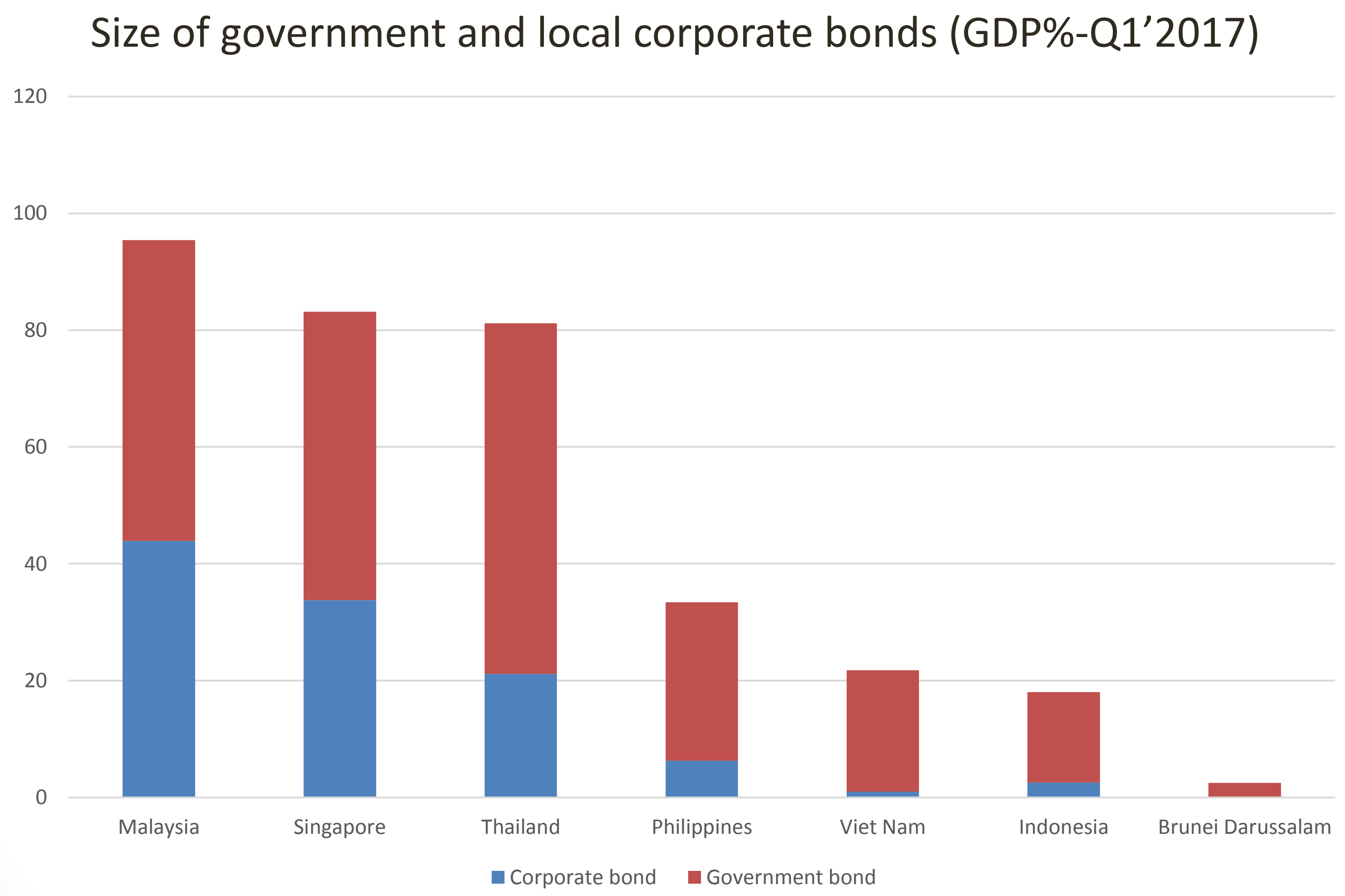
Policy Recommendations: Develop domestic market

Sequencing of financial market development



Source: Managing risk in financial market development: The role of sequencing, Cem Karacadag and others, 2003

Policy Recommendations: Develop domestic market



Source: Asia Bond Monitor, ADB, 2017.
Note: Brunei Government Sukuk (Government bond) outstanding as of 13 October 2016

Policy Recommendations: Strengthen financial integration

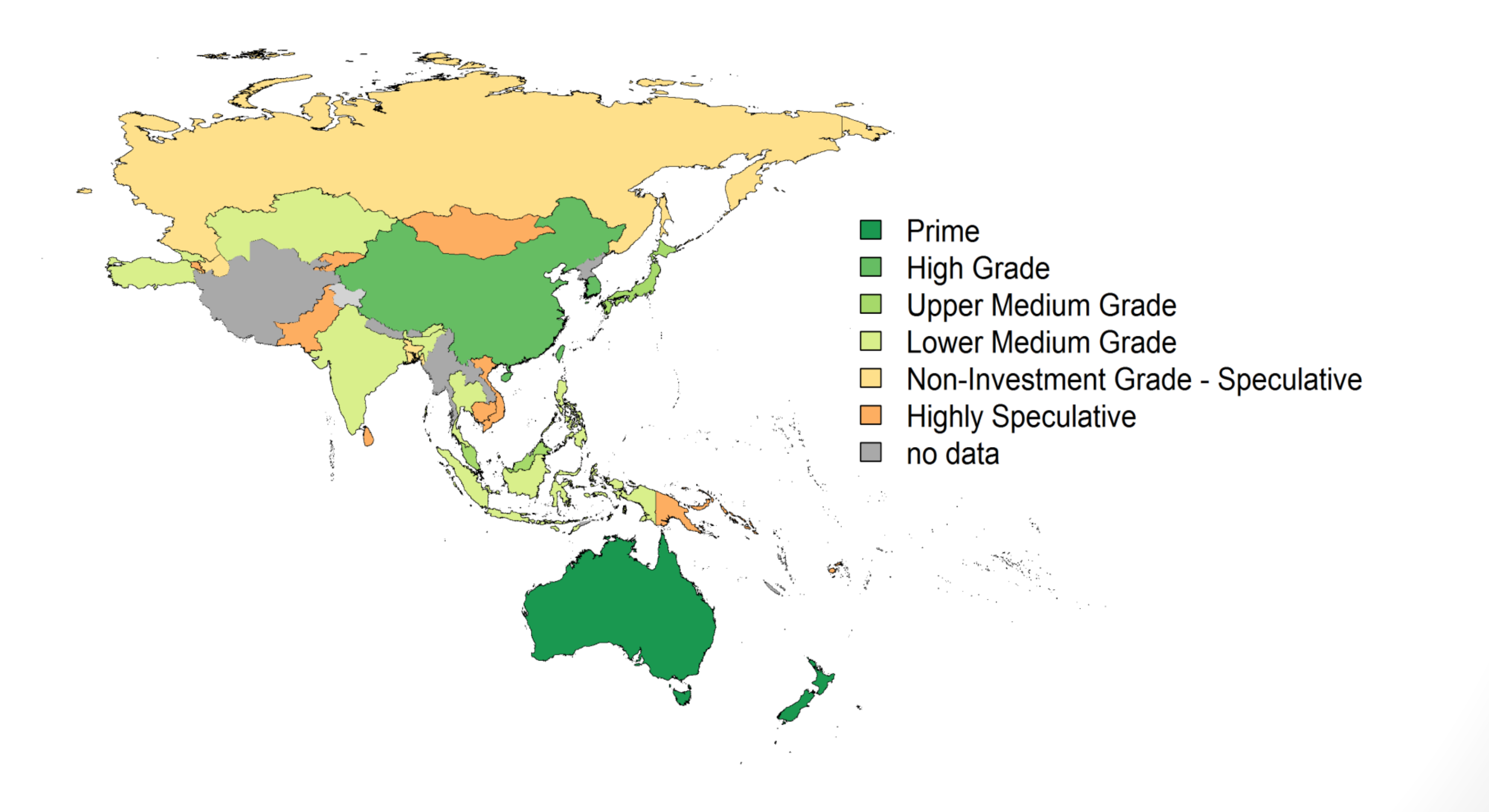
- Leverage offshore markets can provide alternative sources for infrastructure investment.
- Strengthen the financial ties with the regional and global financial markets. In this respect, to harmonize regulation, corporate governance and financial products with the objective of achieving mutual recognition of their trading transactions.

Policy Recommendations: Facilitate foreign investment

Key Impediments Facing Foreign Investors

- Capital Controls
- Lack of hedging instruments
- Low credit rating

Sovereign Rating of Selected Countries



Policy Recommendations: Support domestic institutional investors

Prudential regulations

- Abolish imposing prescribed limitations and narrow investment mandates
- Adopt a principal-based approach

Credit enhancement mechanisms

- Providing a guarantee
- Develop credit enhancement mechanism

Policy Recommendations: Improve Investment Climate

- Develop entrepreneurial capabilities
- Establish local rating agencies
- Strengthen accounting standards, disclosure requirements and data transparency
- Review tax policies
- Improve governance and regulation

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