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CGIF's new guarantee for construction risk in SE Asian greenfield projects

THE FINANCING of greenfield infrastructure projects in Southeast Asia has recently been boosted by the arrival of a new facility to guarantee bond investors against all risks during the construction period. The innovative solution was augmented on May 24 by the signing of a collaboration agreement between the Credit Guarantee & Investment Facility (CGIF), and Surbana Jurong Private Limited (SJ). The initiative is designed to boost the use of local currency-denominated project bonds to finance greenfield infrastructure projects in the Asean markets. GlobalCapital discussed the new facility with Kiyoshi Nishimura, CEO of CGIF.

GC: Why did you create the new Construction Period Guarantee (CPG) facility and why launch this now?

Nishimura: CGIF has been working with Asean governments, regulators, rating agencies and bond investors for several years to boost the flows of domestic currency funding into project finance transactions, and we have been making an especial effort to increase the share of local currency project bonds in such deals.

Greenfield infrastructure projects are vital to so many sectors of the Asean economies but such deals have proved very difficult to finance commercially in the bond markets because local investors see the construction period risk as the biggest impediment. This new facility we are offering – up to the local currency equivalent of US$140 million per transaction – gives a comprehensive guarantee backed by CGIF's high credit ratings, a triple A in many Asean jurisdictions, to the construction period risk, thereby allowing these domestic institutional investors to have exposure only on the operational risks of a project.

Since our creation in May 2012 CGIF has supported 13 corporates/projects through bond guarantee transactions and this new venture marks an important milestone in the development of our project financing guarantee capabilities.

GC: The construction period risk is far less of an impediment to deals in the developed economies and financial markets. Why?

Nishimura: In the major developed economies with super-efficient capital markets, the major global investors have the internal expertise and manpower to supplement the major banks in funding greenfield infrastructure projects. There is a far greater history of construction period risk assessment on which to base their analysis and a far deeper body of experts available. Moreover, the constant flow of deals and their subsequent performance is providing an ever-growing body of data and experience to support this. In many cases these leading investors have therefore taken over the lead funding roles traditionally reserved for the bank lenders.

But in the emerging economies of Asean there is little internal capacity amongst investors and it is a very costly and time-consuming exercise for these investors to develop their expertise in-house. The banks, especially the local Asean banks, therefore still dominate project financing deals. Our mission is to enhance domestic investors' expertise and interest in financing long-term and safe concession-backed projects particularly those looking to match their investments with their long-term obligations. As the construction period risk was such a major impediment to the growth of such deals we have developed an assessment framework for construction risks and have joined forces with Surbana Jurong to provide the technical inputs to overcome this hurdle.

GC: In a nutshell, what does this CPG facility do?

Nishimura: CGIF will offer irrevocable and unconditional CPG guarantees to domestic currency bonds financing projects in ASEAN with robust construction programmes, as screened with help of SJ. These guarantees can stretch up to US$140 million equivalent per single greenfield infrastructure project to facilitate the issuance of long-term local currency bonds of up to 15 years or possibly even longer. CGIF's "controlling creditor" role during the period when the CPG is in force, will allow consents and creditor approvals to be more efficiently managed instead of engaging a large number of bondholders.

GC: Does this new facility satisfy the concerns of the global and local ratings agencies?

Nishimura: When the ratings agencies rate greenfield infrastructure bonds, their ratings can be seriously constrained by the construction period risk despite the fact that the projects may have stable and robust cashflows during the operational period, and even though the construction period is far shorter – generally up to three years - than the operational period. As there are many elements of construction period risk and they are highly complex to assess the investors, therefore, need pricing of the bonds that ultimately reflect those many risks. This generally makes bond financing for such deals economically unviable and deters investors. Accordingly, we have created the CPG facility to remove that construction period risk entirely from transactions and remove any rating penalties arising from it, allowing bond investors to focus only on the operational risks of the project.

GC: But the originators of the projects will have to pay CGIF for the CPG facility, so does it make economic sense for them as well as for the investors?

Nishimura: Yes, it does. While bank lenders for project financings in Asean are liquid and usually very keen to participate – and at attractive pricing – the bonds we can attach to the funding packages price with fixed rates, thereby giving certainty to the originators for that portion of the deal. Moreover, whereas the banks' maximum perspective is generally about up to 10 years or, in very liquid local bank markets, occasionally 15 years or so, bond investors can provide longer tenors than banks, even 20 years or longer. Stretching a finance tenor will improve the project's economics and create a room to reduce the tariff level. Finally, originators can diversify their funding sources. This is especially vital to overcome

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single customer limits that the banks set. In the Philippines, for example, there is only a small number of leading domestic conglomerates and single customer limits hinder the development of greenfield infrastructure projects. The CPG facility will unlock all these benefits of bond finance to greenfield infrastructure projects.

For investors, the pricing of the bonds will be pitched to match their demand and they can rest assured that the presence of CGIF underpins the bonds. Many institutional investors, especially the life insurance and retirement funds, in this ASEAN region are very conservative, but they also have a strong and growing appetite for quality, good yielding long-dated bonds to match their future liabilities and to boost returns for their underlying investors.

GC: How long does the CPG facility last?

Nishimura: This is very important to understand. Our guarantee endures only for the period of the construction risk, so the credit ratings of the bonds and the risk assessment by the investors will at the end of that period revert to the operational risk, as is normal for such deals. Asean investors are far more comfortable and experienced in making this assessment and of course they also have the credit ratings agencies own assessments to help this process.

Generally, the CPG facility will cover the construction period which may last for a one to three year period depending on the project and there is also a buffer period to allow for any construction or other delays. Therefore the tenor of the CPG facility is expected to be for a three to five year period or so at the outset, but if the construction is further delayed, the CPG cover will continue until the project will meet the completion test. Depending on the nature of the project (e.g. initial ramp-up period is necessary before being fully operational) and investors' requirements, the CPG could also be extended to cover the initial operation period until the project actually demonstrates its ability to generate stable cashflows. Such flexibility embedded in the CPG is important to address bond investors' concerns about construction delays. In other words, as the project bonds will have maturities of up to 15-20 years, or possibly even beyond that, you can see that the CPG facility is an underwriting by CGIF of the early construction period before the project begins to generate its projected operational cashflows.

GC: What role does Surbana Jurong play in the CPG facility?

Nishimura: Surbana Jurong is a Singapore based company with extensive experience in the region. SJ is one of the largest Asia-based urban, industrial and infrastructure consultancy service providers. Under this collaboration, SJ will provide technical assessments to validate the time, cost and quality aspects of construction programs of selected greenfield infrastructure projects that are aiming to issue project bonds with the support of CGIF's CPG.

It is of course vital that CGIF's CPG guarantee supports only the best quality greenfield projects and that the bonds we issue are ultimately financing deals where construction risks have been adequately appraised and mitigated as guided by the engineering prowess of a firm like Surbana Jurong. This is certainly not supposed to be a facility that underpins any but the projects with robust construction programs.

GC: To clarify, is it only CGIF's credit rating that is supporting the CPG facility?

Nishimura: Of course, CGIF's high credit rating is important for bond investors. However, more important is a robust construction risk assessment and mitigation framework which will be implemented under the CPG facility with help of technical expertise and engineering prowess of Surbana Jurong. We plan to share our assessment tools with bond investors. While bond investors may first rely on CGIF's CPG, overtime, bond investors will become familiarized with assessment of construction risks and will develop their own capacities in future to understand, evaluate and mitigate construction risks to acceptable levels to consider investing in greenfield bonds themselves even without our CPG support.

GC: Will it be only Asean domestic currency bonds that will be issued supported by the CPG facility?

Nishimura: Yes. CGIF is a multilateral institution established and funded by the Asean+3 countries and the Asian Development Bank to develop and strengthen local currency and regional bond markets in Asean. These countries are growing rapidly and in great need of new infrastructure projects to support and sustain that fast growth. However, perceived risks in such projects in Asean – and more widely in emerging Asia - deter investors, and infrastructure development is, in turn, often severely hampered.

At the same time, many Asean countries are witnessing rapid accumulation of domestic savings in the non-bank sectors, such as pension funds and insurance companies as their economies grow and their income levels rise. However, these savings have generally not been so well utilized to finance the critically needed infrastructure assets. Our facility is specifically designed therefore to answer the needs of originators of greenfield infrastructure projects, as well as mobilizing institutional investor funds to support those transactions.

GC: Finally, can you set the needs of the Asean countries in context?

Nishimura: The numbers are daunting. According to the Asian Development Bank's latest forecasts, developing Asia will need to invest US$26 trillion from 2016 to 2030, or US$1.7 trillion per year, in order to maintain the region's growth momentum, eradicate poverty, and respond to climate change. New approaches will be required to stimulate private sector finance in infrastructure investments and to prevent the region from falling further behind.

Mobilizing long-term savings to meet long-term funding needs in matching currencies is the most efficient model of financing infrastructure. However, only a few countries have successfully pursued this capability. A critical impediment towards mobilizing long-term savings is the low-risk appetite of pension and insurance fund managers and their aversion to construction risks.

The collaboration between CGIF and SJ aims to deliver the assurance needed by institutional investors to make investments in these greenfield project bonds. When construction risks are expertly assessed, properly managed and mitigated, CGIF's irrevocable and unconditional guarantee for project completion will, we believe, attract more and more of Asean's long-term investors to invest in greenfield project bonds.