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Commentary: Borrowing plan for infrastructure projects expands Govt's fiscal envelope

The Singapore Government's plan to provide guarantees for long-term borrowings for some infrastructure projects will also lower the cost of borrowing and infuse projects with private sector due diligence, say two NUS Business School observers.



Artist's impression of the RTS Link Woodlands North Station. (Image: LTA)

SINGAPORE: Budget 2018 has received a lot of public attention, particularly [over news](#) of a GST hike and an SG Bonus hongbao that many Singaporeans will receive.

Online comments have also focused on benefits households and broader society can look forward to – including the enhanced [Proximity Housing Grant](#) and higher annual [Edusave](#) contributions for students.

Yet one significant announcement has gone quietly under the radar – despite the potency it packs in giving the Government greater fiscal heft to do more within the same budget.

INCREASING SINGAPORE'S FISCAL ENVELOP

Last Monday (Feb 19), Finance Minister Heng Swee Keat announced that the Singapore Government plans to [provide guarantees](#) for long-term borrowings made by statutory boards and government-owned companies for infrastructure projects.

To many observers, the approach does not seem new on first sight.

Government agencies that have already issued bonds to finance their projects include the Housing and Development Board (HDB), the Land Transport Authority (LTA) and the Public Utilities Board (PUB). According to United Overseas Bank (UOB), the bonds issued by HDB, LTA and PUB are used for financing public housing, rail and water infrastructure.

Some say when an agency issues bonds, there is already an implicit government guarantee as market participants invest assuming the Government will not let the agency fail.

Yet the larger point to be observed is the policy shift towards seizing more bond financing opportunities to fund public works heralded in Mr Heng's announcement.

The move opens up a new pot of money to the Government to fund expensive infrastructure projects – most of which would take up a sizable chunk of the Budget, leaving less room for other public programmes.

Mr Heng highlighted at Budget 2018:

“The key challenge is that certain expenditures can be very lumpy, with hefty upfront investments.”

Such an approach opens the fiscal envelop for the Government budget, ensuring that projects like the Changi Airport Terminal 5 or rail projects secure the financing they need so that they can proceed unimpeded by the Government's fiscal envelop constraints.



A view of the site where Changi Airport Terminal 5 will be built.

At the same time, it ensures these do not curtail the Government's ability to fund other new or existing initiatives.

If this access to capital markets comes from an investor base that includes domestic and foreign investors, it might also go some way to avoid Government expenditure from drying up local capital.

It also means that foreign investors will be funding some of Singapore's public projects to some extent going forward.

LOWERING COST OF BORROWING

To an investor, borrowing with an explicit guarantee comes with a valuable difference – the guarantees typically cover the interest and principal repayment of the agency bonds.

Making the guarantee explicit also removes any uncertainty as to which investors will have first recourse in the event of financial distress, and hence serves as a smart way of lowering investor risks, and increasing investor appetite for funding these projects.



File photo of HDB flats under construction. (Photo: TODAY)

The Government has used such debt guarantees in the past – by way of senior debt financing instruments through project financing firm Clifford Capital for large-ticket, cross-border projects in the infrastructure and offshore marine sectors taken up by Singapore-based companies.

(Notably, Clifford Capital was the brainchild of the Economic Strategies Committee led by Tharman Shanmugaratnam when he was Finance Minister.)

These guarantees will help to reduce financing costs without drawing on the reserves. But because they are backed by reserves of the triple-A rated Singapore Government, the risk of default is seen to be lower, and investors are likely willing to stomach a lower interest rate.

This low cost of borrowing is to the agency and the Singapore Budget's advantage.

And because the risk of a default is low, the reserves can back a larger number of projects and investments compared to how many can be funded if expenditure came directly from Government coffers in theory.



Singapore's fifth NEWater plant located at Changi Water Reclamation Plant. (Photo: PUB)

PRIVATE SECTOR DUE DILIGENCE

Besides being an external source of capital, external investors including individual and institutional players, based locally and overseas, provide another layer of monitoring for the projects.

Agencies issuing bonds are required to provide regular information to all investors as part of due diligence and disclosure requirements.

This additional transparency requirement increases accountability for the projects, infuses them with private-sector expertise and provides an added layer of checks and balances.

DEVELOPMENT OF THE BOND MARKET

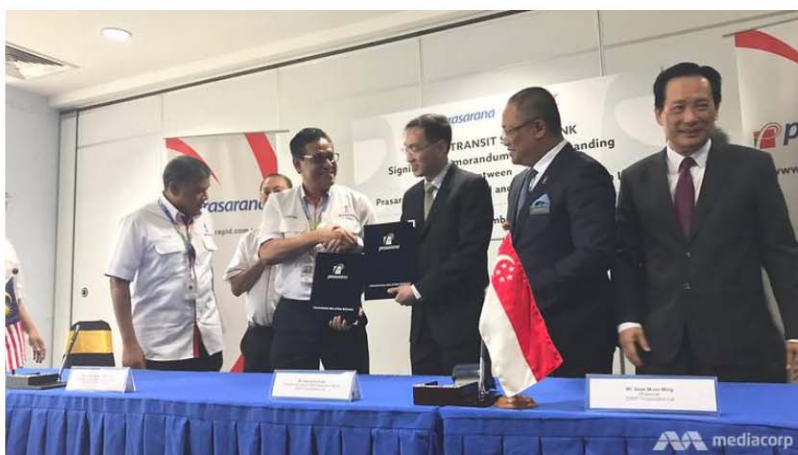
A greater supply of such bonds also adds depth to the Singapore bond market.

UOB estimates that the initial target for the new infrastructure bonds would be around S\$24 billion over a few years.

In the near term, National Environment Agency (NEA) is considering borrowing to finance a new integrated waste management facility. LTA may borrow for the Kuala Lumpur-Singapore High Speed Rail and the Johor Baru-Singapore Rapid Transit System Link.

The Changi Airport Group will also weigh up borrowing for Terminal 5. Other potential projects include the redevelopment of public housing areas and rejuvenation work in mature HDB estates.

These new infrastructure bonds may be similar to the low credit risk Singapore Government Securities (SGS) which is backed by the full credit of the government, and has been used to develop the domestic debt market, particularly in the long-term low-yield bond market segment.



Public transport operator SMRT and Malaysia rail operator Prasarana on Monday (Sep 25, 2017) signed a Memorandum of Understanding to form a joint venture company for the Johor Baru-Singapore Rapid Transit System Link. (Photo: Sumisha Naidu)

Using the SGS as a benchmark, the average SGS annual supply between 2010 and 2017 is around S\$16 billion and the outstanding SGS issuance is about S\$109.4 billion (as of Feb 1).

Going by UOB's estimate of S\$24 billion, the new infrastructure bonds may be worth 22 per cent of the SGS-equivalent debt securities if issued.

The market is probably ready - where more than one-third of the long-term SGS debt have been taken up by asset management firms and insurance companies.

MANAGE PROJECT RISKS GOING FORWARD

Going forward, while there are numerous benefits, the provision of explicit guarantees on bonds needs to be managed to limit the total risks to the Government. For example, if the project risk is higher in the early stages of the project, then it might be appropriate to delay bond funding to a later stage.

Also, if the project has foreign partnership, the Singapore Government's guarantee should be designed to optimise risk sharing among all investors. For example, risk sharing between multiple partners could depend on the control exercised and gains shared among partners.

After all, the onus is on the Government to ensure each guaranteed project is viable and able to meet its financial obligations during the tenor of the bond.

Statutory boards and government-owned companies will also need to exercise due diligence to assure the quality and delivery of these critical national projects.

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