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HD Sponsored Feature: Infrastructure tide rises for Asia

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Private infrastructure investment in Australia and around the region is undergoing a revival providing scope for Asian banks and non-banks to participate.

Asia's infrastructure sector is heading for a recovery in 2015 and a spike in demand for private finance which could create challenges and opportunities for banks, export credit agencies and financial institutions, according to ANZ Banking Group, the biggest Australian bank in the Asia region.

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ANZ, which has roots in New Zealand as well as Australia, also sees the potential for a spin-off in cross-border funding into its domestic markets.

This year's elections in two key economies - India and Indonesia - and a lessening of civil unrest following a military coup in Thailand, are seen as triggers for the turnaround. The elections ended periods of political uncertainty, important in helping to restore momentum to some projects and ushered in new governments with reformist agendas that recognise the importance of infrastructure in helping to build sustainable economic growth.

Uncertainty remains over how effectively the new governments will implement their policies. For example, while Indonesia's new President Joko Widodo built a track record on infrastructure projects as governor of Jakarta, few believe that replicating such success at a national level will be easy; and the first budget of Indian Prime Minister Narendra Modi following his landslide victory in May disappointed many with its moderate approach to reform.

ANZ's own economists are cautiously optimistic in their outlook for both countries, noting that the global system liquidity which is helping to finance both countries' twin current account and fiscal deficits is likely to continue for some time, as the US Federal Reserve only gradually normalises its unusually accommodative policy settings. For the countries' infrastructure prospects, Paul Finn from ANZ's project and structured finance team has robust expectations.

'In some ways it's been a year of changing gears, or a changing of the guard,' said Finn, reflecting on the way the two elections contributed to Asian infrastructure's relatively quiet 2014. 'I tend to think that Asia really operates at two speeds, stop and catch up, and I really believe that next year we'll see the beginning of infrastructure investment (in Asia), the likes of which we've never seen before.'

Private sector opportunities

Paul Richards, the bank's global head of structured export finance, agrees and points to the financial implications: 'If these countries get going with genuine public-private partnerships in their infrastructure agenda, there is no way the bank market on its own, even with all the liquidity available internationally and domestically in India or in Indonesia, will be able to finance it. Governments around the region will look to the private sector to write the cheques.'

This is because many governments, Indonesia's is a case in point, have rebuilt their balance sheets since the 1998 Asian currency crisis and are cautious about exposing the hard-earned recovery in their sovereign credit ratings to the vagaries of international markets. For this reason, adds Finn, Asia's governments 'really like the discipline of private development of infrastructure'. This prompts the question: where will the balance in infrastructure finance come from?

It is the kind of question that plays well to ANZ's strategy in Asia, which draws on the bank's ability to leverage its domestic-market experience into regional opportunities using what it calls 'connectivity', or the ability to mobilise client contacts, specialised industry knowledge, local market understanding and relationships with government and relevant regulators, and a broad and diverse product range, including project finance, export finance and syndications/club deals across borders, and to do so in a way that adds value for clients.

In the case of making up the shortfall in bank finance for Asian infrastructure, ANZ sees potential in institutional liquidity and the export credit agencies (ECAs) of countries such as Japan, Korea and **China** which have already played a large role in providing untied finance to resources projects in countries including Australia. There is a challenge, however. ECAs are more familiar with mines and liquefied natural gas (LNG) plants that have large components of imported equipment from their own home countries, as well as home country **equity** in the case of North Asia's ECAs, with the underlying commodities all traded on global markets and priced in US dollars.

On the other hand, infrastructure has a higher domestic content with less imported equipment than resources. LNG projects, for example, require massive upfront investment in transportation and the supply of processing plants. Infrastructure project tenders can also be time consuming and costly. 'ECAs, like everyone else, are resource-constrained and don't like long due diligences with uncertain outcomes,' said Richards.

Engaging with ECAs

Applying the principles of ANZ's 'connectivity' model, however, Richards believes he has identified a way for Asian ECAs to become more comfortable with infrastructure: by helping them to develop, in a relatively low-risk environment, the expertise they will need to take advantage of Asian opportunities. 'I'**m** saying to them, 'Why not build your PPP (public private partnership) capability in a developed market like Australia, and then carry that experience over to a market like Indonesia, for example?''

According to Finn, the attraction to ECAs of using Australia as a test-bed for infrastructure finance is that it's a market with a lot of established norms, including openness to foreign investment, a trusted legal system and a well-traded currency. 'Australia is the most advanced market, certainly south of the equator,' says Finn. 'While some in North Asia and Singapore for example, are pretty advanced, they tend to rely on local currency finance and are not as open. Australia offers an incredible opportunity.'

The role of ECAs is to promote home country exports and investment into growing industry segments such as infrastructure, and in the fastest growing region in the global economy - Asia. They facilitate Asian infrastructure financing not only by plugging gaps in overall volumes required, potentially offering extended tenors and sharing of political risks, but also by developing deep cooperation with **commercial** banks and other private sector financiers that can be used again in other countries in the region.

The scope for Asian banks and non-banks to participate in Australian infrastructure appears to be considerable, given the strength of the project pipeline. Private infrastructure in Australia is undergoing a revival, having flourished in the south-eastern state of Victoria during the 1990s with the privatisation of power stations and other assets to help restore the state government's then battered finances.

Now the eastern states of New South Wales (NSW) and Queensland, driven by budget pressures and a new generation of political leaders seeing the benefits privately financed infrastructure have brought to their southern neighbour, are pursuing similar programmes. After privatising three ports - Port Botany and Port Kembla last year and earlier this year, Port of Newcastle - NSW is focusing on selling electricity generating assets. Queensland this year **sold** a portfolio of toll roads.

There is more to come. NSW is part-way into a 10-year programme, known as NSW 2021, to revitalise the state's infrastructure. Victoria and Queensland also have plans to privatise ports, and there is strong awareness at federal government level of the need for a nationwide improvement in infrastructure. Prime Minister Tony Abbott said during his election campaign last year that he wanted to be 'an infrastructure Prime Minister'.

New Zealand, a much smaller market, is also pursuing privately financed infrastructure. Last year saw completion of the PPP for Wiri Prison in Auckland and work begins soon on a 27km PPP road project through Transmission Gully near Wellington. The rebuilding of Christchurch following the devastating 2010 earthquake continues, and investment of about NZdollars 20 **billion** is required under a 30-year development plan for Auckland.

As Finn notes, domestic **commercial** banks, which have played an important role in financing Australian infrastructure during the past 30 years, have abundant liquidity. Ironically, however, at a time when public sector demand for private infrastructure finance in the country has 'never been stronger', re-regulation is limiting the extent to which Australian and other OECD banks, can lend to such projects, creating opportunities for Australian and other non-bank financiers.

While keen to promote the opportunity, Finn cautions that, for all its attractions, the Australian market can pose challenges.

'In the electricity market, for example, there is a lot of talk about how system demand is falling for the first time ever, just as governments are looking at privatising assets,' he said. Demand has fallen in response to a sharp escalation in power prices, attributed to over-investment in the transmission sector. 'This has increased the incentive for people to convert to **solar** power. It's a highly evolved market, and when the dynamics change they can have a dramatic impact.'

Two-way traffic

Encouraging Asian ECAs into the Australian market is just one flow in the two-way traffic that ANZ maintains between the region and its domestic Australian and New Zealand markets. The bank has built much of its Asian track record to date on financial solutions for Australian resource projects exporting to Asian countries, and for Asian investors seeking strategic Australian assets, in deals brokered through its offices in **Hong Kong** and Singapore.

More recently, it expanded its presence in the Pacific Basin which, though a vast area geographically, consists of small **island** nations with quite specific needs, such as renewable **energy**, telecommunications and, in some cases, ports and airports. As Finn points out, the cost of fossil fuel for some of these countries is 'quite phenomenal'. In one, for example, half of total expenditure on diesel imports is incurred simply by transporting the fuel to where it is needed.

Renewable **energy** is an area in which the bank has acknowledged expertise, having advised or otherwise acted on the development and/or **sale** of a number of Australian **wind** farms to private investors, including Asian utilities. In an example of connectivity in action, the bank has applied this subject knowledge, its familiarity with Asian markets and broad product suite in support of the Burgos **wind** power project in the Philippines.

Energy Development Corporation, the project's sponsor, and its parent **company** FirstGen, are important clients of ANZ in the Philippines. ANZ had already led its USD syndicated facilities so when EDC moved forward with its plans to develop the 150MW Burgos **wind** project using Vestas turbines from Denmark, ANZ was well placed to offer its **wind** sector and project and export finance expertise. 'Integrating the export finance into a complete financing solution plays to our strengths, not only as a project and export finance bank, but also our strong credentials in developed and emerging **wind**-power markets and our relationships arising from that,' said Richards.

'We regard those qualities in combination as strong differentiators for the bank and that's the strategy we will seek to adopt, whether it is on infrastructure or resources projects in the Philippines or Vietnam or any country in Asia. That is our fundamental strategy.' Involvement in Burgos adds more strands of connectivity that the bank can use to market itself in the Philippines and in the Asia-Pacific renewables sector more broadly.

'Burgos will be a milestone **transaction** in Asia and will serve as a benchmark for other markets in the region as they roll out environmentally-friendly development networks,' says Richards. 'These projects are expensive to get off the ground and investors are rightly concerned about execution risk. And that's not just about picking the right equipment supplier, everybody who provides a major input is scrutinised, and finance is definitely part of that.'

According to Finn, the tendency of Asian countries to benchmark off each other is an important growth dynamic, and this is particularly true among members of the Association of Southeast Asian Nations (Asean) 'The attitude seems to be that the risk of falling behind the neighbours is not acceptable,' said Finn. 'When somebody accelerates, then it seems that everyone else has to, too.'

Philippines sets the pace

The current pacesetter in infrastructure development among Asean member states is widely agreed to be the Philippines, with Finn describing its capital, Manila, as the centre of 'best practice' for regional infrastructure.

This isn't an overnight success: an extensive private power programme began in the early 1990s, while two water concessions covering Manila were created and privatised in the early 2000s. Current milestone PPP projects include the Light Rail Transit system and Mactan-Cebu International Airport development. The dynamism of the country's infrastructure sector is such that Philippine water companies are now expanding internationally with investments in Vietnam and Indonesia.

Recently the government, which has a pipeline of 47 PPP projects, said it would roll out 18 of them worth a combined Ps602.2 **billion** (dollars 13.8 **billion**) before June 2015. They include the North-South commuter rail project worth Ps265.3 **billion** and a Mass Transit subway loop worth Ps132 **billion**. Others are aircraft operation and maintenance projects at six airports, regional prison facilities, a motor vehicle inspection system and a market in Tanauaun City, Batangas.

It is not infrastructure development per se that is watched closely so much as its impact on economic growth and hence the ability to attract investment, said Finn. 'Relative to what you would see in less flexible labour markets, there would be a very quick pick-up in employment, and the regional response is, 'investment is flowing in and employment is growing; many of the jobs are new and we want to share in that growth!''

As Finn points out, there's a sense of collaboration more than competition among Asean nations that may prove to be just as important in helping to underpin future infrastructure development. Indeed, Asean also uses the word 'connectivity' to describe its vision of a regional community based on a number of key infrastructure projects, including a highway network and a broadband corridor and the harmonisation, to some degree, of regulatory frameworks.

There are tensions behind this vision, such as the need to balance the drive for regional connectivity with the equally important need to meet demand for highly localised infrastructure in some of the remoter areas of Asean member states.

As Finn notes, however, a rising tide lifts all boats. 'If you take the view that basic infrastructure facilitates economic growth and trade, then what Asean is moving towards is completely identical to our strategy.'

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