Indonesia's borrowers adapt to a new reality

The country’s pool of bond investors and issuers were forced to adjust to a new landscape after a series of rate hikes from the central bank last year sent government and corporate bond yields shooting upwards. But market participants are now largely used to the new, higher yield environment, so talk has turned to tackling older problems. These include how to broaden the issuer base from a preponderance of multi-finance names, how to encourage more sukuk (Islamic bond) issuance, and how best to structure deals to allow lower-rated issuers into the market. Asiamoney sat down with a high-profile group of panellists in Jakarta to discuss what needs to change.

Panellists:
Chung Chee Leong, chief executive, Cagamas
Rafael Concepcion, Jr, executive director, Golden Agri-Resources
Ni Made Daryanti, head of investment, Asuransi Allianz Life Indonesia
Christian de Guzman, vice president, sovereign risk group, Moody’s Investors Service
Reynaldi Hermansjah, finance director, Jasa Marga
Tomio Komatsu, senior investment officer, International Finance Corp.
Ezra Nazula, head of fixed income, Manulife Asset Management
Kiyoshi Nishimura, chief executive, Credit Guarantee Investment Facility
John Simon, treasury and capital market director, CIMB Niaga
Nor Masliza Sulaiman, head of debt markets, CIMB
Denise Thean, deputy chief executive, RAM Rating Services
Moderator: Matthew Thomas, contributing editor, Asiamoney

Asiamoney (AM): A series of aggressive rate hikes from Bank Indonesia last year led 10 year government bond yields to rise from 5% to over 8%. Stability has since returned to Indonesia’s bond markets, but was the government right to be so aggressive — and how did the rate hikes impact the primary debt markets?

John Simon, CIMB: The rate hikes that started in July last year was the measure taken by Bank Indonesia to dampen inflationary pressure — mostly as a result of fuel price hike necessary to reduce budget deficit — and to stabilise the country’s overall economic condition. The result has worked very well so far, as indicated by a number of factors.

The rupiah exchange rate has stabilised. It is worth noting that the implementation of the Jakarta Interbank Spot Dollar Rate, or Jisdor, has also helped to improve transparency and liquidity in the market. The trade balance has improved. It hit a high of $2.3bn, but the latest data showed a surplus of $700m.

Bond yields have moved back to a level where investors are interested again. Furthermore, the stability has brought back investors’ confidence to re-enter the market. This is indicated by the results of government bond issuance in the current fiscal year, across a range of metrics.

Issuance between January and April 2014 reached Rph193.05tr ($16.37bn), 53.93% of the annual target. In the same period last year, issuance was only Rph120.78tr. Transaction volumes in the secondary market for government bonds went up to Rph14tr a day in March 2014, versus Rph7tr in July 2013. And, finally, foreign investors in the government bond market held around Rph380tr of bonds in April — around 35% of the total — from Rph280tr in June 2013.

All in all, the rate hikes have been good for the economy and the market. They have brought back stability.

Nor Masliza Sulaiman, CIMB: Although volumes are lower than last year’s corresponding period, Indonesia’s primary rupiah corporate bond market has enjoyed a healthy pipeline for the past few months. We expect issuance of around Rph60tr-Rph65tr this year, which will be a growth from last year’s closing issuance of IDR56 trillion. The pipeline is driven by Rph41tr of maturities but we hope that the pipeline will increase further at the end of the year, largely due to goodwill following the presidential election.

The primary corporate bond market is a lot more stable with stronger interest from investors compared to the choppy sentiment prevalent during the multiple interest rate hikes. Primary yields have trended down by 10bp (basis points) to 50bp for five year ‘AAA’ to ‘A+’ credits since January this year versus the widening of 250bp-280bp in 2013, demonstrating
investors improved confidence. There also seems to be a lot more interest from issuers to tap the market.

The rupiah corporate bond market has historically been inundated with multi-finance companies, whose issuance represents approximately 50% of the overall market. But investors want to see more sector diversification and new issuers tapping the market. In our efforts to offer new credits and diverse sectors we facilitated debut issuances from Protelindo and Ciputra Residence. We facilitated Ciputra Residence’s issuance to the market with a partial 20% guarantee from the IFC (International Finance Corp.), which elevated the deal’s rating a notch and made it appeal to a wider investor base.

**AM:** Your clients must constantly be asking where interest rates are going next. How long can rates stay at this level?

**Simon, CIMB:** That is the million dollar question. We were at 8.87% or 8.8% [in terms of 10 year bond yields] when the fuel price hike was imposed last year. The rate has come down significantly since then — it is now at around 7.3% — and the impact of the fuel price increase on inflation should be reduced by the second half of the year.

Our in-house view is that inflation should be at about 4.9% by the end of the year, significantly lower than where it is now. Because of that, there should be room for Bank Indonesia to cut rates.

This may be seen as a contrary move from Bank Indonesia when you compare it to some of the other central banks that are tightening, but there has been a significant tightening of interest rates already. That gives room for a bit of monetary easing.

We have to be mindful that there is an election coming soon, and there could be some volatility there. But we feel that it is only going to be short-term. Market players and traders will make use of it and play the noises, but in the long-run we do not believe the two main candidates will be all that different in terms of economic policy.

**AM:** Investors are also watching the pace at which the US Federal Reserve will taper quantitative easing. How has this impacted how Indonesian companies borrow in the US dollar market?

**Nor Masliza, CIMB:** Judging by the number of Indonesian issuers that were successful in raising dollar or ringgit funding recently, it is clear that the window is still wide open for Indonesian issuers to explore offshore funding. If you are looking for size and longer tenors, the ringgit and dollar market remains attractive as an alternative funding currency. We see more Indonesian corporates looking to the Malaysia ringgit market given the flush local liquidity and access to competitive financing. We have also observed high demand from offshore banks for Indonesian credits in recent dollar and Singapore dollar loan syndications.

**AM:** How have all of these issues — rate hikes, the cuts in fuel subsidies, and the continued speculation about Fed tapering — impacted Indonesia as a credit?

**Christian de Guzman, Moody’s:** We see a structural break in the way Bank Indonesia conducts monetary policy now. There has been a shift away from a pro-growth stance to one that is focused almost entirely on stability, and particularly the stability of the current account and the balance of payments. This is important.

When the current account was widening last year, it had a knock-on effect on rupiah appreciation, which in turn had a knock-on effect on interest rates. To the extent that this has stabilised, Bank Indonesia has shown to be much more credible in terms of its policies. That should help keep the government’s cost of funding down, which will be a positive for the borrowing rates of local banks and corporations.
Denise Thean, RAM: RAM rates the Indonesian government at ‘BBB2’ on our global scale and ‘AA3’ on the Asean (Association of Southeast Asian Nations) scale, with a stable outlook. We believe this rating is very well-placed, although we do think the actions by the government last year were a definite positive from a credit perspective.

These measures are clearly paying dividends now. The rupiah has rebounded; foreign exchange reserves have gone back up to a comfortable level of above $100bn. Inflation has also been brought back down to around 7%, compared to a peak in the fourth quarter of more than 9%. All in all, we believe the government’s policy responses have been well executed and the focus on containing the fiscal deficit further supports our view of Indonesia’s rating. The government’s debt has been progressively brought down to 25% of GDP, compared to 77% in 2001. That compares well against its Asean peers.

AM: Sukuk issuance in Indonesia only accounts for around 7.5% of Indonesia's outstanding bonds, according to the Asian Development Bank. What needs to be done to push that percentage higher?

Nor Masliza, CIMB: We have invested a lot of effort to grow the sukuk market in the country, and what we have come up against — among other things — is a lack of clarity over the guidelines for corporate sukuk issuance. Sukuk is typically asset-based, which raises uncertainty over whether issuers would have tax neutrality, or whether additional costs may be incurred to execute the sukuk transaction.

The challenge for investors mainly revolves around the lack of natural sukuk requirements and also the perception that liquidity is generally quite low. Those investors who are unsure about the sukuk but are interested in buying a few deals tend to get put off by the lack of liquidity.

From the perspective of banks, there is still a debate whether trading sukuk would essentially make the assets non-shariah compliant due to the possibility of sukuk investment being classified as “speculative” instrument if traded.

There are ambiguities revolving the treatment of sukuk to issuers and investors and how the exact details will work out. In Malaysia, the regulators have very clear guidelines for the sukuk market, and not only do they ensure tax neutrality — they actually offer incentives for issuers undertaking sukuk issuance. Investors are also assured that the classification of sukuk is similar to any conventional fixed income product.

Reynaldi Hermansjah, Jasa Marga: We have not yet issued a sukuk, but going forward we think that the opportunities are huge. At the moment, Jasa Marga is expanding its business, adding 40% capacity by building nine new toll roads. According to the current law, each of these has to be operated by separate entities. In the next few years, these will be fully operational and these separate entities can each issue sukuk to offset the bank borrowing.

But for Jasa Marga at the holding company level, it is a little more difficult. You need to set aside a certain asset to back your payments, which is difficult for us at the moment since we have 13 different toll roads at the moment that are all lumped together into one concession. These toll roads were built prior to 2005, which is when the new road law came in stating that each toll road needs to be operated by a separate entity. Since the existing toll roads are grouped together under our control, we would face difficult legal issues by separating just one cash flow stream for sukuk investors.

Rafael Concepcion, Golden Agri-Resources: We believe the best way to consider bond issuance is first to look at the capital structure of the company, and the long-term cash flow cycle of your business. In the plantation sector it takes at least four years before meaningful cash flow comes from investments, so we prefer longer-term financing. And given the US dollar revenue base of the company, we tend to look at funding structures that we can at least hedge back into US dollars. After taking this into consideration, we try to look for the more liquid sources of funding, as well as competitive pricing based on the US dollar cost after hedging.

Even though we’re based in Indonesia and already have some rupiah bonds outstanding, these considerations combined made us go into the Malaysian ringgit sukuk market a few years ago. It is a very liquid and competitive market in terms of pricing which offered some arbitrage opportunities for us. We could have sold a dollar bond at the time for around or above 6%, but when we turned to ringgit the after-swap coupon for us was just a little over 3%. That is very cost-competitive.

The initial challenge to issuing the ringgit sukuk was opening up our minds to the asset-backed nature of sukuk. Fortunately for us, it worked well. Buying and selling commodities is part of our day-to-day business, which perfectly fits the requirements of structuring a sukuk. It turned out to be equally smooth as doing an issuance in Indonesia.

Chung Chee Leong, Cagamas: There is certainly clarity over regulations for both investors and issuers in Malaysia, as Liza mentioned earlier. The government, the central bank, and the Securities Commission have put in place a system to promote Islamic finance as a whole — not just sukuk issuance, but Islamic
banking, Islamic unit trusts, Islamic asset management, and other ancillary services as well. This is why Malaysia has taken the lead in sukuk issuance: there is a holistic approach.

Cagamas was mandated to facilitate the promotion of the Islamic market, so we are a frequent issuer of sukuk in Malaysia. We issue all the way from one year deals out to 20 years, and as a consequence we have in place an indicative yield curve which can provide something of a benchmark for other issuers. We find that when we issue sukuk, the pricing is either the same or even lower than that of a conventional bond.

At the end of the last quarter, around 52% of outstanding bonds in Malaysia were sukuk, and 68% of private debt securities were in the form of sukuk. It is clear how the market has evolved given the incentives put in place by regulators and the government.

It is crucial to look at structures that are acceptable not just to local investors, but particularly to GCC (Gulf Cooperation Council) investors. This can be difficult in the early stages of a market, but it is very important since it stimulates greater demand and, in turn, greater growth of individual markets. We are actually now looking at setting up an EMTN programme, and we hope we will be able to market deals to Indonesian investors.

**Ni Made Daryanti, Asuransi Allianz Life Indonesia:** The spreads offered in the rupiah sukuk market are quite attractive at the moment, but we have to pay attention to liquidity. That is the key factor for us to invest in a market, especially for the unit-linked funds since we cannot control fund redemptions. We do invest in the sukuk market, however. Our shariah (Islamic law) portfolio is roughly 30% of our overall portfolio. We prefer government bonds at the moment because of the liquidity.

**Ezra Nazula, Manulife Asset Management:** Liquidity is certainly the key issue for us too. It is hard for us to acquire deals or to sell deals in the secondary market. But we do invest in sukuk bonds, in particular government bonds like the retail sukuk issuances, which are quite liquid. Demand for sukuk bonds is in its infancy; we need to educate investors as to the benefits of investing in sukuk. It is not simply about earning a premium, but about the other benefits of the market.

**De Guzman, Moody’s:** The comparison always seems to be Malaysia versus Indonesia when we talk about the sukuk market. But it is not just about the government deepening the market through regulations or clarity. It can also help simply by issuing more.

For example, Malaysia’s funding profile is increasingly in Islamic instruments, which imparts stability on the market and facilitates demand for similar instruments. That is really not present in Indonesia. Rupiah-denominated government instruments are a fairly marginal portion of the Indonesian government’s funding profile.

**Thean, RAM:** The perception that sukuk transactions are far more complex than conventional deals may have deterred certain issuers from opting for a sukuk issuance. But in Malaysia, we have seen that the sukuk market has become a lot more internationalised. We have rated 26 foreign issuers from 12 countries that have tapped the ringgit sukuk market, and the structures are getting more sophisticated, increasingly to support demand from Middle Eastern investors. These foreign issuers have taken the time to understand how to clear some of the hurdles presented by sukuk issuance.

Of course, we believe that rating agencies have a role to play in this area by explaining the sukuk transaction structures and how ultimately, the credit is linked to the originating issuer. That adds comfort to the investor community.

**AM:** Another sticking point among some investors is the lack of issuer diversity in the bond market. How much of a hurdle is this to the bond market’s growth?

**Nor Masliza, CIMB:** Investors need to see diversity, both in terms of sectors and individual issuers. As mentioned earlier, the Indonesian rupiah debt capital market is dominated by multi-finance companies. These are often very strong names but investors are increasingly cautious on sector concentration. We have seen more issuances from the property and telco sector, but there is still plenty of work to do in this area.

We are working on various structures and strategies that offer financing opportunities to issuers which would otherwise be unable to tap the bond market. This can be from guarantees, such as those offered by IFC or CGIF (Credit Guarantee and Investment Facility). We are also trying to bring in conglomerates that have businesses in Indonesia by convincing them to move their funding away from their headquarters to the local level. This would help bring new names into the market, but at the same time ensure that these are established names since they are often global players.

**Ni Made, Asuransi Allianz Life Indonesia:** Diversification is one of the key principles in managing a fund, because it is related to manage risk. Risk management and the preservation of capital are fundamental beliefs of our investment process.

The difficulty in finding enough names to diversification comes from the general
lack of issuers here, rather than from us being too selective against the backdrop of a range of issuers. We have strict limits against individual credit concentration, but also sector concentration. Lisa has already mentioned that multi-finance companies represent about 50% of the bond market. It would be impossible for us to have multi-finance companies as 50% of our portfolio. We need to wait for new names to come into the market.

We sometimes move offshore, but that depends on the mandate we have. We do have some mandates that allow us to move offshore, but there can be concerns over liquidity when considering the offshore bonds of Indonesian companies.

It is almost impossible to do arbitrage between offshore and onshore markets, because CDS (credit default swap) quotes on Indonesian corporate names have not been developed for long, and domestic liquidity is very thin.

Nazula, Manulife Asset Management: Made [Daryanti] hit the nail on the head there. Diversification is the key for us, and we have not just internal guidelines but local regulations that limit us from investors too much in an issue, an issuer, or a sector. The more names we see, and the more sectors come to the market, the better things will be for us.

This is how a lot of investors look at the market at the moment, so I think it’s clear that by bringing more issuers to the market we will see an increase in the investor base as well. The introduction of more issuers and sectors is really essential to develop the bond market here.

Chung, Cagamas: Malaysia also has a problem in terms of getting lower-rated corporations to market. Triple-A and double-A issuers represent about 96% of all the outstanding corporate bonds. The issue is to get single-A and triple-B issuers to come in to the bond market, or the sukuk market.

One of the biggest challenges is convincing investors to join these deals because of liquidity issues. We need to put in place an institutionalised credit protection mechanism, where investors can actually hedge part of their credit risk. This would stimulate the bond market in its entirety, not just triple-A and double-A. This is partly done in Malaysia through

Danajamin, and is something that should be considered for the Indonesian market too.

**AM:** There has been some mention of using guarantees from triple-A rated issuers. What has been CGIF’s experience in the Indonesian market?

**Kiyoshi Nishimura, CGIF:** The reason why the governments of the Asean+3 countries decided to set up the CGIF is because they were concerned that, despite the growth of the markets over the last few years, the number of companies that can access the market is quite limited. This is, generally speaking, true across the region, but Indonesia is one of the most extreme cases.

The largest 30 issuers account for around 80% of outstanding bonds, which is quite high compared to other countries like Malaysia or Thailand. Even those established issuers that can access the bond market are realising that they cannot continue to keep issuing at the same pace, because they have issued so much already.

We are a relatively new organisation and, in Indonesia, have done only two transactions, both with BCA Finance, an automotive financing company. The company is rated very high locally, and was already a frequent issuer in the market. So, why did they need our guarantee? They wanted to have access to a new type of investors, in this case foreign — and in particular, Japanese — investors.

We started talking to Japanese investors last year and they told us they were interested in the rupiah bond market but did not want to take the currency risk. We spent a few months devising a solution — and then all of a sudden they told us they now wanted to take rupiah risk and no longer wanted BCA Finance’ rupiah bonds to be swapped into yen. They were becoming hungry for yields and more willing to take the exchange rate risk since the yields on offer in the Indonesian rupiah market are so much higher than in Japan.

The potential pool of offshore investors in the region — whether from Japan, Korea, or in the long-term China — could ultimately show a lot of interest in Indonesian rupiah bonds. If only one small part of the Japanese investor base starts investing in the Indonesian rupiah market, for instance, the impact could be huge. We are now working on other potential transactions of the same sort.

**AM:** What about using a CGIF guarantee for a purely domestic deal that would not really be geared towards increasing foreign investment?

**Nishimura, CGIF:** That was a primary reason for the establishment of the CGIF. We were created to help bring in issuers that have not accessed their domestic market, allowing investors to become familiar with them by using our guarantee — and then ultimately, we hope, allowing them to come to the market on a stand-alone basis in future.

We are in talks at the moment with some Indonesian companies that have not tapped the market yet.

**AM:** Ciputra Residence’s Rph500bn issue, partially guaranteed by IFC, has been mentioned a few times over the course of the discussion. How did this deal come to fruition?
Tomio Komatsu, International Finance Corp: One of the key focuses of the IFC is providing alternative sources of funding for corporations, and mobilising third-party capital. One of the ways that we do that is by investing in local currency bond issues, which provides other investors with a sense of increased comfort that there is a stamp of approval from a triple-A rated institution like IFC. This is something we have done in several markets, for instance Zambia, where we recently invested in one of the country’s local corporate bonds.

Here in Indonesia, we went a step further. We are proud to have cooperated with CIMB and Mandiri Securities on a breakthrough capital markets transaction for Ciputra Residence. This was the first partial credit guarantee for a bond in the market, and enabled the company to raise Rph500bn.

If you look at the rupiah bond market since mid-July of last year, when we saw the onset of significant volatility, it has been extremely difficult for issuers below a single-A rating to tap the market. I am only aware of one issuance, in fact, which was around Rph250bn. That accounts for only about 1% of corporate bond issuance from that time to date.

In the case of Ciputra Residence, we were working with a subsidiary of one of the largest local property developers, which has a corporate rating of ‘A’. It would have been extremely challenging for them to issue the bond at that rating. By providing a 20% guarantee, IFC was able to elevate the bonds to an ‘A’ rating, allowing the transaction to proceed at the intended size. It also achieved a slightly longer tenor than most transactions we have seen to date. The deal include a seven year tranche, which has been relatively uncommon in the current market.

AM: Given concerns over a lack of issuer diversity, what is the best approach for a borrower like Jasa Marga?
Hermansjah, Jasa Marga: Most of our funding still comes from the banking side. Our policy is that we finance the construction of the toll roads through bank loans, since that allows us to draw down funding when needed, but then when we have financial stability, we move to the bond market to refinance these bank loans. We do, however, issue some bonds on the holding company level, largely to refinance old bonds.

From our point of view, the demand is still there. We do not see any problem. PLN managed to issue around $2bn without much difficulty in the local market, so clearly the depth is there. One of the main hurdles for us, however, is that we do not see enough long tenor investors, because that will really match the profile of our business model.

AM: How do financing opportunities in the US dollar market, and other foreign currency markets, compare to the Indonesian rupiah market?
Nor Masliza, CIMB: Straight US dollar funding is no longer the only option for well established Indonesian corporates who want to raise cross-border funding. There has and continues to be a significant price advantage of tapping the ringgit market and swapping back into US dollar for issuers who are rated ‘AA3’ and above by the Malaysian rating agencies. For lower rated credits, benefits in tapping the Singapore dollar market include no mandatory ratings and ability to tap excess liquidity from the private banking funds.

Since 2009, we have seen S$600m ($477.54m) of issuance from Indonesian corporates in the Singapore dollar market and MR4.35bn ($1.34bn) of issuance from Indonesian corporates in the Malaysian ringgit market. These are both alternative funding currencies that Indonesian issuers should seriously evaluate. Both markets offer deep liquidity and access to synthetic solutions. Cross-currency swaps can go up to 15 or 20 years.

For locally rated high grade Indonesian issuers, the rupiah market remains competitive for traditional and familiar sectors but is limited in size and tenor. CIMB value adds to our issuer clients by providing periodic pricing updates for straight and synthetic funding solutions in G3 and Asean local currency markets to propose the most optimal funding currency.

Hermansjah, Jasa Marga: Since we are a rupiah earner, it is our policy that we will finance our assets and construction entirely in rupiah. Unless we start charging for tolls in US dollars, it is unlikely we will want to come to the dollar market, or any foreign currency debt market for that matter.

Concepcion, Golden Agri-Resources: Our capital expenditure has been in the $500m-$600m a year range, but similar to Jasa Marga, that capex had been undertaken through several subsidiaries. That gives us a lot of different funding options. Clearly, the bond market is one but the bank market is another, and we simply try to find the best pricing to match our target maturity profile. We think the Indonesian rupiah market is a good market but we look at the swap rate, since we will want to swap [proceeds] back into US dollars.

The Malaysian market is very interesting because analysts in the country understand our sector very well. The Singapore dollar market, where we have issued a convertible bond in the past, is also interesting for us, especially since we are listed there. We feel that selling bonds...
in markets that are close to us is a good way to build a track record. The rating of companies operating in Indonesia is still lower in the US dollar market, compared to what we get when we are selling only to Asean investors.

When we look at our credit metrics, and compare them to companies in the US or Europe, we are up there with the double-A rated companies. But because we are an Indonesian company, suddenly the rating comes down few notches if we tap the US dollar market.

**AM:** *This is something highly-rated issuers complain about a lot. What is the key rationale behind country ceilings?*

**De Guzman, Moody’s:** Not only do we provide a sovereign rating – in which we try to measure a government’s creditworthiness – we also look at the environment that the government operates in, which gives us the ceiling. The country ceiling in part encapsulates the risks of a moratorium. We’re trying to measure the risk that, in the instance of a default by the government, the government seizes foreign currency to service its own debt, leaving less hard currency to go around to service private sector debt.

To the extent that companies internationalise, we have provided another option. If a particular entity gets most of its receipts in hard currency outside of its country of jurisdiction, there are instances when their credit rating can pierce this so-called country ceiling. The most prominent example for a long time was Petronas, the national oil company in Malaysia. They received a lot of their revenue from outside of Malaysia in US dollars, so there was little to no risk that Bank Negara Malaysia (the country’s central bank) could confiscate their earnings. As such, Petronas’ credit rating did previously pierce the country ceiling, and even today, its credit rating remains higher than that of the government of Malaysia. So there is an increasing acknowledgement that these restrictions can be worked around.

**Thean, RAM:** The subject of country caps is pretty controversial. We don’t cap the rating of an issuer at the sovereign rating. We do, however, incorporate the country operating risk into the stand-alone rating of the issuer. We look at the transfer and convertibility risk of a country, and depending on the outcome, we apply a sovereign weight to notch down the rating of issuers domiciled in that particular country. That’s a slightly different approach.

**AM:** *What is the chance of a mortgage-backed securities (MBS) market developing in Indonesia any time soon?*

**Nor Masliza, CIMB:** We have attempted this. There are a few critical issues at the moment. There is a perception of illiquidity for MBS in general, and there is still an impediment that issuers are uncertain whether, if they securitised their assets, are these assets on-balance sheet or off-balance sheet? There could also be potential tax issues on the MBS transactions to the Issuer as well. These are still unclear in Indonesia, given the lack of clarity over MBS regulations.

**Chung, Cagamas:** We saw the demand for MBS diminishing in Malaysia following the global financial crisis, and since then we’ve actually seen that it is cheaper to sell senior unsecured debt in our local market than it is to sell a mortgage-backed deal. The uncertainty over whether these deals are off-balance sheet or on-balance is interesting because, of course, technically speaking, they are off-balance sheet — but when we speak to both investors and rating analysts, they do expect us to have some exposure to these assets to give investors some protection. They want to know what we’re going to do if things go wrong.

**AM:** *A more important step for the rupiah market is providing viable options for infrastructure and project financing. How flexible is private sector funding for these deals?*

**Nishimura, CGIF:** The infrastructure funding need is around $8tr across emerging Asia by 2020, according to the ADB. Everyone knows there are huge investment needs across emerging Asia, and because of the limited ability of the government to finance infrastructure investments there is an expectation that the private sector will take part of the burden.

It is an area where the capital markets need to play a larger role than they do right now. When you talk about private sector funding in the infrastructure sector, you are mainly talking about funding coming from banks. You don’t see many infrastructure or project bonds outside of Malaysia. Why? Well, one of the reasons is that, in most Asean countries, local institutional investors simply do not want to take project risk because they do not have the internal capacity to analyse and monitor the risks. They can certainly develop that capacity, but many investors are not really convinced it is worth it at the moment, because they do not see the supply coming.

One of our focus areas is to kick-start project bonds in the Asean markets with our guarantee support so that local institutional will become familiarised with this type of debt instruments. We are currently working on a number of our pilot projects for this purpose.

**Nor Masliza, CIMB:** The opportunity for infrastructure funding is massive in Indonesia. We anticipate approximately $50bn of infrastructure financing, the bulk
of which will be allocated to toll roads/bridges and transportation. There are clearly a lot of opportunities in this area but there are also a lot of issues to be resolved.

We have engaged investors on what it would take for them to finance a project that would be on a limited recourse or even on a non-recourse basis. They said they are reluctant to fund Greenfield projects where they take construction risks prior to a stable stream of ‘tested’ cash flows. They prefer to invest in matured projects with stable cash flows which may not work from the issuers’ point of view. Issuers need certainty of financing to support their bids and hence bank financing provides a much better alternative at the moment.

For the project financing market to grow in Indonesia, we need stable concessions where financiers can be comforted by the stable cash flows and the sanctity of contracts, strong sponsors with deep pockets to withstand costs overruns and mitigate completion risks, and investors that are willing to take a leap of faith in the early stages of a project.

**Hermansjah, Jasa Marga:** One change could make things easier for investors. Previously, land acquisition only started after contracts were awarded, following the bidding process. But since last year, the government has begun clearing the land, and then starts the tender.

We recently participated in a tender for the Medang-Kualanamu toll road, which was done after the land acquisition was cleared. That means that — if we win the tender — theoretically we can start construction immediately. That lowers the risk, which should help convince investors to finance the project. That is a good step.

**Ni Made, Asuransi Allianz Life Indonesia:** We do not have any project finance investments in our portfolio yet, although Allianz does of course have a framework for investing in project finance. We manage a very long tenor fund, so in theory project financing — especially infrastructure funding — is a good fit. But we still require very lengthy discussions before we get into a deal, and right now we have not found a deal we can invest in. There is not really much project finance in this market.

**Hermansjah, Jasa Marga:** That depends on how you define project finance. From our point of view, all our nine projects are pure project financing. As I mentioned earlier, with the new road law, each project needs to be controlled by a separate entity. The project finance is done separately for each, with no recourse to Jasa Marga. These are real project financing and they are financed, at this point, by local bank syndicates.

**Nazula, Manulife Asset Management:** We are certainly interested in buying more project finance deals, although clearly we need to be adequately compensated for the risks. We’re a firm believer in doing intensive research in any area, but there is nothing stopping us investing in project like those that Reynaldi is talking about.

**De Guzman, Moody’s:** We see the state of infrastructure development in Indonesia as perhaps akin to India 10 years ago or China 20 years ago. The contrast between those countries is interesting, because India has not sustained high levels of growth as it did not push on with enough infrastructure spending. China moved to increase infrastructure spending dramatically, and that has clearly had a positive effect.

It is important that Indonesia sustain its focus on infrastructure development given the potential impact on sustainably higher growth. In the medium to long-term that could lead to upward pressure on the rating.

Thean, RAM: Malaysia is clearly the poster child for infrastructure project finance bonds in the region, as seen in the sizeable share of such financing in the bond market. It is important to start with a strong sponsor that has the financial muscle to push past any challenges, and bring things through to the commissioning stage.

The land acquisition issue has been a bit of a roadblock for Indonesia, but as Reynaldi mentioned, that is changing. The Land Acquisition Bill 2012 expected to be effective by end of this year could be a real boost for project financing because it provides a lot of clarity over timing of land acquisition.