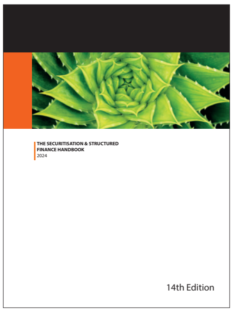
THE SECURITISATION & STRUCTURED FINANCE HANDBOOK

2024

14th Edition



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Green infrastructure securitisation development in Asia

By Dr Stan Ho Ho Ming, Asia Pacific Structured Finance Association (APSA)

There is a high urgency to mobilise private finance to decarbonise infrastructure globally, as energy, industry and buildings account for more than 70% of global greenhouse gases (GHGs); and public funding alone will not be enough to pay for the US$93.2 trillion transition at the scale and speed needed to meet the Paris Agreement goals limiting global warming to 1.5°C by 2030.

Introduction

It is not clear how private financiers, asset owners and policy-makers can work together to move from the current position, in which private capital principally flows to developed nations - largely into assets that are already generating predictable revenues - to a future position in which money also flows to what is often perceived as riskier and less stable opportunities in under-financed emerging and frontier markets.

There is a certain practicality at work. Environmental, social and governance (ESG) commitments adopted by lenders, investors and policy-makers in these economies are driving positive results, including advancing the search for low-carbon technologies and assets, such as carbon capture and storage, hydrogen use, and renewable energy projects. Besides, over the last decade, a record level of dry powder from infrastructure funds has been matched by a steadily increasing need for investment in new and retrofitted infrastructure.

However, a large majority of the infrastructure money has yet to be invested in new builds and technology, as investors in these funds tend to be savings institutions looking for lower-risk, lower-return exposure. According to the OECD, US$120 trillion of spare capital is held by private equity funds, banks and other private investors. At the same time, the United Nations estimates that 75% of the infrastructure needed by 2050 has yet to be built, the vast majority of which is in emerging markets.

Green infrastructure securitisation is expected to be one of the effective means of enlarging the investor base for the much-needed funding in Asia Pacific.

Green infrastructure securitisation

The generic infrastructure structure envisages the purchase of a pool of loan participations by a special purpose vehicle (SPV) financed by the issuance of tranches of rated securitised bonds and unrated “equity”. The securitisation tranches are rated by credit rating agencies according to their seniority within the capital structure with the senior most tranche considered the least risky and the equity being the riskiest tranche. A broad range of investor groups purchase the tranches based on their individual risk and return preferences and investment criteria. An asset manager typically manages the underlying pool of loans by constructing a portfolio and optimizing portfolio performance.

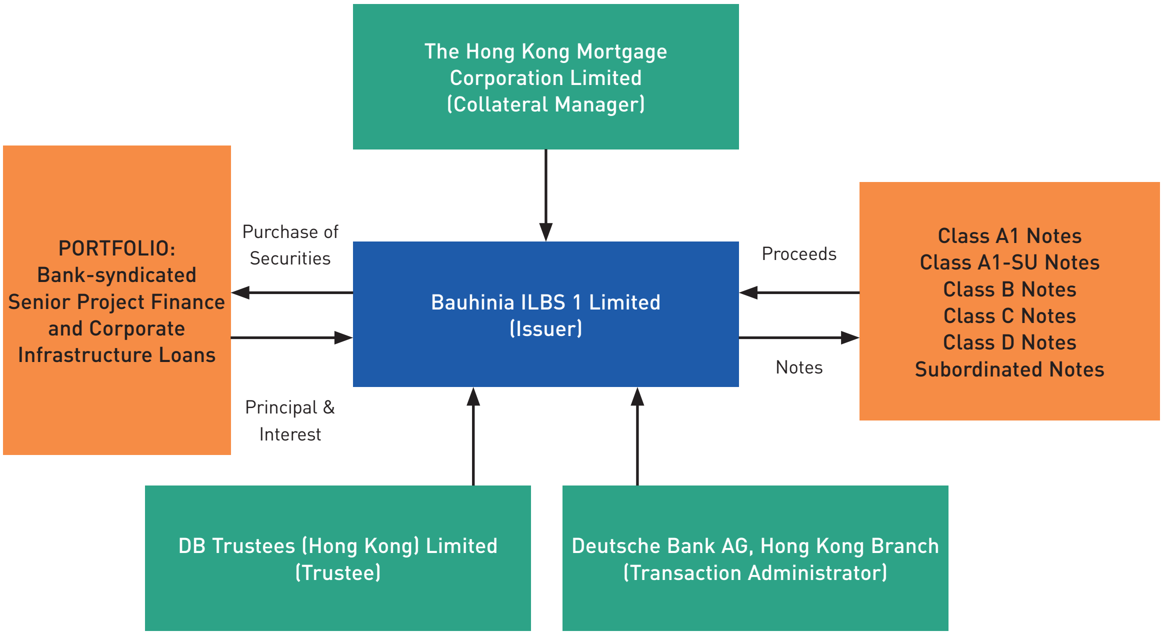
Green infrastructure loans are more complex and long dated that assets generally used to populate ABS such as leases, credit card receivables and mortgages. It is due to this complexity that requires monitoring and actions by a manager well aquatinted with the underlying assets, hence, why a securitisation issued by an asset manager is optimal to sustainable infrastructure. By transferring the credit risk of the underlying loan portfolio to bond investors via securitisation, securitisations have accelerated loan issuance, freed up bank lending capacity and thereby expanded overall credit formation. The same principles can be applied to the sustainable loan market to accelerate credit formation for other sustainable projects.

Green infrastructure securitisations are warming up to take their rightful place as a pillar of the sustainable securitisation revolution. The supply of assets for this product is plentiful and given the vast commitments by financial institutions to increase the quantity of green loans on their books, this trend looks set to continue. Sustainable borrowers are becoming increasingly diverse in terms of profile and use of sustainable use-allocated funds. For example, oil companies are increasingly investing in renewable projects and innovations such as electric aircraft are on the horizon.

Bauhinia ILBS 1 Limited

Bauhinia ILBS 1 Limited (the, issuer) is a pilot project finance and corporate infrastructure collateralised loan obligation (the CLO or the transaction) cash flow securitisation transaction, sponsored by The Hong Kong Mortgage Corporation Limited (HKMC, the collateral manager).

Bauhinia ILBS - Structure Diagram **Exhibit 1**



Source: Moodys

The notes issued by the issuer are backed by a US$404.78m portfolio of bank-syndicated project finance loans and corporate infrastructure loans predominantly in Asia-Pacific, the Middle East and South America at closing. All the loans were acquired directly from or by way of funded participation with HKMC or rated bank(s) around the closing date.

Of the US$404.78m portfolio, US$6.68m relates to undrawn commitments, which were deposited in the issuer's bank account at closing, pending to be drawn by the borrowers.

HKMC was established in Hong Kong in 1997 and is wholly owned by the Hong Kong Government through the Exchange Fund, with reported total assets of HK$173.2bn as of the end of December 2021. This CLO transaction will be managed by the Infrastructure Financing and Securitisation Division (IFS) of HKMC.

The issuer issued five classes of rated notes: Class A1, A1-SU, B, C and D Notes. The Class A1 notes and Class A1-SU notes rank pari passu with each other and rank senior to the Class B, C, D and the unrated subordinated notes.

In addition, the issuer issued unrated subordinated notes to HKMC that receive only residual interest and principal payments. HKMC provided a sponsor loan to the issuer at closing to support the liquidity of the issuer in meeting interest payments on the rated notes on the first payment date.

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External review of Bauhinia ILBS 1 Limited Sustainability Tranche

DNV Business Assurance Singapore ("DNV") was commissioned by HKMC to provide a pre-issuance eligibility assessment of the Sustainability Notes. DNV's objective was to provide an assessment that the Sustainability Notes have met the criteria established on the basis set out below.

The scope of DNV's opinion is limited to the Green Bond Principles ("GBP"), Social Bond Principles ("SBP") and

Bauhinia ILBS: rated and unrated notes issued **Exhibit 2**

Class	Ratings	Amount (USD mm)	Capital Structure	Effective Subordination	Pricing
A1-SU	Aaa (sf)	100.00	74.0%	26.0%	SOFR + 160bps
A1	Aaa (sf)	199.60			SOFR + 170bps
B	Aa1 (sf)	36.50	9.0%	17.0%	SOFR + 160bps
C	A2 (sf)	18.25	4.5%	12.5%	SOFR + 160bps
D	Baa3 (sf)	10.00	2.5%	10.0%	SOFR + 160bps
Sub	Not rated	40.43	10.0%	N/A	SOFR + 160bps
		404.78	100.0%		

Source: Moodys

Sustainability Bond Guidelines ("SBG") issued by the International Capital Markets Association ("ICMA").

DNV has provided a pre-issuance eligibility assessment on the Sustainability Notes:

1. Use of Proceeds: The Issuer intends to use the proceeds of the Sustainability Notes to finance and refinance Green projects and assets including Solar Energy projects, Wind Energy projects, Run-of-River hydro projects; and/or to finance and refinance Social projects and assets including Education projects and telecommunication projects. DNV has reviewed evidence that demonstrates that the Green and Social projects and assets for the issuance of Sustainability Notes meet the eligibility criteria specified in the Framework.

2. Principle Two: Process for Project Evaluation and Selection: The raised proceeds will be allocated to finance and refinance the assets as set out under Use of Proceeds. DNV has reviewed evidence that demonstrates that HKMC regularly assesses opportunities for improvement and devises action plans and initiatives to mitigate negative environmental and social impacts from its operations.

3. Management of Proceeds: The HKMC as the collateral manager of the Issuer, shall establish an independent allocation register to record and track the allocation of the proceeds from the issuance of Sustainability Notes. The full amount of the proceeds will be deposited in the accounts of the Issuer, and not be commingled with general accounts of HKMC, and an amount equal to the net proceeds will be earmarked for allocation to the eligible loan portfolio. HKMC will review the outstanding balance of the Sustainability Notes as part of its allocation reporting at least on an annual basis.

4. Reporting: HKMC has confirmed that it will report on its website the following:

i) The total amount of proceeds allocated to Eligible Loans;
ii) Description of selected allocated Eligible Loans;
iii) The balance of unallocated proceeds (if any);
iv) The amount or the percentage of new financing and refinancing;
v) Impact Reporting to a range of metrics as available and as selected.

It is DNV's opinion that the proposed Sustainability Notes meet the criteria established in the Protocol and are aligned with the stated definition of green/social/sustainability bonds within the GBP, SBP and SBG.

Significance of Bauhinia ILBS 1 Limited Sustainability Tranche

Investors in this transaction include multilateral, local and international financial institutions, insurance companies and asset managers, as well as the Asian Infrastructure Investment Bank ("AIIB"), which participated as an anchor investor.

Since the global financial crisis in 2008, there has not been a publicly listed securitisation in Hong Kong, and there isn't one listed on Hong Kong Stock Exchange using a Hong Kong SPV. This transaction has helped put Hong Kong on the map in terms of its development into an infrastructure financing and securitisation hub.

Most importantly, the A1 sustainability tranche achieved a 10bps greenium compared with the A1 non-sustainability tranche, which strongly demonstrates the cost saving a green and sustainable securitisation can achieve for the issuer. This provides solid evidence for future originators considering green infrastructure securitisation.

Green infrastructure securitisation development in Asia

The path for green infrastructure securitisation in Asia Pacific is still at an early stage, but it is important for the runway to be laid in order to ensure that APAC does not miss out on potential growth opportunities.

Implementing green infrastructure projects would require emerging countries in APAC etc. to change the way they approach infrastructure planning. Equally, the benefits of green infrastructure securitisation must be emphasised to Asia Pacific, especially given how sustainable infrastructure is associated with expensive, costly projects.

While multiple factors and reasons are driving the rise of sustainable infrastructure financing from different angles, one important factor required for the successful implementation of sustainable infrastructure will be the creation of partnerships between private and public sector stakeholders in the infrastructure ecosystem.

Such partnerships are already being formed in the Singapore ecosystem, for both soft and hard infrastructure. This showcases the ability to lay the runway for green infrastructure securitisation to truly take off in APAC.

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