Bayfront Infrastructure Capital II IABS securitisation

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Tembusu is a large evergreen tree in the family *Gentianaceae*, native to Southeast Asia. It's a dendrological cousin to Angel Oak, the 450-year-old tree that stands proud near this cub reporter's hometown of Charleston, South Carolina. Tembusu is an apt project name for Bayfront Infrastructure Management's $401.2 million infrastructure asset-backed securities (IABS) priced and listed last month (June 2021) on SGX's bond market.

"Similar to Project Orchid for the first Bayfront Infrastructure Capital, we were looking for a project name that bears a strong Singapore linkage and landed on Project Tembusu," said a Bayfront spokesperson. "The Tembusu is one of Singapore's most distinctive trees and is known to be evergreen, resilient, and versatile in its applications."

Imagine originating, bundling, and issuing a diversified portfolio of 30 project finance loans to institutional investors in 5 months… 5 weeks or 5 days. Now contemplate that the entire process of origination, warehousing and securitization happens in 5 seconds. What about IABS tokens? Far-fetched? Is that even a future worth creating? Let's first unpack the problems IABS are trying to solve and detail the innovative transaction.

Identifying barriers to entry

Institutional investors eyeing direct investments in infrastructure have limited investment-grade and rated opportunities in emerging markets. Portfolio construction is time-consuming and a challenge without allocating large amounts of capital. Credit analysis and portfolio management require substantial resources and the secondary PF loan market is far less liquid than public equities, sovereign or corporate bonds. Another barrier is that pension funds, insurance companies and other institutional investors need to underwrite their direct credit risk exposure for bespoke loans. In sum, opportunity and transaction costs crowd out institutions with the appetite – but not the stomach – to recycle capital.

IABS are structured notes backed by a diversified portfolio of high quality, senior ranking infrastructure loans. They have a spectrum of investment-grade securities across a range of ratings, tenor, and returns. The attractive and innovative credit enhanced debt securities have first loss risk retention by the notes' sponsor and other investor-friendly structural protections. The collateral manager routinely monitors performance with tests involving over-collateralisation, interest coverage, and limited asset substitution.

Bayfront's issuance gave large investors access to emerging market infrastructure debt through investment grade-rated notes. It offered diversified exposure to dozens of loans and projects and visibility of loans from Bayfront's network of more than 20 contributing banks. The bond format meant that liquidity was greater than standalone PF loans – with a smaller minimum investment. The first loss risk retention and subordination provided an additional layer of credit enhancement that protected investors.

"The securitization market is a potential solution to Asia's infrastructure financing gap because it provides institutional investors a way to access Asian infrastructure assets," said Stefen Shin (pictured right), principal investment officer at the Asian Infrastructure Investment Bank (AIIB) and Bayfront non-executive director. "The debut investment will facilitate the growth of the securitization market in Asia. This, in turn, will diversify infrastructure funding channels and crowd in institutional capital for the region's infrastructure financing needs."

Summarising Bayfront Infrastructure Capital II

Companies and their roles were as follows:

- Bayfront Infrastructure Management, a 70/30 platform between Clifford Capital and AIIB – sponsor and retention holder
- Bayfront Infrastructure Capital II (BIC II) – issuer
- BIM Asset Management (BIMAM) – collateral manager

Bank roles comprised:

- Citi – joint global coordinator, joint bookrunner, joint lead manager and sole structuring
- ING – joint global coordinator, joint bookrunner, joint lead manager and sole sustainability structuring
- Standard Chartered Bank – joint global coordinator, joint bookrunner and joint lead manager

The Singapore-headquartered Bayfront issuance included the world's first publicly issued securitization sustainability tranche backed by sustainable assets. It offered institutional investors in Asia Pacific, Europe, the Middle East and supranationals a diversified risk-return profile and exposure to emerging markets infrastructure sector through securitisation.

The issuance had 5 classes of notes with semi-annual floating-rate payments. Along with a dedicated senior sustainability tranche, there was an equity tranche, through preference shares fully retained by Bayfront, that was 10% of the issuance. Bayfront had a similar equity tranche in BIC I – Asia's first project finance collateralised loan obligation (PFCLO) issued in July 2018 – to demonstrate to investors its continued commitment to the new asset class.

The diversified and "primarily static" portfolio consisted 27 project and infrastructure loans across 25 individual projects in Asia Pacific, the Middle East and South America. Bayfront sourced the portfolio from project finance lenders and Bayfront's sister company Clifford Capital Private (CCPL).

Insurance guarantee covers by export credit agencies and multilateral financial institutions benefited 22.4% on a value basis of the portfolio. The portfolio's weighted average rating factor (WARF) was 748 before applying credit estimate notching adjustments and 937 after applying the adjustments. Ba1/Baa3 rating is about tantamount to 748. The lower the WARF, the higher the credit quality.

The IABS delivered 5 highlights to institutional investors:

- diversified portfolio of high-quality project and infrastructure loans
- experienced and dedicated project finance specialist, with the appropriate alignment of interests with noteholders
- high-quality assets with credit enhancement features
- stable and predictable cash flows
- multi-layered credit approval process

Detailing the nuts and bolts

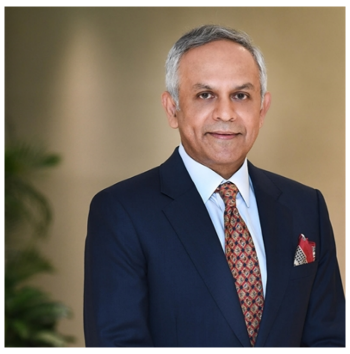
Citi, ING and Standard Chartered Bank were the joint global coordinators of the $401.2 million RegS issuance that listed on 18 June on the Singapore Exchange.

Last month, *IJGlobal* exclusively revealed the pricing thoughts of the 5 classes of notes – all due 11 January 2044 except the preference shares – of 6-month USD Libor + spread as follows:

Class	Amount ($ million)	Type	Moody's definitive rating	WAL - Early call (years)	WAL - Non-call (years)	Indicative price thoughts (bp)
A1	176.9	senior secured floating	Aaa (sf)	3.9		120-125
A1-SU	120	senior secured floating	Aaa (sf)	3.9		120 area
B	33.3	senior secured floating	Aa1 (sf)	8.0	8.6	170-185
C	22.1	senior secured deferrable floating	A3 (sf)	8.0	10.3	215-235
D	8.8	senior secured deferrable floating	Baa3 (sf)	8.0	11.8	340 area
Preference shares	40.1	Retained and not offered or listed				
Total	401.2					

In practical terms, the interest rate on the first cycle of semi-annual payments is:

- A1 – 1.41277%
- A1-SU – 1.36277%
- B – 2.01277%
- C – 2.51277%
- D – 3.56277%



"Our aim with pricing was to attract as many investors as possible," said Bayfront chief executive Premod Thomas (pictured left). "We had a 5bp differential between the normal and green tranches of the A1 and A1-SU classes. We could have priced tighter, but we would have had to drop some investors before we closed. We were trying to be as inclusive as possible since it is a new programme."

The early call figures assumed that the Class B, C and D notes are redeemed early in year 8, following the expected maturity of Class A notes. The reinvestment and non-call periods were 3 years until 11 July 2024.

"These are learnings from the first issuance that increases Bayfront's flexibility," remarked Thomas.

"Classes C and D for this issuance, similar to class C in the first transaction, are different to classes A and B to the extent that if there are insufficient cashflows to cover the interest payable for classes C and D, we have the option to defer the interest payable and that will be accrued against the principal amount of those notes," added Nicholas Tan, Bayfront chief operating officer. "Whereas, if there are insufficient cashflows for class A and B notes, then it's an event of default."

As opposed to a synthetic securitisation, BIC II conducted a project finance collateralised loans obligation (CLO) cash flow securitisation.

"Synthetic securitisations are typically done by banks," said Tan (pictured right). "They have the loans on their balance sheets, and they are syndicating the equity, or first-loss tranche, to investors who invest at the bottom (of the cashflow waterfall) so they can get capital relief at the top. Whereas, our platform is really meant to distribute securities that provide a credit enhanced exposure of the underlying infrastructure asset to investors."

"In other words, it's a means of taking assets off the bank's balance sheet – both in terms of risks and funding," added Thomas. "We pay them for their assets and Bayfront becomes the lender of record. Similarly, we provide notes that give investors the option to pick up the risks of the notes and the funding. It's a fully funded product on both sides."

Sustainability tranche

Bayfront issued the dedicated sustainability tranche – class A1-SU notes – under its Sustainable Finance Framework. ING was Bayfront's sole sustainability structuring bank. DNV opined that the A1-SU notes aligned with several sustainability standards, including the International Capital Market Association (ICMA) Green Bond Principles and Asean Capital Markets Forum Green Bond Standards.

"We are aligned with helping banks recycle sustainability loans so they can do more," commented Thomas. "We give banks confidence that they can originate more of these types of loans. The issuance is a signal that these products are in high demand by institutional investors."

Bayfront bifurcated the sustainability tranche in green or renewable energy and social assets or affordable basic infrastructure.

Renewable energy totalled $63.9 million from wind ($34 million), solar ($15.9 million) and run-of-river hydropower ($14 million).

The $82.3 million in affordable basic infrastructure comprised desalination in the Middle East ($45 million), roadway upgrades in an undisclosed Asean country ($20.3 million), and transmission and distribution of electricity in Cambodia ($17 million).

"A total of $185 million of which $146.2 million is drawn against which we will issue notes of $120 million. The over-collateralisation is to ensure the assets are always in well of excess of the sustainability notes in circulation," said Thomas.

Composing the portfolio

Bayfront's leadership including head of loan acquisitions Saumitra Shrivastava and Richard Desai, chief risk officer, constructed the portfolio based on several factors.

These included:

- geographical project location
  - of the 13 countries, investors were most exposed to India (17.7%), Bangladesh (10.3%) and Qatar (10.2%)
- ultimate source of payment risk
  - of the 16 countries and suprasovereign organisations, most exposures were in India (17.7%), Qatar (10.2%) and Brazil (9.5%)
- ratings distribution
  - 41.6% was Ba1-Ba3 while 16.9% was Aa1-Aa3
- sector
  - of the 8 industry sub-sectors, conventional power and water made up 36.4% while 34.8% were in the dedicated sustainability tranche
- maturity
  - 29.2% were 6-8 years and 16% were more than 15 years
- credit enhancement
  - 77.6% were uncovered while multilaterals covered 11.8% and ECAs supported 10.6%
- construction risk
  - of the 16.2% under construction, all had SCODs within a year while 83.8% were operational
- commodity price exposure
  - 87% were availability-based, fixed price offtaker or charter contracts while 13% were exposed to commodity prices

Profiling the investors

Investor demand was strong, including $60 million from AIIB. The entire book across all classes was 1.4x oversubscribed and the dedicated sustainability tranche was 1.6x oversubscribed.

The investor breakdown was as follows:

Investor type	**By value**	**By number of investors**
MDB	17%	6%
Bank	48%	25%
Insurance and Pension	21%	31%
Asset Manager	14%	38%
	100%	**100%**
Allocation by geography	**By value**	**By number of investors**
Singapore	11%	38%
Hong Kong	12%	19%
Japan	12%	6%
Philippines	17%	6%
Bahrain	11%	6%
Denmark	2%	6%
Suprasovereign	17%	6%

Netherlands	8%	6%
Switzerland	10%	6%
	100%	**100%**

Transaction counterparties and advisers were:

- Latham & Watkins – issuer counsel, English law
- Allen & Gledhill – issuer counsel, Singapore law
- Clifford Chance – joint global coordinator counsel
- Allen & Overy – trustee counsel
- White & Case – AIIB counsel
- DB International Trust – trustee
- Sanne – transaction administrator
- DBS – account bank
- Deutsche Bank – calculation agent, principal paying agent, registrar and transfer agent
- Moody's – rating agency
- DNV – sustainable finance framework second party opinion provider

Developing an ecosystem for securitisation technology

Bayfront aims to be a frequent issuer of IABS. Don't let the 35 months between BIC I and II fool you, insists Thomas. Leaders spent time during issuances designing an organisational structure, policies, and procedures.

In July 2019, Bayfront received 2 consequential approvals – a $1.8 billion Singapore government guarantee and a $54 million investment by AIIB. Amid the Covid-19 pandemic in April 2020, the company signed an agreement with Singapore's Ministry of Finance for the guarantee and began operations, initially drawing down $90 million from Clifford Capital Holdings and AIIB. By March 2021, Bayfront had signed MoUs with 22 participating banks and acquired loans from 14.

"We're looking to get embedded in our participating banks' distribution processes," said Thomas. "These banks often distribute to other banks. We want to get exposure to these assets into the hands of the institutional investor markets."

How quickly IABS becomes a new technique to recycle capital is debatable. Much will depend on Bayfront's meeting its June-September 2022 target of its next issuance.

"We're the only one who uses this securitisation technology in Asia," said Thomas. "Banks find us interesting because we have a different way of transforming their balance sheets as Basel makes it more difficult."

Yet is 12 months sufficiently quick to get to market and have the impact that Bayfront envisions?

"We've been having discussions (with fintech providers) to assist on the due diligence process to allow us to get to market faster," said Tan. "While each diligence, including contract review, of the individual loans is bespoke, we see standardisation perhaps at the loan agreement level. We think AI can help us streamline reviewing the terms and conditions and preparing credit applications."

InfraClear, a top 10 finalist in G20 initiative Global Infrastructure Hub's InfraChallenge 2021, is a fintech and software-as-a-service company founded by people with expertise in infrastructure finance, NLP, machine learning, and cloud computing. Led by IFC alumni Giridhar Srinivasan, the New York City-based start-up claims to have one of the world's largest databases of publicly available project agreements. It aims to use machine learning to build a database of project terms and performance.

InfraClear directly links the use of its data to the IABS market. "This could add up to 2.5 percentage points to the return for a securitized infrastructure loan portfolio," the company said in a pitch reviewed by *IJGlobal*. It's talking with a consortium led by HSBC to use their analytics to create a platform.

Tan adds: "Some fintech platforms are looking to facilitate the distribution process. These platforms may assist us to connect with more institutions and enhance the velocity of loan acquisitions and due diligence."

"The received wisdom is that project financing is clunky, bespoke and highly structured," said Thomas. "We are taking a different view. Onboarding assets can be quicker. On the distribution side, we are having interesting conversations with exchanges about tokenisation. Issuing asset-backed securities tokens is on people's minds."

Bayfront Infrastructure Capital Securitisation 2021

Transaction Snapshot

Financial Close:	11/06/2021
SPV:	Bayfront Infrastructure Capital II
Value:	$401.20m USD
Equity:	$0.00m
Debt:	$401.20m
Debt/Equity Ratio:	100:0