TRADING: LIQUIDITY SUPPORT IN THE TOUGHEST MARKETS

HIGH-GRADE MARKET: NEW SUPPLY, DURATION AND PRICE DYNAMICS TRANSPORTATION:
SECTOR OUTLOOK AFTER
THE DUST SETTLES

VOLUME 15 ISSUE 121_ OCT/NOV 2020 www.kanganews.com AUSTRALASIAN FIXED INCOME: GLOBAL REACH, LOCAL EXPERTISE

THE HUNT FOR YIELD

AS CASH RATES
APPROACH – AND
POSSIBLY SINK BELOW
– ZERO, AUSTRALASIAN
INVESTORS ARE
EXPLORING ALL OPTIONS
TO CAPTURE RETURN





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KangaNews

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Australia's private-debt market and the investors that specialise in it are not new phenomena. What is new is a headline cash rate at close to zero and the withdrawal of supply from the biggest historical source of local credit issuance – the major banks. Specialist investors say their sector is attracting more interest and inflows.

MARKET NEWS

- **AOFM**'s record syndication flow continues in Q3.
- **CBA** bides time for domestic tier-two
- Do **Woori**, be happy: Korean debutant follows Shinhan to Kangaroo GSS issuance.
- **Defensive corporate credit** hits the mark in Australia.
- Qantas sticks tricky landing to print A\$625 million.
- **KEC** talks funding strategy after Australian dollar debut.
- Australia's rejuvenated GSS pipeline delivers new issue for Lendlease.
- **Equity-credit deals** back in vogue for Australian corporates.
- Kiwibank takes a different path as asset growth spurs Kangaroo foray.
- Breakthrough for New Zealand duration as **Auckland Council** issues 30-year green bond.
- New Zealand dollar demand meets World Bank tenor preference.

COLUMN

Changes for the long haul

It is time to start asking what impact massively increased sovereign-sector

issuance and massively reduced bank supply will have – and whether these changes will be permanent.

COPUBLISHED Q+A COMMUNICATION KEY AS RATING PRESSURE **MOUNTS**

Ratings across the sovereign and subsovereign sector have come under considerable strain during the COVID-19 era. Germany's federal state of Baden-Württemberg, and its development agency L-Bank, provide a model for managing the fallout.

FEATURE

Before the deluge

In mid-October, the EU embarked on a funding programme so large that European market participants say it could reshape the European market and have ripple-effect consequences for others. There is no suggestion that the supply cannot be digested by the euro market, but other issuers may adjust their funding plans around the EU's jumbo issuance forecast.

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The stripes in the graph show the average annual temperature increase in Germany from 1881 to 2018. Sustainable investments help to achieve the UN's SDGs. #showyourstripes @nrwbank



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COPUBLISHED ROUNDTABLE GOING WITH THE FLOW

Trading capability, including a willingness to deploy balance sheet to support client needs, has long been a major differentiating factor for **ANZ**'s all-conquering fixed-income business. A group of the bank's traders gathered to talk about 2020 at a *KangaNews* roundtable.

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NEWS FEATURE

Responsible lending: unleashing banks, leashing nonbanks?

The Australian federal government has proposed changes to responsible-lending rules, with the goal of encouraging credit supply and thus maximising the economic impact of ultra-low rates. Nonbank lenders are watching developments closely and with some concern that they may further tilt the playing field.

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NEWS FEATURE

Australian dollar securitisation issuance bounces back

Australia's securitisation market has maintained deal volume at a level in line with outcomes from recent years despite massive upheaval to the supply and demand picture in 2020. In particular, bank issuers have been

all-but absent this year. A particularly active September and October for new issuance kept annual volume robust.

51

NEWS FEATURE

New opportunities for New Zealand securitisation A more optimistic tone has emerged in New Zealand's securitisation market on the back of two primary-market transactions and the emergence of a potential large-scale new issuer. The tone is markedly different from the first half of the year, when market participants did not expect to see deal flow in 2020.

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FEATURE

Reconstructive surgery

New Zealand investors face ultra-low rates and a radically reshaped credit-supply picture. As New Zealand struggles in the wake of COVID-19 – despite having been, at least for now, effectively able to eliminate the virus locally – the domestic buy side is considering its new strategy.

58

NEWS FEATURE

Conditions stabilise for New Zealand corporates as investors flood in

A flurry of corporate deals reopened the New Zealand market with a high level of demand, seemingly undeterred by the outbreak of COVID-19 and associated lockdowns. Deal sources say demand has always been present, especially in the retail space, but it took a while for



borrowers to become willing to test the waters for new issuance.

60

Q+A

MERIDIAN ROLLS OUT ALL-GREEN FINANCING STRATEGY

Meridian Energy became the latest New Zealand corporate issuer to certify its debt funding based on environmental criteria, with the 26 August launch of its green-finance programme. All Meridian's debt instruments are covered by the programme, which means its existing and, potentially, future domestic and USPP issuance is now in green-bond format. The issuer and its programme adviser speak to *KangaNews*.

62

NEWS FEATURE

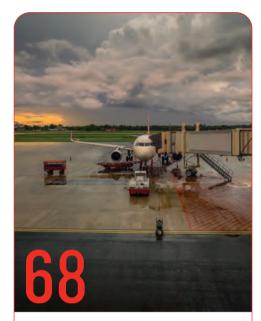
New Zealand corporates return to green-bond market

As well as a clutch of mainstream corporate bond deals, the New Zealand market welcomed the return of corporate green-bond issuance in September. Mercury reopened the market with the first deal in nearly a year, followed in a matter of weeks by a third green-bond transaction from Argosy Property.

64

COPUBLISHED Q+A ING HOLDS THE LINE ON AUSTRALIAN AMBITIONS

The events of 2020 could have tested **ING Bank**'s commitment to building its wholesale balance sheet in Australia. Instead, says **Charles Ho**, the bank's managing director and head of wholesale banking, it has used its sectoral expertise and strong local retail brand to grow its exposure – and prepare for a further expansion of debt-market coverage.



COPUBLISHED ROUNDTABLE Eye of the storm

When Australia went into lockdown, transport and shipping infrastructure saw an unprecedented business shock. Airport and toll-road passenger numbers collapsed while even freight flows dropped as the global economy ground to a halt. In October, *KangaNews* and **Westpac Institutional Bank** gathered key players in the Australian sector to discuss business impact, balance-sheet resilience and the swift rebound of debt capital markets including the domestic option.

80SURVEY Rocky road ahead

The 2020 iteration of the KangaNews-Moody's Investor's Service Corporate Borrower's Intentions Survey highlights the response of corporate Australia and New Zealand to COVID-19. The results show treasury teams are anticipating a rocky path out of the crisis and a heightened domestic focus to their funding plans.

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KangaNews is a one-stop information source on anything relevant to Australian and New Zealand debt markets – including in- and outbound issuance.

Each issue provides all the information market participants need to keep up to date with the deals and trends making headlines in the markets, in-depth issuer and investor insights, and deal and league tables.

KangaNews is published six times a year, with regular reports and yearbooks adding to the suite of printed offerings. Subscribers also have access to email updates on breaking deals and news from the KangaNewsAlert service, as well as priority invitations to KangaNews events and full access to the www.kanganews.com website.

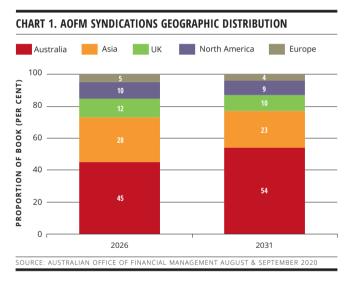
To subscribe or request a free trial please contact Jeremy Masters jmasters@kanganews.com +61 2 8256 5577

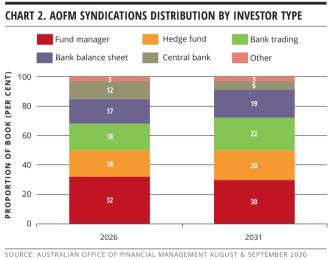


AOFM's record syndication flow continues in Q3

The Australian Office of Financial Management (AOFM) printed two more record-sized syndicated transactions in August and September, pricing a total of A\$46 billion (US\$33 billion) at six- and 11-year tenors (see table). The issuer says the market continues to show significant depth as broad distribution by geography and type featured in both deals (see charts 1 and 2).

PRICING DATE	MATURITY DATE	VOLUME (A\$BN)	BOOK VOLUME (A\$BN)	MARGIN (BP/EFP)	INDICATIVE MARGIN (BP/EFP)	LEADS
26 Aug 20	21 Nov 31	21	66.1	9	8-11	Citi, CBA, UBS, Westpac
23 Sep 20	21 Sep 26	25	66.1	24	24-27	ANZ, BofA, Deutsche, JPM





ISSUER INSIGHTS



AUSTRALIAN OFFICE OF FINANCIAL
MANAGEMENT

"There is still depth in the market. It should be evident that we are not printing these deals by relying any more heavily than in the

past on hedge funds and trading books - we are doing this with real-money bids."

"We have been happy to see a strong contingent of hedge funds and trading accounts in our books. We know most of the hedge funds that participate and are comfortable with the way they operate."

"Issuing [the] 2026 maturity ahead of the launch of the ASX's five-year futures contract was not necessary but it was an important opportunity nonetheless. It signals to the market that bonds will be there to support liquidity in the five-year contract."

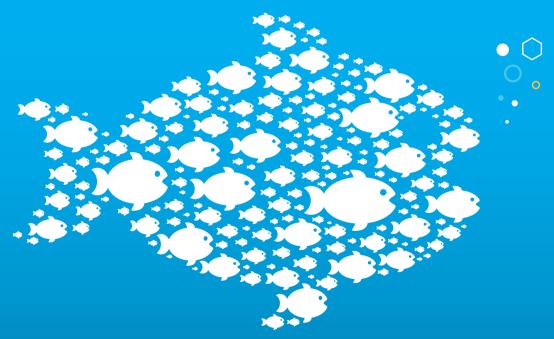
"There was an unusually high allocation to offshore investors for [mid-curve] tenor in my view, led by strong Asian and North American bids. While it is not surprising to see central bank participation in our mid-curve deals, the high level this time was notable – by volume of bids and the number of institutions. There were also good real-money bids from North America, which is a positive development."

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In the Peter Lee Associates Large Corporate & Institutional Relationship Banking surveys, New Zealand and Australia, ANZ Bank New Zealand Limited was Rated No.1 for Relationship Strength Index in the 2010 through to 2019 surveys and Australia and New Zealand Banking Group Limited was Rated No.1 for Relationship Strength Index in the 2014 through to 2019 surveys. "KangaNews Awards 2019. Australia and New Zealand Banking Group Limited (ANZ) ABN 11 005 357 522.





CBA bides time for domestic tier-two deal

Commonwealth Bank of Australia (CBA) joined Australia's tier-two issuance line-up at the start of September. The issuer says it took its time after releasing annual results to launch the best possible deal.

Issuer: Commonwealth Bank of Australia

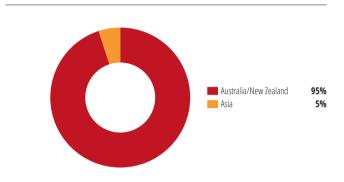
Issuer rating: AA-/Aa3/A+ Issue rating: BBB+/Baa1/A-Pricing date: 1 September 2020 Call date: 10 September 2025 Maturity date: 10 September 2030

Format: tier-two

Volume: A\$1.4 billion (US\$1 billion) Book volume at pricing: **A\$2.1 billion** Margin: 180bp/3m BBSW Indicative margin: 195bp/3m BBSW Geographic distribution: see chart 1 Distribution by investor type: see chart 2 Number of investors in book: 65

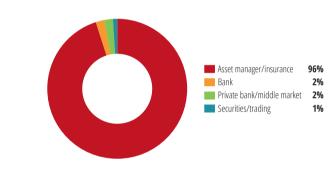
Lead manager: CBA

CHART 1. CBA TIER-TWO DEAL GEOGRAPHIC DISTRIBUTION



SOURCE: COMMONWEALTH BANK OF AUSTRALIA 3 SEPTEMBER 2020

CHART 2. CBA TIER-TWO DEAL DISTRIBUTION BY INVESTOR TYPE



TRANSACTION INSIGHTS (



HEAD OF TERM FUNDING
COMMONWEALTH BANK OF AUSTRALIA

"The Australian dollar market was competitive on a pricing basis compared with offshore and the domestic investor base had let us know it would be keen to

participate in a tier-two transaction issued by CBA."

"While the US dollar market has been the most popular destination for global banks executing capital transactions in recent months, we were conscious of our long absence from the domestic market"

DESMOND FENNELL HEAD OF GLOBAL SYNDICATE

COMMONWEALTH BANK OF AUSTRALIA

"There has been a strong pick up in interest in Australian major-bank tier-two paper from domestic and offshore investors. While there has been an increase at the margin in investor interest in tier-two paper from investors previously unable to participate in subordinated product, the bulk of demand is coming from investors increasing their exposure."



Do Woori, be happy: Korean debutant follows Shinhan to Kangaroo GSS issuance

A brace of Korean bank issuers priced Kangaroo bonds in green, social and sustainability (GSS) format in September and October, one of them – Woori Bank – as a first transaction in the Australian market. The issuers benefited from the lack of domestic financial-institution supply to attract solid complementary demand from local investors.

Issuer: **Shinhan Bank**

Issuer rating: A+/Aa3/A Pricing date: 22 September 2020 Maturity date: 29 September 2025

Format: social bond

Volume: A\$150 million (US\$107.7 million) & AS250 million

Book volume at pricing: >A\$800 million

Margin: 88bp/s-q swap & 88bp/3m BBSW

Indicative margin: 100bp/swap Geographic distribution: see chart 1 Distribution by investor type: see chart 2

Lead managers: J.P. Morgan, Mizuho Securities, National Australia Bank

Issuer: Woori Bank Issuer rating: A/A1/A-

Pricing date: 15 October 2020 Maturity date: 23 October 2023 Format: **sustainability bond**

Volume: A\$150 million & A\$250 million Margin: 72bp/s-q swap & 72bp/3m BBSW

Indicative margin: 80bp/swap

Lead managers: MUFG Securities, Nomura, Westpac Institutional Bank

CHART 1. SHINHAN SOCIAL BOND GEOGRAPHIC DISTRIBUTION

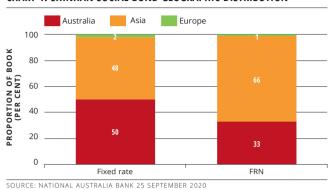
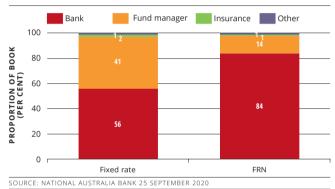


CHART 2. SHINHAN SOCIAL BOND DISTRIBUTION BY INVESTOR TYPE



ISSUER INSIGHTS (

HYE JIN KWON DEPUTY GENERAL MANAGER, TREASURY DEPARTMENT SHINHAN BANK

"[Shinhan] has issued multiple bonds under its SDG framework since it was established in 2018, but in 2020 its GSS issuance focus has been specifically on social outcomes related to its financing of projects to mitigate the spread and economic impact of COVID-19 in South Korea."

TREASURY REPRESENTATIVE WOORI BANK

"For this specific issuance, we decided to go with a COVID-19-recovery overlay to our sustainability bond to align our funding initiatives with the government's recently announced 'new deal' - which is a package of digital, green and social reforms aiming to expedite recovery from the pandemic and fundamentally reshape the economy."



Defensive corporate credit hits the mark in Australia

A trio of benchmark-sized domestic deals from Australian corporate issuers with relatively defensive profiles highlight the robustness of the local issuance option in the second half of 2020. While capacity for Aurizon may have been somewhat limited by environmental, social and governance (ESG) considerations, all three transactions demonstrated depth of demand for good-quality corporate names – including appetite for extended tenor.

Issuer: Coles Group

Issuer rating: BBB+/Baa1 Pricing date: 20 August 2020

Maturity date: 27 August 2025

& 27 August 2030

Volume: A\$150 million (US\$107.7 million) & A\$300 million

Book volume at pricing: **A\$725 million**

& A\$1.8 billion

Margin: 97bp/3m BBSW & 137bp/s-q swap

Indicative margin: 110bp/3m BBSW

& 155bp/s-q swap

Geographic distribution: see chart 1 Distribution by investor type: see chart 2 Lead managers: ANZ, Goldman Sachs, **SMBC Nikko**

Issuer: Aurizon Network

Issuer rating: BBB+/Baa1 Pricing date: 26 August 2020

Maturity date: 2 September 2030 Volume: **A\$500 million**

Book volume at pricing: A\$950 million

Margin: 210bp/s-q swap

Indicative margin: 215-220bp/s-q swap Geographic distribution: see chart 1 Distribution by investor type: see chart 2 Lead managers: Mizuho Securities,

National Australia Bank (NAB), Westpac **Institutional Bank**

Issuer: NSW Electricity Networks Finance (Transgrid)

Issuer rating: Baa2

Pricing date: 15 September 2020

Maturity date: 23 September 2030 Volume: A\$600 million

Margin: 177bp/s-q swap

Indicative margin: 185-190bp/s-q swap

Geographic distribution: see chart 1 Distribution by investor type: see chart 2 Number of investors in book: "around 40" Lead managers: Commonwealth Bank

of Australia, NAB

CHART 1. CORPORATE DEALS GEOGRAPHIC DISTRIBUTION

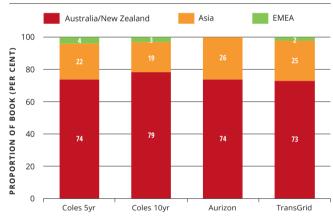
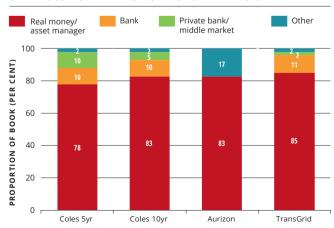


CHART 2. CORPORATE DEALS DISTRIBUTION BY INVESTOR TYPE



SOURCE: GOLDMAN SACHS, NATIONAL AUSTRALIA BANK, WESTPAC INSTITUTIONAL BANK AUGUST & SEPTEMBER 2020

TRANSACTION INSIGHTS (



EUKE SPITTY
EXECUTIVE DIRECTOR
SMBC NIKKO

"Coles identified
conducive market
conditions and strong
demand dynamics for
corporate paper, and was
able to take advantage

of a window of opportunity by using a condensed execution process off the back of its annual results announcement."



ANDREW EDWARDS-PARTON HEAD OF AUSTRALIA AND NEW ZEALAND DCM GOLDMAN SACHS

"Limited outstanding volume from Coles, and the modest volume of its debt book constraining potential future issuance,

creates a scarcity value that trumps investors' typical preference for larger volume."

CHRIS VAGG HEAD OF INVESTOR RELATIONS AND GROUP TREASURER AURIZON NETWORK

"We typically receive questions on our approach to ESG but there were fewer in this update than there were when we met the market in February. This is likely due to the current nature of the COVID-19 crisis, compared with the long-term nature of investors' ESG concerns."



TABITHA CHANG
DIRECTOR, DEBT CAPITAL MARKETS
NATIONAL AUSTRALIA BANK

"While ESG has an impact on some investment behaviour, Aurizon's status as a regulated entity with stable cash flows, and its greater

exposure to metallurgical than thermal coal, mean it still has a supportive investor base in Australian dollars."



FLORIAN SCHWARZ DIRECTOR, DEBT CAPITAL MARKETS MIZUHO SECURITIES

"Australian dollar credit spreads have largely retraced and the macro backdrop has become relatively benign given the level of government support

for the economy. Meanwhile, equity markets have been rallying so there is an overall positive market sentiment."



PETER BLOCK
HEAD OF CORPORATE AND
NONFREQUENT BORROWER ORIGINATION
WESTPAC INSTITUTIONAL BANK

"The ability of the market to digest this amount of supply is testament to its recovery so far and is an indication that investors are willing to be serious providers of capital to

the economy through its recovery."



JASON CONROY CHIEF FINANCIAL OFFICER TRANSGRID

"TransGrid is keen to use public debt capital markets to term out bank debt. The Australian dollar market's recent performance for investment-grade

corporates issuing benchmark, long-dated deals provided further impetus to debut."



SIMON QUINNELL DIRECTOR, DEBT CAPITAL MARKETS ORIGINATION COMMONWEALTH BANK OF AUSTRALIA

"The Australian dollar market has evolved significantly in 2020. Few would have predicted that, in a year of such disruption, the market would remain open and

10-year issuance would dominate corporate transactions."



Qantas sticks tricky landing to print A\$625 million

Qantas's new 10-year deal was business-asusual process, the issuer says, as it sought to refinance a 2021 maturity and maintain a diverse funding base. The COVID-19 pandemic was always going to be a big factor in the deal, but Qantas tells KangaNews its financial record and future prospects were sufficient catalysts for investor engagement.

The airline printed an initial A\$500 million (US\$359.1 million) of 10-year bonds and followed up with a A\$125 million increase to its outstanding 2026 line three weeks later.

Issuer: Qantas Airways

Issuer rating: Baa2

Pricing date: 1 September 2020 & 22 September 2020

Maturity date: 9 September 2030

& 12 October 2026

Volume: A\$500 million & A\$125 million

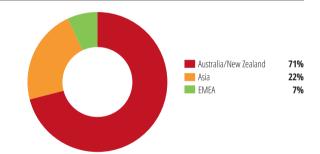
Margin: 450bp/s-q swap & 385bp/s-q swap

Indicative margin: 450bp/s-q swap

& 385bp/s-q swap

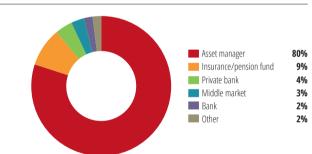
Geographic distribution: see chart 1 Distribution by investor type: **see chart 2** Lead managers: Citi, Commonwealth Bank of Australia, National Australia Bank, Westpac Institutional Bank

CHART 1. QANTAS 10-YEAR DEAL GEOGRAPHIC DISTRIBUTION



SOURCE: WESTPAC INSTITUTIONAL BANK 8 SEPTEMBER 2020

CHART 2. QANTAS 10-YEAR DEAL DISTRIBUTION BY INVESTOR TYPE



ISSUER INSIGHTS



TREASURER, CAPITAL MARKETS QANTAS

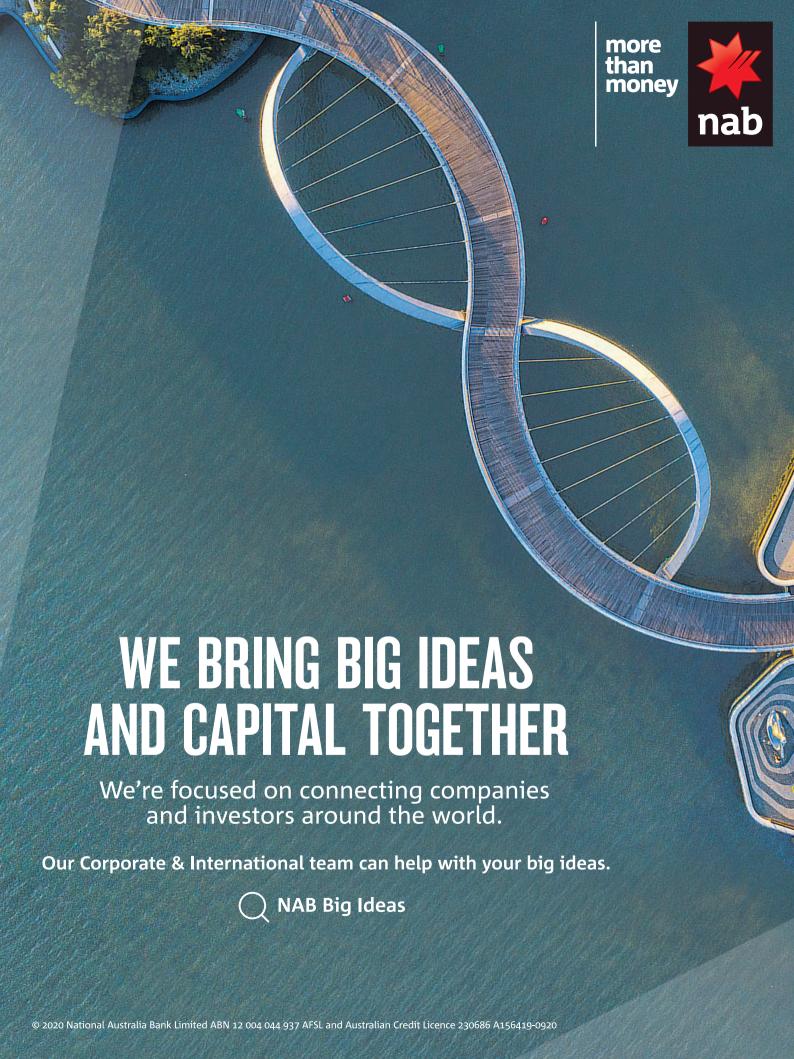
"The impact of the COVID-19 pandemic on Qantas has only enhanced our desire to maintain access to a diverse range of funding sources. We have already tapped

bank funding lines for additional liquidity during the crisis."

"We expect our business will be smaller for a period of time and we see a faster recovery of domestic flying than international. Qantas has a track record of transforming the business

when required and the executive management team understands tough decisions need to be made to ensure the long-term profitability and sustainability of the Qantas group."

"Qantas had a strong balance sheet ahead of the crisis and the measures we have taken will ensure we maintain strength as we head into the recovery phase. We are now one of only a few investment-grade airlines and our investors are showing support for the business and financial framework that underpins Qantas's balance-sheet strength."



ISSUER INSIGHTS

KEC talks funding strategy after Australian dollar debut

After establishing its Australian debt-issuance programme in late July, Korea Expressway Corporation (KEC) issued its inaugural Kangaroo transaction on 26 August. The issuer shared deal insights with *KangaNews* in the wake of the transaction.

Issuer: Korea Expressway Corporation

Issuer rating: AA/Aa2
Pricing date: 26 August 2020

Maturity date: **2 September 2023**Volume: **A\$450 million (US\$323.1 million)**

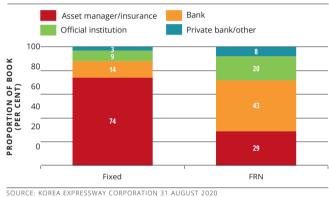
Margin: 72bp/3m BBSW & s-q swap

Indicative margin: **78-80bp/swap**Geographic distribution: **see chart 1**Distribution by investor type: **see chart 2**Lead managers: **HSBC**, **Mizuho Securities**,

Standard Chartered

CHART 1. KOREA EXPRESSWAY DEAL GEOGRAPHIC DISTRIBUTION Australia Asia Europe 20 20 40 40 65 Fixed Fixed FRN





ISSUER INSIGHTS

KEUNWOOK KANG SENIOR MANAGER, FINANCE KOREA EXPRESSWAY CORPORATION

Why did KEC establish an Australian debt issuance programme in Kangaroo format?

We sought to benefit from the flexibility and efficiency it offers in accessing Australian dollar-denominated capital markets.

One of our key goals was to establish a relationship with, and garner demand from, Australian onshore investors. We believed Kangaroo format to be an optimal choice.

We are committed to deepening our relationship with Kangaroo investors and Australian dollars is one of our key non-US dollar bond funding initiatives.

What is your funding programme and issuance by currency?

We've been tapping international capital markets off the MTN programme we established in 2006.

We have raised funding in more than eight currency markets globally. Of our outstanding volume, US dollar bonds account for 61 per cent, followed by Swiss francs, renminbi and Hong Kong dollars – with 7-10 per cent each – among others.

The mandate announcement said Korea Expressway was considering 3-5 year tenor. Why was a deal in the short end of the curve the focus, and why was three-year tenor ultimately chosen? Would you like to return for longer tenor?

We considered our own debt-maturityprofile management as well as investor preference. Although we found demand to be as robust for five years as for three, we concluded that threeyear tenor worked best for us on this occasion. We could consider longer tenors in future funding exercises.

What were your pricing expectations and how did Australian dollar pricing stack up on an international basis?

We set our pricing expectation at a reasonable premium over Korean policy banks that have been regular Kangaroo issuers. We believe we have achieved fair pricing that was in fact slightly tighter than our US dollar secondary curve.

We achieved funding arbitrage by swapping the proceeds into Korean won, leveraging the current basis as well as Australian dollar denominated bondmarket conditions – noting that our base funding currency is Korean won.

In addition, we're extremely satisfied with the breadth of investor demand we could accommodate through our three-year fixed and floating dual-tranche format. •

Australia's rejuvenated GSS pipeline delivers new issue for Lendlease

Lendlease Group printed its debut green bond on 20 October to become the first nonfinancial corporate credit to print labelled green, social and sustainability (GSS) product in Australia this year. The issuer tells *KangaNews* its financing strategy now aligns with the business's strong green credentials.

Issuer: Lendlease Group

Issuer rating: **Baa3/BBB-**Pricing date: **20 October 2020**Maturity date: **27 October 2027**

Format: **green bond**

Volume: A\$500 million (US\$359.1 million)

Book volume at pricing: >A\$1.1 billion

Margin: 300bp/s-q swap

Indicative margin: 315bp/s-q swap

Geographic distribution: **see chart 1**Distribution by investor type: **see chart 2**

Number of investors in book: **>100**

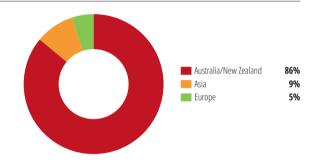
Green-bond advisers and lead managers:

ANZ, Commonwealth Bank of Australia, HSBC

Additional lead managers:

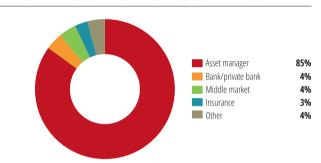
National Australia Bank, SMBC Nikko

CHART 1. LENDLEASE GREEN BOND GEOGRAPHIC DISTRIBUTION



OURCE: LENDLEASE 23 OCTOBER 2020

CHART 2. LENDLEASE GREEN BOND DISTRIBUTION BY INVESTOR TYPE



SOURCE: LENDLEASE 23 OCTOBER 2020

ISSUER INSIGHTS 0



MICHAEL LARKIN GROUP TREASURER LENDLEASE

How does issuing a green bond fit in with Lendlease's wider corporate strategy?

It brings funding in line with wider corporate strategy. Barangaroo is the first carbon-neutral precinct in Australia and our funds are global leaders in sustainability – evidenced by their GRESB rankings. We did Australia's

first five- and six-star green buildings and all the projects in our pipeline are targeting five- or six-star green ratings or equivalent.

On 17 August, Lendlease also set a target of becoming a 1.5 degree-aligned company as well as committing to 'net zero' carbon for scope one and two emissions by 2025 and 'absolute zero' carbon across all operations, including the supply chain, by 2040.

This and our sustainable-finance framework allow us to tell the story of the focus on sustainability in the business to a new cohort of stakeholders that is perhaps not as aware of our green credentials.

The framework also facilitates social or sustainability issuance.

Why did you start with a green bond?

Green bonds are well understood in the market. It is a simple and compelling story to tell investors about the projects we have in the pool. Lendlease views the new deal as an opportunity to reposition itself in the Australian dollar market in preparation for future financing arrangements.

The deal priced on the same day as a jumbo New South Wales Treasury Corporation green bond. Was there any concern about capacity?

The increasing maturity and size of the Australian dollar market is such that it can absorb issuance from a number of borrowers. We are also seeing more deals launched and priced intraday. •



Equity-credit deals back in vogue for Australian corporates

Australian corporate issuers printed a pair of large subordinated capital transactions in September, one in the US 144A market and the other in Australian dollars. Attention focused in particular on Scentre Group's US dollar deal, given its size and the status of retail during and after COVID-19 lockdowns.

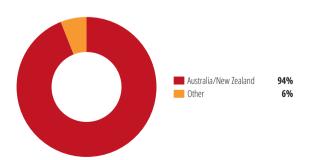
he transaction followed Scentre's half-year results. The ongoing impact of the COVID-19 crisis on retail trade resulted in a A\$3.7 billion (US\$2.7 billion) loss for the six-month period and a A\$4.1 billion property-valuation write down. However, 93 per cent of the group's stores outside Victoria had reopened while 99 per cent of its portfolio was occupied by the same point.

The features of the securities include deep subordination, a 60-year final maturity date, coupon deferability and distribution stopper. As a result, the notes qualify for 50 per cent equity credit from all three major rating agencies and therefore support Scentre's long-term credit ratings.

AusNet Services, meanwhile, last issued in hybrid format with a US and Singapore dollar dual-tranche deal in March 2016. The issuer says it undertook the latest deal to support its credit rating in the coming years as it embarks on a capex programme, given low interest rates are likely to have a negative impact on upcoming resets for its regulated networks.

Leads say AusNet's hybrid transaction was not directly related to Scentre's trade, though momentum from the first deal may have contributed to AusNet's result. Deal sources say there was meaningful demand for Scentre from Australian investors.

CHART 1. AUSNET DEAL GEOGRAPHIC DISTRIBUTION



SOURCE: ANZ 30 SEPTEMBER 2020

Issuer: Scentre Group Issuer rating: A/A2/A

Issue rating: BBB+/Baa1/BBB+

Pricing date: 16 September 2020 Call date: 24 June 2026 & 24 June 2030

Maturity date: 24 September 2080 Format: 50% equity-credit hybrid-capital note

Volume: US\$1.5 billion & US\$1.5 billion

Coupon: 4.75% & 5.125%

Indicative margin: "low 5%" & "mid 5%" Number of investors in book: "more than 300"

Structuring adviser: **UBS**

Lead managers: ANZ, BNP Paribas, Citi, Commonwealth Bank of Australia, HSBC, **UBS**



Issuer: AusNet Services

Issuer rating: A-/A3 Issue rating: BBB/Baa2

Pricing date: 24 September 2020 Call date: 6 October 2025 Maturity date: 6 October 2080

Format: 50% equity-credit hybrid-capital note

Volume: A\$650 million Book volume at pricing: **A\$900 million**

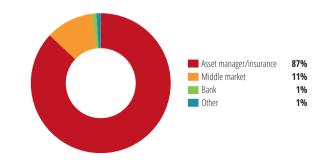
Margin: 310bp/3m BBSW

Indicative margin: 310-320bp/3m BBSW

Geographic distribution: see chart 1 Distribution by investor type: **see chart 2**

Lead managers: ANZ, National Australia Bank, UBS

CHART 2. AUSNET DEAL DISTRIBUTION BY INVESTOR TYPE



SOURCE: ANZ 30 SEPTEMBER 2020

TRANSACTION INSIGHTS O



RICHARD WILLIAMS GROUP TREASURER SCENTRE GROUP

"Visitation to our centres has recovered strongly following the removal of mobility restrictions. The reality is that people are social beings and

want to be together. Investors acknowledge that Westfield Living Centres are still the best platform for retailers to access the strongest levels of foot traffic and connect with customers."

"Capital management has been a key priority throughout the pandemic. Issuing longdated subordinated debt delivers additional diversification of Scentre's capital sources and investor base while providing significant additional financial flexibility."

ALASTAIR WATSON TREASURER AUSNET SERVICES

"We looked at various options for our deal but the preference was always for Australian dollars. If we required much larger volume other markets may have come into play, but with our price and volume requirements we were confident the local market would produce the best result."



BARRY SHARKEY
MANAGING DIRECTOR
UBS

"The AusNet and Scentre transactions highlight the benefits of taking a broad approach to capital management, in both cases raising a cost-

effective form of capital as an alternative to vanilla debt or equity. However, hybrids are a more tailored form of capital and so may not suit every issuer, every time. We take an agnostic approach when advising issuers on capital-management strategy – every horse has its own course."

"We have always felt this form of capital could make sense for Scentre. Global hybrid markets were firmly shut from March to May, at the height of the COVID-19 crisis, but the market reopened in June with a string of large issues from BP, Vodafone, Electricité de France and others. The success of these deals provided us with the confidence to pursue a debut issue for Scentre."



GWEN GREENBERG DIRECTOR, DEBT CAPITAL MARKETS ANZ

"Investors are very familiar and comfortable with the AusNet credit. For this transaction, the issuer was clear in its intention to support

its balance sheet ahead of regulatory resets in the next two years, to fund capital expenditures and ensure ratings are maintained. Investors were comfortable supporting these capital-management plans."



TABITHA CHANG
DIRECTOR, DEBT CAPITAL MARKETS
NATIONAL AUSTRALIA BANK
"With a more volatile
market backdrop the
[AusNet] IOI process
was helpful because it
enabled us to prepare

key investors to be confident to proceed to launch. The borrower's condensed timeframe between mandate and execution should give confidence to other potential capital issuers."

ISSUER INSIGHTS O



"There has been a very strong rebound in our housing market as we have come out of the COVID-19 lockdown, and this has seen a jump in our credit growth and our lending book. So much so that we felt issuing a term wholesale debt transaction was required to help support

our asset growth into the end of this calendar year."

TIM MAIN KIWIBANK

Kiwibank takes a different path as asset growth spurs Kangaroo foray

Kiwibank says its credit growth is outstripping the incremental funding provided by central-bank facilities and deposit inflows, leading the borrower to print its inaugural Kangaroo covered bond on 16 September. Tim Main, Kiwibank's Auckland-based treasurer, speaks to *KangaNews* about the deal.



Issuer: **Kiwibank**Issuer rating: **A/A1/AA**Issue rating: **Aaa/AAA**

Pricing date: 16 September 2020

Maturity date: 23 September 2025

Format: soft-bullet covered bond

Volume: A\$500 million (US\$359.1 million)

Book volume at pricing: **A\$1.2 billion**

Margin: 70bp/3m BBSW
Indicative margin: 75-80bp/3m BBSW
Geographic distribution: see chart 1
Distribution by investor type: see chart 2
Number of investors in book: 39
Lead managers: ANZ, UBS

This is Kiwibank's second coveredbond deal, the first being issued in April 2013 in Swiss francs. Why has

issuance?

We regard the covered-bond programme as a contingent source

there been such a long spell between

of funding, only to be used in times of emergency and need. We haven't needed to access this form of funding since 2013. Before returning to market, the programme documentation needed to be updated for current legislation and operational changes.

The maturity of the first transaction is due in December this year, which made it an opportune time to review and update the programme and, at the same time, issue a replacement covered-bond transaction.

The Australian dollar credit market has been active for corporates and non-big-four banks, so why did Kiwibank pursue the extra level of credit certainty covered bonds afford?

We wanted to maximise issuance volume. We felt offering a triple-A rated, repo-eligible security would provide that for us, as well as delivering a lower overall cost. The Australian market, aside from the Swiss market, has always been favoured for our covered-bond issuance

Was any consideration given to issuing in New Zealand? The market seems quite active and liquid at present.

We considered the domestic market but we had undertaken a roadshow in Australia in March – with the intention to issue senior-unsecured bonds. The onset of COVID-19 meant we had to cancel that planned issuance but we were keen to leverage the investor presentation work done earlier this year.

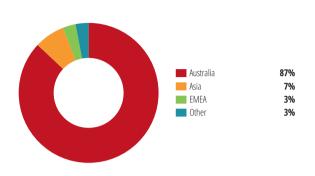
The A\$500 million deal is the largest-ever transaction from Kiwibank in our short history and it is the first covered bond from a New Zealand bank in Australia since BNZ issued a A\$700 million five-year deal in 2011. We believe it has generated very good interest in our name, which we hope makes future access into the Australian market easier.

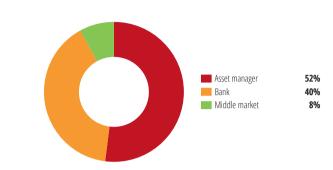
What engagement did Kiwibank have with Australian dollar investors subsequent to March and then heading into the transaction?

The joint lead managers kept in contact with investors since that time and all

CHART 1. KIWIBANK DEAL GEOGRAPHIC DISTRIBUTION

CHART 2. KIWIBANK DEAL BY INVESTOR TYPE





SOURCE: KIWIBANK 18 SEPTEMBER 2020

SOURCE: KIWIBANK 18 SEPTEMBER 2020

the transaction marketing was done online

The deal launched at 75-80 basis points area over three-month bank bill swap-rate (BBSW) and priced at 70 basis points. What is your view on pricing and the new-issue concession?

As a first-time issuer of covered bonds into the Australian market we knew we had to offer a new-issue premium to make it attractive for investors. We felt beginning at 80 basis points area over BBSW would catalyse interest.

As the transaction progressed there was very strong support and, consequently, we were able to trim the margin down to 70 basis points. Even at this level there was still some margin left for investors.

How have Kiwibank's loan books performed through COVID-19, in overall terms and relative to expectations in the early stages of the crisis?

Performance has surprised us on the upside, with asset growth increasing more than we originally thought. When we were first confronted with the outbreak we felt consumer and business demand for credit would fall.

The reality has been the opposite. There has been a very strong rebound in our housing market as we have come out of the COVID-19 lockdown, and this has seen a jump in our credit growth and our lending book.

So much so that we felt issuing a term wholesale debt transaction was required to help support our asset growth into the end of this calendar year.

The big-four banks, in Australia and New Zealand, have been absent from senior capital markets for more than six months due to central-bank funding facilities and deposit inflows. What is the story for Kiwibank?

Like all banks, we experienced a strong inflow of deposits as COVID-19 broke out and lockdown was enforced. The inflow was a flight to liquidity, buoyed by an increase in government support for people out of work such as the wage-subsidy payments.

A lot of this money found its way into the banking system and into our transaction accounts. It has helped fund our asset growth over the last six months. We are, however, seeing a continued rebound in credit growth coming out of COVID-19. We felt it was necessary to tap the term wholesale market to supplement our deposit growth and help fund asset growth.

On this basis, do you expect Kiwibank's wholesale issuance needs will ramp up further in the medium-to-long term?

We are rather cautious. We know some government support, such as the wage subsidy, is expected to end and this could lead to increased unemployment. This could dampen credit growth next year, so we are taking a careful approach to our fundraising needs.

Another point to add, though, is that it is important for us to maintain an appropriate duration of our wholesale term-funding profile. At some point we were always going to need to issue term debt at duration to reduce the concentration of refinancing risk as our outstanding deals mature – so we thought this was a good time to lengthen the duration of our term-funding book.

How is Kiwibank progressing with the Reserve Bank of New Zealand (RBNZ)'s higher capital requirements? What effect has COVID-19 had on how you are viewing the ramp up?

We are looking forward to issuing new capital instruments when the RBNZ reintroduces the higher capital-requirement rules from 1 July next year. As the economy recovers and our lending increases, we will have to raise additional capital in the market at some stage. We are working with the RBNZ on the timing of all this and ensuring the capital securities we come up with meet requirements. •



Breakthrough for New Zealand duration as Auckland Council issues 30-year green bond

An expanded pool of eligible green-bond projects, including many long-dated assets, and New Zealand's interest-rate environment provided the catalyst for Auckland Council to print a 30-year green-bond deal. The issuer says the tenor is an important development and the success of its transaction should encourage others to test the water at extended duration.

Issuer: Auckland Council

Issuer rating: AA/Aa2

Pricing date: 16 September 2020

Maturity date: 28 September 2050

Format: green bond Volume: NZ\$500 million (US\$330.6 million)

Volume at launch: NZ\$300 million

Coupon: 2.95%

Lead managers: ANZ, BNZ, Westpac

ccording to KangaNews data, the transaction is the longest-duration vanilla benchmark deal ever printed in New Zealand – including sovereign and inflation-linked bonds (see table). It is Auckland Council's third, and by far its largest, green-bond deal.

Auckland Council published its latest list of eligible greenbond assets at the end of June and updated its sustainablefinancing framework at the beginning of September. Its greenbond asset pool previously focused on low-carbon transport assets but now includes a greater array of assets that are Climate Bonds Initiative-certified or aligned to the Green Bond Principles. These include more transport assets, green buildings and water assets. Auckland Council's total eligible green-bond pool is now more than NZ\$2.1 billion.

Importantly, many of these assets are long-dated and in the infrastructure sector. Auckland Council is therefore able to consider long-dated funding to match, according to its group treasurer, John Bishop. He reiterates that the expanded asset pool and Auckland Council's forthcoming capex plans mean it is possible that the majority of future debt issuance will also be in green format.

On the demand side, yield is forcing investors further out on the high-grade curve. The three-year New Zealand government bond traded at negative rates throughout the week of 14 September, for instance.

Bishop says: "We saw this as an opportunity to target longdated funding at a low interest rate, which is a good outcome for Auckland's ratepayers."

PRICING DATE	ISSUER	VOLUME (NZ\$M)	ISSUANCE TYPE	TENOR AT ISSUE (YEARS)
16 Sep 20	Auckland Council	500	Nominal	30
3 Mar 17	New Zealand Debt Management	1,500	Inflation- linked	23
6 Nov 14	New Zealand Debt Management	1,500	Inflation- linked	21
25 Aug 16	New Zealand Debt Management	2,000	Nominal	21
14 Jul 20	New Zealand Debt Management	4,000	Nominal	21
23 Apr 20	Kāinga Ora – Homes and Communities	300	Inflation- linked	20

The Auckland Council deal priced with a coupon of 2.95 per cent. In 2016, the same issuer printed a NZ\$180 million 10-year deal with a coupon of 3.5 per cent, and in 2014 it printed a NZ\$200 million 10-year at 5.8 per cent.

Auckland Council has been an active issuer in the euro market in recent years, where long-dated liquidity is well established. However, Bishop says the issuer was keen to print a deal longer than 20 years, and beyond this point the crosscurrency basis swap makes foreign-currency issuance difficult.

With an absence of pricing points at the 30-year point of the New Zealand dollar curve, Auckland Council referenced Australian semi-government deals at the tenor and formed its view that the deal should price with a coupon of just less than 3 per cent.

Bishop says there was interest from around 25 accounts and that distribution was primarily to domestic investors with a contingent of offshore demand from Australia, Europe and the Middle East. "The transaction was well supported and we are pleased with the diversity of accounts that came into the book. It is an encouraging development for the New Zealand debt capital market to have this point on the curve," Bishop tells KangaNews.

This is particularly so given the rise in New Zealand government-sector funding requirements as a result of the COVID-19 pandemic. In its pre-election fiscal update on 16 September, New Zealand Debt Management reduced its 2021 financial-year requirement but the forecast level of issuance for coming years is still a significant increase on historical norms. •

New Zealand dollar demand meets World Bank tenor preference

World Bank's latest New Zealand dollar transaction is the largest-ever Kauri deal with tenor longer than five years (see table). With rates continuing to head lower in New Zealand, investor appetite for longer-tenor deals is apparent and matched World Bank's desire to fund further out on the curve.

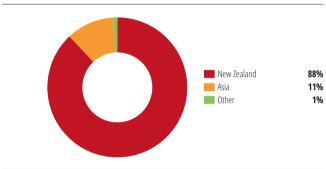
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Issuer name: World Bank
Issuer rating: AAA/Aaa
Pricing date: 15 September 2020
Maturity date: 24 September 2027
Volume: NZ\$550 million
(US\$363.6 million)

Volume at launch: NZ\$150 million
Margin: 36bp/mid-swap
Margin at launch: 36bp/mid-swap
Geographic distribution: see chart 1
Distribution by investor type: see chart 2
Lead managers: ANZ, BNZ,
TD Securities

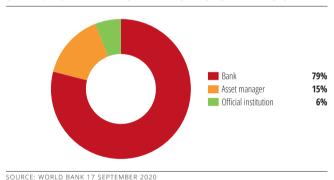
LARGEST KAURI DEALS WITH TENOR BEYOND FIVE YEARS					
PRICING DATE	ISSUER	VOLUME (NZ\$M)	TENOR AT ISSUE (YEARS)		
15 Sep 20	World Bank	550	7		
13 Mar 18	Inter-American Development Bank	500	10		
19 Jun 20	Kommunalbanken Norway	500	10		
5 Sep 07	Queensland Treasury Corporation	375	10		
20 Jul 07	World Bank	350	7		
SOURCE: KANGA	NEWS 18 SEPTEMBER 2020				

CHART 1. WORLD BANK KAURI DEAL GEOGRAPHIC DISTRIBUTION



SOURCE: WORLD BANK 17 SEPTEMBER 2020

CHART 2. WORLD BANK KAURI DEAL DISTRIBUTION BY INVESTOR TYPE



ISSUER INSIGHTS O



ANDREA DORE HEAD OF FUNDING WORLD BANK

"We received feedback from New Zealand banks and investors that there is demand further out on the curve than five years. We have a strong focus

on duration at the moment and always want funding diversification, so we were pleased to record such a strong result in this deal."

"We are monitoring curves for the best yield pickup for investors and where demand is likely to be. For example, in US dollars the curve from five-to seven-year tenor is quite steep compared with 7-10 years. In New Zealand dollars the seven-year point provides attractive yield, and it also swapped to levels in line with US dollars."

"The level of offshore demand for our New Zealand dollar deals, although lower than in the past, was still meaningful even though interest rates have declined significantly and no longer offer a pick-up to US dollars. This added to strong domestic demand and allowed World Bank to raise its highest New Zealand dollar volume in a calendar year since 2016."

FROM THE EDITOR



LAURENCE DAVISON LDAVISON@KANGANEWS.COM

Changes for the long haul

With so much going on in the here and now, the fact that Australasian fixed-income markets have fundamentally changed in 2020 has passed almost without comment. It is time to start asking what impact massively increased sovereign-sector issuance and massively reduced bank supply will have – and whether these changes will be permanent.

he trajectory of bond issuance by the Australian government is well known but still worth illustrating – particularly because gross annual Treasury bond supply has increased by a further A\$37 billion (US\$26.6 billion) since *KangaNews* last published the data, two months ago.

Gross Treasury bond issuance passed A\$218 billion in the first three quarters of 2020 – more than A\$200 billion of it coming in Q2 and Q3, after the COVID-19 pandemic hit. To put this in perspective, in 2013 – the year the Liberal Party won a general election on the back of a "Labor's debt and deficit disaster" campaign – the full-year gross issuance figure was just shy of A\$70 billion (see chart).

It seems government stimulus can be the right policy for Australia, after all – and I for one look forward to a 2022 election campaign that acknowledges the change in perspective. As my old housemate used to say: do get your hopes up, because it will happen.

CREDIT SHIFT

On the other hand, the Australian credit market has seen supply cut off at source. The domestic big-four banks have issued at least A\$20 billion combined domestically in every year since 2008 and as much as A\$43 billion in particularly busy or conducive years. That figure will be less than A\$10 billion in 2020, as the Reserve Bank of Australia (RBA)'s term funding facility (TFF) and deposit inflows have reduced the majors' wholesale funding need to a relative trickle of tiertwo issuance.

With the TFF now extended and a more or less universal expectation of further QE to come, market participants are now resigned to the majors being absent for a matter of years. There is practically no expectation of their return in calendar 2021, certainly – and one of the lessons of QE globally is that it is easier to enter than to exit.

The big question, presumably, will come to be whether the RBA is confident to remove the TFF before the volume of lending it has outstanding to the major banks exceeds their refinancing capacity in global markets.

The three-year tenor TFF maturity spike was more than A\$80 billion by the end of September and could be more than double this by the end of June next year. It has effectively replaced the Australian banking system's aggregate wholesalefunding task. The manner in which the pendulum swings back toward capital markets – and thus moves from fixed-rate 0.25 per cent cost of funds to prevailing market-clearing rates – will be fascinating and challenging at the same time.

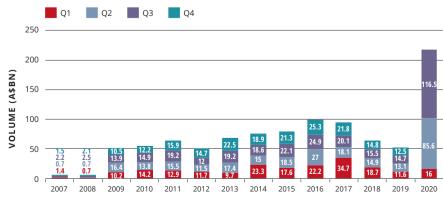
The ripples of the TFF have spread across the Australian credit market. One notable consequence has been the decimation of inbound Australian dollar issuance from global borrowers.

The most active sector of such issuers – supranational, sovereign and agency (SSA) names – tends to be price focused. Without a counterweight on the crosscurrency basis swap provided by large and consistent foreign-currency issuance from Australian banks, Kangaroo deal economics have been harder than ever in 2020 – and SSA issuance has fallen precipitously as a result.

On the flip side, other than the banks themselves perhaps the biggest winner in funding markets has been corporate borrowers. While the crisis has been intensely difficult for many – though not all – large companies in Australia, funding markets have held up much better than might have been expected.

Corporate borrowers generally turned to their banks in the early days of COVID-19, and those who have spoken to *KangaNews* universally report no widespread retreat of liquidity – certainly nothing remotely comparable to the





SOURCE: AUSTRALIAN OFFICE OF FINANCIAL MANAGEMENT 27 OCTOBER 2020

financial crisis – and doors open for renegotiation of terms and conditions.

Even more surprisingly, the Australian corporate bond market has rebounded hard and fast. I wrote about this in the last edition but suffice to say the availability of Australian dollar liquidity has continued to surprise on the up side, especially at extended tenor. The investor view seems to be that if a company can make it through the next couple of years it is probably good for a decade – so one might as well take the extra term premium on offer.

It is a mixed picture, meanwhile, for nonbank borrowers. The good news is that the same demand for alternative credit assets that has been spurred by lack of bank

supply appears to be fuelling a buoyant Australian securitisation market. Nonbank transactions have been coming to market thick and fast, including more than twice a week in October alone. Deal flow now includes a raft of assets from buy-now, pay-later loans to commercial mortgages, and also features deal structures that top out below triple-A rating level. Clearly the market is functional and well supported.

On the other hand, a competitive landscape that has been predominantly supportive for Australia's nonbanks has clouded significantly thanks to government and RBA support for the bank sector. Even the most cost-effective structured-finance market cannot provide funding at cost competitive with three-year TFF loans at 0.25 per cent; the going rate for triple-A, prime mortgage-backed securitisation is more than five times as much.

In the prime-mortgage space, at least, it is increasingly hard for nonbanks to compete with the regulated bank sector on price – and service proposition only goes so far in winning business.

LASTING CONSEQUENCES

At the same time, bank lenders may be about to have the handbrake released in nonprime lending due to the promise of eased responsible-lending requirements. As an aside, it seems quite astonishing that barely a decade after the financial

crisis took the world banking system to the brink of collapse, the Australian government thinks it is time to remove or substantially relax the requirement on banks to verify the credit quality of their own customers.

The devil will be in the detail, of course. But with the housing market already rebounding well ahead of a wider economic recovery, the idea that yet more cheap credit needs to be pushed into residential property is about as counterintuitive as the government's belief that front-loading a massive tax cut for the demographic segment least likely to spend the windfall is the best available mechanism for economic stimulus.

THE PAST DECADE HAS BEEN A STORY OF VAST QUANTITIES OF LIQUIDITY CHASING YIELD INTO INCREASINGLY DISPARATE JURISDICTIONS AND ASSET CLASSES. FOR SOME TIME, AUSTRALIA WAS A RECIPIENT OF SUCH FUNDS. IN FUTURE, IT MAY INCREASINGLY BE A SOURCE OF THEM.

Coming back to capital markets, the long-term consequences of new Australian supply dynamics are as yet unknown. So far, the sovereign market has shown no sign of capacity issues even when the RBA has not been an active market participant. Even with a likely expanded QE programme and greater demand from local bank liquid-asset books, the Australian sovereign market seems set for a bigger place in the global market.

This should be good news for sovereign-bond traders and for the Australian Securities Exchange's new five-year futures contract — as well as its existing 20-year future, assuming liquidity continues to build in the long-dated part of the curve. I have never been totally convinced that a bigger sovereign market is in and of itself a growth catalyst elsewhere, but it surely cannot harm the Australian market if more global capital has its biggest borrower on the radar.

On the other hand, while nature may abhor a vacuum it is hard to predict what might fill the credit supply gap. Australian dollar credit was struggling for supply diversity even before the bank issuance hiatus, and a protracted economic downturn does not seem likely to spark a surge in domestic corporate issuance. Some supply that previously would have found its way to the US dollar or euro markets may remain onshore but this would not represent exponential growth.

Whether demand is elevated enough to produce sufficiently attractive pricing conditions to draw international names – SSAs and credit borrowers – to Australian dollars is as yet unknown. But it is hard to be too optimistic.

With a glut of domestic high-grade supply, Australian investors' impetus to

buy global SSAs seems as low as ever. Global banks have seen their own issuance needs drop for the same reasons as their Australian peers, and regular Kangaroo corporate issuance does not seem to be on the agenda at this stage.

Much more likely, I think, is that

Australian credit funds will increasingly spread across the globe. The size of the local superannuation market relative to domestic credit suggests this is all but inevitable, even without the new supply dynamics of 2020. The collapse of the local issuance core will surely only accelerate the process.

On the other hand, it is not as if there is an easy path to appealing credit absolute return anywhere in the world at present. The past decade has been a story of vast quantities of liquidity chasing yield into increasingly disparate jurisdictions and asset classes. For some time, Australia was a recipient of such funds. In future, it may increasingly be a source of them.

Perhaps this period of extraordinary government liquidity will pass, and Australia will be left with a larger sovereign-bond market and a rejuvenated and restored credit market. But, like so much else associated with this pandemic year, it would take a brave person to say with conviction that we will soon return to the old normal. •

COMMUNICATION KEY AS RATING PRESSURE MOUNTS

Ratings across the sovereign and subsovereign sector have come under considerable strain during the COVID-19 era as governments seek to ensure the health and economic wellbeing of their citizens in an environment of falling revenue. Germany's federal state of Baden-Württemberg, and its development agency **L-Bank**, provide a model for managing the fallout.

he worst may still be to come for parts of Europe as the end of warmer weather brings a second wave of COVID-19. Cases in many of the larger European nations have been steadily increasing over the last couple of months and new lockdown measures are being enforced in numerous Eurozone countries and the UK.

Government finances have kicked into overdrive, requiring a quantum leap in debt funding to steer nations through the pandemic. Germany's federal government, for instance, added more than €60 billion (US\$43.1 billion) to its year-ahead newmoney task, bringing the total to a record €219 billion. It is far from alone.

On top of individual nations' fiscal support, the EU itself is now entering the funding market in size. In May, the EU announced a €750 billion recovery package to revive the 27-member bloc. In early October, the European Commission announced it will print EU SURE bonds – to be issued as social bonds under its social-bond framework – of up to €100 billion by July 2021 (see p26).

It is unsurprising in this context that sovereign-sector ratings have come under pressure. It will take years for many to return to balanced budgets, by which time their accumulated debt burdens will have taken a significant step up. Germany's debt-to-GDP ratio is expected to be close to 80 per cent by the end of 2020 – up by nearly 20 per cent year-on-year. UK public debt passed 100 per cent of GDP in June, for the first time since 1963.

STATE FINANCES

he same challenges apply at subsovereign level. As a result
— and despite being one of the largest and most fiscally
sound states in the German federation — S&P Global
Ratings downgraded Baden-Württemberg to AA+ from AAA on 14
August. Because L-Bank, the state development agency for Baden-Württemberg, is guaranteed by the federal state, the same rating
is applied to the agency issuer. For L-Bank, managing the investor
relations task around the downgrade has been a key focus (see box
on facing page).

S&P considers L-Bank to be "a government-related entity benefiting from an almost certain likelihood of receiving timely and sufficient government support in times of stress". On this basis, it does not view the agency as a fully separate entity from the government.

In justifying its downgrade of the agency, the S&P report points to "L-Bank's critical role for and integral link with Baden-Württemberg". Harm Semder, director, financial institutions ratings at S&P in Frankfurt, says the link is best explained as the state mandating a strategy, which is then operationally implemented by L-Bank.

The state was on a positive financial trajectory until the beginning of 2020, "demonstrating continuously improving surpluses in operating and capital accounts" according to S&P. COVID-19 has materially changed the outlook.

Baden-Württemberg increased and used its borrowing allowance for an extensive support package of \in 5 billion for its economy, which S&P expects to be fully spent in 2020. Another stimulus package, of \in 3 billion, is mooted for 2021.

Beyond the support package and an additional €2.3 billion provided by the federal government, Baden-Württemberg will experience significant tax-revenue shortfall in the coming years – a forecast €3.3 billion in 2020 and €3.5 billion in 2021. "Such deterioration will lead to increased borrowing of roughly €6.5 billion and a reduction in liquidity of about €2 billion," S&P's latest report on the state says.

As COVID-19 continues to weaken Baden-Württemberg's budgetary performance, resulting in increased debt and lower liquidity, S&P forecasts deficits of 10.6 per cent and 10.9 per cent of total revenue for 2020 and 2021.

However, speaking to *KangaNeus* in mid-October, Michael Stroschein, associate director, sovereign and international public finance ratings at S&P in Frankfurt, says there may be a risk to the upside for the state's budget given recent signs of better-than-expected economic resilience to the impact of COVID-19.

In any case, S&P believes the pandemic will have only a temporary impact on the state. Moreover, it assumes the state's economic fundamentals will remain robust and is confident its



TRANSPARENCY AND CONSISTENCY

In an environment of significant government-sector debt and the potential for ratings to be downgraded, funding agencies need to be proactive in engaging with investors. Sven Lautenschläger, international funding officer at L-Bank in Karlsruhe, speaks to *KangaNews* about the agency's commitment to transparency and consistency.

With a typical annual termfunding programme of €5-8 billion (US\$3.6-5.7 billion) – €7 billion for 2020 – investor relations is always an active part of L-Bank's treasury function. It is the secondlargest of the German state development agencies by capital-markets footprint.

Because it holds an explicit and unconditional guarantee from the state of Baden-Württemberg, L-Bank was downgraded to AA+ from AAA on 17 August by S&P Global Ratings. This was three days after the guarantor and 100 per cent owner state was downgraded to the same level, and is in line with the rating agency's equalised-ratings principle.

The rating downgrade is in all likelihood not as

significant for L-Bank as it would be for a private-sector entity. The issuer has support from the sizeable European Central Bank QE bond-buying programme among other factors.

Investor engagement

Even so, it could be a concern for L-Bank investors. Within a week of L-Bank's downgrade, Lautenschläger contacted a significant number of the issuer's global investors to inform them of the change and to solicit their questions on the implications of the decision.

"I heard back from around one-fifth of the investors contacted. The feedback was very positive – and all stressed that the immediate update was much appreciated and that the rating downgrade would not affect the investment strategy towards L-Bank," says Lautenschläger.

This is not the first time L-Bank has been downgraded from a triple-A rating. In December 2004, S&P downgraded the state of Baden-Württemberg – and therefore L-Bank

– to AA+ from AAA.

The state and its development agency regained triple-A status in 2012, but in the interim L-Bank had to contend with challenges including its Kangaroo bonds not being repo-eligible with the Reserve Bank of Australia (RBA) for

To meet the RBA's repoeligibility criteria, securities issued by supranationals, and foreign sovereigns and subsovereign entities must have a triple-A rating from

the intervening years.

two rating agencies. L-Bank is still rated triple-A by Moody's Investors Service and Fitch Ratings, though Fitch's AAA mark for L-Bank is unsolicited. As a result, and to ensure that investors have the greatest possible certainty, Lautenschläger took action to confirm the state development agency's repo-eligible status directly with the RBA.

These two actions provide real-life examples of the transparency at the heart of L-Bank's funding strategy. As Lautenschläger comments: "I got into action with investors and the RBA as soon as we received news of the downgrade. For me, transparency is about proactive communication. The positive responses I received from investors and the RBA validate this strategy."

administration is combating the effects of the pandemic with appropriate support packages.

S&P expects Baden-Württemberg will get back to a position of balanced budgets in the medium term, helped by improving tax revenue and – yet-to-be defined – cost-containment measures. These could result in improvements beyond current forecasts.

UNDERLYING DRIVERS

n effect, rating agencies are being asked to assess the financial position of governments that are undergoing a once-in-a-lifetime event but where there are otherwise no significant structural problems with the economy of the state nor the way its finances are managed.

Stroschein says debt accumulation is not the current problem for Baden-Württemberg or L-Bank – even though S&P forecasts consolidated debt to increase substantially, to 113 per cent of consolidated operating revenue through 2022, following a considerable drop to 82 per cent in 2019. Rather, the issue is that budgetary performance has changed materially compared to recent years.

Acknowledging that S&P's criteria do not make special provisions for an exceptional shock such as COVID-19, Stroschein explains: "If the budget is not balanced by 2022 or 2023, it quickly worsens the multi-year weighted-average approach we take to rating budgetary performance."

S&P also recognises that it is government's role to support its citizens, and that Baden-Württemberg is one of the most ambitious states of the German federation in its COVID-19-response spending. Stroschein points to the fact the state has guaranteed its municipalities almost the same amount of business tax and fiscal equalisation revenues for 2020 that they received last year.

"This gives testament to the fiscal and economic strength of the state of Baden-Württemberg. But it will naturally weigh on its budgetary performance for the current year, and most likely the next few years," he says.

Stroschein also refers to the German debt-brake law, which requires states to refrain from net new borrowing except in certain legally defined cases. Given the scale of the pandemic's consequences, S&P expects the exception clause will once again be used in 2021.

Before the deluge

In mid-October, the EU embarked on a funding programme so large that European market participants say it could reshape the European market and have ripple-effect consequences for others. There is no suggestion that the supply cannot be digested by the euro market, but other issuers may adjust their funding plans around the EU's jumbo issuance forecast.

BY MATT ZAUNMAYR

n 19 May, the European Council adopted the Support to Mitigate Unemployment Risks in an Emergency (SURE) regulation. This is designed to provide loans to EU member states to help fund programmes designed to preserve employment during the COVID-19 crisis.

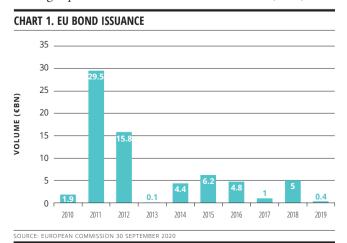
By the end of September, the EU had approved €87.4 billion (US\$102.9 billion) of loans to 16 member states. The programme has a current limit of €100 billion that will be funded in the euro debt market. This marks a step-change in issuance for the EU, even compared with its previous period of emergency funding around the Eurozone sovereign-debt crisis (see chart 1). The EU's borrowing programme is arranged by Crédit Agricole.

The EU's first foray into the bond market under its new issuance mandate suggests appetite is ample to say the least. The first SURE transaction priced on 20 October, raising $\ensuremath{\epsilon}17$ billion (US\$20 billion) in 10- and 20-year tranches from a staggering book of more than $\ensuremath{\epsilon}233$ billion.

All the EU's SURE funding will be compliant with the EU's social-bond framework, which aligns with International Capital Market Association's Social Bond Principles.

EU transactions will range in maturity from three to 30 years, with amounts due in any given year not to exceed €10 billion. SURE loans will have a maximum average maturity of 15 years.

SURE funding will be in addition to the EU's existing funding requirements. The macrofinancial assistance (MFA)



programme will raise €3 billion aggregate in 2020 and 2021, of which €160 million has so far been raised. The European Financial Stabilisation Mechanism (EFSM), meanwhile, has a requirement of €9.8 billion in 2021 to lengthen expiring loans to Portugal and Ireland.

The EU officially has until the end of 2021 to raise what is expected to be the full €100 billion of the SURE package. However, given most of it is already subscribed to, the consensus in the market is that it will seek to raise it by the middle of 2021.

KangaNews understands the EU indicated on a global investor call in July that it plans to be in the market roughly every second week, though it will not have a specific issuance calendar.

PRICING THE DELUGE

ow the market – including other supranational, sovereign and agency (SSA) sector issuers – responds to the influx of EU paper will be a subject of keen interest, in Europe and elsewhere.

The EU currently prices wide of French and German sovereign bonds. Florian Eichert, head of covered bond and SSA research at Crédit Agricole in Frankfurt, tells *KangalNews* the EU was in a good place ahead of its its new deal on the back of significant widening in the French government sovereign curve in recent weeks. He adds that the EU was trading 5-6 basis points wide of the French government 10-year bond and would likely need to add a further 5-7 basis points for its inaugural deal.

What happens after the debut is debatable – and market participants are not yet sure whether EU supply will pull the market wider or have the opposite effect. Stuart McGregor, managing director and head of European SSA debt capital markets at RBC Capital Markets in London, points out that one reason the EU trades wide to France is its lack of issuance volume and thus liquidity. This will not be the case for much longer.

"There is a school of thought that having another benchmark issuer in the market could attract more interest. Having more liquidity in euros could attract more foreign reserves and more international attention. In this scenario, EU pricing could actually tighten," explains McGregor.

The geographic investor distribution of EU bonds from 32 benchmark transactions between 2011 and September 2020 was overwhelmingly European (see chart 2).

The liquidity of the EU curve will be crucial to attracting offshore central-bank and official-institution investors, comments Eichert. "If the EU manages to price large and liquid benchmarks, I think non-European investors will start to look at the EU as a partial substitute for some of the smaller European government-bond markets. However, if the EU ends up pricing a lot of $\ensuremath{\epsilon}3-5$ billion benchmarks, in line with other supranational names, this will not materialise."

Mark Byrne, syndicate at TD Securities in London, agrees that scaling up the EU programme will not necessarily mean spreading the same investor dollars across more supply. In fact, he believes, the market as a whole will grow as the EU will crowd in investors.

While more global investor participation would help, Byrne adds that existing investors in European government and SSA bonds are currently showing strongest interest.

There are further complicating factors for the direction of EU pricing. On the positive side for the EU, SURE loans could ease individual sovereign funding needs and lead to better performance for some European sovereign bonds. "When Italy and Spain trade well, it gives an overall positive tone to European credit," says McGregor.

Conversely, investors will be aware that the SURE programme will be followed by the Next Generation EU package to fund the region's COVID-19 recovery. The EU estimates this will require around €800 billion from 2021-26, with front loading expected in the first three years.

There is no doubt among European bankers that liquidity conditions in Europe and around the world are sufficient for markets to swallow the initial SURE programme.

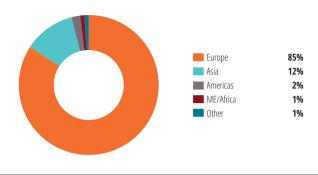
The European Central Bank's repo operations are creating demand for high-quality liquid assets and by October euro high-grade markets were trading at their tightest levels since the beginning of the COVID-19 crisis.

Eichert tells *KangaNews* the makeup of the EU's ongoing buyer base will depend on the maturities the issuer targets. "There is more than €3 trillion of excess liquidity in the eurozone banking system so bank treasuries will jump on 10-15 year issuance with pricing above France. Long-end EU pricing that is flat or slightly positive to France will find assetmanagement and insurance demand."

The market may be replete with liquidity at the moment but multiple years of €100 billion-plus EU funding requirements will be the true test of appetite. Byrne says the depth of the European market means the volume of issuance will be manageable, although it may attract a premium at some points and under certain market conditions.

He adds that ongoing QE in Europe, which unlike other markets includes SSA borrowers, will play a key role in the EU's funding programme. The European Central Bank, under one or more of its raft of QE programmes, has capacity to purchase 50 per cent or more of European supranational bonds in the secondary market and therefore provides a powerful support mechanism in more challenging conditions.

CHART 2. EU INVESTOR GEOGRAPHIC DISTRIBUTION, 2011-2020 YTD



SOURCE: EUROPEAN COMMISSION 30 SEPTEMBER 2020

TRICKLE DOWN

loods can often be a benefit to regions downstream, away from the main impact area. This may be the case in the Eurozone bond market as the consequences of the EU's turbo-charged funding flow through capital markets. The short-and long-term effects on the funding plans and pricing of other European borrowers, particularly SSAs, could be large.

While €100 billion of EU funding per year will not mean an equal amount of issuance by other borrowers being displaced into global markets, there is no doubt some trepidation around what the EU's plans mean for Europe's other large borrowers.

Major SSA names like European Investment Bank and KfW Bankengruppe already typically raise around €65 billion each per year. Eichert says these issuers have tried to get as much as possible of their 2020 funding done before the EU enters the market. However, he adds that beyond 2020 borrowers have few options other than to take market conditions as they come.

The end of the year is often quiet for SSA issuers, before they come out aggressively in the new year. However, McGregor says it would not be surprising to see both periods busier than usual given the circumstances.

He tells *KangaNews* that with SSA pricing currently at tight levels those that can pre-fund for next year may take the opportunity to do. He adds: "There are so many unknowns and so much money to be raised by governments globally that SSAs may come out even more eagerly at the start of the new year."

Only a few markets provide benchmark-volume deals for SSAs, with euros and US dollars being the mainstays while Australian, Canadian and New Zealand dollars, sterling and the Nordic currencies usually account for most of the remainder.

While SSA access to the euro market may not be hindered, the price they can fund at may need to change – particularly if they are competing with the EU for a similar buyer base. Byrne explains: "If the EU is consistently offering a new-issue concession investors may start to require similar for all new transactions."

Eichert says the level at which the EU is expected to begin funding would not necessarily cause other issuers' secondary pricing to move. However, if other benchmarks, such as the French sovereign, begin to show signs of volatility, this could shift the EU and other SSA pricing wider. •



Left to right: Rakesh Jampala, Ian Ravenscroft, Sarah Valente, Chris Khan, Glenn Woodward

GOING WITH THE FLOW

rading capability, including a willingness to deploy balance sheet to support client needs, has long been a major differentiating factor for **ANZ**'s all-conquering fixed-income business. A group of the bank's traders gathered to talk about 2020 at a KangaNews roundtable, including views on the extraordinary circumstances of the year and how liquidity may be affected for some time to come.

ANZ PARTICIPANTS

Rakesh Jampala Head of Fixed Income Trading Chris Khan Head of Credit Trading, Australia In Ravenscroft Director, Government Bond Trading ■ Sarah Valente Fixed Income Trader ■ Glenn Woodward Senior Bond Trader

MODERATOR

■ Laurence Davison Head of Content and Editor KANGANEWS

TRADING IN 2020

Davison 2020 has of course been an extremely challenging period for fixed-income market participants, including in the secondary market. How has ANZ's trading function sought to navigate these conditions?

JAMPALA Perhaps even more so than during the financial crisis, the period beginning in March - punctuated by a complete deterioration in bid-side liquidity – presented great challenges for the market and indeed our business.

However, during the period when markets froze and a number of participants stepped back, ANZ was able to remain active in the provision of risk transfer and warehousing. This was possible in no small part because our domestic fixedincome operation is at the very core of our institutional and markets businesses.

Our bank-wide purpose is to help shape a world in which people and communities thrive. Helping the government finance itself and establish COVID-19 support programmes via tender takedown and duration-management support - and providing liquidity to our clients in stressed situations goes to



IN AT THE **DEEP END**

If crises are career-shaping events, 2020 provided young traders with a lifetime's experience in just a few months. Sarah Valente is newer to the business than many of her veteran colleagues. She shares a view on learning to swim in rough waters.

DAVISON What have the circumstances of 2020 been like for someone who is relatively early in a trading career?

VALENTE It has been a unique and exciting year. I think the team has navigated the challenges exceptionally well and I feel very fortunate to have joined the bond-trading team at a time when government and semigovernment bonds are at the forefront of conversation,

with market moves similar in many ways to those of the financial crisis.

I'm glad to have had the chance to witness and be a part of history in the form of the AOFM [Australian Office of Financial Management]'s unprecedented borrowing programme and the RBA [Reserve Bank of Australia]'s first QE programme.

I certainly wasn't prepared to work under the circumstances

"THESE CIRCUMSTANCES HAVE HELPED ME QUICKLY LEARN THE NUANCES OF MANAGING A BOND BOOK AND HAVE ALLOWED ME TO BE INVOLVED IN TEAM CONVERSATIONS ABOUT TOPICS I NEVER THOUGHT WE WOULD BE DISCUSSING – LIKE NEGATIVE RATES AND THE IMPACT OF ECONOMIC SHUTDOWN."

SARAH VALENTE

that COVID-19 forced us into. But it was key to our success that the team was able to be flexible, adapt quickly and understand each others' circumstances. Working from home for a period was challenging. But ANZ supported the team with all the necessary tools to keep working seamlessly.

I have learned how important it is to maintain clear communication with the team, remain disciplined and be a team player. I have gained a better understanding of risk and have been able to see first-hand the impact of new information on the market when liquidity has been challenged.

These circumstances have helped me quickly learn the nuances of managing a bond book and have allowed me to be involved in team conversations about topics I never thought we would be discussing – like negative rates and the impact of economic shutdown on the market and the bank.

The unusual conditions have also given me an opportunity to trade independently and

build confidence in making risk decisions of my own, having experienced a major markets crisis. It has been the ultimate learning experience for a trader starting their career and given me a lot to draw on when markets next encounter such volatility.

DAVISON It is often suggested that working from home is particularly tough on more junior people as they miss out on the 'learning by osmosis' that comes from being in a team environment.

VALENTE It was challenging, especially at the start, to play a role and support the team in a way that seemed valuable. But the systems we were provided and the capabilities that enabled us to communicate meant that, at all times of day, I was involved in trading decisions and was able to discuss them with the senior traders either on the phone or online.

I think we adapted well – and very quickly – to the circumstances. But it's great to be back in the office and with everyone now we're out of the crisis scenario.

the heart of this purpose. We are proud to have delivered in this respect.

Davison How does fixed-income trading fit into the markets operation at ANZ in such a way that facilitates the kind of customer support you have been able to offer in 2020?

■ JAMPALA The strength and expertise of our trading operation and our full-service bond proposition across credit, SSAs [supranationals, sovereigns and agencies], and government and semi-government bonds generates a compelling value proposition. A secondary factor — but one that might have been more important during the period of stress — is our strategic focus on being a major risk-transfer participant.

Our strategy is predicated on being able to help our clients with the big trades and warehouse large amounts of risk. Having this skill set and appetite in our trading team was a major element of being able to support the market during the most difficult period.

RATES SPECIFICS

Davison How did Australian dollar rates liquidity hold up in the worst of the COVID-19 crisis? Were there times when liquidity was challenged on an outright basis – that bond sellers could not get a price at all – versus prices being available but unattractive?

■ RAVENSCROFT Australian dollar liquidity held up very well until late February, when it became clear that COVID-19 had begun to spread through continental Europe and the risk-off tone began to accelerate. At this time we began to experience major portfolio redemptions across all geographies.

The search for bid-side liquidity led investors to ACGBs [Australian Commonwealth government bonds] as the way to raise cash, as the asset class with the best depth of liquidity in the Australian market. This gathered pace through early March and dealers' ability to warehouse risk clearly became exhausted. ACGBs began to underperform materially versus US Treasuries

"Perhaps even more so than during the financial crisis, the period beginning in March – punctuated by a complete deterioration in bid-side liquidity – presented great challenges for the market and indeed our business."

RAKESH JAMPALA

and also, on a domestic basis, relative to the corresponding bond future.

The best demonstration of this underperformance was in the 10-year bond basket. The basis between the 10-year future and the bonds from which it is derived was trading at 10 basis points just days before the futures roll. The main driver of this move was offshore redemptions: sellers that were agnostic to the basis and had little option but to access what liquidity was left in Australian fixed income.

Davison What about liquidity in other Australian dollar asset classes, specifically local semi-governments and the Kangaroo SSA sector?

■ RAVENSCROFT This particular liquidity crisis was driven by a rush to raise cash in order to de-risk fixed-income portfolios. The sharp downturn in confidence had a negative impact across all Australian dollar asset classes but ACGBs were clearly the most affected sector at the peak of the crisis.

There was an 80 basis point underperformance in 10-year ACGB versus US Treasury spreads from mid-February to mid-March, coupled with a 13 per cent sell-off in the Australian dollar itself over the same period. This demonstrated the pace at which investors were moving back to the relative safety of the US dollar market.

"Our aim was to maintain transparent communication with our clients – not just about our view on the market but also our capacity to warehouse risk. At the deepest point of the crisis, broking bonds was not an option given one-way client flow and zero interbank liquidity. This left a very limited pool of dealers able to warehouse risk."

IAN RAVENSCROFT

Semi-government spreads widened sharply on relatively light outflows, but lack of liquidity in the sector actually drove clients further into selling the more liquid ACGBs.

There was little liquidity available in SSAs in meaningful size, at least beyond very short-dated bonds. While spread movement here was similar to that seen in semis, the sector's bid-offer spreads were wider yet.

Davison How did March 2020 compare with previous crises going back to the financial crisis?

EKHAN I think it's important to note that the COVID-19 pandemic has been, first and foremost, a tragic health crisis that immediately affected the health and economic wellbeing of people on a scale none of us has witnessed before. As a liquidity event for Australian dollar bonds, it was of equal or even greater magnitude than the financial crisis.

However, unlike the financial crisis it was not driven primarily by concerns of default risk. Instead there was an abrupt and violent withdrawal of liquidity, and subsequently volatility.

At the same time, the upheaval to the traditional workplace added further pressures – and still does, unfortunately, for many of our clients and colleagues.

■ WOODWARD The reduction in liquidity in the ACGB and semi-government market happened in a much more compressed timeframe in March 2020 compared with the financial crisis. Bid-side support for semi-government paper effectively disappeared as domestic and offshore holders attempted to liquidate positions.

On the other side, the return to normal market conditions was also quicker than during the global financial crisis. The intervention of the RBA [Reserve Bank of Australia] was a major driver and injected much-needed confidence.

Davison Was restoring confidence, and thus liquidity, as simple as the story of the RBA stepping in to backstop the ACGB and semi market, and thus trading function returning?

■ RAVENSCROFT RBA bond purchases and the government's crisis-response package were undoubtedly the key catalysts for the improvement in liquidity conditions. The first RBA purchase came on 20 March, just one day after the flash crash in Australian bond futures that could have ushered in a new wave of Australian dollar-specific risk-off tone.

Instead, A\$27 billion (US\$19.4 billion) of ACGB and semi-government bond purchases from 20 March to the end of the month saw a material correction in EFP spreads and a significant return of market confidence.

The normalisation of bid-offer spreads through April was also key in securing confidence. Secondary-market volume remained below average. But clients were able to access two-way markets in large volume from mid-April onward, from a wider selection of dealers that started to return to the market more actively.



Davison Did you see other dealers pulling back from the market? In this context, how was ANZ able to stay active during the period of disruption when others were not?

■ RAVENSCROFT It became evident as early as late February that liquidity provision had begun to pull back. We had to consider our own liquidity offering through this challenging period, which meant — more than ever — aligning our risk-taking with our clients' liquidity requirements.

The message from our management was to continue supporting our clients through this unprecedented crisis. I think back to what proved to be our last team meeting before we enacted BCP [business-continuity planning] procedures that saw the trading team separated for what ended up being six months. The clear message then was to support our customers, first and foremost.

Our aim was to maintain transparent communication with our clients – not just about our view on the market but also our capacity to warehouse risk. At the deepest point of the crisis, broking bonds was not an option given one-way client flow and zero interbank liquidity. This left a very limited pool of dealers that was able to warehouse risk.

Recycling risk was incredibly challenging but we were, at times, able to find pockets of demand that allowed us to provide liquidity without materially increasing our balance-sheet exposure. Keeping sellers aware of where liquidity existed allowed them to achieve best execution despite the challenging market backdrop.

Davison How significant an impact has the massive increase in ACGB supply – including more frequent and larger Australian Office of Financial Management (AOFM) syndications – had on the dynamics of the Australian secondary rates market?

■ RAVENSCROFT Market conditions in ACGBs continued to improve throughout April, to a point where liquidity was arguably back — or at least close — to pre-COVID-19 levels. This allowed the AOFM to start tackling an increased issuance programme. Buyers began to reappear in quite large volume from early April, noting the shift in ACGB relative value on a global basis.

The first AOFM syndication in this period came on 15 April. By this point investors were actively seeking the offer side of liquidity – which had been significantly reduced by the volume of QE purchases. The book size of all five AOFM syndications since then tells a story about global demand for ACGBs as we emerge from the COVID-19 crisis.

What has stood out to me as a market maker during this period of supply is the lack of switching activity. ANZ has been a lead manager on four of the five AOFM syndications and these transactions have seen offshore investors allocating to Australian fixed-income product rather than switching on the curve. Even domestic investors, which had taken defensive

"The unintended consequence of the TFF is a significantly smaller Australian dollar credit market in the short-to-medium term. It will bounce back after these policies are unwound – the major and regional banks will resume issuance, and offshore borrowers will return. But it will be a period of consolidation for 18 months to two years."

CHRIS KHAN

positions in short-term cash instruments, were now shifting back to the ACGB market.

CREDIT CONDITIONS

Davison What was the story for liquidity conditions in the Australian credit market during the early part of the crisis?

KHAN The liquidity story was very similar to the financial crisis in many respects, and far worse than any of the smaller crises in the intervening time. There was no imminent threat of financial institutions collapsing on this occasion, but trading conditions very quickly came to resemble that period. By this I mean large-scale liquidation — often of the highest-grade bonds, because they were the easiest or only ones clients could sell.

What differentiated this crisis was the speed of the widening but also of the subsequent recovery. This was driven by government support but also by a quicker response from market participants – in particular those conditioned by the financial crisis.

The only meaningful liquidity in the Australian credit market was in bank senior paper followed by – to a lesser degree – in repo-eligible regional banks and offshore financial institutions. These were therefore the bonds clients reached for to sell if needed.

These bonds also had a backstop bid: at some point the large bank balance sheets and asset managers would step in to buy. At the same time, if needed the RBA would offer these issuers emergency liquidity through the committed liquidity facility or other mechanisms.

Liquidity in tier-two bonds and corporates was, to say the least, very challenging – particularly for corporates. This is because it became necessary to evaluate default risk as well as liquidity risk.

Davison How did ANZ approach this period?

KHAN We always endeavoured to show a bid even though, much like the buy-side community, we had no way to predict

"The reduction in liquidity in the ACGB and semi-government market happened in a much more compressed timeframe in March 2020 compared with the financial crisis. Bid-side support for semigovernment paper effectively disappeared as domestic and offshore holders attempted to liquidate positions."

GLENN WOODWARD

where the turning point in the spread market might be. There was also no interbank market into which we could sell risk. We were pricing at-risk bids and, when hit, taking bonds onto the trading book.

Like most market participants, there were no easy days for us during the worst of the crisis. We run an at-risk trading book and significant inventory - unlike quite a lot of banks it is not a solely brokered model. Our model brings significant P&L volatility. But, rather than shut up shop, we have a duty to try to assist our clients through these times.

This is with 100 per cent support of ANZ senior management in the markets business. They backed our call to keep making markets through the worst of the crisis – and the decision proved to be the correct call.

We don't have infinite liquidity as a trading book. Far from it – provision of liquidity is scarce and, in stressed conditions, we prioritise its allocation to clients with which we have longterm relationships and have successfully worked in the past. Looking back, I believe we fulfilled our duty.

Davison One of the particular challenges in the financial crisis was the overhang of bonds as investors had to sell to meet redemption pressure. How much forced selling was there this time round, especially as the government allowed early access to superannuation funds, and how did ANZ help manage it?

KHAN Superannuation-fund redemption and many clients' rush for cash had a substantial impact on the credit market and, in particular, the major-bank senior curve. These floating-rate notes are a major component of many super funds' short-dated holdings. Selling in this space was compounded by further selling by other investors as they were the only securities in which they could get large-sized bids.

This quickly resulted in the credit curve inverting – the short end traded wider than the five-year point at various times. Our role was to provide bid-side liquidity in what is – relatively - the safest of sectors. Again, ANZ management was very

supportive when we required more balance sheet to support this flow. It ultimately resulted in March and April being the largest monthly flow ANZ has ever seen – albeit substantially weighted toward client selling.

Davison The biggest change in credit-market dynamics has been the absence of the major banks from new issuance. How has this changed secondary-market dynamics around overall liquidity and price discovery in particular?

KHAN The RBA's term funding facility (TFF) has resulted in the largest and most abrupt change to the composition and dynamics of the Australian credit market ever seen. Due to the TFF, there very likely will be no major-bank or regional-bank senior issuance for an extended period. TFF cash has also driven strong investment demand for these bonds by banks themselves.

This has resulted in spreads collapsing to post-financialcrisis tight levels. Combined with the large ongoing redemption schedule, we have seen the largest segment of the Australian dollar credit market essentially grind to a halt. It is likely to stay this way for a matter of years.

With the major banks no longer frequently issuing offshore, the cross-currency basis swap has collapsed and made the Australian dollar market considerably less appealing for SSA and other Kangaroo issuers.

Traders and investors alike are being forced to focus on a significantly limited universe of investable credit, concentrated on corporate bonds, tier-two and securitisation. Alternatively, investors can expand their mandates to incorporate semigovernment bonds or foreign-currency credit markets.

The focus on corporate and tier-two securities has created greater liquidity in these assets. My opinion is that this remains a bull-market phenomenon, however. Structurally, liquidity is unlikely to be significantly better in future periods of market stress – particularly compared with what we had come to expect in domestic financials.

TRADING PRACTICE

Davison It has been a consistent talking point for the past decade that banks' trading capabilities have been fundamentally altered by regulation and the consequent reduced capacity to warehouse bonds. How has ANZ navigated this challenge to continue supporting liquidity for clients?

KHAN It's a similar story across the high-grade and credit sectors. The impact of Dodd-Frank and banks' reduced ability to warehouse risk was evident to all in the crisis of March and April 2020. The lack of warehousing and an overreliance on broking severely affected the state of liquidity across markets.

ANZ principally runs an at-risk model, under which we warehouse risk and use our global distribution network



to recycle it. Our sales team will look to broker risk when necessary but it's not our primary approach.

Davison To what extent has the Australian dollar market diversified over recent years to provide more genuine two-way flow? It always used to be said that investors were either all buying or all selling at the same time. Has this changed?

RAVENSCROFT The breadth of investors in the Australian dollar market has grown in tandem with its increasing scale. For example, while some might point to a small drop in proportion of offshore holdings of ACGBs since the start of the year, the notional volume of these holdings is a more significant figure. This has grown substantially over the same period.

Big thematic moves like those we have witnessed this year will always lead to same-direction client flow. But we certainly see more two-way flow in less volatile periods nowadays. It is not just an onshore versus offshore dynamic, either. We have clients locally that trade with differing views on the market.

LASTING CHANGE

Davison We are looking at ultra-low rates and a lot more ACGB supply for the foreseeable future, with the RBA ready to step in if needed. How will these factors influence liquidity on an ongoing basis?

RAVENSCROFT The RBA has clearly indicated that it is prepared to support the bond market in times of stress. This will underpin investor confidence in ACGBs and semis as the issuers work through greatly increased funding requirements.

We are not immune to volatility shocks, but the likelihood of another risk-off scenario of the magnitude we saw in February and March is somewhat low in a market of coordinated central-bank stimulus on a global scale.

The Australian dollar bond market continues to offer good value to global investors across a number of metrics, including spread to US Treasuries and on an FX-hedged basis. Australia has also been commended for its management of the crisis from a health perspective.

My view is that offshore investors will continue to participate actively in our increased funding needs as they view the Australian market as one of the best investment opportunities globally.

Davison There is a reasonably significant evolution coming to the Australian futures complex, in the form of a new five-year Treasury bond contract. What impact will this have on the cash market?

RAVENSCROFT The five-year futures contract is a key development for our market going forward. It is a very different proposition from the 20-year contract, which has struggled to

"It will be a low-yield environment overall. Combined with the smaller investable credit universe, this will result in investors diversifying further into the corporate market and into subordinated debt – including financials and the emerging corporate subordinated sector."

CHRIS KHAN

become an active instrument. I think physical and derivative markets will react very positively to the five-year bond future, which also brings us more closely in line with international markets. It will certainly provide a more relevant hedge for ACGBs than the relatively anchored three-year bond future.

This can only be positive for liquidity. The opening up of a five-year bond basket provides opportunity for domestic participants that had largely been restricted to activity in 10-year bonds after the change in dynamic at the three-year point.

Davison What is the longer-term outlook for credit trading given the dynamic of little or no major-bank senior issuance?

EXHAN I think a number of key themes will play out over the coming years. It will be a low-yield environment overall. Combined with the smaller investable credit universe, this will result in investors diversifying further into the corporate market and into subordinated debt – including financials and the emerging corporate subordinated sector. Investors with more flexible mandates will also look to add alpha in the semigovernment and US dollar credit markets.

Davison Do you expect Australia to become a more rates-focused market in future, based on the drivers of more government-sector issuance, less credit volume and pricing dynamics working against Kangaroo issuers?

■ KHAN Undoubtedly. The unintended consequence of the TFF is a significantly smaller Australian dollar credit market in the short-to-medium term. It will bounce back after these policies are unwound – the major and regional banks will resume issuance, and offshore borrowers will return. But it will be a period of consolidation for 18 months to two years.

While the credit market is facing structural challenges, the ACGB and semi markets are seeing prodigious growth. Providing investors and issuers in those sectors with risk and distribution support is at the core of our focus in financial markets at ANZ.



KangaNews DCM Summit rates market webinar

On 22 October, KangaNews hosted the latest in the **KangaNews Debt Capital Markets Summit 2020** webinar series. The session had a rates-market flavour, including a discussion between some of Australia's leading market participants about how massively increased sovereign issuance, central-bank intervention and a raft of new dynamics will shape their sector.

PARTICIPANTS

- Anne Anderson Head of Fixed Income, Asia Pacific UBS ASSET MANAGEMENT Rakesh Jampala Head of Fixed Income Trading ANZ
- **Rob Nicholl** Chief Executive AUSTRALIAN OFFICE OF FINANCIAL MANAGEMENT **Fiona Trigona** Head of Funding and Balance Sheet NEW SOUTH WALES TREASURY CORPORATION

MODERATORS

■ Laurence Davison Head of Content and Editor KANGANEWS ■ Apoorva Tandon Head of Asia Syndicate TD SECURITIES

MARKET CAPACITY

Davison A couple of years ago, when the AOFM was last heading toward a peak in annual issuance, there was a feeling that capacity was being stretched. Issuance has gone up by a step change even from that level but there do not seem to be any capacity issues. Has this been a surprise?

■ NICHOLL Back in 2016/17 we had an issuance task of just less than A\$110 billion (US\$79 billion), which was by far the largest programme we had undertaken to that point. Our weekly issuance rate at that stage was A\$2-2.25 billion. There were some weeks when the market felt tight and the feedback we received from banks was that there was some congestion in the market for a few short periods.

On the basis of that experience, in April this year I wondered how our new funding programme would be received

"At various times we have thought about whether we would go longer than 30 years but at the moment we have no plans to do so. In my view, this is a market for the big currencies – euros and US dollars."

ROB NICHOLL

AUSTRALIAN OFFICE OF FINANCIAL MANAGEMENT

given we had been out of the market for a couple of weeks due to volatility and our financing task had risen to A\$130 billion from A\$60 billion.

However, we have been able to get the required issuance programme away smoothly – and it is still going very smoothly.

There are a number of contributing factors. For one thing, the world is a different place now from what it was in 2016/17. There has been a flight to quality, for all the reasons that make the world look a much riskier place than it did back then. Sovereigns around the world have materially increased their issuance, too, so there has been a structural change in the global asset pool.

There is good liquidity in the market. Our spread to US Treasuries has gone positive again after being negative for quite a while, which has made a big difference for our offshore investor base.

We have also engaged heavily with syndication as a means of issuance. This can be a more effective way for us to raise this quantity of funding quickly, rather than straining the

capacity of intermediaries in tenders.

Davison It has been suggested in at least some quarters that Australia's semigovernment borrowers may confront capacity issues before the sovereign. What is New South Wales Treasury Corporation (TCorp)'s experience through this crisis?











"I still do not believe the RBA will go to a negative cash rate. I think it will validate where the market has taken the cash and exchange-settlement-account rates. The TFF rate will also drop, which will have benefit through the lower cost of funding encouraging people to buy assets and maintain liquidity."

ANNE ANDERSON UBS ASSET MANAGEMENT



■TRIGONA We were faced with capacity constraints in March and April as the crisis unfolded. It really took the RBA [Reserve Bank of Australia] stepping in and providing liquidity to the market for investors to become comfortable. We were then able to issue again via syndication, with two transactions totalling A\$3.2 billion.

Our funding tasks were and are a lot less than the AOFM's – in the last financial year it was A\$13.3 billion, which then increased to A\$17 billion. This was the largest task we have ever had to complete. By the end of the financial year we had raised around A\$29 billion.

We are seeing substantial investor demand for our funding, though. With US\$17 trillion worth of negative-yielding bonds globally, Australian high-grade bonds remain a very attractive opportunity especially given the steepness of our yield curve.

We see a lot of opportunities to issue and meet the task at hand. We will not know our full task for this financial year until the New South Wales (NSW) budget, on 17 November, but we are progressing nonetheless. So far this year we have issued around A\$14 billion.

Davison TCorp recently returned to the greenbond market. How does this help with any capacity issues that might arise from a larger overall funding task?

■ TRIGONA This deal was ground-breaking as it is was the first time we have ever had more than 40 per cent of participation from offshore in one of our green bonds. It was 15-18 per cent in our last two green and sustainability bonds.

Issuing in this format opens a lot of opportunities for us to attract new investors. Our capacity to issue depends on the eligible asset pool. We now have A\$5.2 billion of bonds outstanding in the green and sustainability programme. We continue to build out the pool and we will look to increase our sustainability- and green-bond lines in the new calendar year.

DURATION EXTENSION

Davison The RBA support programme has anchored the three-year yield point and created a relatively steep curve. How is this affecting market dynamics and demand?

JAMPALA To the extent that there is a pre-specified price on duration it will reduce the volume and frequency of trading

 both speculative and for hedging purposes. This is a global phenomenon as we find most major markets are effectively anchored at the front end.

As a consequence, one would expect to see increased trading in the long end, aided by greater issuance in this space. Market participants should be trading 20 years in the same way they previously might have traded the 5-10 year part of the curve.

Davison Historically, liquidity in the Australian market has focused around the futures baskets at three and 10 years. Will we start seeing the trading focus shift toward 10 and 20 years?

■ JAMPALA I am sure we will get there — it is just a matter of time. It is largely a chicken-and-egg scenario where the 20-year future needs more physical supply, and for this to happen the future needs to be more liquid.

In time, I imagine the AOFM and semi-government issuers will increase supply in this part of the curve to the extent that the pool of investors will grow, too – creating a natural increase in trading and liquidity.

Davison To what extent is the push to a longer-dated market being driven by investors – specifically in a hunt for yield?

ANDERSON We have seen evidence of a heavy international investor bias in some long-dated sovereign and semigovernment syndications. In our own books, we are more comfortable investing in the long end when we are managing money for liability matches and captive investors. However, in my experience most domestic investors have not ventured out meaningfully into 10-20 year duration, in large part because a lot of them are index driven.

More importantly, though, liquidity in the long end is still a challenge. From time to time there have been sensational relative-value opportunities but, overall, I have found this part of the curve frustrating. To go there we really need the supply concession we get from some syndications. This has been a valuable trading opportunity.

As a term investor, I do not think we are there yet – and it has been a slow process even to get to this point. While 10-30 years tends to be quite steep in all markets, Australia is arguably steeper than others. I think this is a reflection of the way our market funds and the lack of captive investors compared with jurisdictions such as the UK.

AOFM FUNDING STRATEGY IN DEPTH

The Australian Office of Financial Management (AOFM) has seen a quantum leap in its bond issuance task. How it approaches funding this volume will shape the Australian dollar market for years to come.

TANDON Going back to Q1 and Q2, what was the AOFM's experience of liquidity conditions? How has that period shaped funding plans this year and beyond?

■ NICHOLL Liquidity completely disappeared in March. It began to reappear in Australia in early April, in concert with the RBA [Reserve Bank of Australia] beginning to buy bonds as part of its market-clearing operations.

When we first regained access to the market we were issuing very short tenor, which is consistent with most issuers' approach. There was a complete lack of appetite for duration at that point in time.

We monitored conditions and tracked the recovery as it unfolded. This allowed us to follow the recovery out with our issuance until we observed liquidity in the 10-year futures part of the curve returning to something close to normal. The process took 6-8 weeks.

We were able to test the market in mid-April when we did a syndication for a new four-year bond. In mid-May, we did a new 10-year syndication. These transactions in particular were very important for us – to get a window into what was happening in the market in the early phase of recovery.

We were also faced with a completely unprecedented increase in our funding task in a short period of time. This forced us to take a no-risk approach to getting cash in the door and managing liquidity risk.

As the months passed, we saw that the financing task would be manageable. This meant we could relax our liquidityrisk reduction strategy and move toward re-engaging in a pattern of issuance more in line with a portfolio strategy.

TANDON How has the international buyer base evolved through this year? How do you assess the depth and commitment of international investors in the programme?

■ NICHOLL The offshore investor base has been important to us for a long time, although we saw offshore investors re-engage with the market later than domestic investors. This was mostly down to them being in lockdown and containment situations themselves, as well as facing their own domestic-market challenges.

We have seen an increase in offshore interest, though. There has been a recent surge in Japanese allocation to the Australian dollar market, for us and the semi-governments.

From our syndication statistics, even the 2024 bond showed a higher allocation to offshore investors than the average for all our past syndications, except the 2047 transactions in 2016. This suggests a step-change in offshore participation has taken place.

The offshore investor base is very important for the long end of our curve and our 2051 syndication showed this. There was a strong return to interest in the AOFM doing a 30-year benchmark and close to two-thirds was allocated offshore.

TANDON What insights can you share about communication between the RBA and the AOFM regarding the reserve bank's market intervention?

• NICHOLL From March to May, there was frequent interaction between the AOFM and the RBA with the key objective at first being for the RBA to understand our read on the market and how we thought it would respond to operations to remove congestion.

As RBA operations began to take effect and the market regained its footing, the need for us to be in regular communication diminished. We let the RBA know in advance when we planned to do large syndications, though.

There has been little to no discussion with the RBA about three-year yield-curve control. We see this as independent of what we are doing and we have not been a large volume short-end issuer for the last 5-6 years anyway.

I believe the communication we had with the RBA was highly effective and functional. But it was done from the perspective that we were operating independently of one another.

TANDON Notwithstanding that the AOFM's focus has been on 10 years and longer for a while, do you think the five-year maturity has replaced three years as the 'live' point in the Australian dollar mid-curve?

■ NICHOLL There is no doubt that there is appreciable interest in the five-year part of the curve and I think this has been driven in part by three-year yield-curve control. The curve steepens past three years and there is attraction for some investors to buy 1-2 years out from the three-year, knowing yield will roll toward the RBA's target.

There is probably diminished interest in the three-year part as a result, too. A lot of investors like some volatility and uncertainty – it is where traders tend to make their mark.



"FROM OUR SYNDICATION STATISTICS, EVEN THE 2024 BOND SHOWED A HIGHER ALLOCATION TO OFFSHORE INVESTORS THAN THE AVERAGE FOR ALL OUR PAST SYNDICATIONS, EXCEPT THE 2047 TRANSACTIONS IN 2016. THIS SUGGESTS A STEP-CHANGE IN OFFSHORE PARTICIPATION HAS TAKEN PLACE."

ROB NICHOLL AUSTRALIAN OFFICE OF FINANCIAL MANAGEMENT











Davison If the long end has not developed to a point of comfort and the front end is not an exciting trading option, does this mean the focus is on the 5-10 year part of the curve?

"I can certainly see us issuing more in euros. US dollar issuance is more difficult as we do not have a 144A programme. But the cost of issuing in the US market has improved, so it may become more compelling in future."

FIONA TRIGONA NEW SOUTH WALES TREASURY CORPORATION



■ ANDERSON Yes. There are still directional opportunities — there has just been a good rally in 10 years and the Australia-US spread has been a tradeable theme. There is relative value as you roll up the curve and try to anticipate the actions of the market in response to possible QE options, and from time to time there have been good opportunities in 10s-30s. But when you go in there as a term investor you need to be mindful of what you are prepared to pay if you need to exit.

Davison Can we assume the AOFM is happy to extend its funding curve as much as possible and will respond to primary demand for long-dated issuance?

■ NICHOLL We are not capping the volume we will put into our ultra-long maturities. In fact, we are constantly looking for opportunities to do appropriately sized tenders or syndicated taps. We have found these very effective in the past and they tend to create a liquidity event in their own right, as they give an opportunity for offshore investors to participate in good volume.

We are mindful of the fact that this part of the curve is not nearly as liquid as others at the moment. We do not want to push supply and create volatility that would scare away investors. We will be looking for every available opportunity to get stock into that part of the curve responsibly, though.

At various times we have thought about whether we would go longer than 30 years but at the moment we have no plans to do so. In my view, this is a market for the big currencies – euros and US dollars. We are sure there would be some demand out there but I do not think it would be nearly sufficient or consistent enough to develop a meaningful 50-year Australian dollar market.

Davison Does the AOFM have any preference between providing supply into the 20-year futures basket or to the 30-year point where the curve currently ends?

NICHOLL We would not pick one over the other as a strategy.

We monitor the feedback we get from the market and banks and focus on maturities where interest appears to be building at the time.

Davison Do match-funding issues constrain TCorp's ability to service long-dated demand?

■ TRIGONA Lengthening the curve is definitely a focus given our main borrowing client is NSW Treasury so we are currently able to accommodate long-dated demand.

This calendar year, we have issued more than A\$4.8 billion in long tenors. Our 2041 bond now has A\$2.1 billion on issue. We are looking to increase this line as well as our other long-dated bonds including our new 30-year line.

PRIMARY FOCUS

Davison Australia seems to be developing an increasingly primary-focused market. What does this mean for the trading environment and the market generally?

■ JAMPALA The proliferation of bond issuance globally, leading up to and after the onset of COVID-19, has been quick and extraordinary. We have seen the return to primacy of cash markets. The pool of investable fixed-income securities is not going to diminish any time soon so I imagine this trend will be pervasive for some time yet.

The yield structure we have before us is such that there will be significant challenges for cash and income funds. Navigating primary issuance as part of the collective and all-pervasive search for yield will be a dynamic consideration for investors for some time.

Davison Given there is typically a premium required for syndicated issuance, would the

"The RBA has done a great job so far but significant challenges lie ahead. What seems clear to me is that the RBA, in its dovish movements, seems to want to ameliorate outcomes from an inflation and employment perspective. Its focus is on doing what is right for main street."

RAKESH JAMPALA ANZ



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RAKESH JAMPALA ANZ

AOFM's preference be to rely on it for less of its total volume?

■ NICHOLL The concession we pay has diminished since our 2024 syndication. The market was very crowded back in April and May so issuers were forced to give away slightly higher concessions. But this seems to have unwound in the months since.

We are happy to do syndication – but only if it is required and to the extent of demand. If we build up a new line by tender, we still pay for it indirectly because investors demand some illiquidity premium for smaller lines. We do not avoid the cost – it just comes in a different form, through tenders.

We will continue considering whether to use syndication for new maturities. We think of it in terms of execution risk. If we go back to April and May, there was huge demand on us to provide more liquidity quickly. Syndications were a sensible way of getting large volume away and not putting too much pressure on trading accounts to do it. But the pressure has certainly abated.

We did not use syndication much at all over the last couple of years, because our programmes were much smaller. In this situation a syndication would take up a large part of our issuance programme and affect our regular tender operations.

■ **ANDERSON** The supply concession is a welcome opportunity for investors to make some money. This is not just an Australian phenomenon, to be clear. Last night we saw supply backed up even in the US market, for instance

Taking down supply is a bit of an art form and it is also a tradeable opportunity – which obviously as an active investor I think is a good thing. The market makes room and we attempt to value the premium.

It may not be material but in this world of very finely priced securities and low absolute yield we need to adapt what we are prepared to trade for to make capital gains.

"We are seeing large investor demand for our funding. With US\$17 trillion worth of negative-yielding bonds globally, Australian high-grade bonds remain a very attractive opportunity especially given the steepness of our yield curve."

FIONA TRIGONA NEW SOUTH WALES TREASURY CORPORATION

RBA DIRECTION

Davison The RBA has been clear about three years being the best point of transfer of its purchases to the real economy, and that negative rates do not achieve their

intended goal. Why do so many people assume the reserve bank is likely to enact longer-dated purchases and negative rates?

ANDERSON I think the RBA has been good at navigating messaging over many years. The quality of its communication around the drivers of its thinking is second to none. In fact, in re-reading governor Philip Lowe's and assistant governor Christopher Kent's recent speeches, it is clear what the RBA is trying to solve for.

They speak about being as transparent as possible but, ultimately, the RBA needs to make a judgement about using its policy toolkit in the most effective way to solve a challenging paradigm.

I still do not believe the RBA will go to a negative cash rate. I think it will validate where the market has taken the cash and exchange-settlement-account rates. The TFF rate will also drop, which will have benefit through the lower cost of funding encouraging people to buy assets and maintain liquidity.

This enables households to repair their balance sheets, which in turn reduces financial-stability risk. The cash mechanism also gives people greater ability to consume. It is working – it is just slow.

What I am personally grappling with at the moment is whether further asset purchases in the form of QE will be effective to address the divergence in our economy.

It feels to me that the RBA wants to be somewhat procyclical – to deliver more stimulus when the economy is opening, which is where we are now. However, we have just had the budget and we are waiting for it to work through the system. Whether the RBA announces QE [in November] or gives it a bit more time is the big question. There is a cacophony of voices from the market and the RBA would weigh market disappointment.

The question is what disappointment looks like. If 10-year

bond yield rises by 10-20 basis points I do not think it would be a significant policy consideration, given the level of transparency the RBA has offered in its communication. My views are informed first by what I hear from central bankers then shaped by the market.

JAMPALA If I had to mark the RBA on its actions in response to COVID-19 it would be a 9.5 out of 10, and I think the market











recognises this. Its credibility as a central bank is second to none and I think we have seen this in the way other central banks have looked into the RBA's policy instructions as a learning tool.

Having said this, there are significant challenges and implications now as we grapple with the concept of negative rates. If we move into negative territory we may have cash funds returning negative yield to their investors even before considering fees. We may have end users and corporate borrowers paying out on both sides of an interest-rate swap. There are all sorts of considerations we need to think about.

On the flip side, a much-expanded QE programme could diminish the liquidity and real activity in the long end of the curve that has been a feature of the market in the last six months.

The RBA has done a great job so far but significant challenges lie ahead. What seems clear to me is that the RBA, in its dovish movements, seems to want to ameliorate outcomes from an inflation and employment perspective. Its focus is on doing what is right for main street.

GLOBAL OUTREACH

Davison The last time the AOFM's funding task was rising quickly it got on the road to engage with as many investors as possible. Putting aside the fact that a global roadshow is impossible at the moment, how has the investor-relations strategy changed?

■ NICHOLL In April and May, we felt the need to get as much information out to investors as possible to give guidance around fiscal impacts and how issuance would respond. We conducted a teleconference campaign, which was quite short and sharp because we did not have a budget update. This also helped us understand the path of market recovery. We also tried to give guidance on weekly issuance rates just to give investors some reference points.

We have just kicked off another campaign where we will do around 50 teleconferences to follow the budget release, having done around 80 in the first round in April-May.

We have also enhanced the information we make available online. We are looking for different instruments by which we can engage the buy side. This is through our quarterly *Investor Insights* note as well as the updates we give after official budget

releases. As part of this, we are also about to launch a short video webcast to complement the investor packs we put out.

We are also engaged with the banks and we speak to investors continuously. We have not broadened the nature of our task, but it has been intensified. We are looking for meaningful ways to communicate transparently.

■ TRIGONA We have not marketed to the same extent as the AOFM. After the NSW budget on 17 November we will put out a video explaining our funding task over the remainder of the year and in future. We are working on our investor presentation pack and will look to meet investors when it is complete – which will be predominantly online.

Davison Does the EU's borrowing programme make it more difficult to attract the attention European investors?

- TRIGONA We have seen increased European investor interest in our bonds this year and, for the first time, we issued in euros. The 30-year bond we first issued in February is now at €430 million (US\$506.4 million) outstanding, so it is not far away from benchmark status.
- **NICHOLL** Our market is now quite familiar to most of the buy side as a product of everything that has happened since the financial crisis. This is a strong foundation.

I think as long as there is value for investors – either taking currency risk or the cost of hedging the currency into account – and they are confident about liquidity in the market, we will continue to see reasonable demand. I do not get the sense from our experience in the last few months that there has been a diminishment of offshore interest. In fact, we have seen more of it: we are seeing a lot of new names in our syndication books from Europe and North America.

Davison Will offshore demand wane as the 10-year Australia-US bond yield is now flat or slightly negative?

■ NICHOLL If it is prolonged we may go through another cycle of what we saw 18-24 months ago, but it is not likely to be an instantaneous response. There needs to be a clear differential and investors need to believe it will be sustained in order to switch markets. I do not think it will have a meaningful impact in the near term.

Davison Has the value proposition shifted

somewhat for semigovernment foreigncurrency issuance?

■ TRIGONA I can certainly see us issuing more in euros. US dollar issuance is more difficult as we do not have a 144A programme. But the cost of issuing in the US market has improved, so it may become more compelling in future. •

"Liquidity in the long end is still a challenge. From time to time there have been sensational relative-value opportunities but, overall, I have found this part of the curve frustrating. To go there we really need the supply concession we get from some syndications."

ANNE ANDERSON UBS ASSET MANAGEMENT

KangaNews DCM Summit economic outlook webinar

The latest in the **KangaNews Debt Capital Markets Summit 2020** webinar series included an outlook on the Australian economy and bond market approaching the end of a tumultuous year. Discussion focused on the scale of fiscal support still required, how central-bank stimulus will be deployed and the outlook for key indicators including the housing market.

PARTICIPANTS

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MODERATOR

Shaun Roache Chief Economist, Asia Pacific S&P GLOBAL RATINGS

STATE OF PLAY

Roache We have almost run out of hyperbole to describe the events of 2020, but it is helpful to be a bit more prosaic in how we look at the year. We had an enormous shock in the first half and we keep getting aftershocks as we carry on through the year.

What we have experienced can be characterised as a demand and supply crisis, and it was global in nature. We have also seen shifting geopolitical relationships layered on top of these challenges.

We have seen an immense policy response that, in many ways, has been quite innovative. It has been absolutely fascinating to be an outsider looking at Australia because I think it has been at the cutting edge of global thinking about how to deal with these types of events.

It is going to be interesting to see how everything plays out in the next 1-2 years. How are panellists thinking about the economic outlook moving into 2021, and how are fiscal and monetary policies shaping views?

EVANS We expect growth will bounce back pretty well in the second half of this year. We are forecasting growth of 4 per



"JobKeeper only rolls back if a business has recovered, so to a certain extent there is an offset. Not everyone who comes off JobKeeper will end up being unemployed. There are also the income-tax cuts, which have been brought forward. It is not disastrous at the moment."

IVAN COLHOUN NATIONAL AUSTRALIA BANK











cent -1.8 per cent in Q3 and 2.2 per cent in Q4 - reflecting a recovery in Victoria in the last quarter.

Next year, we think it will slow to around 2.8 per cent. Before the budget we thought it would be about 2.5 per cent, but we expect households to spend around half their tax cuts so there should be a stronger consumer story.

The middle of the year will be the soft part of 2021. We are forecasting 2 per cent annualised growth in this period, because it is when we will see how households and consumers deal with the withdrawal of JobKeeper and the wind-back of loan deferrals.

Policy will continue to be stimulatory with the budget in May getting ready for an election in 2022. The Reserve Bank of Australia [RBA] is committed to keeping rates extraordinarily low.

Margins on banks' mortgage books are at healthy levels, so the banks have further scope to cut their lending rates. I am very optimistic about the housing market from Q4 next year when we get over the headwind of deferred loans. We are looking at 3.5 per cent GDP growth in 2022.

I also have one comment on the budget. There were some big numbers in it but actual new policy only averages 1.2 per cent of GDP over the four-year forecast period. Quite frankly, I was underwhelmed by the value of the new policies.

I think the government will do more with, for instance, JobSeeker. It will have to remain at A\$850 (US\$610) a fortnight and this will cost about A\$4 billion a quarter. This means at least a further A\$8 billion in the 2020/21 budget deficit and another A\$16 billion in 2021/22.

I think the government will have to do more around the elimination of JobKeeper at the end of the March quarter in 2021. In particular, industries still affected by border closures will need help.

Roache This is a really interesting point around the scale of the budget measures, because it is not always obvious that a package is not as big as the headlines suggest. What do other panellists think about the budget's impact on the growth outlook?

ONG We upgraded our 2021 growth numbers following the budget, though this was also driven by expectation of further measures from the RBA. More stimulus coming into the

system, and sooner, has led us to take our GDP number for next year up to just less than 3 per cent from about 2.5 per cent – following a contraction in 2020 of about 3.5 per cent.

There is no doubt in our mind that the recovery is under way. But it is fragile. Confidence will determine whether the big-ticket budget measures underpin activity and hiring. As we look forward into an uncertain future, I agree there will need to be ongoing fiscal and monetary stimulus.

It becomes somewhat circular, though. The numbers are firmer – if a bit patchy – but it becomes somewhat more challenging going into Q2 next year when some of the incomesupport measures are withdrawn and the loan-deferral period ends. The front loading of some of the stimulus, including what is likely to be more RBA stimulus, will help the recovery.

One of the lessons learned from the post-financial-crisis period is the importance of not withdrawing support too soon. If anything, I suspect we will see more stimulus on the fiscal side – and Australia is very fortunate to have scope to do so. Our debt level is low by international standards and the RBA is in the early stages of unconventional policy.

COLHOUN It has been a very complex shock. Some sectors have done okay but obviously others have been smashed. Also, when thinking about fiscal and monetary policy it is important not to forget health policy. This is one of the biggest levers the government can pull to affect the economic outlook.

Hopefully, we get a vaccine soon. If not, we will have to work out how to live with this virus. Some overseas locations are now getting 30-minute COVID-19 tests at airports. Singapore is testing people when they arrive in the country. These are ways to get some activities back to normal if we invest in some of these testing systems. Governments also have to get the quarantine, testing and tracing programmes right. This is their biggest contribution.

The economy has been surprisingly good of late. Retail sales are above February levels and job ads, outside the big states, are the same. Consumer confidence is actually better than February and house prices are holding up much better than expected. We know this is because so much stimulus has been given out, though – and other sectors have more or less closed down.

Overall, though, so far the economy is performing a lot better than one would have thought given the numbers printed in Q2. I expect a further big bounce back in Q3, then we have to work through the end of JobSeeker and JobKeeper.

"There is no doubt in our mind that the recovery is under way. But it is fragile. Confidence will determine whether the bigticket budget measures underpin activity and hiring. As we look forward into an uncertain future, I agree there will need to be ongoing fiscal and monetary stimulus."

SU-LIN ONG RBC CAPITAL MARKETS



HOUSING – THE UPSIDE SURPRISE

Prognostications of doom have not come to pass in the Australian housing market – at least not so far. Economists are keeping a close eye on housing outperformance, especially as some support measures and loan deferrals roll off.

ROACHE The housing market has surprised on the upside so far in the early stages of the recovery, and it could help support the economy through various channels. But is a housing-market rebound also a financial-stability risk?

COLHOUN Based on the stress tests APRA [the Australian Prudential Regulation Authority] and all the other regulators get the banks to do every year, the scenario of a really big fall in GDP and much higher unemployment should have produced a very different housing-market outcome

from what we have seen. This tells us how important government and reservebank support has been.

I was really surprised to hear the RBA [Reserve Bank of Australia] governor say rising house prices would be positive for financial stability.

We are still a bit cautious on housing when support measures run off. But house prices have done well around the globe even where there hasn't been this much support. They are doing very well in New Zealand, too. Very low interest rates are clearly an important factor.

The other thing is that while some of the shocks we are dealing with might be prolonged, such as those that require international borders to reopen, others should rebound relatively quickly.

I am sure people will be keen to go on offshore holidays when it is safe to do so, and I am also sure international students will come back here and influence rental vacancy rates. Markets are also behaving as if this is some form of temporary crisis rather than a really nasty recession.

EVANS We are very positive about the housing market,

once we get over the deferredloan issue. The information on deferred loans is very encouraging, too. People are starting to restore their repayments and the problem now seems to be mainly in Victoria, so the issue of too many stressed loans going onto the market next year seems to be fading.

Once we get through that problem we will end up with very low interest rates and a government committed to addressing the jobs issue ahead of an election. I think we will be in for a very strong couple of years in 2022 and 2023.

I agree that removing support too early is always a worry. But the budget includes good support, including bringing forward income-tax cuts and giving incentives for business investment, while the RBA's next move should help further. Recovery will be slow and grinding but it is turning out a lot better than we were expecting 3-6 months ago.

FISCAL CLIFF

Roache Most of the forecasts I have seen seem to downplay the risk of a fiscal cliff. Why has this risk apparently reduced, relative to expectations from March?

■ PLANK We actually have a very different view on growth, particularly in Q4. We are quite concerned about the fiscal cliff. The budget didn't boost our numbers relative to what we built into our forecasts because it delivered less than we were

expecting and the form of delivery was much more reliant on the private sector than direct spending.

I can understand the strategy the government has taken. The risk of delivering more tax cuts to households and tax incentives to businesses is that you can lead a business to a tax incentive but you cannot make it do the spending necessary to generate the tax incentive. I think the budget strategy is quite risky in this regard.

The pullback in fiscal spending in Q4 is enormous, so while we forecast a positive GDP number – helped a lot by the expected reopening in Victoria – it is not far above zero. The fiscal cliff will be tough to negotiate. On the other hand, there is a lot else going on – such as a bounce in consumer confidence after the budget that has been really encouraging.

I think the government will skate through it, but the fiscal cliff is a real challenge. With this in mind, there will inevitably be more fiscal spending to come. It is too late for Q4, but if



"We have seen an immense policy response that, in many ways, has been quite innovative. It has been absolutely fascinating to be an outsider looking at Australia because I think it has been at the cutting edge of global thinking about how to deal with these types of shocks."

SHAUN ROACHE S&P GLOBAL RATINGS











we are right that the quarter ends up being a bit rocky the government will be very concerned about Q1 and Q2 when there is also the fiscal cliff.

ONG We agree that Q1 and Q2 will be challenging as some of the key income support, JobKeeper in particular, ends in March as do main loan deferrals for businesses and households. Part of the reason we feel a little more confident is that some of the measures expected from the RBA, as well as some of the budget measures, are being delivered earlier than we anticipated.

There is probably more stimulus coming into the system sooner than our base case. I also agree, though, that if Q4 turns out to be more challenging we will see additional measures from the government either at the mid-year update or another time.

What we have seen in the past is industry-specific measures, such as an arts package. There is scope to deliver additional, targeted fiscal stimulus as needed – depending on how restrictions are eased and how Victoria opens up.

It is really a function of policy action – monetary and fiscal – and from a state and Commonwealth perspective. This is what makes us a little bit more confident as we head into next year, though there is no doubt Q1 and Q2 will be a more challenging period.

EVANS In my defence, one of the factors that hasn't been discussed is the improvement of the balance sheet in the household and business sector. We are seeing this in the build-up of deposits and of course we have seen a spectacular 20 per cent savings rate.

The question is if there is any lift in confidence that might see the household sector in particular use the strength of its balance sheet to boost spending. We saw the missing piece of the puzzle last week when consumer sentiment went up by 32 per cent in two months. This is giving me some confidence that the ongoing reopening of Victoria and other states should see more spending in the latter half of this year and into the first quarter of next. Then we expect a soft patch associated with the elimination of JobKeeper.

COLHOUN I'd add, similarly, that reopening is the really big part here. Q2 was weak because a lot of things were closed – which is also why the saving rate surged. We were all at home and it wasn't that easy to spend income or government support.

It is also worth noting that JobKeeper only rolls back if a business has recovered, so to a certain extent there is an offset. Not everyone who comes off JobKeeper will end up being unemployed. There are also the income-tax cuts, which have been brought forward. Again, it is not disastrous at the moment.

RBA CONTRIBUTION

Roache The language the RBA is using is fascinating, including how clear it has been about what it is trying to do. How might its actions further affect markets?

■ NEWNAHA It is worth remembering that we wouldn't be in this pickle without the pandemic — and that one of the things it injects into the market is uncertainty. This has a follow-on impact on underlying demand and whether businesses will remain solvent, which has further implications for the labour market and inflation. These are the factors driving global bond markets.

At the same time, sovereign-debt issuance is at a record level globally and there is an elevated level of corporate issuance as well. Despite the elevated level of issuance, though, bonds are trading at multi-year lows and credit spreads are very narrow.

A number of factors are driving this. The first is a flight-to-safety trade from the uncertainty about how long COVID-19 will persist. There is also a global hunt for yield, which is keeping yield low and spreads tight. At the same time, global central banks are willing to offer monetary accommodation and support via conventional and unconventional measures.

Overall, the message from the RBA governor last week is that it is watching economic and monetary-policy developments offshore because these will affect the Australian dollar and yield curve. Taking COVID-19 and offshore monetary-policy developments together, the RBA is clearly going to have an impact on the market in 2021.

On the other hand, the data has been better than expected and the RBA has drawn attention to this. In fact, it thinks the data has started to turn to the extent that any accommodative measures the reserve bank provides are more likely to gain traction.

Roache When central banks run out of space with the interest rate they have to do other things. So far, the RBA has enacted yield-curve control (YCC) and compressed risk premia, and

"The data has been better than expected and the RBA has drawn attention to this. In fact, it thinks the data has started to turn to the extent that any accommodative measures the reserve bank provides are more likely to gain traction."

PRAHSANT NEWNAHA TD SECURITIES



it sounds like it believes, on balance, that this is helping reduce financial-stability risks rather than increasing them. But what will the likely strategy be if the RBA decides it needs to do more?

PLANK The RBA effectively put 'pure' QE to the side. It is only now realising that central banks globally are buying a lot of bonds while the RBA, on a relative scale, is doing very little. We always expected it would shift to pure QE.

YCC was unsustainable in this rates world because it left the Australian yield curve too steep, which attracts capital inflows and pushes the currency above where it otherwise would be. Shifting to QE now would be a little earlier than we originally thought – but this is true for a lot of policies this year. Events have unfolded faster than expected.

The RBA's policy decision about YCC at the beginning of the year was misplaced, it should have opted for full QE straight away. But we have got there anyway and it will be effective when the RBA announces a reasonably large programme in a couple of weeks.

To not deliver now after signalling intent could lead to significant disappointment and possibly undermine the effectiveness of anything else the RBA does, such as a micro cash-rate cut to 10 basis points. I think we will get the micro cut and the delivery of QE.

To a large extent this is already priced in — it is certainly the case that we have seen our bonds compress sharply relative to US Treasuries. How much further this can go will depend on the direction of markets to at least some extent. If there is a sell off, the RBA leaning into global curve steepening will prove quite effective. If US Treasuries start to rally, though, the RBA will have its work cut out trying to keep pace. Global movements will be quite an important determinant of how things go from here.

On the currency side, we think it is more about the RBA ensuring Australia is part of the pack rather than beating it when it comes to monetary easing. If we had stayed as we were – with the steepest yield curve in the G10 and relatively less monetary easing than everybody else – I think there was considerable upside for the currency. The RBA change has removed this potential.

EVANS The RBA's view on the plumbing of the financial system is that negative rates would constrain the credit-

creation process. We believe the 3 November RBA package will cut the rate offered to the banks on their deposits down to 1 basis point.

This will mean the money-market rate will be 3-4 basis points. But it will also mean banks offering a negative rate on deposits from corporates and institutional funds. In other words, we might start to see evidence of negative rates at the very short end of the yield curve. I don't believe at all that the RBA is preparing to set the policy rate negative but at least it will give the financial system an opportunity to see how it deals with negative rates.

Another view is that the cash rate can go to 5 basis points and thus the RBA can avoid negative rates. Given the difficulty of defending a bond target of 10 basis points, a 5 basis point exchange-settlement account might mean a money-market rate of about 7-8 basis points.

Regarding the general attitude toward negative rates, the RBA governor said it is extraordinarily unlikely. We need to take this at face value. As a small open economy, it would be advantageous for the currency to have negative rates while everyone around has positive rates. I think New Zealand is salivating about this prospect but Australia is well behind on that particular goal at the moment.

- **PLANK** The problem at the moment is that the Bank of England (BoE) and Bank of Canada (BoC) are suddenly talking about negative rates. Come the middle of next year, Australia may be standing out as one of the few countries with positive rates. Going negative may not be our choice, in a way.
- **ONG** We have been fairly vocal that a negative rate is a tool in the RBA's kit though, like all central banks, it is absolutely not one it wants to reach for. But if there is one thing we have learned this year it is never to say never.

It was only late last year that the RBA governor talked about QE as unlikely – and look where we are less than 12 months later. I think David Plank is right, in other words. If other central banks head down the negative-rate path for overnight cash it would place pressure on the RBA to move in the same direction.

COLHOUN I agree with these themes. At the moment the RBA's focus is on relative balance-sheet expansion. Since the pandemic, we calculate average central-bank expansion has been about 14 per cent of GDP, and the RBA has expanded its balance sheet by 7 per cent.



"The risk of delivering more tax cuts to households and tax incentives to businesses is that you can lead a business to a tax incentive but you cannot make it do the spending necessary to generate the tax incentive. I think the budget strategy is quite risky in this regard."

DAVID PLANK ANZ











You could say it is 7 per cent behind and this might be one way to view how much more it has to do. But by whatever time we get to that 7 per cent, other banks will still be expanding their balance sheets – so we have more than 7 per cent to do over whatever timeframe the RBA chooses.

One of the key influences is what the Fed [US Federal Reserve] does – and it has remained against negative interest rates. If it changes, I think the market here would change very quickly too.

RBA PROGRAMME EXPANSION

Roache To what extent is RBA policy having a permanent effect on the way the market works and how investors are thinking – and how much bigger is its intervention likely to get as we move into 2021?

■ NEWNAHA The RBA's role in the bond market will increase in 2021. Even after the TFF [term funding facility] increase the RBA still falls well behind its global peers in the scale of its balance sheet usage. The RBA's assets on balance sheet is only 15 per cent of GDP − the lowest of its global peers. The RBNZ [Reserve Bank of New Zealand] is at 20 per cent, the BoE and Fed are at 35 per cent, the ECB [European Central Bank] is at 55 per cent and the Bank of Japan is in triple-digit territory.

We are trying to figure out how big the RBA's programme could be under QE. As a back-of-envelope calculation, by June 2021 after all the TFF drawdowns have taken place the RBA will have a balance sheet of around A\$420-450 billion. To get anywhere near the Fed or BoE, at 35 per cent of GDP, suggests a QE programme of A\$250-300 billion. This would be a significant amount of liquidity hitting the market.

We think most of the QE volume is going to be implemented in the 5-10 year part of the curve. Within this we don't think there will be much buying at five years, only because we have a five-year bond futures contract coming into the market that we think the RBA will want to avoid hijacking. We should see bond purchases in the back end of that range – we think this is highly likely.

TFF-driven bond buying means there is less product out there for deposit-taking institutions to pick up and, at the same time, the supply of credit is going to drop – also because of the TFF. A large proportion of the action will be

in Australian Commonwealth government bonds and semigovernment bonds.

There is scope for supranational issuance to pick up and potentially for corporate issuance to hit the market as well – if banks decide not to lend the TFF money out to the market.

EVANS The RBA balance sheet is currently at A\$300 billion, up from A\$180 billion prior to COVID-19. If it went to the Fed's level, it would be at A\$650-700 billion – and the Fed has doubled its balance sheet since COVID-19.

I just don't think the RBA would feel comfortable with this sort of aggressive expansion, coming from the starting point it has relative to where the Fed and BoE have been for a long time.

I would be really surprised if the RBA felt it was a target to expand its balance sheet to be the same size relative to GDP as the Fed and BoE. I think the RBA may be more interested in the size the RBNZ and BoC have got to, which is 20 per cent.

My view is that we are going to get A\$150 billion from the TFF between now and June and there may be some scale back of reverse repos – so I think A\$100-150 billion would be the maximum the RBA would be comfortable with.

■ **ONG** A 'proper' QE programme could be anywhere from A\$100 billion to A\$180 billion. I suspect it is probably going to be toward the lower end of that range, around A\$100-125 billion. I note, though, that central bank programmes globally tend to start heading in one direction and that is to be upsized.

Another discussion point is whether QE will include semi-government paper in an expanded intervention programme. We think there is merit in doing so but the sector can be a key beneficiary even if the RBA doesn't include semi-governments this time around. It could also be included in the programme further down the track as it wouldn't be surprising to see the QE programme upscaled at some point if needed. This seems to be the pattern around the globe.

■ NEWNAHA I should say that I agree about the RBA's willingness to grow its balance sheet. I was just pointing to how large a QE programme could be. We think the RBA will want to maintain maximum flexibility but the size of QE programmes typically only goes higher. We have seen this from the ECB, too — it keeps saying it has more tools available.

I think over time A\$200-300 billion is a signpost more than anything else. But yes, a programme of around A\$100 billion in the first year seems entirely likely. •

"There were some big numbers in [the budget] but actual new policy only averages 1.2 per cent of GDP over the four-year forecast period. Quite frankly, I was underwhelmed by the value of the new policies. I think the government will do more with, for instance, JobSeeker."

BILL EVANS WESTPAC BANKING CORPORATION





Responsible lending: unleashing banks, leashing nonbanks?

The Australian federal government has proposed changes to responsible-lending rules, with the goal of encouraging credit supply and thus maximising the economic impact of ultra-low rates. Nonbank lenders are watching developments closely and with some concern that they may further tilt the playing field in favour of authorised deposit-taking institutions (ADIs).

BY MATT ZAUNMAYR

proposed changes on 25 September. They would relieve some of the burden of verification of loan applications from ADIs by replacing a "lender beware" principle with "borrower responsibility".

Specifically, the government wants to remove responsible-lending obligations from the *National Consumer Credit Protection Act 2009* (Credit Act) while ensuring ADIs continue to comply with the Australian Prudential Regulation Authority (APRA)'s ADI lending standards. At the same time, the government wants to incorporate elements of the same APRA lending standards to nonbank regulation.

ederal treasurer, Josh Frydenberg, revealed the

Broadly, the government aims to simplify the process by which lenders – primarily ADIs – can assess, verify and make loans. Frydenberg said: "Credit is the lifeblood of the Australian economy, with billions of dollars in new credit extended to households and businesses in Australia each month. Now more than ever, it is critical that unnecessary barriers to accessing credit are removed so that consumers can continue to spend and businesses can invest and create jobs."

The government is targeting 1 March 2021 as the implementation date for its proposed changes, following a consultation period.

The impetus for the changes is weak credit growth, which persists despite record low interest rates and incentivised term funding made available to banks via the Reserve Bank of Australia (RBA)'s term funding facility (TFF). In effect, banks can fund and lend cheaply, but the government still wants further to promote credit-supply growth.

Lending to various sectors of the economy has never recovered to pre-2008 financial-crisis levels (see chart), and the government now appears to have concluded that responsible-lending rules in their current form are a roadblock to freer flow of credit.

The government pins at least some of the blame for lacklustre lending growth on the Credit Act, which was introduced to help ensure financial stability in the wake of the financial crisis. A fact sheet accompanying Frydenberg's announcement states: "The principles which underpin responsible-lending obligations have

been implemented in a way that is no longer fit for purpose and which risks slowing our economic recovery."

The main problem, the government says, is a one-size-fitsall approach to credit assessment that makes lenders responsible for verifying information provided by prospective borrowers. By shifting the responsibility for providing correct information to the borrower, the government hopes to cut application and verification time and thus ease constraints on the flow of credit.

The government insists the changes will not affect the quality of loan credit, given the maintenance of various lending standards including those overseen by APRA and the Australian Securities and Investments Commission (ASIC).

UNLEASHING ANIMAL SPIRITS

he extent to which the proposed changes stimulate credit growth remains to be seen. But at least some market analysts are bullish on their potential, noting that they could unwind historic tightening of lending standards.

On 25 September, ANZ's research team published a research note stating: "This is potentially a big deal for the flow of credit, if we think back to the impact that a tighter application of these obligations had on the flow of housing credit a few years back."

Similarly, on 28 September, Commonwealth Bank of Australia credit strategist, Belinda Cheung, wrote: "The initiative is positive for credit origination by reducing finance approval turnaround for borrowers – and facilitating turnover in property markets. While the initiative may lead to a higher share of bad loans, this will be kept in check by APRA's lending standards."

By contrast, a Westpac Institutional Bank research note on 28 September noted that the highly uncertain economic backdrop would likely keep credit assessment cautious and demand weak in many segments.

The Westpac analysts' suggestion is that credit growth will still depend largely on whether consumers are confident to borrow. Debt is already cheap, so while the application and verification process can be as streamlined as much as possible, stirring animal spirits during the greatest global recession since the great depression may not be so straightforward.

COMPETITION SHIFT

ending market participants are paying close attention to the potential impact of responsible-lending changes on the competitive environment. Nonbank lenders are reluctant to speak publicly on an early-stage development, but there are at least some indications that their marketplace advantage may be eroded to at least some extent by a lighter-touch regulatory approach in the bank sector.

Banks are currently subject to the Credit Act, administered by ASIC, and to APRA's capital-adequacy regime. Under the new laws, they would only need to comply with the APRA regulations.

However, a note authored by King and Wood Mallesons partners, Katherine Forrest and Moira Saville, argues that it is not the case that lending standards will inevitably deteriorate if responsible-lending rules are revised. APRA's standards are not in line for change, while most Australian ADIs subscribe to the Banking Code of Practice (BCP) as well as being members of the Australian Financial Conduct Authority (AFCA)'s dispute-resolution scheme.

Forrest and Saville note that APRA has not historically played a role in consumer protection but the BCP requires banks to be diligent and prudent. Meanwhile, AFCA is able to rule on consumer complaints on the grounds of fairness even when the lender is in compliance with all legal requirements.

In other words, the impact of easier responsible-lending requirements for ADIs may not be a flood of bank credit into the nonbanks' traditional focus area of nonconforming lending. What could happen, though, is one of the main value propositions of the nonbank sector — its quick servicing and verification offering — being chipped away by banks.

Nonbank lenders have made strong progress in prime and near-prime mortgages since the mid-2010s. Not coincidentally, this is when regulatory focus sharpened on banks' residential-mortgage lending, particularly to investors. Nonbank lenders' ability to turn loan applications around quickly – initially for less conventional applicants but increasingly in the prime space too – has been key to their success over the past decade.

The COVID-19 crisis has already delivered a hit to nonbanks' price competitiveness. Kim Cannon, Brisbane-based chief executive at Firstmac, warned on 1 October that the TFF was severely distorting competition in the sector by giving banks funding at such cheap rates that they are able to price loans significantly more competitively than nonbanks.

Nonbanks have no access to the TFF. While funding margins in capital markets have improved over the course of 2020 they are still no match for the 0.25 per cent fixed rate the TFF offers ADIs for three-year debt.

If the latest proposed reforms are successful in reducing the loan-verification burden on banks, they could further hamstring the nonbank offering particularly in prime mortgage lending.

Furthermore, the government's point about applying APRA lending standards to nonbanks has caused some confusion given its vagueness. Allens Linklaters lawyers, Amy Atashi, Kerensa



SOURCE: RESERVE BANK OF AUSTRALIA 9 OCTOBER 2020

Sneyd and Nicola Greenberg, wrote in a note on 29 September that this part of the proposal raises more questions than answers.

Atashi, Sneyd and Greenberg question the government's signalling of all non-ADIs, rather than specifically non-ADI housing credit providers, in its proposals. This, they say, could be a case of loose drafting, but could also imply that the government is looking to apply new lending standards to all nonbank lenders — including small-business and buy-now, pay-later providers.

Nonbanks will continue to be regulated by ASIC, but with some elements of APRA's lending standards to be imposed. This is despite APRA electing not to deploy powers it was granted in March 2018 to introduce nonbank lending regulations. Market participants have tended to assume APRA concluded that, with no consumer deposits at risk and given the relatively small market share of nonbank lending, the sector is not a significant risk to financial-system stability.

Nonbanks have always maintained that they are a responsible, crucial and well-regulated part of the Australian lending market. It is possible that having the same lending standards applied across the full spectrum of Australian lenders could prove beneficial for nonbanks over the long term, especially given the high regard in which Australia's banks are held by investors globally.

Tally Dewan, senior securitisation strategist at Commonwealth Bank of Australia (CBA) in Sydney, wrote on 9 October that being under the same umbrella as the banks could be "optically positive for non-ADIs".

However, she adds that clarity on what the changes mean for nonbanks will first need to be found. "What is unclear is to what extent APG 223 will apply to the non-ADIs, such as buffers, floors, models et cetera. In particular, APG 223 mentions ADIs setting risk limits for the residential-mortgage portfolio based on various parameters. How could this be applied for specialist non-ADIs that inherently originate loans geared toward certain types of borrowers?"

Dewan says the lack of clarity may create short-term uncertainty for nonbanks. They would be further disadvantaged if the new guidelines require modification to existing systems and processes, she adds – but again probably only in the short term. •



Australian dollar securitisation issuance bounces back

Australia's securitisation market has maintained deal volume at a level in line with outcomes from recent years despite massive upheaval to the supply and demand picture in 2020. In particular, bank issuers have been all-but absent this year. A particularly active September and October for new issuance kept annual volume robust.

BY CHRIS RICH AND MATT ZAUNMAYR

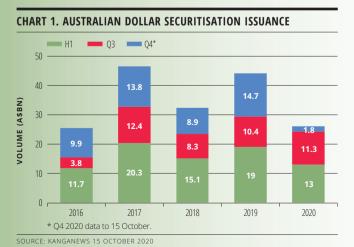
large drop in H1 deal flow saw new-issuance volume at its lowest point since 2016.

Q3 deal flow, however, has bounced back significantly with A\$11.3 billion (US\$8.1 billion) printed – the most for this period since 2017 (see chart 1).

Most issuance came in September as a total of A\$5.8 billion printed across nine transactions (see table). Volume was bolstered, for the first time in the COVID-19 era, by supply from authorised-deposit taking institutions (ADIs) that accounted for nearly half the month's total issuance.

Deal flow continued at the start of Q4 in advance of potential headwinds – notably the US election on 3 November. Three more deals priced in early October while mandates were also outstanding for Allied Credit, Brighte, flexigroup and Pepper as at 16 October

The Reserve Bank of Australia (RBA)'s term-funding facility (TFF) has replaced bank issuance over 2020, and more than 70 per cent of total Australian dollar securitisation has come from nonbank names. Nonbank issuance for Q3 almost topped H1 volume, with A\$8.4 billion printed versus A\$8.9 billion. Year-to-date 2020 nonbank issuance is only A\$6.2 billion shy of the record A\$23.5 billion printed last year.



In a sign of returning confidence, the Australian Office of Financial Management (AOFM) – through the structured finance support fund (SFSF) – has not participated in a primary securitisation transaction since mid-June or been active in the secondary market since 1 July.

Established at the height of the COVID-19 pandemic to ensure access to funding markets for lenders outside the RBA's TFF, the SFSF's attention has turned to warehouse investments and a forbearance special purpose vehicle (FSPV).

Its intervention has been low, even so. Between 1 July and mid-October, the AOFM invested A\$467.3 million in warehouses and dedicated A\$56.5 million to the FSPV.

DEMAND CONDITIONS

arket sources say investor interest in securitisation product is being supported by a lack of competing supply. With the TFF in full effect, Australia's major banks have been absent from senior-unsecured and RMBS markets – and the buy side is starting to look for product alternatives.

"There has been significant demand for securitised product, driven by lack of supply and the relative value of what investors can buy globally," Sarah Samson, head of securitisation originations at National Australia Bank in Melbourne, reveals. "Investors still need to allocate as redemptions and cash flow through their accounts."

This redemption story is especially significant as a demand driver. Craig Johnston, Deutsche Bank's Sydney-based head of syndicate, explains: "There was in excess of A\$7 billion of redemptions from the major banks between July and September. The lack of senior-unsecured issuance from them and other ADIs, and the fact that spreads are tight, has led investors increasingly to turn toward RMBS on a relative-value basis."

The pricing equation is still finely balanced but the signs are that relative value is working for investors. John Stormon, head of securitisation, Australia and New Zealand at MUFG in Sydney, tells *KangaNews*: "There has always been confidence in the securitisation market but the challenge has been pricing. With the levelling of the COVID-19 curve, we have seen corporate spreads

AUSTRALIAN DOLLAR PUBLIC SECURITISATION ISSUANCE, 1 SEPTEMBER – 15 OCTOBER 2020						
PRICING DATE	DEAL NAME	SPONSOR	TYPE	VOLUME (A\$M)	LEAD(S)	
3 Sep 20	Liberty Series 2020-1 SME	Liberty Financial	CMBS	600	CS, WIB	
3 Sep 20	Bluestone Sapphire XXIV Series 2020-2	Bluestone Group	Nonconforming RMBS	350	CBA, MB, NAB	
4 Sep 20	RedZed Series 2020-2	RedZed Lending Solutions	Nonconforming RMBS	400	CBA, NAB	
9 Sep 20	Medallion Series 2015-2 Class A1-R	Commonwealth Bank of Australia	Prime RMBS	555.8	СВА	
11 Sep 20	Lion Series 2020-1	HSBC Bank Australia	Prime RMBS	1,000	ANZ, HSBC, NAB	
17 Sep 20	Mortgage House RMBS Series 2020-1	Mortgage House	Nonconforming RMBS	400	NAB, WIB	
23 Sep 20	La Trobe Financial Capital Markets 2020-S1	La Trobe Financial	Nonconforming RMBS	500	MB, NAB, WIB	
23 Sep 20	Resimac Premier Series 2020-1	Resimac	Prime RMBS	1,000	DB, JPM, MUFG, NAB	
24 Sep 20	Progress 2020-1	AMP Bank	Prime RMBS	1,000	CBA, DB, MB, MUFG, NAB, SC	
7 Oct 20	Vermilion 2020-1	Columbus Capital	Nonresident RMBS	418.9	CS, Natixis, SC	
9 Oct 20	Think Tank Series 2020-1	Thinktank	CMBS	600	CBA, Deutsche, Westpac	
9 Oct 20	AFG 2020-1NC	Australian Finance Group	Nonconforming RMBS	500	CBA, NAB	
15 Oct 20	Zip Master Trust Series 2020-1	Zip Co	Buy-now, pay-later ABS	300	NAB	

SOURCE: KANGANEWS 6 OCTOBER 2020

contract and price compression flow through to the structured-finance environment."

Samson notes that order books stayed strong in recent RMBS deals even through the price-tightening process – something she says NAB had not seen prior to COVID-19 when bids would typically drop off beyond a certain price.

In particular, offshore real-money interest in Australian RMBS transactions has continued to support deal flow – demonstrated once again in four of the transactions printed in September (see charts 2 and 3).

Stormon adds: "There is healthy demand from domestic and international investors, with a continued recognition that Australian RMBS offers a high degree of quality priced in line with an appropriate level of risk-adjusted return."

BANKS RETURN

hile there remains no sign of a return to benchmark issuance by Australia's major banks – although Commonwealth Bank of Australia completed a refinancing trade in September – the securitisation market has become sufficiently appealing to attract some ADI issuance. As

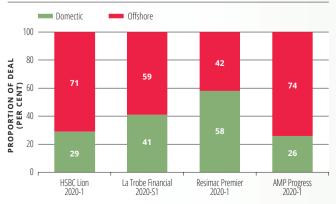
well as AMP Bank's A\$1 billion RMBS, September saw HSBC Bank Australia's first RMBS transaction since 2007.

HSBC Australia seized on the absence of local bank supply to tighten pricing and increase volume – to A\$1 billion from A\$750 million at launch. The bank plans to be a prominent issuer of capital-relief RMBS in future. Guy Dickinson, HSBC Australia's Sydney-based treasurer, says capital relief, rather than funding, was the issuer's priority. In this context it benefited from the supply dynamic as margins have tightened across the capital stack.

Dickinson tells *KangaNews* capital-relief RMBS will be a regular part of HSBC Australia's market activity going forward. "We had strong mortgage growth in the 2020 financial year – well above system. We want this growth to continue and to fund it we will be looking to bring a capital-relief RMBS deal every 12 months or so," he explains.

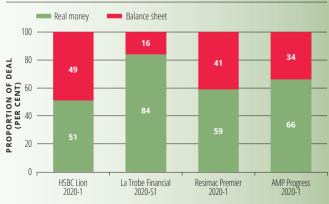
He adds that the size of future transactions will depend on the ongoing growth of HSBC Australia's mortgage book, but that messaging on intended frequency of transactions was a key part of investor engagement for the deal. The bank's approach to COVID-19 relief was the other main aspect of investor questions during marketing.

CHART 2. GEOGRAPHIC DISTRIBUTION OF SELECTED RMBS DEALS

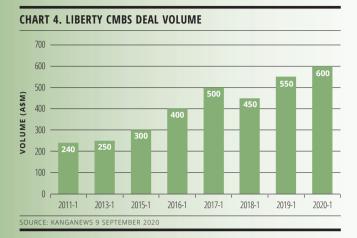


SOURCE: HSBC, LA TROBE FINANCIAL, NATIONAL AUSTRALIA BANK SEPTEMBER-OCTOBER 2020

CHART 3. SELECTED RMBS DEAL BY INVESTOR TYPE



SOURCE: HSBC, LA TROBE FINANCIAL, NATIONAL AUSTRALIA BANK SEPTEMBER-OCTOBER 2020



On 10 September, the Australian Prudential Regulation Authority released statistics on the Australian banking industry's ongoing level of COVID-19-related loan deferrals. HSBC Australia's share of total loans subject to deferral was less than 5 per cent, lower than any other major or large regional bank.

"We have been engaging with customers every three months to ensure the loan arrangements we have in place remain appropriate. As a result, many that were deferred have returned to full payment. Investors appreciated this colour on our loan book," Dickinson says.

No deferred loans were included when the Lion 2020-1 loan pool was cut at the end of July, he adds.

ABS FLICKERS

here are also signs that nonmortgage asset-backed securities (ABS) can find demand in Australia. Liberty Financial and Thinktank issued commercial mortgage-backed securities (CMBS) transactions in the September-October deal flow. Zip Co returned to market for its second buy-now, pay-later ABS deal and Brighte is lining up a debut public deal backed by household solar loans.

Samson comments: "The pipeline of mandates for nonmortgage ABS is a combination of issuers being ready to come to market and improved conditions. Investors watched how these books performed in COVID-19 hardship and, in a lot of cases, the level of consumer loans in hardship for these issuers is less than for mortgage lenders."

Liberty's ABS was its largest-ever SME deal (see chart 4). Peter Riedel, the nonbank lender's Melbourne-based chief financial officer, says the outcome exceeded expectations amid the market backdrop created by COVID-19. The SME sector has not escaped the COVID-19 crisis and Riedel acknowledges that investors are understandably cautious on the asset class.

However, over time the collateral mix of Liberty's SME transactions has evolved toward a heavier weighting of self-managed superannuation fund (SMSF) investor loans, diminishing some concerns around collateral.

"In this transaction, 88 per cent of the loans in the collateral pool are to SMSF borrowers," Riedel tells *KangaNews*. "The

credit support that comes with lending to SMSF investors is significant. Given this clarity, most – if not all – investors were comfortable to participate."

The security backing the loans included in the latest CMBS pool is split roughly evenly between residential and commercial collateral, Riedel adds.

According to Liberty, 80 per cent of the deal was allocated to domestic investors. Riedel says the SMSF asset class is more familiar to domestic investors, leading to a typically higher reliance on this buyer base in Liberty's SME deals. He adds that some offshore mandates also prohibit investment pools with exposure to commercial property.

The participation of domestic investors in Liberty's SME CMBS also suggests an improving outlook, as Riedel also says many participated with greater volume than in Liberty's A\$800 million RMBS deal priced in June.

He explains: "The impact of COVID-19 is now better understood than it was in the early months of the crisis. Borrowers and customers that need support – whether it is from banks, nonbanks or superannuation funds – are largely known. The need for investors to hold higher volumes of liquid funds therefore seems to have lessened and, in turn, investor demand for ABS has risen."

Riedel is confident of the performance of Liberty's loan portfolio through the COVID-19 crisis, regardless of asset class. He tells *KangaNews* non-SMSF SME loans have been the most affected portion of its lending book, but overall the proportion of customers on full payment holidays has been negligible from the beginning of the crisis.

Liberty had about 8,000 customers on payment arrangements at the end of April, but only 0.4 per cent of these were on payment holidays. By the end of August, only about 2,000 customers were on reduced-payment arrangements. Liberty's approach means liquidity flows coming into existing trusts have remained consistent. Riedel says this has been noted by investors.

"In executing payment arrangements with customers, rather than taking a one-size-fits-all approach we tailor a solution for the customer based on their unique circumstances," he explains. "Borrowers, lenders and investors all benefit if customers are able to continue to make loan repayments appropriate to their circumstances even at a reduced level."

Liberty's confidence in the performance of its loan portfolio is matched by belief in its ability to access funding markets. Three of its four securitisation transactions in 2020 have come since the beginning of the COVID-19 crisis and it also printed a senior-unsecured deal in February.

Its funding plans for 2020 are not over yet. Liberty's 2016-2 and 2016-3 RMBS deals have call dates in the final quarter of 2020, and Riedel says based on recent investor engagement it is confident it will be able to issue a new deal with these assets.

"We will keep looking at the market and monitor how it evolves in response to the crisis. But we are encouraged by the stability and improving conditions we have seen in recent months," he tells *KangaNews*. •

New opportunities for New Zealand securitisation

A more optimistic tone has emerged in New Zealand's securitisation market on the back of two primary-market transactions and the emergence of a potential large-scale new issuer. The tone is markedly different from the first half of the year, when market participants did not expect to see deal flow in 2020.

BY CHRIS RICH AND MATT ZAUNMAYR

esimac reopened the New Zealand residential mortgage-backed securities (RMBS) market with a transaction that had been pencilled in to its execution window for pricing at around the final date even prior to the COVID-19 crisis. Deal sources say surprisingly positive housing data and a new rates environment supported execution.

The NZ\$300 million (US\$198.3 million) Versailles Trust Series 2020-1 deal priced on 4 September with BNZ and Westpac New Zealand as arrangers and lead managers. It takes Resimac's total New Zealand RMBS issuance to NZ\$950 million.

Avanti Finance followed with its own RMBS deal on 9 October – a NZ\$250 million transaction via Westpac that was the issuer's largest ever. Sound origination standards and technical tailwinds have caused interest in the asset class to jump, Avanti says.

While the Australian RMBS market has recovered from the shock of COVID-19 to support regular issuance (see p48), Resimac's securitisation was the first public deal in the New Zealand structured-finance market for 2020. It printed almost a year after the last local deal – a NZ\$250 million auto asset-backed securities trade from Eclipx.

Resimac had planned a New Zealand deal around this time of year as part of its regular issuance intentions for 2020, Andrew Marsden, general manager, treasury and securitisation at Resimac in Sydney, tells *KangaNews*. The issuer is well funded but wanted to demonstrate availability of multiple capital-markets options.

"While we still had strong support with our banking facilities, we thought it was important to demonstrate some resilience of our RMBS programme and proceed with the deal. It is a fundamental piece for our New Zealand business and our growth aspirations in the sector," Marsden reveals.

HOUSING REBOUND

simon O'Connell, director, corporate and structured finance at Westpac in Auckland, tells *KangaNews* uncertainty about the impact of COVID-19 on the local economy lingered even as the immediate health threat of the pandemic largely dissipated earlier in the year. Most economists continue to forecast a weaker near-term economy and a fall in house prices, but recent economic data have surprised to the upside, especially in the housing market.

The August iteration of Real Estate Institute of New Zealand (REINZ)'s monthly house price index (HPI) – the same month as a COVID-19 outbreak and subsequent lockdown in Auckland – shows house prices increasing by 1.9 per cent. This is the third consecutive monthly rise after decreases in April and May. In fact, house prices actually rose by 2.6 per cent between March and August 2020.

With a low number of mortgages in arrears and house prices rising, O'Connell says investors are increasingly seeing relative value in RMBS.

Avanti's Auckland-based group treasurer, Paul Jamieson, reveals that arrears in the issuer's lending book have actually improved from pre-crisis levels due to customers saving during and subsequent to New Zealand's lockdowns, and rapidly repaying debt obligations.

Jamieson tells *KangaNews* the Avanti book's strong performance, as well as generally improving market confidence

"While we still had strong support with our banking facilities, we thought it was important to demonstrate some resilience of our RMBS programme and proceed with the deal. It is a fundamental piece for our New Zealand business and our growth aspirations in the sector."

ANDREW MARSDEN RESIMAC

UDC sale a potential boon for New Zealand securitisation market

UDC Finance's sale to Shinsei Bank by ANZ has established what *KangaNews* understands is New Zealand's largest warehouse facility. The issuer expects eventually to bring public term securitisation deals to New Zealand and could also access funding from further afield.

The warehouses – a NZ\$1.2 billion (US\$773.5 million) facility for UDC's auto loans and a NZ\$1.1 billion facility for its equipment loans – were a staple of the funding package supporting UDC's sale.

ANZ and Deutsche Bank were arrangers, while the warehouses have six funders: the Australasian major banks plus the Sydney branches of Royal Bank of Canada and Societe Generale. Russell McVeagh acted for UDC in the structuring of the warehouses as well as for the M&A transaction.

The warehouse facilities account for around two-thirds of UDC's funding, with the balance provided predominantly by Shinsei Bank. Mark de Ree, Aucklandbased treasurer at UDC, says the facilities provide a strong, stable, cost-effective and long-term funding base with which it can continue to provide lending to the New Zealand economy.

The sale of UDC – New Zealand's largest nonbank financial institution – has been more than three years in the

making. The maturing of New Zealand's public securitisation market, which has facilitated sporadic but generally increasing supply since the 2008 financial crisis, has been a goal of the local capital-market community for even longer.

The prospects of significant growth in bank securitisation seem further away than ever, so the emergence of a substantial, ready-made nonbank issuer could be a major boon to the local market.

The development of New Zealand dollar securitisation has in recent years been pegged to the Reserve Bank of New Zealand's residential mortgage obligations project, which could see New Zealand's banks emerging as residential mortgage-backed securities (RMBS) issuers.

The project is on the backburner as the RBNZ focuses on urgent priorities to manage the COVID-19 crisis. Like their Australian parents, New Zealand's major banks have also seen their wholesale funding need all but evaporate in the crisis.

Consistent New Zealand dollar securitisation issuance has come from the likes of Avanti Finance, flexigroup, MTF Finance and Resimac. But the addition of New Zealand's largest nonbank to the mix could further elevate the status of the market.

UDC's warehouses are twoyear revolving facilities. They can be extended but de Ree confirms the intention is to access term markets to recycle warehouse capacity and that such transactions could be backed by either or both of the auto and equipment portfolios.

Path to market

UDC has been operating in New Zealand for more than 80 years so it would not need to go through the same multiple-year process required by most new borrowers between establishing a warehouse and bringing a public securitisation deal.

In fact, de Ree tells KangaNews UDC would like to come to market within the next 12 months if conditions are favourable. "Issuance timing will depend on the ongoing performance of the economy and markets through the COVID-19 period, and we will also be giving appropriate time to ensure any processes and reporting involved with the new facilities is bedded down before considering a term transaction," he comments.

De Ree says, so far, COVID-19 has had relatively minimal impact on UDC's lending book and it has been buoyed by the number of customers returning to principal-and-interest payments from hardship arrangements.

He adds that the warehouse facilities have parameters for loans in any form of COVID-19 relief, but none of these loans are securitised in UDC's warehouse facilities at present.

UDC's scale is such that
New Zealand's securitisation
market in its current form is
unlikely to be able to satisfy
all its future funding needs.
As a result, de Ree says the
issuer could look to issuance
options such as Australia or
potentially even Japan – where
its new parent could herald
support – in addition to its New
Zealand dollar funding plans.

"Issuance timing will depend on the ongoing performance of the economy and markets through the COVID-19 period, and we will also be giving appropriate time to ensure any processes and reporting involved with the new facilities is bedded down before considering a term transaction."

MARK DE REE UDC FINANCE

and tailwinds behind RMBS issuance in particular, led to robust investor support.

"Some investors we have been engaged with in the past are now more inclined to participate in transactions. Investors are hunting for yield and more are turning their attention to securitisation, including KiwiSaver funds – which are growing rapidly," Jamieson says.

DEAL DYNAMICS

eintroducing deal flow was a manageable process for deal leads. With a relatively small amount of securitisation issuance in the New Zealand market each year, Mike Faville, Auckland-based head of debt capital markets at BNZ, says it is normal for price discovery to begin by looking at the more liquid Australian market as a starting point.

This meant the lack of previous issuance in 2020 was not a major impediment to Resimac's return. The deal team was also able to use the same issuer's 2019 RMBS in the price discovery process, Faville adds.

All four major banks in New Zealand now have negative rates factored in their outlooks for 2021 – an outcome which, Faville believes, could spur demand for securitised product.

"The investor base for this asset class has been relatively narrow in the past but investors are certainly looking wider for where they can achieve returns," he explains. "In bringing the trade to market Resimac offered a zero-coupon floor, which gave investors comfort with the backdrop of a lower cash rate."

Although the subset of New Zealand investors that participate in the RMBS space is small, leads say interest and participation in recent deals was pleasingly high. Resimac's final book comprised 14 investors.

Meanwhile, Jamieson says Avanti met around 20 investors prior to launching its deal, including some KiwiSaver accounts that have not previously invested in Avanti securitisation. He adds that the top and bottom tranches in the capital stack were the most difficult to fill – as Avanti expected going into the deal process. However, the hurdles were not too onerous and the issuer was able to execute the transaction with 2-4 times subscription across all tranches.

Resimac upsized its deal to NZ\$300 million from NZ\$250 million at launch. Domestic investors took most of the deal, though only by a small amount: 44 per cent was sold offshore, including 19 per cent to Australia. Real money dominated the book.

Marsden says the increase in offshore participation represents an acknowledgment that New Zealand's management of the health crisis has been successful. In this context, he adds that the underlying growth opportunities for Resimac in New Zealand have not materially changed despite COVID-19. The lender has an entrenched focus on the nonconforming market but also continues to explore ways in which it can offer a competitive prime product.

"Being competitive with the major banks in New Zealand is the real growth opportunity for our business. Over time, this will allow us to establish a separate prime shelf for funding as the Versailles pool is a mix of prime and nonconforming," Marsden adds.

The nonbank funding market in New Zealand has also gained a new player. The long-awaited sale by ANZ of its subsidiary,

UDC Finance, is likely to result in public term securitisation in the next year or two at most (see box on facing page).

MARKET CONTEXT

further tailwind behind the securitisation asset class is lack of supply of New Zealand dollar financial institution (FI) debt. Since March, there has been just one local FI deal, from China Construction Bank New Zealand Branch, as deposit flows and government support have limited FI senior funding needs.

Market participants have been targeting growth in the securitisation space for several years but say the tailwinds behind it have likely never been as strong as they are now. "RMBS is a known asset class backed by a known, tangible security. Any investor education needed is typically just on the originator's servicing and processes," comments Jamieson.

Avanti says it is well positioned to take advantage of increasing interest in New Zealand RMBS, as it has moved to annual issuance and has further growth plans for its residential-mortgage and auto lending.

Jamieson says the issuer's plan is to continue growing the volume of its annual RMBS transactions before potentially increasing issuance frequency. Meanwhile, an auto asset-backed securities deal remains on the cards but is more likely to come in 2022 once Avanti has solidified its origination pipeline and asset base.

At the same time, New Zealand's nonbank financial-institution sector has not benefited from the same degree of government support and exemptions from regulatory requirements afforded to local bank lenders or to their Australian nonbank peers.

For instance, while banks were exempted from some specific requirements of New Zealand's *Credit Contracts and Consumer Finance Act* in relation to COVID-19 relief provided to borrowers from 1 April, nonbanks have not been able to apply a blanket rule for hardship applications.

O'Connell says, though, that this has led to nonbanks being nimbler and more prudent when assessing applications and, as a result, better performance in their books.

He explains: "There was a peak in COVID-19 hardship in March and April but this has dropped dramatically across all our nonbank borrowers." In order to streamline engagement with investors, O'Connell says Resimac's transaction did not include any COVID-19 hardship cases. •

"Some investors we have been engaged with in the past are now more inclined to participate. With investors hunting for yield more are turning their attention to securitisation, including KiwiSaver funds – which are growing rapidly."

securitisation, including idly."

PAUL JAMIESON AVANTI FINANCE

Reconstructive surgery

New Zealand investors face ultra-low rates and a radically reshaped creditsupply picture. As New Zealand struggles in the wake of COVID-19 – despite having been, at least for now, effectively able to eliminate the virus locally – the domestic buy side is considering its new strategy.

BY MATT ZAUNMAYR

he New Zealand debt capital market sprang to life in Q3 2020, after Q1 was derailed by the beginning of the COVID-19 crisis and Q2 issuance was dominated by a few government-sector borrowers and opportunistic supranational, sovereign and agency issuance.

New Zealand Debt Management (NZDM) still accounted for more than half of overall syndicated supply in Q3. But the credit market re-emerged with a steady flow of corporate deals from across the rating spectrum (see p58) – for the first time since the end of 2019 (see chart 1).

Within the high-grade sector, issuance pushed tenor boundaries in Q3. Kāinga Ora – Homes and Communities, New Zealand Local Government Funding Agency (LGFA) and Auckland Council all extended their New Zealand dollar bond curves, the latter to 30 years in green-bond format (see p20). The long-dated green bond in particular is a major breakthrough for the New Zealand market, adding seven years to the longest tenor ever issued in a local benchmark and 10 years to any deal placed by a borrower other than the sovereign.

The emergence of long-tenor debt availability for governmentsector issuers and the low yield on offer to corporate borrowers are a positive development for borrowers. These evolutions also bring the New Zealand dollar environment more in line with larger global markets.

For investors, both developments demonstrate the scarce options on offer locally to achieve acceptable returns in the new operating environment. There are plenty of challenges for New Zealand fund managers, particularly as the market has condensed years of development into a mere six months. But the circumstances also offer some potential to cement the market as one with a wider set of investment options.

ECONOMIC REPAIR

irtually all rates analysts now expect New Zealand monetary policy to go negative in 2021 – an option reiterated by the Reserve Bank of New Zealand (RBNZ) following its August Monetary Policy Committee (MPC) meeting. The reserve bank also expanded and extended its large-scale asset purchase programme (LSAP), indicating that the NZ\$100 billion (US\$66.1 billion) of purchases available could mean it ends up owning 60 per cent of the NZGB market.

A month later, following another MPC meeting, the RBNZ reinforced its willingness to use further monetary-policy measures, highlighting its view that weak underlying domestic and international economic conditions are likely to cause a rise in unemployment and business failures.

The expectation of further monetary and fiscal stimulus is a product of the depth of the hole the New Zealand economy has to climb out of. GDP posted a 10.1 per cent real year-on-year drop in the June quarter of 2020, and the second lockdown in Auckland in August and September will inevitably slow the rebound.

On the other hand, New Zealand's apparent success in combating COVID-19 gives some hope for a more positive than expected outlook. For instance, the unemployment rate actually decreased to 4 per cent in the June quarter, from 4.2 per cent in March. This was in part due to more people exiting the labour force but still represents an upside surprise.

New Zealand's economy had reopened domestically by early October though its international borders remain strictly closed. There should be enough juice locally for a rebound of some degree.

David McLeish, Auckland-based senior portfolio manager and head of fixed income at Fisher Funds, says the economy



NZGBs remain a reliable benchmark for sovereign portfolios, but it is up for debate when you are talking about a credit portfolio. Given how sticky some sovereign wealth funds are, the remaining free float of NZGBs is likely to be even less than what is implied by the RBNZ's holding."

IAIN COX ANZ INVESTMENTS

has moved into the repair phase after a sharp and significant downturn in March and April – but adds that growth does not have the typical characteristics of a more positive environment. "In a repair phase, we expect growth and inflation to be below long-term average and, as the name suggests, households and businesses to be repairing their balance sheets through cutting costs and paying down debt."

Interest rates are normally already at their lowest ebb once an economy is in the repair phase of a cycle, rather than predicted to go significantly lower – as is the case in New Zealand in late 2020.

Diana Gordon, head of fixed income at Kiwi Invest in Wellington, says at face value the New Zealand economy may not appear to warrant negative cash rates. However, the RBNZ and other analysts have an extremely bearish outlook for the next 12 months largely because of the global picture.

COVID-19 is not under control internationally and the largest economies are likely to be tested, Gordon explains. As a small, open economy, it will be difficult for New Zealand to escape the reality of a global recession. As a result, the RBNZ may well be willing to push the cash rate even lower than it already has in the hope that still-lower borrowing costs will give a tailwind to investment and growth.

RATES RALLY

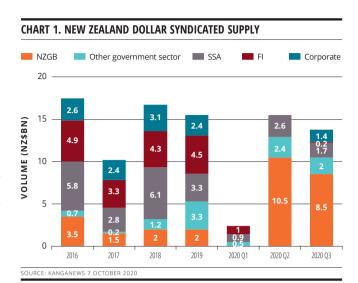
his context creates a challenging environment for New Zealand investors, starting with the government sector. The NZGB curve rallied significantly in Q3 as investors digested the RBNZ's message and revised future cash-rate expectations accordingly. By late September, NZGB yields were negative in much of the mid-curve (see chart 2).

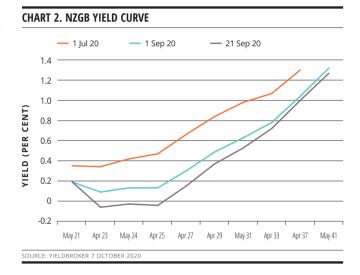
Some fund managers have been happy to ride the NZGB curve down through the COVID-19 crisis. Gordon says most of Kiwi Invest's allocations in the last 4-5 months have been in the New Zealand dollar high-grade sector, based on the RBNZ's strong language and bond buying.

She acknowledges, though, that this strategy is likely only to work in the short term. With rates expected to reach a floor in 2021, investors need to consider other options to enhance returns for their clients (see box on p56). "As a fiduciary, we have to take risks. But at the same time, if there is no value in the market – because it is being run by central banks – we also need to keep an eye on the exit even as we play along."

Going further out on the curve is one way of doing this while maintaining the credit quality of a portfolio. Fergus McDonald, Auckland-based head of bonds and currency at Nikko Asset Management New Zealand, says Nikko's portfolios have preferred the long-dated bonds of local nonsovereign government-sector borrowers.

For portfolios with a requirement to hold sovereign bonds, McDonald says Nikko has been buying inflation-linked bonds in expectation that stimulus measures will usher in an inflation pick-up over the medium term. This theme has clearly been identified elsewhere as there was solid buying of New Zealand government inflation-indexed bonds (NZIIBs) in Q3.





Elsewhere, ANZ Investments has broadened its definition of eligible government bonds to allow for more purchases of bonds from the likes of Kāinga Ora, according to Mia Prkusic, Auckland-based portfolio manager. "This gives us government-like exposure with extra spread and it is not a material increase in risk compared with the sovereign," she says.

Long-dated demand is a boon for most government-sector issuers, which will likely have higher funding tasks in the wake of the COVID-19 crisis. It is no surprise, therefore, that issuers have been quick to take advantage of the availability of long-dated liquidity. Syndicated supply of New Zealand government-sector bonds has been larger and broader in 2020 than ever before.

KangaNews understands long-dated primary deals from Kāinga Ora, LGFA and Auckland Council have performed well since pricing, indicating further latent demand for long-dated, high-grade New Zealand dollar bonds.

But not all fund managers are confident that holding long positions, even in high-grade names, is the best strategy for the current environment. Gordon says either of a COVID-19 vaccine in 2021 or a large US stimulus package following its presidential

ALTERNATIVE APPETITE GROWS

New Zealand debt has long been a high-quality, high-yield and highly intermediated market, which has deterred and limited asset managers from exploring opportunities in alternative assets such as private debt. The increasing likelihood of a negative cash rate and regulatory change could change this.

Yield has plunged in 2020 across the full spectrum of the New Zealand dollar debt capital market. This only accelerates what was already a trend. The impetus for asset managers to look outside the realm of vanilla debt securities in order to achieve clients' expected returns was already there but has now become greater.

Diana Gordon, head of fixed income at Kiwi Invest, explains: "There is now a fundamental mismatch between the needs of long-term investors and the vanilla instruments we have relied upon for return. We need to take risk as our clients need to retire – so it is likely that the whole industry will need to think more about alternative assets."

Kiwi Invest recently made its first foray into venture capital, as a cornerstone investor in New Zealand firm Movac's new technology fund, Movac Fund 5. Gordon says Movac aligns with Kiwi Invest's prerequisite of being a high-quality manager that is expected to generate solid returns from its funds.

Regulatory winds

The rising interest in private debt in New Zealand comes at a time when disintermediation is firmly on the cards.
Reserve Bank of New Zealand (RBNZ) plans to increase capital requirements for locally incorporated banks caused a stir during 2019, with many in the market predicting the major banks could seek to meet the new requirement by divesting assets in particular sectors.

The RBNZ delayed the timeline for implementation of the new capital standards when the COVID-19 crisis hit. But they will come back onto the agenda for banks in 2021.

At the same time, New Zealand regulators are focused on ensuring investors retain appropriate liquidity, particularly those administering KiwiSaver funds. Private debt is typically highly illiquid, naturally limiting the appetite of many investors.

For instance, lain Cox, head of fixed interest and cash at ANZ Investments, says private debt's inherent illiquidity means his firm is more likely to consider other options for enhancing return.

There is still an opportunity for asset managers willing to accept the liquidity risk. Indeed, Gordon believes providing the returns necessary for New Zealanders to enjoy the retirements they expect may hinge on the ability to open up asset classes such as private debt.

"The industry needs to discuss how this can be done and form a consensus on the criteria that will make this work, including how funds can ensure they are maintaining sufficient levels of liquidity," she tells *KangaNews*.

A consistent private-debt market cannot spring up overnight. David McLeish, senior portfolio manager and head of fixed income at Fisher Funds, says discussions around private debt have been taking place in New Zealand for some years and it is a space Fisher Funds is interested in.

The fund manager is well placed in this regard, McLeish says, but he believes it will take more time for the market to come to fruition. "Private debt requires asset managers to deploy a lot of skill and resources to ensure deals are appropriately structured for the risk."

Investors from outside New Zealand are also circling. For example, *KangaNews* spoke with two Australia-based fund managers specialising in private debt that are eyeing opportunities across the Tasman Sea and are keen to expand their presence in New Zealand (see p84).



"There is now a fundamental mismatch between the needs of long-term investors and the vanilla instruments we have relied upon for return. We need to take risk as our clients need to retire – so it is likely that the whole industry will need to think more about alternative assets."

DIANA GORDON KIWI INVEST

election could cause long positions to become unfavourable. She acknowledges that neither is close to certain at this stage, though.

LSAP PLAY OUT

he LSAP has also contributed to the suppression of rates in New Zealand. Meanwhile, RBNZ bond buying ramped up in Q3 after a formal programme extension and expansion. At the end of September, the RBNZ owned approximately 27 per cent of NZGBs on issue as well as 8 per cent of NZIIBs and around 11 per cent of LGFA bonds.

Investors report that the desired outcome of putting downward pressure on rates even outside the direct subjects of LSAP purchases is coming to fruition, though with the wider market lagging the tighter yield in the curves of issuers that are LSAP eligible.

Iain Cox, head of fixed interest and cash at ANZ Investments in Auckland, tells *KangaNews* the market is exhibiting a preference for government-sector bonds that are ineligible for LSAP based on an expectation that the bond-buying programme will eventually lead to wider performance.

The RBNZ expects that when the LSAP concludes in June 2022 it may own as much as 60 per cent of the NZGB market. While free float should remain substantial and may even grow, given NZDM's expanded issuance programme, the scale of reserve-bank activity has also spurred questions about the effectiveness of the NZGB curve as a benchmark for the market.

Cox says: "NZGBs remain a reliable benchmark for sovereign portfolios, but it is up for debate when you are talking about a credit portfolio. Given how sticky some sovereign-wealth funds are, the remaining free float of NZGBs is likely to be even less than what is implied by the RBNZ's holding."

How the LSAP plays out over the next 18 months will continue to be crucial to the shape of the New Zealand dollar market, investors say. The RBNZ's programme expansion means there will be plentiful support for the government to execute its fiscal plans, which are likely to be updated but not totally overhauled following the resounding re-election of the Labour government on 17 October.

The degree to which the RBNZ continues to intervene is likely to be crucial in determining the flow of demand and pricing discounts to other government-sector and corporate borrowers. In the more remote future, the question of how the reserve bank starts to pare back its intervention looms.

McDonald says one of the key risks he is considering is what the market response to an economic recovery that is either quicker or better than expected may be. However, he adds: "We think it will be a long time before the cash rate returns to 1 per cent or higher. Maintaining exposure to high-quality names is the right strategy for this environment."

CORPORATE FLOW

arket conditions were already favourable enough in Q3 to entice the return of New Zealand corporate borrowers to the domestic primary market after an absence of more than six months. Many were attracted by the yield environment heralded by central-bank intervention.

New Zealand corporate spreads have also benefited from the same technical factors present in Australia, specifically the absence of major-bank issuance removing a significant portion of competing supply. In the past, banks have been a sweet spot for New Zealand institutional investors, being highly rated and relatively liquid while offering spread.

Cox says the ongoing absence of bank supply could free up capacity for other corporate borrowers to access the market at a

lower spread than they could in the past. As a result, he believes the New Zealand market is likely to become more "bar-belled" – with higher issuance volume from liquid, government-sector borrowers and from less liquid, higher yielding corporates.

McLeish says the level of corporate borrowing being undertaken in New Zealand is also not typical of an economy in the repair phase of an economic cycle. He adds that this debt does not appear to be for productive purposes at this stage.

"The reason for borrowing is often stated as 'general corporate purposes', so it is not always clear what the funds are going to be used for. This typically indicates that companies are undertaking the funding because rates are cheap and they either want to get ahead of future refinancing needs or for growth opportunities that may come in the recovery phase," explains McLeish.

He tells *KangaNews* that, given the tough economic environment, he does not believe corporate credit spreads appropriately reflect the risk of default for some issuers.

Gordon agrees, adding that the corporate competitive environment posed complex risks for investors even before the pandemic. "We were already in a period of extreme technological change, where previously safe companies were having their moats crossed by new players. This has only been accelerated, so it is more important than ever to focus on what the corporate landscape looks like in future."

New Zealand corporates may be seeing the economy differently, though. In the *KangaNews*-Moody's Investors Service Corporate Treasury Survey 2020 (see p80), New Zealand borrowers primarily indicate either a belief that New Zealand is either still in the downturn phase of the cycle or has already entered recovery.

Most of the corporate supply has been well supported despite the question marks, including by institutional investors keen to snap up investment-grade credit and retail investors increasingly getting to grips with ultra-low yield even for unrated deals.

McDonald says Nikko's credit investments have tended more toward the investment-grade and government-regulated entities that have come to market. "We do not think it is appropriate to be going down the credit spectrum in an environment such as this," he confirms.

Meanwhile, Cox says ANZ Investments has been confident to invest based on the recommendations of its credit council and the fact that many borrowers have been investment-grade rated and regular issuers. He adds that some of the unrated supply that has come has been secured, which adds protection for investors. •

"The reason for borrowing is often stated as 'general corporate purposes'. This typically indicates that companies are undertaking the funding because rates are cheap and they either want to get ahead of future refinancing needs or for growth opportunities that may come in the recovery phase."



DAVID MCLEISH FISHER FUNDS

Conditions stabilise for New Zealand corporates as investors flood in

A flurry of corporate deals reopened the New Zealand market with a high level of demand, seemingly undeterred by the outbreak of COVID-19 and associated lockdowns. Deal sources say demand has always been present, especially in the retail space, but it took a while for borrowers to become willing to test the waters for new issuance.

BY CHRIS RICH

nvestore Property, Transpower New Zealand and GMT Bond Issuer, a wholly owned subsidiary of Goodman Property Trust, all printed new transactions in the space of a week at the end of August. There had only been one previous new benchmark corporate bond since the COVID-19 crisis began, but transaction flow continued through September and into October (see table).

Deal flow is making up for an anaemic start to the year – New Zealand did not see any public corporate issuance in 2020 until July. But with nearly NZ\$1.8 billion (US\$1.2 billion) issued since the market restarted, New Zealand is closing on a record half-year for corporate volume (see chart 1).

Market sources say demand for corporate issuance has been bubbling away throughout the year as supply has fallen short even of what is a relatively slim year for maturities (see chart 2). Meanwhile, competing asset classes – specifically term deposits for retail investors – are offering increasingly unattractive returns.

Mat Carter, Auckland-based director, debt capital markets and syndicate at Westpac, tells *KangaNews* a large amount of liquidity held by retail and wholesale investors has finally been put to work. "After the short, sharp and violent market dislocation caused by COVID-19 earlier in the year, New Zealand has seen a material stabilisation in the overall credit environment," he says.

ISSUER RESILIENCE

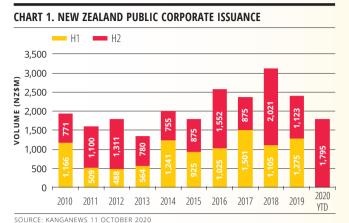
he corporate market renaissance was not materially disrupted by the re-emergence of COVID-19 in New Zealand. The new outbreak in Auckland struck days after Investore announced the offer for its transaction but did not dissuade the borrower from proceeding to launch on 17 August.

Fabio Pagano, fund manager at Investore in Auckland, tells KangaNews the company assessed the impact of the lockdown on the local market and reviewed the pros and cons of going ahead with its deal. This included reflecting on what Investore was able to achieve during the first wave of the pandemic in New Zealand.

"During the first lockdown, we successfully raised NZ\$105 million in equity. With this latest deal, we were confident the market was functioning well, there was liquidity out there and that investors would recognise we had a fundamentally strong business," he says.

Carter agrees. "We did not view the current lockdown as a material headwind to achieving strong execution across our transactions over the past weeks. In the first lockdown, markets kept functioning including a number of equity raisings so, from a process point of view, we were comfortable retail and wholesale accounts would be able to focus on debt transactions."

PUBLICLY OFFERED NEW ZEALAND DOLLAR CORPORATE DEALS, AUGUST-OCTOBER 2020							
PRICING DATE	ISSUER	RATING (S&P)	TENOR (YEARS)	VOLUME (NZ\$M)	MARGIN (BP/SWAP)	LEAD MANAGER(S)	
7 Aug 20	Wellington Airport	BBB	6	100	210	ANZ, ForBarr	
21 Aug 20	Investore Property	NR	7	125	200	ANZ, ForBarr, Jarden, Westpac	
25 Aug 20	Transpower	AA-	5	300	65	Westpac	
26 Aug 20	GMT Bond Issuer	BBB+	8 & 10	50 & 150	185 & 200	Westpac	
4 Sep 20	Mercury	BBB+	7	200	125	ANZ, BNZ, Craigs, ForBarr	
11 Sep 20	Summerset	NR	7	150	200	ANZ, Craigs, ForBarr, Jarden	
23 Sep 20	Port of Tauranga	A-	5	100	90	BNZ	
1 Oct 20	Vector	BBB	6	170	135	ANZ. BNZ	
9 Oct 20	Oceania Healthcare	NR	7	125	200	ANZ, Craigs, Jarden, Westpac	
16 Oct 20	Argosy Property	NR	7	125	195	ANZ, ForBarr, Hobson, Jarden, Westpac	
SOURCE: KANGANEWS 11 OCTOBER 2020							



The three late-August borrowers all make a case for resilience to COVID-19. Transpower is a regulated, essential-service provider while Investore and Goodman are among the less exposed names in the property sector.

Most of Investore's tenants are considered essential businesses and therefore more than 80 per cent of its portfolio was able to continue trading during the March-April lockdown period. Pagano says the majority of the company's income is derived from supermarkets, accounting for 63 per cent of its annual revenue.

He adds that the COVID-19 crisis has thrown delineation within the retail sector in New Zealand into sharper focus, demonstrating the resilience of large-format retail.

Goodman is an industrial property manger and therefore had a similar experience. Around 40 per cent of Goodman's customers, representing around 70 per cent of the trust's total annual rental income, were open to some extent even during the alert level-four restrictions. This increased to 90 per cent with the transition to alert level three while almost all were back operating under alert level two from 14 May.

DEMAND FACTORS

eal sources say all three transactions attracted high levels of oversubscription, with two printing larger volume than indicated at launch. Transpower increased to NZ\$300 million from NZ\$200 million. This was made possible by a book that surpassed NZ\$400 million, Chris Sutherland, treasurer at Transpower in Wellington, tells *KangaNews*. He adds that the company had no near-term need for additional funding beyond NZ\$300 million.

Fiona Doddrell, Wellington-based director, debt capital markets and syndicate at Westpac, says final volume highlights the weight of cash seeking high-quality product, noting it was the largest single-tranche deal Transpower has executed domestically.

In late February, Transpower revealed plans to increase its March 2025 bond but ultimately delayed the transaction after the onset of COVID-19 in March. Sutherland says the transaction was to refinance May and June maturities worth NZ\$250 million, but the issuer instead relied on CP and a new bank facility to meet the repayment in the near term.



Transpower opted to wait until it released its annual results on 21 August to revive the bond deal, to assure investors the impact of COVID-19 on the company was relatively benign. "At which time we benefited from the pricing on offer thanks to a steady narrowing in credit spreads since the market dislocation earlier in the year," Sutherland adds.

It was a similar case with Goodman. After releasing its annual results in May, the borrower was considering a retail bond offer to refinance a NZ\$100 million maturity in December but decided to wait until conditions improved, Andy Eakin, the issuer's Auckland-based chief financial officer, tells *KangaNews*.

Goodman opted for a wholesale-only deal because it sought 10-year debt and it believes seven-year tenor is as far as retail investors will typically go at the type of pricing issuers' need.

While the outbreak in Auckland compelled Goodman to pause the deal process for a few days, Eakin says conditions settled quickly. The company was oversubscribed for the NZ\$150 million 10-year tranche, the longest tenor to date for a senior property transaction in New Zealand. Through the deal process investor interest for eight-year paper emerged at pricing that suited Goodman, enabling it to print a further NZ\$50 million.

Investore was able to secure the lowest-ever coupon for an unrated transaction in the New Zealand market at 2.4 per cent. Carter says the book included wholesale and retail accounts with the latter predominant. He explains that the lower-for-longer theme is increasing in tone so retail investors viewed the coupon as suitably attractive given the issuer's credit quality and the robustness of its portfolio.

The Reserve Bank of New Zealand's dovish turn on the official cash-rate (OCR) and increased expectation of a negative OCR during Investore's bookbuild generated further demand.

"Notwithstanding the 2.4 per cent coupon was a historic low for an unrated property transaction, retail investors are hunting for yield. This resulted in the maximum volume of NZ\$125 million being printed" Carter adds.

While Transpower's transaction was offered to retail investors, Sutherland says the 0.791 per cent yield was challenging for this buyer base and most of the book was allocated to domestic wholesale accounts. •

MERIDIAN ROLLS OUT ALL-GREEN FINANCING STRATEGY

Meridian Energy became the latest New Zealand corporate issuer to certify its debt funding based on environmental criteria, with the 26 August launch of its green-finance programme. All Meridian's debt instruments – totalling NZ\$1.8 billion (US\$1.2 billion) – are covered by the programme, which means its existing and, potentially, future domestic and US private placement (USPP) issuance is now in green-bond format.

Meridian and Westpac, which assisted with implementation, spoke to *KangaNews* about the programme and the issuer's strategy. Views come from **Janine Crossley**, treasurer at Meridian in Wellington, and two Auckland-based Westpac executives: **Kate Archer**, associate director, sustainable finance, and **Joanna Silver**, head of sustainable finance.

hat was the rationale behind this development and what does Meridian hope will be the benefits of having a greenfinance programme?

CROSSLEY We had been considering the introduction of a green-finance programme for some time, on the basis that it would complement our wider sustainability programme.

The focus of our sustainability framework is two of the UN Sustainable Development Goals (SDGs): SDG 7, affordable energy, and SDG 13, climate action. It's fair to say climate action is the key focus of our sustainability efforts, and we are very proud only to generate electricity from 100 per cent renewable sources. Our emissions from electricity generation are zero.

To make a meaningful difference, though, we know we need to continue to show leadership. The green-finance programme is another tool with which we can champion climate action and sustainability, as well as renewing our commitment to renewable energy by only funding green assets under the programme.

We envision the programme will benefit Meridian in a number of ways. It will allow us to demonstrate our contribution to climate-change mitigation. It also provides another opportunity to increase programme visibility – what we have achieved in the past and our future goals.

It could also increase our investor base, as the number of investors with green mandates is growing and, anecdotally, the range of investors interested in green-bond transactions is much broader than the usual group. A wider investor base and increased demand could also bring pricing benefits. These investors also tend to be more sticky – they hold their debt for longer.

Overall, as a debt issuer we think the green-finance programme should give us a competitive advantage over similarly-rated entities that aren't viewed as green. It will also align us with peers that already have green programmes in place or have issued green securities.

■ SILVER At macro level, Meridian has been progressing with a very strong, clear and determined strategy on renewable energy without having the bond-market credentials it is perhaps entitled to. The green-finance programme is a great way for Meridian to receive recognition for something it is already doing and to recognise additional benefits.

Pricing benefit is not as easy to articulate in the New Zealand market at present. But green bonds bring multiple benefits to organisations beyond pricing. For instance, more than 90 per cent of issuers say green bonds drive greater engagement with their investors and 98 per cent say they attract new investors.

What does the programme offer to investors?

- CROSSLEY We are providing them an investment opportunity with transparent green credentials, a tool to help with their due diligence and a way to support climate-change initiatives. Our hope is that this may allow at least some investors to allocate a larger portion of their portfolios to climate-change activities.
- ARCHER Investors also get a lot of benefit from Meridian's post-issuance impact reporting, which provides additional insight into environmental performance at an asset level.
- **CROSSLEY** We already have a significant reporting regime but the green framework gathers all this information in one place and makes it easier for investors to understand Meridian's climate-action initiatives.

Is all Meridian's future debt issuance going to be green or sustainability labelled?

■ CROSSLEY Our entire debt portfolio is included in the green-finance programme, including all our debt instruments. Initially the programme is retrospective, so we have allocated our current debt portfolio against our green assets.

Where possible, we will issue debt out of this programme in future. We are looking to issue new green debt under the programme, which will likely happen next year.

Meridian has allocated specific assets to specific debt instruments. For instance, its retail bonds have been assigned to funding wind assets while domestic wholesale notes and USPP debt has a hydro asset pool. Why did Meridian take this approach rather than creating a single green asset pool?

■ ARCHER Keeping the asset pools separate helps ensure the Climate Bonds Initiative (CBI) pooled assets are not comingled with non-CBI assets. This is a cleaner and more transparent approach, we believe, given the different criteria and reporting associated with each asset type. Meridian was able to earmark each pool of renewable assets against certain financing instruments within its borrowing programme.

One pool is wind assets, which comply with Climate Bonds Standard (CBS) wind criteria. The other pool is hydro assets, which align with the renewable-energy category of the Green Bond Principles (GBP). The CBS has not yet finalised sector criteria for hydro power so it wasn't possible to get all Meridian's debt certified under the CBS.

The status of hydro has been unresolved for some time now. What is the latest update?

■ ARCHER There is a precedent of greenbond issuance globally to finance or refinance hydro-power assets, so it is not new in this regard. In our region, the market has generally been guided to quite a large extent by the criteria established by the CBI — and these do not yet include finalised hydro-power sector criteria.

Hydro-power assets clearly have a huge range of environmental and climate benefits, which is recognised under the GBP by virtue of being a renewable-energy asset.

Meridian undertook an external review, conducted by DNV GL, which included a thorough review of Meridian's hydro-power assets and the type of impacts associated with them. DNV was then able to set and define appropriate hydro-power criteria that Meridian's assets were assessed against, to ensure they presented low environmental risk.

This included an assessment of changes to pre-existing hydrological conditions, power-density thresholds, and the risk of additional greenhouse-gas emissions associated with the inundation of terrestrial areas in certain regions.

Will future issuance definitely be in green-bond format or is Meridian interested in exploring a wider sustainability-bond programme? What would be the incremental benefits of a transition from green to sustainability?

CROSSLEY It is likely to be green debt under the programme we have in place now. We may add sustainability loans and bonds to the programme in future, though. As Joanna Silver says, the programme is already quite broad with opportunities to expand it

sustainability area that we can look to support via our financing programme and we will look to do so in future.

What does Meridian's announcement mean for its peers in corporate New Zealand?

■ SILVER It's impressive that Meridian has kept this project front of mind during incredibly turbulent times — including COVID-19 and the Rio Tinto Tiwai Point [aluminium smelter] closure. Being able to progress the dialogue internally on the green-finance programme, right up to board level, clearly demonstrates Meridian's desire and commitment to keep sustainability on the agenda at all times.

This also sends a very powerful message to other corporate borrowers that it is possible to maintain focus on sustainability even in circumstances like these – and how important it is to do so.

Meridian's move is also a further example of a company aligning its sustainability and corporate strategies over an extended period. The two things

"We think the green-finance programme should give us a competitive advantage over similarlyrated entities that aren't viewed as green. It will also align us with peers that already have green programmes in place or have issued green securities."

JANINE CROSSLEY MERIDIAN ENERGY

further in future – which would include sustainability assets.

- ARCHER Meridian has quite a wide focus when it comes to the SDGs and wider societal issues. If it wanted to innovate in future, encompassing environmental and social assets and projects would be one way to do so.
- **CROSSLEY** On the issue of incremental benefits, I definitely think these could be worth the work required to achieve them. Meridian has had a corporate-sustainability framework and climate-action plan in place for some years, including various workstreams that may require financing. We have a lot in the

can't be distinct anymore and when issuers line up their financing with their sustainability strategies investors can see the consistency and the synergies. Strategic and sustainability alignment also helps build confidence and resilience in corporate strategy.

Finally, as the largest contributors of capital to the local economy we think New Zealand's banks have a duty to help shift capital flows in the right direction. We are incredibly excited and proud to have worked with Meridian to deliver this outcome, to demonstrate our alignment with the idea of directing capital to where it needs to be. •



New Zealand corporates return to green-bond market

As well as a clutch of mainstream corporate bond deals, the New Zealand market welcomed the return of corporate green-bond issuance in September. Mercury reopened the market with the first deal in nearly a year, followed in a matter of weeks by a third green-bond transaction from Argosy Property.

BY CHRIS RICH AND MATT ZAUNMAYR

ercury took advantage of momentum in the New Zealand market to print a new green-bond transaction on 4
September. The NZ\$200 million
(US\$132.2 million) deal also marks the first time in 12 years that Mercury has accessed the domestic market in senior, retail format. ANZ, BNZ, Craigs Investment Partners and Forsyth Barr led.

Argosy's NZ\$125 million seven-year green deal, priced on 16 October, is its largest since it debuted in the public market in early 2019. This transaction had ANZ, ForBarr, Hobson Wealth Partners, Jarden Securities and Westpac on the top line.

Mercury's debut is the first green bond in the New Zealand market since an Argosy deal in October 2019. The proceeds from Mercury's deal are primarily earmarked to support construction of the Turitea wind farm – which, when completed, will provide 2 per cent of New Zealand's electricity needs.

Geoff Smits, acting treasurer at Mercury in Auckland, tells *KangaNews* the issuer began working on its green financing framework in March this year. "The framework reflects our desire for positive environmental and economic outcomes. Our mission is energy freedom: we want New Zealand to make the most of its renewable-energy advantage and to realise a low-carbon future for all," he explains.

The framework was finalised in August and has been independently reviewed by DNV GL. The review is designed to ensure the process for identifying eligible projects and managing

use of proceeds is consistent with the International Capital Market Association's Green Bond Principles and the Loan Market Association's Green Loan Principles.

Mercury also obtained pre-issuance certification from the Climate Bonds Initiative (CBI) covering the green-bond transaction itself.

Smits says eligible assets for the pool are in the wind and geothermal sectors. The total value of assets in the pool is NZ\$1.9 billion and it will be able to support further green-bond issuance in future. Mercury's hydro assets are not currently part of the pool, Smits adds, as they are not yet covered by CBI criteria.

The question for Mercury was whether it was necessary or valuable to seek green certification on the assets of a 100 per cent renewable-energy provider. Patrick Mullins, Auckland-based director, debt capital markets at ANZ, insists labelled bond issuance is still worthwhile.

"Most investor feedback we received was that Mercury's underlying business was overwhelmingly green, but the CBI green-bond certification allowed for the broadest panoply of investors to participate," he says.

The New Zealand market has always been supportive of labelled green, social and sustainability (GSS) issuance but Mullins tells *KangaNews* thinking is evolving on the issuer side. "What has changed since 2019 is that the discussion with issuers, particularly at board level, is no longer about why should they undertake a GSS bond but why they shouldn't," he reveals.

New Zealand corporate issuance was quiet for most of 2020 until Wellington Airport broke the ice on 7 August. Since then,

TABLE 1. LOWEST COUPONS FOR PUBLICLY OFFERED CORPORATE DEALS IN NEW ZEALAND						
ISSUER	PRICING DATE	VOLUME (NZ\$M)	TENOR AT ISSUE (YEARS)	COUPON (PER CENT)	DEAL RATING	
Port of Tauranga	23 Sep 20	170	5	1.02	A-	
Mercury	4 Sep 20	200	7	1.56	BBB+	
Vector	1 Oct 20	170	6	1.575	BBB	
Toyota Finance New Zealand	3 Sep 19	100	5	1.73	AA-/Aa3	
Transpower	28 Aug 19	150	6	1.735	AA-/Aa3	
Transpower	25 Aug 20	300	5	1.735	AA-/Aa3	
Argosy Property	16 Oct 20	125	7	2.20	NR	

and despite new COVID-19 lockdown measures, deal flow has returned in force (see p58). Deal sources say pent-up investor demand has rushed in to support new issuance.

Like the corporates that issued before it, Smits says Mercury had been targeting an earlier execution date but deferred coming to market until conditions improved.

Its deal launched with an indicative margin range of 125-145 basis points area over mid-swap and eventually printed at the tight end of guidance. According to KangaNews data, Mercury's transaction printed the lowest-ever coupon for a public deal in New Zealand – though this record lasted for barely a fortnight (see table 1).

Mullins says the retail investor base was surprisingly supportive of a deal that offered a coupon more or less in line with term-deposit rates. The book saw a high level of uptake from retail brokers alongside the institutional bid (see chart). The prospect of a lower-for-longer rates environment combined with the Mercury name to drive the retail investor bid, Mullins adds.

Smits says Mercury's future borrowing needs will primarily to be refinancing. The company has a NZ\$300 million wholesale bond maturing in September 2021, and Smits reveals that the issuer is still considering refinancing options. It is likely to issue further green bonds in future now its green-financing framework is in place.

REPEAT ISSUANCE PAYS

rgosy, meanwhile, says its third green-bond deal attracted a good spread of investor interest and tighter pricing than comparable issuers' conventional bonds. The borrower says the green label is one reason for the positive demand outcome.

Combining its three green deals, Argosy has tapped the market for more volume than any New Zealand corporate issuer except the large energy companies since the start of last year (see table 2).

Dave Fraser, Auckland-based chief financial officer at Argosy, says demand increased with each of its three green-bond deals priced since March last year. Retail demand has continued to build and formed the bulk of the book for all three transactions, driven by tumbling bank-deposit rates. But Fraser says institutional interest is also robust.

All Argosy's deals had seven-year tenor at pricing. The margin on the latest is 195 basis points over mid-swap, compared with 175 basis points in its first two deals. However, the decline in real interest rates over this period has seen coupons fall precipitously, to 2.2 per cent this time around compared with 4 per cent in March 2019 and 2.9 per cent in October 2019.

Fraser also says the pricing of Argosy's recent deal was sharper than for recent issuance by similar borrowers and that this could be a product of the green label.

Argosy's issuance frequency may slow from here as its debt is now split nearly 50-50 between bank and capital-markets funding. The NZ\$325 million of green bonds also accounts for most of its NZ\$370 million qualifying asset pool.

MERCURY GREEN-BOND DEAL DISTRIBUTION BY INVESTOR TYPE

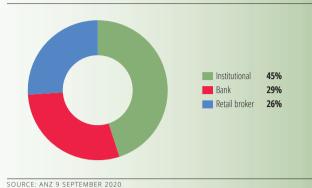


TABLE 2. LARGEST NEW ZEALAND DOMESTIC CORPORATE ISSUERS, 2019-20 YTD

VOLUME ISSUED (NZ\$M)	NUMBER OF DEALS	
600	3	
500	2	
420	2	
325	3	
268	2	
	(NZ\$M) 600 500 420 325	

SOURCE: KANGANEWS 20 OCTOBER 2020

Fraser tells *KangaNews* further assets are in the pipeline, though. "Our green-bond programme is aligned with our green-building strategy, which is a path the business has been on for 10 years and continues to create incremental value for shareholders," he explains. "We are developing new green assets, which when ready will be included in the programme. Even so, another transaction may not occur for a couple of years."

The economics of commercial property in New Zealand are different from most other parts of the world as the country has effectively eliminated COVID-19, at least for the time being, and fully reopened following a strict initial countrywide lockdown and secondary Auckland lockdown in August.

Fraser reveals that investors are interested in how Argosy's property portfolio performed through the lockdowns and how it has emerged. The issuer is able to present a positive story on both counts, he insists.

"Argosy offered rent abatement or deferral arrangements for tenants most in need during the lockdowns, but the diversity of our tenants mitigated this risk. Government accounts for 27 per cent of our rent roll and a lot is also essential services. Following the lockdowns Argosy has lost just one small tenant – out of 177," Fraser says.

An investor newsletter published on 28 September shows industrial and office space each have a 43 per cent share of Argosy's total property portfolio, with retail accounting for the remaining 14 per cent. The newsletter also disclosed that the company had a 99.4 per cent occupancy rate across its portfolio as a whole. •



ING HOLDS THE LINE ON AUSTRALIAN AMBITIONS

The events of 2020 could have tested **ING Bank**'s commitment to building its wholesale balance sheet in Australia. Instead, says **Charles Ho**, the bank's Sydney-based managing director and head of wholesale banking, it has used its sectoral expertise and strong local retail brand to grow its exposure – and prepare for a further expansion of debt-market coverage.

ow able and willing was ING to continue extending liquidity to institutional clients during the period of maximum volatility in March-April and then subsequently?

It comes back to the way we designed the team when we set up shop in Australia, in particular the fact that we consciously put sector experts on the ground. In banking, you have good years but also bad years — and it is important to take a long-term view.

We felt it was vital to have the right level of specialisation with people in our team who were close to clients, so when the difficult years came around we would be able to work closely with those clients.

This is exactly what happened through the course of this year. March to May was a challenging period but we were able to support our clients' requirements for covenant restructuring and the like.

When the air cleared a little, around mid-year, we were actually able to ramp up our business. Not only did we continue to support our clients in Australia but we have also increased lending to the Australian corporate sector – our lending commitments to date in 2020 have increased by more than A\$1.5 billion (US\$1.1 billion) as compared with year-end 2019.

Has the flow of requests for new liquidity and for amendments to existing terms from corporate clients been significant?

• One of the aspects where the current crisis differs from the global financial crisis is that liquidity was available across the bank-debt and equity markets in 2020. The bulk of requests we received, therefore, were changes to facility covenants.

When we received our first covenant waiver requests in support of an equity raising, we were sceptical – on the back of what we saw during the global financial crisis. It quickly became clear that this crisis was different. Since then, it has been a case of working with our clients and ensuring everything is well structured within very tight timeframes.

There were some requests for additional liquidity. This is where the benefit of good sector knowledge came into effect, allowing us to support these borrowers.

How quickly corporates reacted to the situation was also commendable. Almost every client realised they had to act quickly and have discussions with their banks as soon as possible. I think this made a huge difference.

Some corporate borrowers have mentioned that banks' processes slowed during the worst of the pandemic even if liquidity was ultimately always available. Did ING have any additional hurdles in place?

• From a liquidity perspective, we were able to leverage the benefit of operating as a retail and wholesale bank in Australia. This gave us good access to liquidity in the form of customer

deposits and the Reserve Bank of Australia's term-funding facility.

There were, of course, additional hurdles in place. Looking back at the start of the pandemic, there was a huge amount of uncertainty around how it was going to play out and how best to respond. Like all banks, we had to look very closely, for example, at the potential impact of risk costs and migration on our risk-weighted assets and the associated impact on tier-one ratios.

It was a couple of years ago that we started talking about ING's increased ambitions in Australian wholesale banking. How would you assess the progress made ahead of COVID-19?

■ The way we think about it is not just the amount we lend but also the quality of the relationships we build. We were pleased to see strong results in this year's Peter Lee survey. I am a big believer in getting external validation of how we are tracking, whether positive or negative.

The most pleasant surprise in the survey results was the 26-point year-on-year improvement in ING's net promoter score. A large part of this positive change came from our increasing sector and product coverage in Australia. There was also strong recognition of our coverage of offshore debt capital markets.

Has the pandemic changed ING's sector focus in Australia?

■ The strategy remains unchanged and we continue to expand our sector coverage in a steady and progressive manner. Today,



The content you expect – in a new format



The KangaNews Debt Capital Markets Summit is the leading forum for information sharing and dialogue in the Australian debt industry. The KangaNews Sustainable Debt Summit has the same place in the ESG debt space.

It is not possible to hold these market-leading events in person in 2020, but market participants can still hear and join the conversation via a series of online events.



KangaNews **Debt Capital Markets Summit 2020**



Webinars

- 22 October (afternoon)
- 12 November (morning)
- 3 December (afternoon)



KangaNews **Sustainable Debt Summit 2020**



Online event

- 24 November (afternoon)
- 25 November (morning)

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we have on-the-ground sector coverage for infrastructure, real-estate finance, energy, food and agriculture, leveraged finance, large corporations and financial institutions (FIs).

We are currently looking at putting a technology, media, telecoms and healthcare specialist on the ground and hope to have this person in place before Christmas.

We are also aiming to expand our product offering and are in the market right now for a debt capital markets person, based in Australia. The main focus will be on offshore bond markets – specifically euro and US dollar denominated issuance – with coverage across large corporates and FIs.

The other area we are seeking to explore is securitisation. We established a securitisation team in Singapore, which is ING's regional hub for APAC, and Australia is one of the key target markets for the team. Of course it helps that the team is led by an Australian who is very familiar with the market here.

You have already mentioned the value of ING's retail balance sheet in Australia. Can you give some insights into performance of that side of the business in 2020?

■ An important part of all banks' business is brand recognition and this is a significant differentiator for us. Our retail bank has 2.7 million customers in Australia, which has increased by 1 million over the last four years. ING is also the most recommended retail bank in Australia. This positive brand recognition definitely helps the wholesale side of the business.

Sustainable finance has been a central component of ING's institutional strategy for some years. In your experience, did corporate borrowers maintain their focus on environmental, social and governance (ESG) considerations during the period of pressing near-

term liquidity concerns? In other words, did the crisis show that ESG is more than a 'nice to have' for corporate Australia?

Our observation is that it remains front of mind for corporate treasurers — and there are two main drivers for this. The EU taxonomy was released this year and it draws a clear line in the sand between what is green and what is not. This has implications for Australian borrowers that are looking to tap the euro market. Not to mention the expectation that the EU taxonomy is also likely to influence global standards.

We have also seen investors becoming move vocal about the direction

"When the air cleared a little, around mid-year, we were actually able to ramp up our business. Not only did we continue to support our clients in Australia but we have also increased lending to the Australian corporate sector."

of their portfolios. I believe COVID-19 has emphasised the importance of ensuring good access to liquidity and, to this effect, ESG will need to be a top-of-mind priority.

COVID-19 has enhanced interest in the social aspect of ESG, but this seems harder to measure and deliver than environmental outcomes – especially outside the government sector. Does ING see social finance as a major growth area or is the primary focus likely to remain environmental?

The key call-out here is that social reporting is actually captured under sustainability reporting. For example, the Sustainability Accounting Standards Board framework for the mining sector includes a specific category for social capital with subheadings such as human rights and community relationships.

Aside from this, we see emerging trends in the social-financing market. It is not as prominent as transition finance

but deals are emerging. For instance, we helped structure a social-bond framework for Korean Housing Finance Corporation in 2018 and were a joint bookrunner for the same issuer's various social covered bonds – the most recent one having been issued earlier this year.

Can you give some more insight into how ING is managing environmental transition within its overall lending portfolio?

■ The first key commitment we made was in 2017, when we pledged to reduce our lending to the thermalcoal sector to close to zero by 2025. This includes lending to thermal-coal

mining and thermal-coalfired power generation. We remain on track to meet this commitment.

The second key commitment ING made was in 2018, when it announced that it would steer its balance sheet in line with the goals of the Paris Climate Agreement – adopting what we call the "Terra" approach. This is

a science-based approach that looks at measuring and guiding the climate impact of our lending portfolio.

ING released its second Terra report this year. Within this report, we identified nine focus areas that are the most climate-relevant sectors in our portfolio. This group of nine focus sectors covers about 75 per cent of total emissions within the portfolio.

The Terra report identifies measurement benchmarks and indicates how ING is currently tracking against them. We believe ING provides some of the highest transparency levels in tracking the climate impact of its lending portfolio.

As part of the Terra report, we also talk about the opportunities and challenges across the nine sectors that are covered. This is done with the view of encouraging discussion and collaboration with industries on how we can work together in meeting the Paris Agreement climate targets. •

KangaNews and DIVERSITY

Ninety-six per cent of respondents to the **KangaNews Women in Capital Markets Survey**, conducted in August 2020, believe giving profile to female leaders in media and industry events supports gender diversity in financial services.

As the only media and events business devoted to the Australasian debt markets, KangaNews is keen to use its voice and the forums it provides to further industry diversity. This includes promoting female voices in its editorial coverage and on its event agendas. The *KangaNews* Women in Capital Markets Yearbook, published for the first time in September 2020, is one sign of this effort coming to fruition.

View the yearbook at www.kanganews.com/magazine





hen Australia went into lockdown, transport and shipping infrastructure saw an unprecedented business shock. Airport and toll-road passenger numbers collapsed while even freight flows dropped as the global economy ground to a halt. In October, *KangaNews* and **Westpac Institutional Bank** gathered key players in the Australian sector to discuss business impact, balance-sheet resilience and the swift rebound of debt capital markets including the domestic option.

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AIRPORTS GROUNDED

Blix Airports have been among the businesses most affected by COVID-19. What have the consequences been and how have issuers in the sector responded?

■ VAN DER GEEST I recall being in Europe in early February and talking through what the risks could be as they were emerging. It soon became a case of 'scenario planning on steroids'. Every week the impacts we were working through kept increasing.

This means not only the risk to underlying passenger performance and the impacts to the business but also our



"I recall being in Europe in early February and talking through what the risks could be as they were emerging. It soon became a case of 'scenario planning on steroids'. Every week the impacts we were working through kept increasing."

ALICE VAN DER GEEST MELBOURNE AIRPORT



response to the changing conditions. We saw significant impact on overall monthly revenue – passengers are now down 98 per cent on pre-COVID-19 levels, which clearly has a big impact on revenue across the business. Airports are passenger driven and the true diversification of revenue is within the property portfolio.

COVID-19 has been a seismic shock, followed by the response: from curtailing our major capex programme to managing the cost equation and a forensic approach to cash flow and collections. It has been a dynamic working environment across the business that includes managing every lever.

Melbourne is still in stage-two lockdown as of mid-October and everyone has been working from home for six months or so. There are signs, with decreasing COVID-19 caseloads, that we will come out of this soon and we can begin the recovery – as will all other members of the aviation industry.

■ BRIGGS We have similar themes albeit with comparatively less impact over the last 3-4 months. We have also had the benefit of strong intrastate travel within Queensland – this has performed above expectations.

Even so, revenue was effectively switched off in the June quarter. We were down 10 per cent in year-on-year revenue with EBITDA down 25 per cent from 2019.

Sitting here today, domestic travel has recovered to some extent but is still down by 75 per cent year-on-year. International travel remains a sad story – we are seeing around 300 passengers per day through our international terminal where we would normally see 5,000-6,000. At headline level this means our revenue continues to be severely affected.

A key issue we've been addressing is the relatively fixed nature of our cost base. We've been working closely with our suppliers to achieve cost savings and this remains a key focus for Brisbane Airport.

■ **GOLDING** We saw the impact quickly from the end of March. We held up quite well while restrictions only applied to international travel but we felt the effect immediately once domestic restrictions came.

In the June quarter, our passenger numbers were down by 96 per cent. But the diversification we have through property meant our revenue was only down by around two-thirds.

We are predominantly a domestic airport and South Australia's borders have opened sooner than other states, so we are back up to around 30 per cent of normal domestic passenger numbers. It feels as though we are starting to see a recovery.

■ MOMDJIAN Passenger numbers have been down by more than 90 percent since April. Of course, this has affected our revenue. We reported our half-year results showing revenue down by 36 per cent, which followed a 57 per cent decline in passengers half-on-half, highlighting the benefit of diversified income streams.

In response, we reduced controllable operating expenses by more than 20 per cent over the half-year, with a target of reducing operating expenses by at least 35 per cent for the 12 months to March 2021.

We also reduced our capex guidance by more than 50 per cent, with a target of A\$150-200 million (US\$107.7-143.6 million) in spend over the same period. We did not pay a distribution for the first half of 2020 with no distribution expected for full-year 2020. Our response has been swift and decisive.

The future is bright, though. New South Wales is currently open to South Australia, Northern Territory and, hopefully, other states soon. Then there is positive momentum around the trans-Tasman travel bubble, with one-way incoming travel without quarantine operational later this week. This should provide a template for opening to other international

"We never planned for a scenario of no revenue for an extended period. Our pandemic modelling has previously been based around SARS. We are in the middle of a terminal expansion project and had prepared our balance sheet to withstand a SARS-type pandemic."

JOSH GOLDING ADELAIDE AIRPORT



DOMESTIC MARKET **EVOLUTION**

Australia's corporate bond market took years to recover after the financial crisis in 2008-9. The rebound after COVID-19 came in a few months – and market conditions are arguably better than ever for issuers.

BLOCK The strong development of the domestic market has been evident since early May. Are issuers considering the Australian dollar market in a new light relative to other options?

■ MCKAY The performance of the domestic bond market has been exceptional. The two highlights for me have been the size and depth of order books, with transactions being well oversubscribed, and the ability to execute intraday. This is a big positive.

We are used to seeing these conditions in global capital markets, but to see this growth in the Australian market is a really strong development. Our recent experience with the Westlink M7 AMTN issuance was testament to these positive developments.

■ **TRIGGELL** Given our relative size, we have only been active in the domestic, USPP [US private

placement] and bank markets. Our confidence in the domestic market was reinforced through our 2020 deal process as our transaction was heavily oversubscribed with a very good pricing outcome, particularly in the 10.5-year tranche.

The trend over the last few years has been for longer tenor. We are focused on diversifying our debt sources so being able to achieve longer tenor in the domestic market is a great development. Traditionally, 10 years and beyond would be USPP territory.

■ BRIGGS We were very pleased with our domestic bond-issuance result, too. Pricing at the time was obviously materially wider than what we'd been looking at six months earlier. But through the whole process, from March to June, our messaging to the investor base was that we understood what was going on and that we are at the front line

of the crisis. We were willing to be pragmatic on pricing.

It was no secret that there was focus from rating agencies on Brisbane Airport's liquidity position at the time. For us, transaction execution certainty was vital and domestic investor support was fantastic. The deal went a long way toward de-risking the business and having a liquidity buffer more in line with Sydney Airport and Melbourne Airport. This got the rating agencies more confident with our position, too.

■ VAGG It was pleasing for us to print a 10-year deal domestically. When COVID-19 hit the big question was whether the domestic bond market would remain supportive of long-tenor corporate deals.

When we did our update in August ahead of our transaction there was no pushback on tenor, which was very pleasing. It is good

to see investors embrace this duration because it is precisely what we were looking for.

The process went well. We did not have the massive book that some other deals have seen but it was still a solid result and came together quickly. Pricing was not materially wider than pre-COVID-19 levels, either. We valued certainty over price anyway, and we had the extra liquidity of our bank debt so there were no time pressures.

BLOCK How important is it that the market now allows issuers to look at tenors such as 10.5 or even 12 years?

■ BRIGGS It is a great development to have this flexibility. Our maturity profile was suited to 10.5 years and we did not look to test 12-year tenor given the backdrop at the time we issued. When COVID-19 kicked off the discussion was around whether we could even get five years, though – so we were very happy with what we achieved in our transaction.

BLOCK Sydney Airport has not been active in the Australian dollar bond market for a while. Has the dial shifted

jurisdictions – assuming all goes well. The momentum is there and a recovery is on its way.

Davison There was a small bounce in domestic travel in July and it was expected to increase strongly into August – until the Victorian lockdown. What are the prospects for airports if the domestic reopening is slow and international travel a long way off?

■ MOMDJIAN We are optimistic. It is not a pipe dream to think that most if not all borders will soon open domestically. There is significant pent-up demand from people wanting to see their families and friends, as well as those itching to go on holiday — which will help fuel a solid domestic recovery as lockdowns ease.

Rapid domestic improvement has already been demonstrated in parts of Asia, with a recovery of close to or greater than 100 per cent in some countries. On the



"We formed a clear view about how bad things would get. The unknown factor was for how long the downturn would persist and what the recovery would be like. Ultimately, though, if you want to get around Australia you need to fly. We believe there will be desire for travel – for leisure and, eventually, business too."

ADRIAN DAVID MACQUARIE INVESTMENT MANAGEMENT



on how attractive the market is compared with offshore options?

■ MOMDJIAN We have the flexibility to issue bonds locally and offshore. We are focused on long – at times ultra-long – tenors, having issued 20-, 25- and 30-year tranches in the USPP market.

Developing a presence in the Australian dollar market remains on our radar. We always keep an eye on the local market and in the past we have been concerned about execution risk at tenor of 10 years and longer.

However, we have since seen significant issuance at 10-year tenor from triple-B corporates, even throughout COVID-19. Execution risk is no longer a deal-breaker for us in the local market. We are now confident that we would be able to raise the volume we need with low execution risk.

We collect indicative local and offshore bond-market pricing from 15 or so banks every month. Surprisingly, there has been a reversal under which pricing in the domestic market is currently much wider than it is offshore – even after

incorporating swap costs. We have not seen this for many years, so the ability to secure competitive pricing presents a new hurdle.

LUCAS It was actually easier to sell 10-year paper in the secondary market than 3-4 year paper in the crisis, particularly for the most affected names. Is it the case that investors knew issuers were money-good so they might as well own them for 10 years rather than just through a rough short-term period?

- DAVID Definitely. Aviation is potentially going to be a five-year recovery story and the first two years will probably be volatile. We want to enjoy as much upside as possible. If the worst happens it does not matter if we are short or long duration, so we might as well take the long duration.
- **LEWIS** We have been looking for long-term positions for a while, which includes offering tenor of 10 years and beyond. In this situation tenor is definitely preferable from a pricing perspective but also, as Adrian David says, to try to capture some upside in the long term.

international side, the opening of a trans-Tasman bubble will provide additional choice.

The recovery of business travel may take a little longer, but anecdotally our local and offshore debt investors are welcoming some face-to-face interaction.

■ BRIGGS We saw a strong, and much better than expected, response domestically in May and June when economies appeared to be opening again. We were tracking toward 40 per cent of domestic passenger volume going into June. With

the Victorian lockdown this went off the boil again. There is a question mark over whether we will see such a strong response again. There is probably more caution around the economic position of the country and individual job security now. We still expect a reasonably strong ramp up but do not expect domestic traffic to return to 2019 levels until 2023. It will probably be a bit longer for international.

We expect the domestic story will be supported somewhat by substitution travel. People will not have the option to travel overseas for a while so hopefully some of that spend will be applied to domestic travel.

I agree that the big question mark continues to be around the business-travel market. Around 40 per cent of our domestic travel is business-related. By the time things reopen people will have had close to 12 months of virtual meetings rather than doing intraday business travel between Sydney, Brisbane and Melbourne. There is a query around how firms respond to the pandemic and there is no doubt this will be a big swing factor for a full recovery.

■ VAN DER GEEST The economic recovery will also dictate to an extent the recovery of domestic travel outside leisure travel. Some of the key focus areas we all need to work on are opening borders safely and getting economic travel to start and to prosper. The corridors between Melbourne, Sydney and Brisbane need to open to help drive economic growth across the country.

There is also the smaller Virgin Australia – once it begins operating again – which has taken some capacity out of the system.

All the airports are working with the assumption of a domestic-led recovery. A trans-Tasman bubble will help work out how to do international travel safely. Once this happens, we can look at opening to other parts of the globe – whether it is to specific tourist destinations or to other countries around the world that have handled the pandemic well.

Safety is front and centre. But we all want the opening of domestic borders, to support the broader economic recovery and response.

■ GOLDING Being a primarily domestic terminal we see a lot of opportunity in the pent-up demand for travel and have already seen a strong response as borders have opened. We are also seeing more domestic tourism interest in South Australia given the limitation on overseas options. There has been a strong initial rebound but we expect it will be a slow path back

"We are looking at aeronautical pricing, how we structure our deals, and assumptions made over the years about the reliability of investment-property revenue and tenant retail leases. It's not practical to operate a business while planning for these sorts of tail events, though."

WARREN BRIGGS BRISBANE AIRPORT



SUSTAINABILITY FACTORS

While labelled bond issuance from the Australian corporate sector is only starting to fire in the closing months of 2020, market participants say the level of focus on environmental, social and governance (ESG) issues has only increased – including in debt transactions.

BLOCK Michael Chen, you have done a lot of work with investors around the country on ESG factors. What are the trends you have been noticing of late?

■ CHEN When COVID-19 hit Australian shores in March, we thought the sustainable finance market may slow down considerably. Little did we know it would be anything but. Climate change has only grown as an issue. Week after week, investors have come out to announce how their funds are to be aligned with the Paris goal of net-zero emissions by 2050.

But what is interesting about the COVID-19 period is the growing interest in the social aspect of ESG, which has previously been a poor cousin of green and governance concerns. As a sustainability practitioner, it is good to see social issues gaining prevalence.

We have seen a net inflow to the asset class where there has been a net outflow in other asset classes, which speaks to investors' appetite for ESG product. There is resilience in GSS [green, social and sustainability] bonds as they have traded well in disrupted markets.

BLOCK The focus on ESG factors in the debt market has clearly increased substantially. What did this mean for issuers that have recently been active in the domestic market?

■ VAGG ESG has certainly been topical in the equity market for a number of years. As a company that is connected to coal, we were not the eye of the COVID-19 storm but we are certainly the eye of the ESG storm. There have been more and more questions from investors every year, reaching a peak in February after Australia's summer bushfires.

But the interesting thing is that investor focus became more near-term when COVID-19 hit. The issue around coal and ESG is a long-term financial risk, whereas COVID-19 presented near-term challenges for investors. As a result, the focus on ESG was almost zero for a period of 3-4 months. It is coming back now as we get into recovery phase, but certainly for a while investors were only focused on the near term.

We have been around for a long time and we treat ESG proactively through sustainability reports and disclosure on the long-term future of coal. Our update ahead of our recent bond deal focused on three things: a regulatory update, COVID-19 and the future of coal. There were no questions beyond this.

We know where the questions will be as we have had a few years of looking at the area. It is mostly focused on the future of thermal coal and what the transition away from it means for us.

Our job is about being on top of the market and where the industry is going, making sure we are aware of the long-term risks and communicating effectively with the investor base. The last thing we want to do is deny that it is a risk and then be in the position of being reactive. It is better to be on the front foot. Coal may be becoming a threshold issue for a minority of investors.

■ TRIGGELL ESG is a significant focus for the port and our owners. We have dedicated sustainability teams and report

regularly on our initiatives and targets in this space.

We have just released our annual sustainability report, which maps out our strategies around the various aspects of ESG. They align to the UN SDGs [Sustainable Development Goals]. It is a constant focus for us, and there were noticeably more questions in this area through our last refinancing process.

CHEN What potential for growth do issuers see in the GSS bond space coming out of the COVID-19 pandemic?

■ GOLDING I agree with the comments made already. We have seen ESG growing as an issue over the last few years, particularly on the equity side but increasingly on the debt side, too. It is also creeping into the rating agencies as well.

We can see this naturally evolving into the bank and capital markets, including presenting opportunities for sustainability and sustainable finance. It will become a normal part of the credit process and less of a special feature going forward.

We saw our sustainability-linked loan as a huge positive during COVID-19 and we kept up all our efforts on sustainability. While we were focused on covenant and liquidity issues, one of the other things that went to our board was a set of sustainability targets and aligning with the



"WE HAVE SEEN A NET INFLOW TO THE ASSET CLASS WHERE THERE HAS BEEN A NET OUTFLOW IN OTHER ASSET CLASSES, WHICH SPEAKS TO INVESTORS' APPETITE FOR ESG PRODUCT. THERE IS RESILIENCE IN GSS BONDS AS THEY HAVE TRADED WELL IN DISRUPTED MARKETS."

MICHAEL CHEN WESTPAC INSTITUTIONAL BANK

to FY19 numbers, probably including a permanent impact on business travel.

Davison How do institutional investors deal with the type of impact on revenue the airport sector has seen?

LEWIS We look at the long-term value of these assets and in this context we continue to see significant value in airports over an extended time horizon. There is a short-term creditworthiness issue that may extend to a couple of years and will depend on how the airports are financed and their access to funds from supportive owners.



requirements of the TCFD [Taskforce on Climate-related Financial Disclosures].

It would be a great outcome if these efforts reduce our interest costs by helping us achieve our margin incentive this year. But we see it as positive on any basis and believe the market will continue to grow.

■ MOMDJIAN Sustainable financing and sustainability more broadly continue to receive a great deal of focus internally and externally. We are receiving more targeted questions about sustainability, reflecting a clear increase in sophistication among market players.

Bank and bond investors haven't stated an explicit preference between sustainability-linked and use-of-proceeds products.

In the context of COVID-19, where issuers require flexibility in how they are able to use liquidity and are slashing their capex budgets as a key countermeasure, there is greater scope for the issuance of sustainability-linked products than those with use-of-proceeds restrictions.

CHEN Transition as a theme has gathered a lot of interest over the past 12-18 months. This includes investors becoming more supportive of transition-like structures, such as sustainability-linked bonds, that use KPIs instead of use of proceeds. What do the investors here think about this?

■ **LEWIS** We haven't participated in a sustainability-

linked debt product yet but I can see there is scope for it. The area that needs to be solved is the pricing of these products. If it is lower than like-for-like debt we have to get the conceptual buy-in from our clients, who are the end investors.

Participation also comes back to reporting requirements. I think it is helpful if there are controls in place over transition products, to give a bit more transparency as to how the funds are applied. It is quite limiting, though, if we are only able to look at 'pure' green assets.

We recently announced we will target net-zero emissions by 2050. Some clients are ahead of us with these goals and our progress will, to some extent, depend on the response across our entire client base. A transition vehicle that could work is a sustainable-infrastructure debt fund, dedicated to the cause – this would be far easier to manage.

■ **DAVID** We are very supportive of transition. We think it can help address the engagement issue. It is harder for a bondholder to engage with companies than a shareholder, just by virtue of the access available to them.

We need to strike the right balance between the amount of work that goes into determining what sort of thresholds are going to be targeted and the degree to which they are stretch goals versus being easy targets to achieve. From what we have seen offshore, though, it will be coming our way in the Australian market in the not-too-distant future.

Australia's unlisted airports are predominantly owned by large infrastructure funds and experienced airport-sector operators. These owners are in a position to provide equity support if required by the airport. Meanwhile, listed airports have the ability to access capital markets directly by issuing shares or hybrid capital. Early on in the COVID-19 shock in March-April, we looked at immediate access to liquidity and got comfort from it. We also reviewed management strategies to see how airports could get efficiency in operational expenditure and the extent to which they had deferable capex.

Of late, we have seen quite a lot of capital-markets issuance where operators have sought to term out bank debt and preserve their committed bank lines to maintain access to liquidity should things worsen again.

Some airports are in a better position than others – specifically those with fly-in, fly-out and intrastate traffic have weathered the storm a little better. Those more dependent on international travel are clearly taking more pain.

As a debt provider, we take the view that it is always worthwhile to work with the borrower if an asset gets into trouble. This has come to the fore even more in the current environment because the problems are not a result of mismanagement.

These are essential assets so we want them to be viable. Everyone has to do their bit to try to exercise what flexibility they have to support them through this extremely difficult time.

■ DAVID It is amazing to think that we used to look at airports and fret about whether they were growing revenue by 3 or 5 per cent, or earnings by 6 or 8 per cent. This all seems quite superfluous now.

When the pandemic hit, initially we wanted to get a clear sense of how bad things would get. This became apparent quite quickly when traffic slowed to a few per cent of what it once

The disclosure the sector has provided is helpful for us. Airports have offered monthly and even intramonthly updates, revenue and earnings disclosure, and segmental breakdowns. This has allowed us to be confident in our decisions.

We formed a clear view about how bad things would get. The unknown factor was for how long the downturn would persist and what the recovery would be like. Ultimately, though, if you want to get around Australia you need to fly. We believe there will be desire for travel – for leisure and, eventually, business too.

The final piece of the puzzle is liquidity. We started off by assuming cash burn for a period and no access to capital markets. But the airports have very strong liquidity positions with a very healthy buffer they can chip away at in the event COVID-19 lasts longer than anyone expects.

This backdrop gives us comfort that the airports are all in a pretty good position to hibernate while COVID-19 lingers. With some luck, we will come out quicker than expected. A vaccine would obviously be a game changer but, even in its absence, the renewed prospect of a trans-Tasman bubble and beyond will support airports' operating base.

Another factor is the pace at which airports have cut opex and capex. The speed with which capex projects were pared back was much greater than we ever thought possible. The sector responded proactively, which we valued very highly. Westpac Institutional Bank participants







MICHAEL LUCAS

GARY BLIX

TRANSPORT INFRASTRUCTURE

Blix Port of Brisbane's trade numbers are down in 2020 but clearly not as dramatically as airport traffic. What has been the port's experience through this period and how have expectations around factors like export volume changed?

PETER BLOCK

■ TRIGGELL It is certainly a different dynamic for performance than it is for the airports. To give some context, the port has a very diverse revenue base with roughly 45 per cent of our revenue derived through trade and 45 per cent through property.

When COVID-19 first hit there was a lot of uncertainty about the impact on trade. We saw a lot of Chinese manufacturers shut down and 14-day quarantine periods were placed on ships visiting Australia. This initial impact hit trade volume due to supply-chain constraints.

We have emerged well since then. We were down in FY20 trade volume by around 7 per cent and revenue by 5 per cent. The revenue side was partially offset by increased property revenue, though, so overall revenue was flat for the year. This was a pleasing result given the backdrop.

In the current year to date, we are down marginally on trade revenue but property has remained stable. Overall, supply chains are now operating freely and we are well positioned.

However, future trade flows will always be linked to how well the economy is tracking. As long as supply chains are open, we expect core trade volume to remain robust.

Blix Port of Brisbane also has a cruise terminal. What is the outlook for this sector?

■TRIGGELL The cruise facility was completed in July but obviously there are still a lot of unknowns in the industry. The federal government extended its ban on international cruise vessels until mid-December so the outlook for cruise visits in the current year is uncertain and hinges on when the ban is lifted.

Forward bookings beyond the current cruising year are strong, however – and we are confident in the outlook for the cruise industry in the long term.

Blix Aurizon reported a small increase in revenue for FY20. What is the basis for this robust relative performance and how is the impact of the pandemic being felt in the company's business and financials?

VAGG We have been fortunate in that COVID-19 has not had a material impact on Aurizon so far. Demand for metallurgical and thermal coal, as the principal commodity we are involved in, has remained solid.

The only concern we had initially was on the effect of government restrictions on workers being able to get to and from customers' mine sites. However, early on mining was deemed an essential service and therefore everything supporting it, including rail, was also deemed essential. This was a good outcome for us.

As a listed company, we had financial guidance in the market. We had to scenario test this extensively but did not need to adjust it. We hit the middle of the range and maintained our dividend and capital management. This was a pleasing outcome.

We have also not seen any impact on customers' ability to pay – there has been nothing material, whether it be extension or rate-reduction requests.

All this said, there will be an impact this year because COVID-19 has caused global recessionary conditions. Around 90 per cent of the coal we touch is exported and 95 per cent of it is exported to Asia. COVID-19 cases are peaking in India, which is the number-one destination for metallurgical coal exports from Australia. The Indian government has lockdown measures in place and this affects the demand for steel and, in turn, for metallurgical coal.

"The only concern we had initially was on the effect of government restrictions on workers being able to get to and from customers' mine sites. However, early on mining was deemed an essential service and therefore everything supporting it, including rail, was also deemed essential."

CHRIS VAGG AURIZON



For this reason, we have indicated that volume will be a bit soft in the current half-year. We think it will recover in the second half and forecast volume to be flat this year compared to last. Earnings will be a bit lower because of the way our network business works around timing of revenue recognition.

Blix How significant has the impact of restrictions been across Transurban's asset portfolio?

■ MCKAY We recently released our latest traffic data, covering the period from July to September 2020. The data provides an informative snapshot of when and where people are returning to our roads, and helps paint a clearer picture of how our various assets are recovering.

While traffic declined quickly from early March and into mid-April – when most of our markets were experiencing their peak restrictions – we saw it improve steadily through May and June as restrictions were progressively removed.

Our recent traffic data release highlights that Sydney and Brisbane are performing well given the circumstances, with Sydney traffic up 1.5 per cent driven by the contribution of the M8 and M5 East from July, and Brisbane traffic down 9.1 per cent. As you would expect, our roads that service airports continue to be more affected than others.

It will also come as no surprise that CityLink traffic has been affected by the reintroduction of restrictions in Melbourne – it is down 58.6 per cent this quarter. We expect traffic will remain sensitive to government responses in each market.

It is important to remember that CityLink is one of 20 roads we operate around the world, and our experience in other cities suggests traffic starts to recover quickly when restrictions ease, particularly for the more sensitive passenger-vehicle sector.

Pleasingly, large vehicles continue to be resilient despite restrictions, and were down just 18.8 per cent in Melbourne in the third quarter. Of these, heavy commercial vehicles were down only 7.2 per cent for the quarter.

In North America, traffic was down 28.2 per cent for the quarter, with the A25 outperforming our Express Lanes assets.

Davison One of the things we have seen as a result of the pandemic is that when people return to work, at least initially, they are more likely to travel in their own cars than to use

public transport. Is Transurban seeing any data to suggest longer-term trends in how people travel?

■ MCKAY Transurban recently commissioned research into urban mobility trends after COVID-19, by surveying nearly 4,500 people across Australia and North America.

The findings from our research show that commuting to the office is unlikely to disappear as 86 per cent of respondents believe they will not significantly increase the amount of time they work from home following the pandemic.

Personal health and safety is likely to dictate the ways people move around cities. Here, 25 per cent of respondents expect to decrease their public-transport use post the pandemic.

On the other hand, growth in online shopping is likely to continue: 48 per cent of respondents report shopping online more during the pandemic and half of those expect to continue doing so after it.

These mobility trends suggest we may see a level of disruption across transport modes for some time to come. It's an opportune time for governments and industry to work together to ensure we have efficient and resilient transport networks into the future.

Many options – from flexible working hours to leveraging data and technology – should be part of the conversation. We also need integrated transport networks that help spread peak travel periods and give people choice in how they want to travel.

Davison It would be interesting to get a buyside view on this type of development. Are investors thinking some demand and revenue patterns will be completely reshaped by COVID-19?

■ DAVID We forecast everything but all I know for certain is that these forecasts will be wrong! It looks like there will be more flexibility in the workplace going forward and this may mean there are fewer people in the office. But we do not envisage a world where we are all working from home all the time. There are some things you just cannot do productively on your own — not to mention fostering a workplace culture. There is a need to be together.

When we forecast the airports, we expect domestic and international travel will resume but there are differences in how each segment will come back to pre-COVID-19 levels.

"Mobility trends suggest we may see a level of disruption across transport modes for some time to come. It's an opportune time for governments and industry to work together to ensure we have efficient and resilient transport networks into the future."

TOM MCKAY TRANSURBAN



COVENANT CONTROL

Confronted with an unprecedented shock to operating conditions, Australian transport infrastructure borrowers encountered a largely supportive environment for amending debt terms and conditions.

BLOCK What have been the main trends when it comes to demand for amendments and changes to debt structures as a result of the pandemic – starting in the bank market?

■ GRACE During March and April there was a lot of concern internally about what would happen. No-one knew how long this would go for. All the banks became internally focused on looking at existing portfolio names and trying to work their way through their own back books. This process was to determine which companies would be exposed and to what extent.

At the same time, we were getting a lot of amendment and waiver requests, as well as requests for liquidity lines. Everyone was trying to right their own ships during this time of uncertainty.

The bank was nervous about what the impact on funding would be. We had seen what happened during the financial crisis when there was difficulty in funding markets. There was also concern around portfolio names and what would happen to them.

Amendment and waiver requests continued right up to 30 June as companies

sought covenant relief before their full-year reporting. A lot of these, particularly at the start, were short-dated as there was a view that it might only be a six-month blip.

Generally, domestic and international banks have been supportive of most corporate borrowers with covenant waiver requests. Time periods for getting things done extended a bit as lenders had to go through credit departments which were receiving a lot of requests. The bigger and smaller offshore banks came back with consents quickly and there were very few hold-ups for getting covenant waiver relief through.

We are beginning to see a second wave of covenant relief now as it becomes evident that the impact of the pandemic will be longer-lasting than initially thought, particularly due to the second Victorian lockdown.

Requests for liquidity lines have dried up significantly. Initially, everyone was just getting all the liquidity they could and putting it away for a rainy day. A lot of these have been repaid by borrowers that have got through the worst of it.

BLOCK How are fixedincome asset managers responding to the increased number of consentsolicitation requests?

■ **LEWIS** We try to work with borrowers where we can. Fortunately, we have not been inundated with covenant relief requests in the infrastructure debt space. Hopefully this means we have picked the right assets at the beginning – those with enough access to liquidity and good management – rather than just being lucky.

We take a pragmatic approach when consent requests do come. To the extent we can offer flexibility, we



"REQUESTS FOR LIQUIDITY LINES HAVE DRIED UP SIGNIFICANTLY. INITIALLY, EVERYONE WAS JUST GETTING ALL THE LIQUIDITY THEY COULD AND PUTTING IT AWAY FOR A RAINY DAY. A LOT OF THESE HAVE BEEN REPAID BY BORROWERS THAT HAVE GOT THROUGH THE WORST OF IT."

NEVILLE GRACE WESTPAC INSTITUTIONAL BANK

It may be the same with the toll roads – some will do better than others. A lot of it comes down to the corridors and customers they are serving. We use forecasts to provide a glimpse into what may unfold but we are aware that no scenario will play out exactly as we expect.

LEWIS Humans tend to be creatures of habit and can be expected to revert to their behaviour from before the pandemic. If the SARS epidemic and terrorism have not scared people off flying permanently, I think they will revert back to normal pretty quickly after COVID-19 is under control. It will most likely be led by a need for leisure travel as everyone will want a holiday after the pandemic is over.

Regarding toll roads, it is true that there will be some initial aversion to public transport and this will be to the benefit of toll roads. But we are also seeing people's behaviour becoming much more responsible on public transport — including wearing masks and carrying hand sanitiser. Previously, the only people who wore masks on public transport were probably those who had lived through SARS in Asia. But it is now customary to wear a mask.

We try to consider long-term viability beyond the crisis. It may sound strange coming from debt investors – who are generally seen to express doom and gloom – but with this situation we see value in being a bit more visionary about where things are heading.

BALANCE-SHEET POSITION

Blix To what extent can businesses prepare for once-in-a-lifetime events like COVID-19? Are issuers comfortable that their contingency planning prepared them for any reasonable eventualities, or are events like this simply outside the scope of planning?

■ GOLDING We never planned for a scenario of no revenue for an extended period. Our pandemic modelling has previously been based around SARS. We are in the middle of a terminal expansion project and had prepared our balance sheet to withstand a SARS-type pandemic through this as well as a charge reset coming up in 2021.



will do so to ensure the viability of the borrower.

■ DAVID We want to understand the basis for a request. It is good when an issuer holds a call rather than sending us terms written by lawyers, because sometimes we do not understand what is actually behind the request.

We will always approach these from the perspective of what is best for the client. Sometimes it can be difficult if there is a request for us to give something up, like a waiver covenant or to waive reporting requirements. If we are not receiving anything in return it is hard for us to argue to a client that this is in their best interest.

We are happy to use our relationship, spend our time and talk through how we are viewing things, but it is hard for us to use client capital if it is not going to get them something that is at least neutral.

DAVISON Do any borrowers have a view on consent solicitation processes?

■ VAN DER GEEST It was clear that airports were the first

into this crisis and likely to be the last out. For those that required a consent process, a key piece was engaging with the investor community and first and foremost putting yourself in their shoes.

It is important to be transparent, know what you are asking for and have active dialogue along the way. For us, the bank process took three weeks. In the US private placement [USPP] market it took 4-5 weeks. Investors were barraged with consents given the USPP market is based on having covenants.

Given the impact of the crisis on the airport sector, we went for 12-month covenant relief. It was a very orderly process and everyone was very pragmatic. Equally, we needed to provide the right information to investors.

The biggest lesson out of this on the issuer and investor side is that it is best to have a blend of your investor base in there to work with you. We had a good breadth of investors across our requirements. I will be looking at order books differently coming out of this – in a good way.

As part of this preparation, we boosted our cash balances, and secured liquidity and funding for the terminal expansion right through to completion as well as for the rest of our capex plans during this time. We also pushed all our maturities out because we didn't want to be refinancing in the middle of this situation. We have no debt maturities until 2023.

The work we did has held us in good stead through COVID-19. We secured additional liquidity from our existing bank group but haven't needed to draw on this and don't expect to for some time.

BRIGGS As we have all talked about, COVID-19 was a pretty big shock. We made some quick decisions around liquidity. For instance, we were in the market considering a capital-markets transaction but we had to shelve that and move to put a bank facility in place.

We have policies covering the amount of liquidity we aim to hold that consider the volume of obligations over the next 24 months. It is fair to say we are reviewing these policies given what has transpired in the last six months.

It is broader than just balance sheet, though. We are looking at aeronautical pricing, how we structure our deals, and assumptions made over the years about the reliability of investment-property revenue and tenant retail leases. It's not practical to operate a business while planning for these sorts of tail events, though, because doing so would be highly limiting.

Six months on, we are in a very strong liquidity position and we are comfortable with where our policies are at the moment. But they are subject to review over the next 6-12 months.

■ VAN DER GEEST Events such as COVID-19 can never be modelled. What can be considered is how to respond to shocks. The key difference between 2020 and the financial crisis is that we are not experiencing a liquidity event. The goal for Melbourne and other airports was to prioritise and secure liquidity first — and the way banks responded to the pandemic crisis was very pleasing.

This and other shocks really show the importance of the breadth of a banking group and strength of relationships. In a time like this, being able to reach out and get additional bank lines is vital. Doing so depends on having diversity in the bank group and banks that can support you.

When it comes to preparation, we had recently procured term debt in the capital markets and had quite a lot of available liquidity in undrawn bank lines. This stood us in good stead but we also sought further to increase our level of liquidity, providing the airport with a cushion to see us through the turbulent times.

Where we are today – and where I think all the airports are – is with sufficient liquidity and with our attention focused on getting underlying trading performance back on track. We are waiting for the bounce and aiming to manage cost control on the way back up.

■ MOMDJIAN We have learned from diverse shocks since Sydney Airport was privatised in 2002. We have also spent

"Cash-flow forecasting has been a big part of the process for us during the pandemic – understanding downside scenarios and testing them against covenant and liquidity limits to ensure we have an appropriate buffer. We have always done this, but I think the pandemic has heightened the focus."

DARREN TRIGGELL PORT OF BRISBANE





"It is not a pipe dream to think that most if not all borders will soon open up domestically. There is significant pent-up demand from people wanting to see their families and friends, as well as those itching to go on holiday – which will help fuel a solid domestic recovery as lockdowns ease."

MICHAEL MOMDJIAN SYDNEY AIRPORT

significant time carrying out scenario analysis, identifying risks and – importantly – their mitigants. But it is clearly difficult to prepare for a once-in-a-lifetime event of this breadth, length and severity.

Proactive capital management is part of our DNA, though. Aside from the minimum liquidity requirements set out in our policies, the strength of our balance sheet and our well-spread, lengthened and diversified maturity profile afforded us the ability to shift our focus away from reactively responding to the pandemic.

Instead, our goal has been further to strengthen our balance sheet such that we are well positioned under a range of recovery scenarios, regardless of its shape or pace, and are able to capitalise on future growth opportunities as they arise.

We entered the pandemic with more than A\$1.7 billion in cash and undrawn debt – already enough to fund all our debt maturities until the end of 2021. We went over and above to establish A\$850 million of bilateral bank-debt facilities and raise A\$2 billion of equity, bolstering our liquidity position while optimising leverage. We were not forced to access debt capital markets, particularly at a time when margins and all-in funding costs had spiked.

In taking our liquidity position to more than A\$4.5 billion, our bank group – domestic and offshore – was very supportive. A few banks even tried to use the pandemic as a way of entering our bank group, which came as a surprise given the circumstances but highlights a focus on core business fundamentals and long-term credit quality.

Blix Has the pandemic forced a relatively unaffected company like Aurizon to rethink liquidity policies?

■ VAGG Our board is focused on liquidity even though we were relatively unaffected. I was constantly questioned about it — about whether our policies and thresholds were sufficient.

We made some changes to timing. We were planning on issuing in the Australian market in March and we did our deal roadshow in the last week of February – which was when COVID-19 was blowing up from a capital-markets perspective. The relevant maturity was in October but we had to shelve the new deal quite quickly.

The subsequent plan was to refinance our bank facilities and we went ahead with this in March. We then took the

opportunity to increase our capacity by establishing a new bank line and converting it to a bilateral facility from a syndicated one. We were doing this in the eye of the storm, but our message was that the business was largely unaffected.

The process took a lot longer than it normally would but we received good support from our banking group as well as introducing a few new lenders to increase our capacity by about A\$400 million. This was so we could cover our bond maturity only a couple of months later. Although the bond markets were already starting to open up, we decided to take a conservative option.

The message from our board was not to focus too much on cost or to keep just the bare minimum of liquidity needed. They gave their support to be conservative. We closed the bank-debt refinancing in June and bond markets opened up pretty quickly after that, so we were able to issue a bond in August.

We now have ample liquidity and undrawn bank lines. We have left the facilities there for now because, again, the message from the board has been to take our time to think about what liquidity we will need over the next couple of years. We are in no rush to adjust those bank lines but the ultimate strategy will be to term some of them out in capital markets in the future.

It was good to have support from our board about not focusing on achieving the lowest-cost bond transaction. It is important to get the right mix of investors participating in a deal, as well as the right mix of banks in our facility and the right maturity profile.

TRIGGELL Our policies guided us very well through the eye of the storm. We came into it having experienced a heavy period of capex spend with the motorway upgrade and the cruise-facility project over the last two years. Still, we had a good level of headroom in our bank facilities.

We began a debt capital markets issuance process in February-March to fund a maturing bond. We quickly shelved this and turned to the bank market, which was extremely accommodative.

Once we saw calm return to markets, we proceeded with bond issuance locally in July and achieved a great outcome including pricing not materially different from pre-COVID-19 levels. The main objective for our bond issuance was to clear our 2021 calendar-year refinancing obligations and to create space until the next refinancing process, as the outlook in financial markets was uncertain.



"Humans tend to be creatures of habit and can be expected to revert to their behaviour from before the pandemic. If the SARS epidemic and terrorism have not scared people off flying permanently, I think they will revert back to normal pretty quickly after COVID-19 is under control."

KEVIN LEWIS IFM INVESTORS



Cash-flow forecasting has been a big part of the process for us during the pandemic – understanding downside scenarios and testing them against covenant and liquidity limits to ensure we have an appropriate buffer. We have always done this, but I think the pandemic has heightened the focus.

Blix Transurban is one of Australia's most active corporate issuers in global markets. What was the ride like from its euro transaction in April – the peak of the pandemic – through to the recent US dollar deal?

■ MCKAY Global capital markets certainly provided an interesting backdrop to our capital-raising activities this year. Similar to other corporates, as the pandemic continued to grow we quickly took the decision to establish additional bank facilities primarily to cover the risk of a major dislocation to global capital markets.

We also continued to monitor global markets, though. By April, we had sufficient confidence to proceed with a bond transaction. We ultimately launched in the Eurobond market, where we expected to get best execution, and successfully priced a ϵ 600 million (US\$706.6 million) 10-year bond.

During June, given the positive signals in the Australian bond market, we launched a domestic bond deal for Westlink M7. We were delighted with the response from our domestic investor base for this, eventually closing a A\$155 million 10-year transaction.

During the second half of the year, we monitored conditions in the euro and US 144A markets. Given the strong rally that took place in the 144A market, we launched a deal there and were delighted with the response – ultimately pricing a US\$900 million 10.5-year bond.

INVESTMENT CONDITIONS

Lucas Could investors speak to the period of maximum stress and specifically how important the Reserve Bank of Australia (RBA)'s termfunding facility (TFF) was to the market?

■ DAVID Across our platform, our funds aim to provide liquidity to our clients through all considerations. It is important that we treat all clients fairly, though — and when a market is severely dislocated liquidity can dry up very quickly.

If we just sold the bonds that were liquid, we would be selling a lot of high-quality bonds. We applied a sale spread on our funds that effectively allowed us to pass on the cost of accessing liquidity to clients who wished to use it, and thus not to penalise clients that chose to remain in the fund.

The RBA's TFF started the thawing of liquidity in the market. We didn't envisage the RBA following the [US] Federal Reserve and European Central Bank in becoming an active participant in the market. But we definitely saw it using the banks as the transmission mechanism to get liquidity to flow into the market and to corporate Australia, and thus indirectly to benefit the bond market. This was a trigger point.

A lot of excess liquidity investors were holding has been returned to the market. There is probably a little still on the sidelines, which is reflective of an environment where the economic outlook is still quite challenged with moderately high unemployment and a lot of businesses are suffering the effects of the COVID-19 lockdown. Investors are waiting to see what things are like when activity resumes again.

Lucas Has reduced bank issuance domestically affected fund managers' demand for corporates – and is there more demand now for global names?

■ DAVID We have seen a range of new issuers come to the market of late, some within sectors that are quite affected by COVID-19. We have started to see corporate transactions oversubscribed to the same degree that we might typically see in Europe and the US. It was not previously common to see an Australian dollar triple-B corporate with a book of A\$1 billion or more. This is frequently the case nowadays.

The range of investors chasing these transactions is significant and looks to be growing. This brings challenges because there is a lot of competition to get access to deals in the volume we want.

LEWIS We have seen an abundance of debt capital available for quality infrastructure assets. This reinforces the point that investors see value in infrastructure assets over the long term. There is certainly plenty of money chasing infrastructure debt exposure.

We have been significantly scaled from what we have bid in some transactions. This is good for the borrowers but it makes it hard for us to get invested in an asset that fits our portfolios. •

Rocky road ahead

The 2020 iteration of the KangaNews-Moody's Investors Service Corporate Borrower's Intentions Survey highlights the response of corporate Australia and New Zealand to COVID-19. The results show treasury teams are anticipating a rocky path out of the crisis and a heightened domestic focus to their funding plans.

BY MATT ZAUNMAYR

conducted in September and received more than 60 responses from capital-markets-relevant nonfinancial corporate borrowers in Australia and New Zealand.

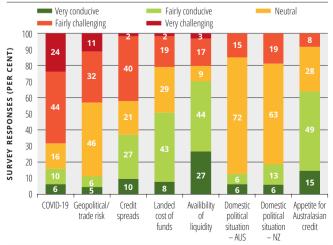
The makeup of respondents is relatively consistent with previous years and broadly reflects the shape of Australian and New Zealand debt capital

he survey, now in its seventh year, was

reflects the shape of Australian and New Zealand debt capital markets issuance. The vast majority of responses – more than 85 per cent – come from investment-grade firms and the dominant sectors are infrastructure, general corporate, real estate and construction, and regulated utilities.

The economic and health crises wrought by COVID-19 in 2020 are, unsurprisingly, survey respondents' key concern related to capital-markets access in 2020. More than two-thirds note that the pandemic represents a challenge in market access (see chart 1).

CHART 1. IMPACT OF ISSUES ON EASE AND COST OF ACCESS TO GLOBAL DEBT CAPITAL MARKETS



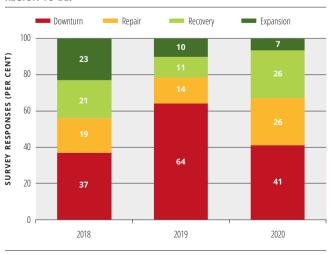
SOURCE: KANGANEWS, MOODY'S INVESTORS SERVICE OCTOBER 2020

Notably, despite the severe economic impact of the pandemic, corporate borrowers continue to find liquidity conditions highly conducive to market access and remain confident in the appeal of Australasian credit.

The pandemic has undoubtedly hammered corporate operating conditions – albeit not equally for all borrowers – but corporates appear to believe the worst of the economic consequences may be over. More respondents indicate that the credit cycle is in repair or recovery than did in 2019, while fewer think the trajectory is still downward (see chart 2).

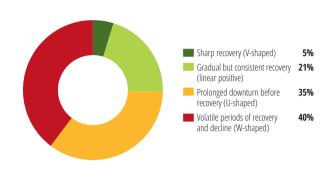
The question is relative, though – so responses may simply indicate how far things fell in H1 2020. Patrick Winsbury, associate managing director at Moody's in Sydney, says 2019 was characterised by weak investment and consumer spending, mediocre growth and US-China trade tensions. "At this point in 2020, after likely seeing the worst of the downturn in the second quarter, the outlook is probably looking better," he comments.

CHART 2. WHERE IN THE CREDIT CYCLE DO YOU CONSIDER YOUR LOCAL REGION TO BE?



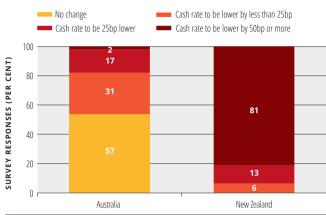
SOURCE: KANGANEWS, MOODY'S INVESTORS SERVICE OCTOBER 2020

CHART 3. WHAT DO YOU EXPECT THE ECONOMIC RECOVERY FROM COVID-19 TO LOOK LIKE OVER THE NEXT 12-24 MONTHS



SOURCE: KANGANEWS, MOODY'S INVESTORS SERVICE OCTOBER 2020

CHART 4. WHAT ARE YOUR EXPECTATIONS FOR THE DIRECTION OF MONETARY POLICY OVER THE NEXT 12 MONTHS



SOURCE: KANGANEWS, MOODY'S INVESTORS SERVICE OCTOBER 2020

"Respondents may also be identifying a move to the recovery phase because of the large amounts of government stimulus undertaken in 2020."

The majority of borrowers still foresee a long road ahead for recovery rather than swift resolution of macroeconomic woes (see chart 3).

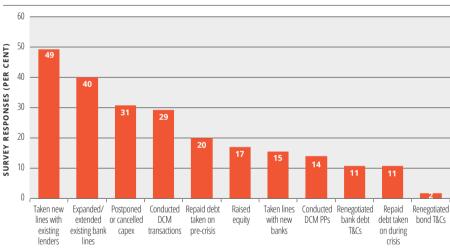
This is broadly in line with the Moody's house view. Martin Petch, vice president at Moody's in Singapore, says: "We expect growth to pick up to moderately above trend in 2021, albeit reflecting the low base for activity following the downturn in 2020. We expect government infrastructure spending to support growth as well as some mild recovery in employment, which will help lift consumer spending. Business investment is likely to remain soft until the momentum of recovery picks up."

Respondents' forecasts for monetary policy in Australia and New Zealand broadly reflect market expectations in September. In Australia, the market is gradually moving toward expectations of an unconventional cash-rate cut – of 10 or 15 basis points. In New Zealand, there is a clear expectation of negative rates within the next 12 months (see chart 4).

CRISIS RESPONSE

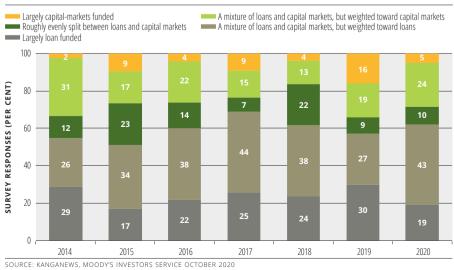
orporate borrowers have responded to the crisis in a range of ways when it comes to debt funding. The most popular were taking

CHART 5. WHICH ACTIONS HAS YOUR COMPANY TAKEN AS A RESULT OF THE COVID-19 CRISIS?



SOURCE: KANGANEWS, MOODY'S INVESTORS SERVICE OCTOBER 2020

CHART 6. HOW IS YOUR COMPANY'S DEBT BOOK COMPOSED?



on new bank lines or extending existing ones, followed by the postponement or cancellation of capex plans (see chart 5).

Fewer borrowers issued bonds as a result of COVID-19 than the number that added or extended bank lines. But there is no sign of a widescale return to complete reliance on bank funding. In fact, issuers overall continue to build the capital-markets proportion of their debt books at the margin (see chart 6).

Arnon Musiker, vice president and senior credit officer at Moody's in Sydney, says Australian Bureau of Statistics data also show firms are expecting to scale back capital investment, and this could influence future borrowing requirements.

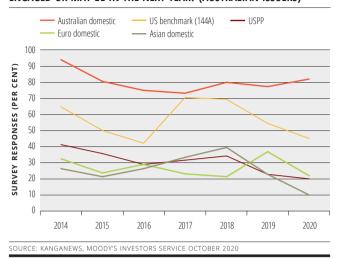
The proportion of borrowers expecting their call on debt capital markets to increase over the next two years is at its lowest level since 2015 (see chart 7). However, half the issuers still expect to increase their call on global bond markets while just 8 per cent expect it to fall.

"Many borrowers have also brought forward issuance plans for the next couple of years, to raise liquidity in response to

CHART 7. OVER THE NEXT TWO YEARS, DO YOU EXPECT YOUR COMPANY'S CALL ON GLOBAL CAPITAL MARKETS TO:



CHART 9. WITH WHICH DEBT MARKETS IS YOUR COMPANY ACTIVELY ENGAGED OR MAY BE IN THE NEXT YEAR? (AUSTRALIAN ISSUERS)



COVID-19-related uncertainty and to strengthen their liquidity position as much as possible in view of an economic downturn," Musiker explains.

The survey also shows that when corporate issuers have a call on debt markets they are increasingly likely to view domestic issuance as their first option. This applies on both sides of the Tasman Sea.

For Australian borrowers, the most notable change in views on ease of market access is a precipitous drop in appeal of the US private placement (USPP) option (see chart 8). Traditionally a close competitor to domestic issuance - if not the preferred option – just 22 per cent of issuers believe USPP is among the best issuance avenues in 2020 compared with 65 per cent naming the domestic market.

Australian borrowers say they have increased or intend to increase engagement with their domestic market in 2020 and the coming year (see chart 9).

CHART 8. WHICH CAPITAL MARKETS PROVIDE THE BEST FUNDING OPTION FOR YOUR COMPANY? (AUSTRALIAN ISSUERS)

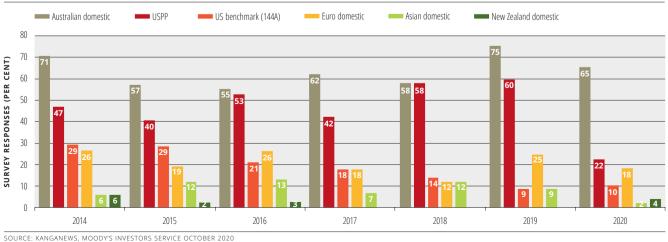


CHART 10. WHICH CAPITAL MARKETS PROVIDE THE BEST FUNDING OPTION FOR YOUR COMPANY? (NEW ZEALAND ISSUERS)

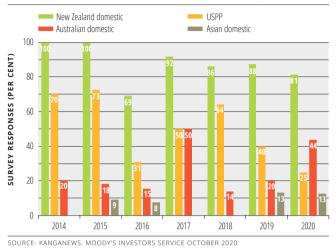
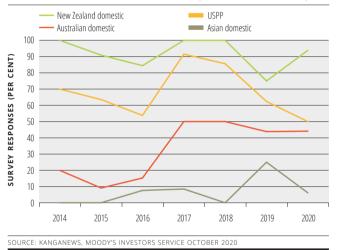


CHART 11. WITH WHICH DEBT MARKETS IS YOUR COMPANY ACTIVELY ENGAGED OR MAY BE IN THE NEXT YEAR? (NEW ZEALAND ISSUERS)



A similar trend comes through in the New Zealand market, where USPP has been replaced by the Australian dollar as the second-best issuance option (see chart 10). It is unclear whether this will translate into more trans-Tasman deals, though, as borrowers indicate that engagement with the Australian dollar market remains stable in 2020 from 2019 (see chart 11).

Despite the large take-up of virtual means for marketing and roadshows, corporate borrowers indicate in the survey that social-distancing restrictions are presenting challenges for investor relations. A small minority think the new paradigm has had a positive impact, but 55 per cent say there are minor challenges and 11 per cent note significant challenges.

ESG AWARENESS

he pandemic has been described as a catalyst for environmental, social and governance (ESG) recognition in capital markets, while 2020 has seen significant

CHART 12. IN WHAT SUSTAINABLE FORMAT(S) ARE YOU INTERESTED IN ISSUING? (AUSTRALIAN ISSUERS)

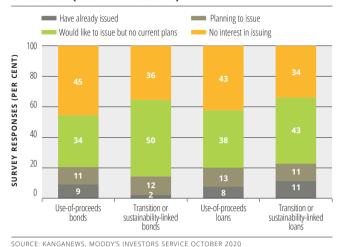
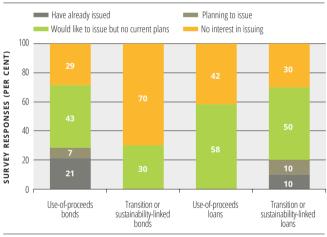


CHART 13. IN WHAT SUSTAINABLE FORMAT(S) ARE YOU INTERESTED IN ISSUING? (NEW ZEALAND ISSUERS)



SOURCE: KANGANEWS, MOODY'S INVESTORS SERVICE OCTOBER 2020

progress in the development, if not the issuance, of transition and sustainability-linked instruments. Australasian corporate issuers' plans are not changing, though.

Only 27 per cent of survey respondents say the pandemic has increased their engagement with ESG concerns related to their business, while 71 per cent indicate no change at all and a tiny minority say it actually decreased awareness.

There is also little sign of an impending boom in ESGthemed debt issuance from the corporate sector. In Australia, the survey indicates a small pick-up in issuance or planned issuance for the various ESG formats, but more than three-quarters of respondents say they still have no firm plans or no interest in issuing sustainability-themed debt of any kind (see chart 12).

New Zealand borrowers that are interested in sustainablefinance products appear to have coalesced around use-of-proceeds product for bonds and transition or sustainability-linked product for loans, though the overall numbers are also low (see chart 13). •

New horizon for specialist investors

Australia's private-debt market and the investors that specialise in it are not new phenomena. What is new is a headline cash rate at close to zero and the withdrawal of supply from the biggest historical source of local credit issuance – the major banks. Specialist investors say their sector is attracting more interest and inflows on the back of this changed environment.

BY CHRIS RICH

rivate debt is a catch-all term for a number of private financing formats including institutional corporate loan placements, leveraged finance, structured finance — especially in mezzanine format — property debt and project finance. Historically, most of this type of funding has been provided by the local major banks supplemented by international banks, with just a small slice available to asset managers.

Given its breadth and diversity, it is impossible accurately to estimate the scale of the market – let alone different lenders' market share within it. But there are signs of more debt becoming available to investors outside the banking sector. For instance, regulatory changes in the securitisation market have made it harder for banks to hold the full capital structure of warehouse facilities provided to nonbank lenders, creating an opportunity for specialist investors to gain mezzanine exposure even before borrowers approach the capital market.

On the demand side, the hunt for yield is prompting interest in fixed-income strategies that focus on higher-yielding securities. In 2020, Australia took its final steps to catch up with the rest of the world as an ultra-low cash-rate environment.

The Reserve Bank of Australia (RBA) cut the cash-rate to 0.25 per cent in the early stages of the COVID-19 pandemic. Most analysts expect a further "micro cut" to 0.1 per cent and even the possibility of negative rates at some stage in 2021 – despite RBA protestations that this approach has not delivered desired results when implemented elsewhere (see p40).

Australia's interest rate had already fallen significantly prior to the onset of COVID-19. The RBA cut the cash-rate to 1.25 per cent from 1.5 per cent in June last year – after spending almost three years at the higher rate – before dropping to 0.75 per cent in October.

Bob Sahota, founder and chief investment officer at Revolution Asset Management in Sydney, says the private-debt space continues to offer appealing absolute-return opportunities in the new environment. "From March onwards, we have been able to demonstrate that we can get the same type of deal done in the market as a pre-pandemic transaction – meaning the same level of credit risk, spread and illiquidity – but be rewarded with 1-1.5 per cent of additional yield in the COVID-19 affected market," he tells *KangaNews*.

This backdrop may be helping specialist investors clear one of the biggest hurdles to entry to their sector. Private debt is typically illiquid, which makes it a tough fit for end investors that require—or are legally required to be offered—daily liquidity. But with rates at an all-time low and credit spreads tight, private-debt managers report investors of all stripes are taking the steps required to gain access to their sector despite the liquidity constraints.

"We think investors are taking the next step, which is strategically understanding fixed-income products in the alternative debt space. This process, which was already ongoing, has been made more profound in the last 12 months with the rates environment," says Robert Camilleri, Melbourne-based founder and investment manager at Realm Investment House.

Metrics Credit Partners is among the beneficiaries. It offers a range of strategies, lends to investment- and subinvestment-grade corporates and has the ability to participate through the entire capital structure from senior-unsecured debt through to equity.



"From March onwards, we have been able to demonstrate that we can get the same type of deal done in the market as a prepandemic transaction – meaning the same level of credit risk, spread and illiquidity – but be rewarded with 1-1.5 per cent of additional yield."

BOB SAHOTA REVOLUTION ASSET MANAGEMENT

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Institutional investor interest has increased across this spectrum of products, according to Andrew Lockhart, managing partner at Metrics in Sydney. "We have won new superannuation-fund clients over the past six months and have received an increase in capital allocation from existing superannuation clients, insurance companies, universities, charities, foundations and others that have all been looking for alternative ways to drive yield," he says.

BANKING ENVIRONMENT

ome of Australia's private-debt investors are longestablished names in the sector. For instance, along with several other asset classes, Moelis Australia manages just more than A\$1 billion (US\$718.1 million) in the private-debt space with a focus on providing secured loans to mid-market corporates and SMEs.

Chris Wyke, Sydney-based joint chief executive at Moelis Australia, says many of the factors that led the asset manager to pursue opportunities in private debt in the early 2010s remain in place today. "In the lead up to the financial crisis the major banks dominated the lending market in Australia, and this led to regulators seeing the need to open up the market in a smooth and controlled manner post-financial-crisis. This has been a global trend," he explains.

Wyke points to the fallout from he banking royal commission and increased regulatory capital requirements as significant factors mitigating banks' capacity to lend in some areas of interest to specialist debt funds.

Some borrowers may fall out of the banks' realm entirely while in other cases funds may be able to invest alongside banks to top up capacity or provide liquidity in specific parts of the capital stack. Securitisation again illustrates this latter outcome, as funds now frequently provide a – smaller, but higher-yielding – mezzanine slice alongside banks as the senior lender in warehouses.

Specialist fund managers say this process was already well underway ahead of COVID-19. "Our credit funds are focused on areas we believe present opportunities for solid risk-adjusted returns – and these are primarily areas where the banks are no longer undertaking lending activities. It is a fertile way to go about growing loan portfolios," Wyke adds.

On the other hand, the bank sector is suffuse with liquidity in the latter months of 2020 and the RBA's term funding facility (TFF) is widely expected to maintain this status quo for an

extended period. All else being equal, this should make the banks more willing and able to lend to any borrower sector. Facilitating credit provision across the economy is certainly the RBA's goal.

The pandemic certainly did not prompt a liquidity crisis. Indeed, one of the largest differences between COVID-19 and the financial crisis has been the availability of capital to corporates – from domestic and, for the most part, international lenders.

Wyke believes this is already changing, though. "In the early days of COVID-19, the banks were extremely accommodative of borrowers due to the sheer number of client applications being thrown at them. I think they are now re-evaluating that accommodation," he says.

While the TFF and strong deposit inflows have enhanced the major banks' ability to lend, specialist investors are quick to point out that the pandemic has not undone the heightened regulatory scrutiny placed on the banking sector after the last crisis.

"APRA [the Australian Prudential Regulation Authority]'s regulations around banks' activities will remain in place. They can capitalise on some pockets of credit thanks to their competitive funding advantage but there is still a large landscape out there for asset managers like us to thrive," Wyke argues.

The environment has certainly not been enough to deter greater interest in private debt, including from some more mainstream players. For instance, in September Revolution announced that it had signed a co-investment relationship and consequent new mandate to manage Australian and New Zealand private debt with QIC.

Phil Miall, Brisbane-based director, credit at QIC, agrees that the opportunity set is not drying up despite the changing environment. "Banks still have to hold greater capital levels so their return on capital is less. Bank appetite for sub-investment-grade loans in particular is likely to be affected, which creates an opportunity for institutional investors to fill the supply gap and provide capital at attractive yield."

This is not a phenomenon unique to Australia, either. In particular, a number of Australia-based specialist funds are looking at opportunities in New Zealand – which is experiencing similar banking-sector dynamics.

Revolution, for instance, has 25 per cent of its assets invested in New Zealand. Sahota says: "Much like the Australian experience, there is an increasing trend toward private-credit investment in the New Zealand market as institutional and wholesale investors seek out reliable and defensive income against a backdrop of poor global growth, low inflation and falling yield."



"Banks still have to hold greater capital levels so their return on capital is less. Bank appetite for sub-investment-grade loans in particular is likely to be affected, which creates an opportunity for institutional investors to fill the supply gap and provide capital at attractive yield."

PHIL MIALL QIC

"Our credit funds are focused on areas we believe present opportunities for solid risk-adjusted returns – and these are primarily areas where the banks are no longer undertaking lending activities. It is a fertile way to go about growing loan portfolios."

CHRIS WYKE MOELIS AUSTRALIA

LIQUIDITY MANAGEMENT

he reality of the return environment is making debt investors of all types contemplate breaking new ground to find yield. In the high-grade space, this often involves moving further out in duration to take advantage of a relatively steep Australian dollar curve. In credit, many investors are prepared to compromise long-held requirements on liquidity.

Sahota tells *KangaNews* institutional-investor interest in the private-debt space has come a long way in a short time as a result. "When we started – two-and-a-half years ago – there was a lot of push back about the illiquidity of our asset class compared with offshore. But as rates have collapsed globally, fund managers are being forced to look at the defensive part of their allocation in a lot more detail," he says.

Liquidity in private debt may also not be as shallow as it is often perceived, says Luke Gersbach, Sydney-based senior portfolio manager at Mirae Asset Global Investments. "If you need to get out of positions, you can. Equally, there are opportunities to increase positions. The illiquidity premium offered by private debt is one of the attractions and it is one of the yield enhancers we are trying to harvest."

In this case, scale can help. Lockhart tells *KangalNews*: "Turnover is substantial when you run an operation the size of ours, and we certainly don't have any liquidity obligations to investors in our various funds that could not be adhered to."

Starting with its first wholesale investor fund in 2013, with one investor and A\$75 million of assets under management, Metrics now oversees in excess of A\$5.5 billion with about A\$4 billion sourced from Australian institutional funds. The firm originates transactions and lends directly to Australian and New Zealand companies via a range of products.

Lockhart believes investors' reassessment of allocations to traditional fixed-income asset classes picked up in intensity following the volatility of March and April. In particular, he suggests that institutional funds invested in public-market securities have not been able to get the liquidity they sought and experienced dislocation in traded prices as volatility abounded.

"The market is less liquid than investors were expecting – they are being charged substantial costs on exit," Lockhart says. "This has led many to reconsider some of their investment positions because they have not performed as they should have in periods of stress."

Sahota says the illiquidity that hit public markets in March and April changed the way typical fixed-income fund managers view illiquidity in the private-debt space, with the COVID-19 overlay making the illiquidity premium an attractive proposition.

In effect, the argument goes, confronted with illiquidity across their portfolios many investors are warming to the idea that they might as well be paid an illiquidity premium in the private-debt space for at least some of their assets under management.

This is not just an institutional-investor story. Specialist funds say retail interest in their strategies is growing, too – and some have made distribution moves to take advantage (see box on p88).

HEIGHTENED RISK ENVIRONMENT

t the same time, the pandemic and the heightened creditrisk environment bring an increased focus on credit quality. Lockhart says some of the inflows to Metrics have moved out of property-related equity and into the debt part of the capital structure, seeking solid return with added security and less asset-price volatility.

Sahota adds that at this point in the cycle there is growing recognition of the benefit of being secured at the top of the capital stack versus unsecured debt or equity. This was already the case coming into the COVID-19 dislocation, though. "We found that this discussion has really started to gain traction as the coordination of central banks around the world has reduced interest rates – in some cases into negative territory," Sahota says.

"If you need to get out of positions, you can. Equally, there are opportunities to increase a position. The illiquidity premium offered by private debt is one of the attractions and it is one of the yield enhancers we are trying to harvest."

LUKE GERSBACH MIRAE ASSET GLOBAL INVESTMENTS



RETAIL INVESTOR OPPORTUNITIES

Institutional investors are not the only ones with eyes on the private-debt space. Retail fixed-income investors have increasingly turned their attention to an asset class that promises greater return in a challenging rates environment.

Retail investors looking to access the private-debt market have limited opportunities in Australia. But, like institutional investors, the rates environment has motivated retail investors to explore options to boost flagging income-asset return.

"Retail investors are not achieving the returns they want from their money. The punitive impact of the rates environment on these investors' assets is forcing them further out on the credit curve – and we are seeing the impact in our fund flows." Andrew Papageorgiou, Melbourne-based founder and investment manager

at Realm Investment House, tells *KangaNews*.

Realm claims to be Australia's first asset manager to offer retail investors a strategy that is wholly invested in the bank warehouse-facility funding space. It has A\$200 million (US\$143.6 million) allocated in this strategy and has placed the fund onto Australia's largest superannuation and retail financial-planning platform for retail investors.

Robert Camilleri, founder and investment manager at Realm, says clients began asking to co-invest in allocations in parts of the market that were difficult to access as early as

2017. It was this demand that spurred Realm to introduce the warehouse fund.

In the retail space, fund managers are faced with the challenge of making sure retail clients fully understand a private-debt strategy – particularly the illiquidity component.

"Assets can become really cheap when there is a market event sparked by something not related to credit quality. But retail investors get penalised because they do not understand how markets work: at the very time one should be buying these cheap assets, these

investors tend to want their money back," Camilleri says.

"We have had to explain to retail investors that there is a trade-off – that we cannot operate this fund in an open, daily-priced manner. If you want to earn 6 per cent total return, you can only do it if your funds are tied up," he adds.

Now its fund is on a financialplanning platform, Realm believes the strategy can be scaled thanks to the range and scale of mezzanine funding requirements of nonbank and regional-bank lenders. This is assisted by major banks' desire to conserve capital.



"We have had to explain to retail investors that there is a trade-off – that we cannot operate this fund in an open, daily-priced manner. If you want to earn 6 per cent total return, you can only do it if your funds are tied up."

ROBERT CAMILLERI REALM INVESTMENT HOUSE

Private-debt practitioners describe COVID-19 as a classic case of a risk event creating challenges and opportunities. Sahota reveals that the secondary market has been a productive pipeline for Revolution, while at the same time the risk environment has led to a renewed focus on structural quality in the new-issuance space. "The upfront fees are higher and the overall margins we have been able to get are better on a risk-adjusted return basis because of the current environment," he comments.

Moelis Australia maintained a comfortable cash position until recent months, Wyke says, when micro- and macroeconomic data began to improve. It has now ramped up lending in structured finance as well as pre-sale construction of residential properties. By contrast, the firm remains cautious on anything consumer-related.

The devastating impact of the pandemic on some economic sectors is not without impact in the private-debt space. As Wyke's rundown implies, lending to the property sector is a significant component of the private-debt market – and this sector was one of the hardest hit by the COVID-19 crisis, at least outside the residential space.

Gersbach says Mirae has become more selective about the sectors it will look at. "We don't knock something out purely because of its sector but we have not looked at anything in the property space for most of the year. Pre-COVID-19 this was from a pricing and competitiveness standpoint but now we have largely dismissed property and retail transactions outright," he says.

There are still opportunities. A steady stream of transactions in sectors that have experienced significantly less impact from COVID-19 has been a decisive factor in moving away from property, Gersbach adds. "The health and technology sectors have provided private-debt investors with the most opportunities, proving their resilience through the crisis," he reveals.

Steering away from procyclical industries has been key to the success of Revolution's strategy. "Through the crisis we have focused on healthcare, consumer staples, infrastructure and mission-critical software companies," Sahota comments. "We have provided, along with other lenders, the senior-secured debt for acquisitions where borrowers could demonstrate they have performed well through the cycle." •



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