Singapore Economics

Post-Budget: Airport REIT an Option for Funding Infra?

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Borrowing to Finance Infrastructure

The government is planning to borrow and tap on a government guarantee, with the President's concurrence, to finance Changi Airport's expansion. The project is set to cost "tens of billions of dollars," which includes a new Terminal 5 (to start in 2030) and a third runway. Borrowing, rather than raising taxes, will spread the burden more equitably across generations.

Strong Balance Sheet, Fiscal Assets Almost S$1.1tn

The government's balance sheet is strong and exceedingly large. Fiscal assets have grown to about S$1.09 trillion or 232% of GDP as of March 2018. This is an increase of S$90.4bn or +9.1% from the previous year. With such large reserves, earmaking a small proportion for a government guarantee on the borrowings or bonds will pose little risk. Investors and rating agencies will rate any infrastructure bond favourably. The exceedingly large fiscal reserves also beg the question of the necessity of higher future GST.

Another Option is an Airport REIT

We think an Airport REIT is another alternative for financing the large infrastructure commitment. Monetizing the existing first 3 Changi Terminals, which already have stable cash flows, could raise a significant amount of funds. This will reduce the amount of borrowings required. Changi Airport's annual operating profit is about S$953 million, with total revenue of S$2.6bn for FY2018. There is no detailed breakdown but the income generated from the first 3 Terminals could be as much as S$500 million. An Airport REIT secured on the rental income of the first 3 Terminals could command a market capitalization near S$10 billion. Our REIT analyst Su Tye believes that the retail portion will be at a premium to the other existing malls and can command as much as $4,500 psf.

Merits of an Airport REIT

An Airport REIT could help revive what has been a moribund period for the Singapore exchange. A recent Bloomberg report highlighted the sorry state, with the number of delisting exceeding listings in recent years. IPO proceeds raised last year only amounted to US$512mn, falling 85% from the previous year. Singapore ranked #7 in Asia ex-Japan in terms of funds raised, far behind Hong Kong ($35bn) and even Vietnam ($2.6bn). An Airport REIT will help increase the representation and weight of "pure play" Singapore companies on the Strait Times Index. Such a REIT will help satisfy yield-hungry institutional and retail investors. A listed Airport REIT can also be used to guarantee or partly guarantee the loans for Terminal 5, reducing the burden on the government for a guarantee or perhaps even the need for the President's concurrence.

Malaysia is Exploring an Airport REIT

Malaysia has proposed to set up an airport REIT, the first in the world, to raise about RM4bn (S$1.3bn) to fund future airport upgrades and expansion. Khazanah will be leading and developing an 80-acre development in Subang as a world-class aerospace hub.

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Post-Budget: Airport REIT an Option for Funding Infrastructure?

"Borrowing, done in a responsible and sustainable manner, will help instill financial discipline and distribute the share of funding more equitably across current and future generations … For the development of Changi East, the Changi Airport Group will be taking up loans to fund it share of the infrastructure investments. To lower funding costs, ***the Government, with the President's concurrence, will provide a guarantee for Changi East borrowings****. This allows us to tap on the strength of the Government's balance sheet to back this strategic investment. This lowers the cost of borrowing."*

Minister of Finance Heng Swee Keat, Budget Speech 2019, 18 Feb 2019.

Borrowing to Finance Infrastructure

The government is planning to borrow and tap on a government guarantee (with the President's approval) to finance Changi airport's expansion. As part of the project, which is set to cost "tens of billions of dollars", a new Terminal 5, which is expected to start operations in 2030, as well as a third runway will be constructed. A new network of tunnels and systems will also be constructed to allow the transfer of passengers and baggage between the new terminal and the rest of the airport.

Borrowing, rather than raising taxes, will spread the burden more equitably across generations. Using the government's strong balance sheet to provide a guarantee for these loans or bonds will also help lower financing costs. The latest government balance sheet shows that fiscal assets have grown to about S$1.09 trillion as of March 2018. This is about 232% of GDP (see Table 1). In terms of absolute change, fiscal assets grew by +S$90.4bn or +9.1% over the previous fiscal year. Investors and rating agencies will rate any infrastructure bond favourably given Singapore's fiscal balance sheet strength. The exceedingly large fiscal reserves also beg the question of the necessity of higher future GST. A +2ppt increase in GST is estimated to raise S$3.2bn (small in proportion to the +$90bn change in fiscal assets over a year).

Table 1: Fiscal Assets & Investments, March 2015 to March 2018

	Assets		Investments	
	Amount (SGD billion)	% of GDP	Amount (SGD billion)	% of GDP
Mar-15	878.0	218	761.6	189
Mar-16	941.3	222	814.3	192
Mar-17	997.4	223	913.6	205
Mar-18	**1,087.8**	**232**	**1,019.4**	**217**

Source: CEIC, Ministry of Finance Budget: Statement of Assets & Liabilities, Maybank KE estimates.

The government also set up the Changi Airport Development Fund in 2015 to start saving and fund Changi Terminal 5. In the Budget 2018 last year, it was mentioned that the fund had about S$4 billion as of Feb 2018. Departure charges, which include a new Airport Development Levy (ADL), were also raised in July last year, by about S13.30 (to S$47.30). Transit passengers also started paying an Airport Development Levy of S$3. We estimate that in the first seven months since the ADL was imposed (Jul 2018 to Jan 2019), around S$209mn revenue was collected (see *Singapore Economics – Budget Preview: A Pre-Election "Merdeka" Boost*, 31 Jan 2019).

Is Changi Airport REIT an Option?

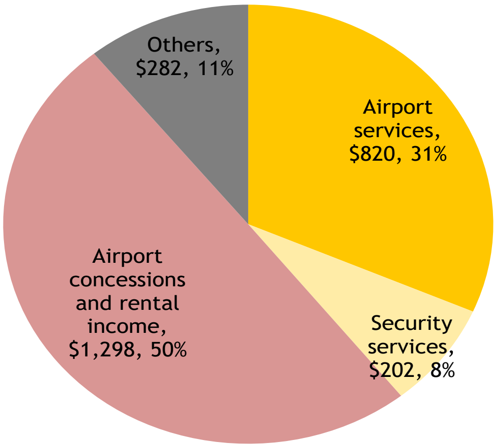
We think an Airport REIT is another alternative worth considering for financing infrastructure. First, monetizing the existing first 3 Changi Terminals which already have stable income and cash flows could raise a significant amount of money for the new Terminal. This will reduce the amount required for borrowings for Terminal 5. Changi Airport's operating profit is about S$953 million, with total revenue of S$2.6 billion for FY2018 (see Table 2). About 50% of Changi Airport's revenue is from airport concessions and rental income (Figure 1). There is no detailed breakdown but the rental income from the first 3 Terminals could be as much as S$500 million. An Airport REIT secured on the rental income of the first 3 Terminals could, by our estimates, command a market capitalization of near S$10 billion.

Table 2: Changi Airport Group Revenues and Operating Profits (FY2014 to FY2018)

	Revenues		Operating Profit	
	SGD mn	%YoY	SGD mn	%YoY
FY2014	2,106		921	
FY2015	2,150	+2.1	895	-2.8
FY2016	2,164	+0.7	880	-1.7
FY2017	2,305	+6.5	904	+2.8
FY2018	**2,602**	**+12.9**	**953**	**+5.4**

Source: Changi Airport Group

Figure 1: Breakdown of Changi Airport Group Revenue (S$2,602mn in FY2018)



Source: Changi Airport Group

Second, a Singapore Airport REIT could help revive what has been a moribund period for the Singapore stock exchange and revive some interest in the IPO market. A recent Bloomberg report for example reported on the shrinking Singapore stock market, where the number of delistings far exceeds listings (see *Bloomberg Markets: The Incredible Shrinking Singapore Stock Market*, 12 Feb 2019). As of end 2018, there were 741 firms listed on SGX, down from a peak of 782 in 2010.

In the IPOs for Asia ex-Japan in 2018, Singapore IPOs raised a paltry S$710.6mn (or US$518mn), ranking seventh and accounting for only 0.8% of total funds raised (see Table 3). Hong Kong ranked #1 and raised $35.4bn from IPOs in 2018, boosted by big names such as China Tower, Xiaomi and Meituan Dianping. Even other ASEAN countries ranked above Singapore in 2018, including Vietnam (#3, US$2.6bn), Thailand (#4, $2.5bn), and Indonesia (#6, $1.2bn). Only one listing in Singapore (Sasseur REIT at $0.3bn) made the top ten ASEAN IPO list in 2018. Thailand and Vietnam dominated with the largest listings in ASEAN last year (see Table 4).

Table 3: Asia ex-Japan IPOs and Proceeds Raised in 2018

Rank	Country	IPOs	Proceeds (USD bn)	%YoY
1	Hong Kong	197	35.4	120%
2	China	105	21.2	-38%
3	Vietnam	5	2.6	NA
4	Thailand	20	2.5	-28%
5	South Korea	62	1.9	-72%
6	Indonesia	53	1.2	66%
7	Singapore	13	0.5	-85%
8	Malaysia	22	0.2	-91%
9	Philippines	1	0.2	-66%
10	Taiwan	5	0.1	117%

Note: Numbers reflect IPOs up to 5 Dec 2018 plus expected IPOs by end of Dec.
Source: Ernst & Young 'Global IPO trends: Q4 2018'

Table 4: Top Ten IPOs in ASEAN in 2018

	Firm	Issuer (Exchange)	USD bn
1	Thailand Future Fund	Thailand	1.37
2	Vinhomes	Ho Chi Minh	1.34
3	Techcombank	Ho Chi Minh	0.92
4	Osotpa	Thailand	0.46
5	Sasseur Real Estate Investment Trust	Singapore	0.30
6	PetroVietnam Oil	Ho Chi Minh	0.18
7	Bhiraj Office Leasehold REIT	Thailand	0.16
8	D.M. Wenceslao & Associates	Philippines	0.15
9	Medikaloka Hermina	Indonesia	0.14
10	Bualuang Office Leashold REIT	Thailand	0.11

Source: Ernst & Young

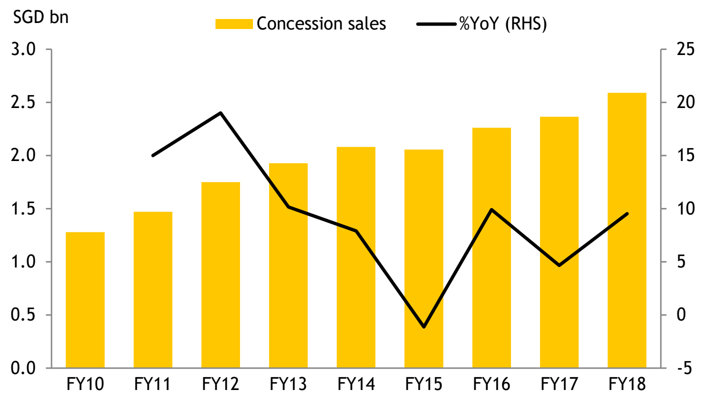
Third, an Airport REIT will increase the representation and weight of "pure play" Singapore companies in the Straits Times Index (STI). An increasing proportion of STI earnings are now coming from abroad, with several large companies including the Jardine Group and Thai Beverage, where almost all the earnings are generated from abroad. A market capitalization of over S$10 billion will likely qualify the REIT as an STI constituent index stock.

Fourth, Singaporean retail and institutional investors are also hungry for yield stocks. An Airport REIT will help broaden and complement the current diversity of REIT and business trusts offered on the Singapore exchange. This could help catalyze Singapore's efforts to be an infrastructure financing hub.

Fifth, the listed Airport REIT can be used to guarantee or partly guarantee the investments into Terminal 5, provided the debt ratio is low and comfortably below the debt ceiling. This might remove the need for the government to seek the President's concurrence, or earmark part of the fiscal reserves, for the guarantee on the borrowings. The funds will also reduce the pressure for new taxes (including the GST) or even higher airport charges to fund the airport expansion.

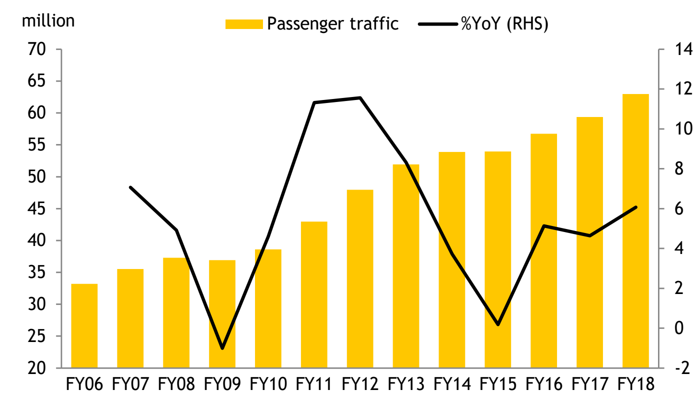
Our REITs analyst, Chua Su Tye, believes that a Changi Airport REIT is feasible given the strong cashflows supported by rental income from the retail space across all terminals. This may need to be separated from the group's relatively more volatile aeronautical segment. According to Changi Airport Group, total concession space across all terminals is about 980,000 sf, with transit malls on the air-side accounting for 667,000 sf. The latter would mostly include rental contribution from duty-free shops and hence could be volatile as well.

Figure 2: Concession Sales Posted Robust Growth of +10% in FY2018



Source: Changi Airport Group

Figure 3: Passenger Traffic Reached 63 Million in FY2018



Source: Changi Airport Group

Su Tye believes the retail portion could support conservatively a capital value of SGD4,500 psf, implying a valuation of SGD4.4bn. This compares against other large destinations malls - Causeway Point (416,000 sf at SGD2,930 psf), VivoCity (1,080,000 sf at SGD2,810 psf) and Northpoint City North Wing (230,000 sf at SGD3,520 psf). There could also be profit-sharing element in the rental contracts. Airport stocks moreover command a high price-earnings multiple, including those in Thailand and Malaysia, because of their monopoly position.

Dividends per unit will likely be driven by rental growth, which could reasonably achieve around +3% annually, given a 4% to 6% projection for visitor growth. There is an acquisition growth pipeline from Changi Airport Group's 51% interest in Jewel, which was valued on CapitaLand's books at SGD360m (100% interest) at end-Dec 2018, and potential retail pockets at Terminal 5.

Malaysia is Exploring an Airport REIT

The Malaysian government has proposed to set up an airport REIT to raise about RM4 billion (S$1.3bn) to fund future airport upgrades and expansion in Nov last year. The idea is to move the aviation industry towards a self-sustainable model that does not have to depend on the government's expenditure for future upgrades and expansion (see *Malaysia Aviation - Budget 2019: Moving towards user funding*, 4 Nov 2018). Formation of the Airport REIT will help the government to securitize its infrastructure assets.

Malaysia will also be raising the departure levy for all passengers travelling overseas via air routes starting June 2019. The levy increase will be RM20 (to RM55) for passengers travelling to ASEAN countries and RM40 (to RM113) for other countries. Khazanah will be leading and developing an 80-acre development in Subang as a world-class aerospace hub. Some of the funds generated will be to fund this project.

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