

SUKUK GROWING RELEVANCE IN INFRASTRUCTURE DEVELOPMENT

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Huge infrastructure development plans globally, especially around the GCC, African and Asian regions, will further fuel sukuk issuances in the infrastructure sector in 2014.

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Infrastructure Financing: Sukuk as viable alternative

Growing capital needs in the infrastructure sector globally present strong opportunities for sukuk to enhance its role as an important source of financing to the development requirements of the world economy.

Based on statistics reported by Organisation of Economic Cooperation and Development (OECD) an estimated of USD71tln would be required by 2030 for investments in road, rail, telecommunication, electricity and water infrastructure, without taking into account seaports, airports and social infrastructure. The amount represents approximately 2.5% of global GDP to 2030. The Gulf Cooperation Council (GCC), which is one of the key markets for sukuk issuances, is expected to witness substantial infrastructure investments during the decade 2010-2020, with market estimates ranging from USD535bln to about USD2tln. In addition, Africa, which in recent years has seen the introduction of Islamic finance in a number of jurisdictions, faces an infrastructure financing gap of USD35bln per year according to the World Bank. The International Finance Corporation (IFC) also estimated that a total of USD21tln in infrastructure investments are needed by emerging markets during 2008-2018. The immense infrastructure development plans globally presents strong opportunities for sukuk to support and partly shoulder the global infrastructure financing needs.

The method of raising funds through sukuk has become an integral part of Islamic finance and a pivotal pillar of overall Islamic finance's continuous growth. Since 2001, the world has seen steady growth of the global sukuk market attracting great interest from the wider international community. Sukuk have attracted numerous corporates, sovereigns, quasi-sovereigns and multilateral entities such as the Islamic Development Bank (IDB) and IFC to choose sukuk for fund raising. This rapidly growing segment within the overall Islamic financial system has expanded by a compound annual growth rate (CAGR) of 19.35% between 2007 and 2012. As at 1H2013, total sukuk outstanding reached USD245.3bln, contributing an estimated 14.15% of the global Islamic financial assets¹

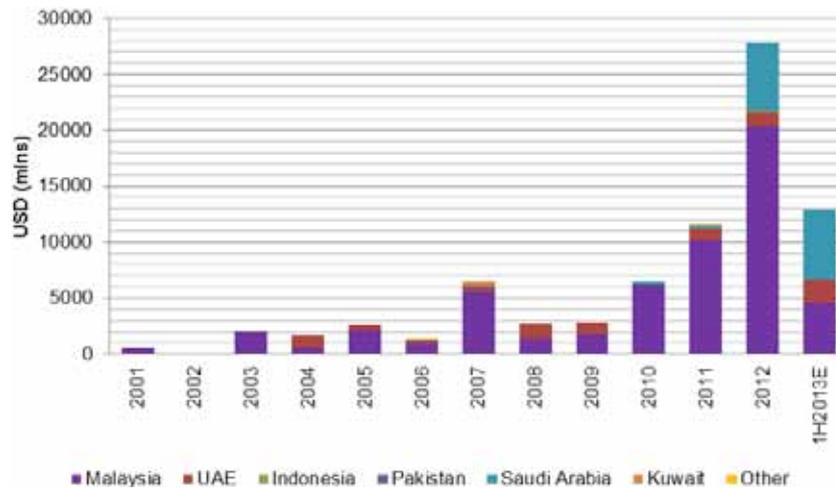
The infrastructure sector has seen a large portion of the sukuk fund raised directed to development projects around the globe, largely driven by infrastructure projects from both the GCC and Southeast Asian regions. The year 2012 witnessed a record-breaking number of new infrastructure sukuk issuances amounting to USD27.81bln, a tremendous 140.2% y-o-y growth. During this year, infrastructure sukuk issuances represented 21.2% of total global sukuk issuances. Malaysia led the cohort of countries with infrastructure issuances worth USD20.37bln or 73.24% of all sukuk issuances in the year 2012. Saudi Arabia ranked second with issuances worth USD6.08bln or 21.9% of all sukuk issuances in the same year. Other notable countries that have issued infrastructure sukuk include Indonesia, Pakistan, Kuwait and Brunei².

¹ KFH Research

² ibid

Infrastructure Sukuk Issuances by Country (USD mln per year)

Source: IFIS, KFH Research



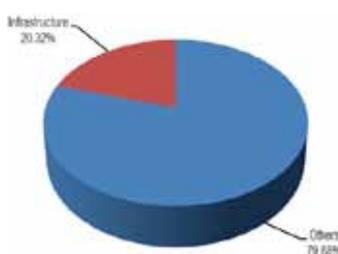
Overall, from 2001 till 1H2013, Malaysian-domiciled infrastructure sukuk accounted for 71.01% of all infrastructure Sukuk issuances followed by Saudi Arabia 16.21% and United Arab Emirates 11.27%. During 1H13, infrastructure sukuk issuances amounted to USD12.95bln and this time Saudi Arabia led the issuances with USD6.27bln or 48.4% share of total global infrastructure sukuk issuances. Malaysia followed next with USD4.62bln or 35.7% share of all issuances and United Arab Emirates ranked third with USD2.07bln or 15.95% share³.

Infrastructure sukuk can be structured using various types of Shariah contractual principles. Among the foremost principles utilised are Musharakah, Ijarah and Murabahah. Collectively, these three structures accounted for more than 79% of all issuances during 2H2010 till 1H2013. The central merit of Musharakah sukuk is that it promotes principles of risk sharing where investors and issuer agree to share profits and absorb losses based on actual outcomes of the underlying business activity.

³ KFH Research

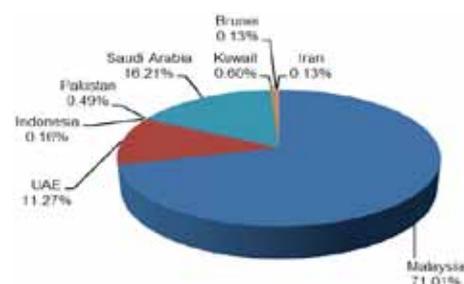
Share of Infrastructure Sukuk versus Other Sukuk Issuances (2012-1H13E)

Source: IFIS, KFH Research



Total Share of Infrastructure Sukuk Issuances by Country (2001-1H13E)

Source: IFIS, KFH Research

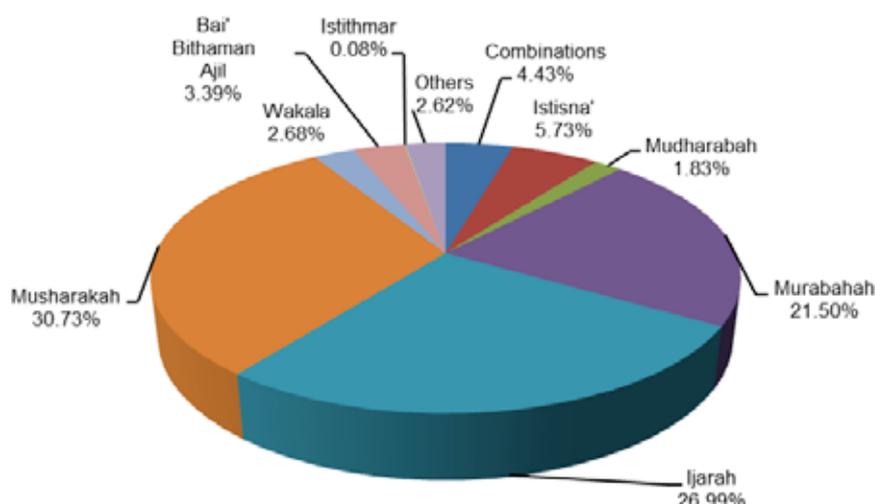


Hence, Musharakah sukuk usually attract higher yields and issuers normally offer higher profit-sharing rates to entice investors. Comparatively, Ijarah and Murabahah sukuk are preferred by investors seeking certainty of returns, as these instruments allow fixing of Ijarah rental income

or Murabahah profits throughout the tenure of the sukuk. In terms of risk, the issuer bears the underlying business outcome responsibility and is liable to pay the agreed rental or profit on sale of the underlying asset to the investors.

Infrastructure Sukuk by Shariah Principles (2H10 to 1H2013E)

Source: IFIS, KFH Research



Notable infrastructure sukuk issued during 2012-1H13 for infrastructure projects include the following:

DanaInfra Sukuk

Issuer	Dana Infra Nasional Bhd
Issue Size	USD300mln
Sector	Construction
Profit Rate	3.62% - 4.04%
Tenure	7-15 years
Structure	Murabahah
Governing Law	Laws of Malaysia
Purpose of Issuance	The proceeds of the issuance are to partly finance the Klang Valley Mass Rapid Transit Project

Source: Zawya, IFIS, KFH Research

Saudi Electricity Global Sukuk

Issuer	Saudi Electricity Global Sukuk Co
Issue Size	USD1.75bln
Sector	Power and Utilities
Profit Rate	2.67%
Tenure	5 years
Structure	Ijarah
Governing Law	English Law
Purpose of Issuance	Proceeds will be used by the Trustee as the purchase price to be paid to SEC on the Closing Date for the purchase of the Ijarah Assets

Source: Zawya, IFIS, KFH Research

Projek Lebuhraya Utara-Selatan Berhad (PLUS)

Issuer	Projek Lebuhraya Utara-Selatan Berhad
Issue Size	MYR30.4bln
Sector	Transportation
Profit Rate	3.9%-5.75%
Tenure	5-25 years
Structure	Musharakah
Governing Law	Laws of Malaysia
Purpose of Issuance	The proceeds of the issuance are to finance the construction of highways

Source: Zawya, IFIS, KFH Research

Prospects of sukuk as financing solution for infrastructure sector remain bright. Various infrastructure projects in GCC such as the Kuwaiti Development Plan worth USD110bln, Qatar Infrastructure Development Plan worth USD140bln, etc. and other projects in Southeast Asia such as Malaysia-Singapore rail link, etc. are expected to be potential drivers for further infrastructure sukuk issuances in the near future. In Asia alone, according to the Asian Development Bank, the cost of building power plants, transportation hubs, telecom facilities, water systems and other infrastructure across Asia will exceed USD8.0tln over the next 10

years. Islamic finance can offer tremendous opportunities to emerging markets such as India and China to meet their infrastructure development plans. According to the Planning Commission of India, the country is facing a funding gap of USD300bln – or 30% – in meeting its infrastructure funding requirement until 2017. The infrastructure funding requirements are much higher in the case of China which is spending on average 9% of its GDP annually on infrastructure investments. The Chinese GDP in 2012 valued in excess of USD8.2tln⁴.

⁴ KFH Research

Emerging African nations such as Nigeria and Kenya have also expressed interest in financing their infrastructure development plans through use of sukuk. The Nigerian Federal Government recently announced its 30-year National Integrated Infrastructure Master Plan which requires as much as USD2.9tn investments and regulators in the country have introduced initiatives to unlock the potential of Islamic instruments such as sukuk in funding the infrastructure projects. On the other hand, the Central Bank of Kenya, in 2009, structured its first infrastructure bond worth USD 222.8mln of which nearly USD12mln was a sukuk tranche. In addition, the Capital Markets Authority of Kenya (CMAK) is currently structuring a

regulatory and policy framework to govern the trade of Shariah-compliant papers following which sukuk is likely to be a key source of funds for capital-intensive infrastructure and manufacturing projects in Kenya.

Moving into 2014, huge infrastructure needs in the GCC, African and Asian regions will further fuel sukuk issuances in the infrastructure sector. In addition, this sector is expected to be supported by the increasing popularity of Shariah-compliant products among bond investors as well as further facilitation by many jurisdictions to develop Islamic finance.

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