

**Comments on Bowden and Lorimer (2008)  
“The NZ term structure: Going long in  
infrastructure”**

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# *Basic Proposed Structure*

## **Infrastructure SIV**

### Invests in:

- NZ Govt bonds
- Local Authority bonds

Funding for

**Infrastructure Projects  
(Roads/bridges etc)**

### Funded from:

- Govt and local govt in form of equity/quasi equity
- Financial markets in form of bonds/bills

# *Objectives*

- **To provide a source of demand for relatively long term domestic securities**
  - **SIV will buy bonds that otherwise would struggle to find a natural buyer in NZ at present**
  - **Aim to help reduce funding costs associated with issuing long term bonds into an illiquid market**
- **To provide a source of long term funding for infrastructure projects**

## *How well will the objectives be met?*

- **Depends crucially on someone to supply the long term bonds for the SIV to buy**
  - **This is likely to be the government**
  - **But issuing ultra long term bonds likely to be more expensive than other funding alternatives**
    - **No hedging markets available beyond 10 years realistically (i.e. interest and cross currency swaps)**
    - **No established benchmark curve for such long maturities – issuer would need to create this**
    - **Probably will be more economic for government to fund at current established benchmark maturities and leverage off wider investor demand as well as the SIV**

# *How well will the objectives be met?*

- **SIV could help Local Authorities issue debt to markets more easily**
  - **This would help deepen to the local capital markets in the same way RBNZ repo-eligibility helped the Kauris**
  - **Although there would be other challenges for local authority issuers that are arguably more important**
    - **They issue in such small size – limited liquidity**
    - **Public debt issues usually require two credit ratings but LA's only have one at most – too expensive otherwise**
  - **Key point is that the SIV is just one source of demand – needs to leverage off other sources of demand as well to create a new market – i.e. offshore investors and local funds**

## *Other issues to consider*

- **SIV will need to issue shorter term debt to fund its long term bond holdings**
  - **To some extent this could cannibalize demand from the long term issues funding infrastructure by govt and local govt**
  - **Will investors buy SIV debt given the experience of the credit crunch?**
    - **Possibly wouldn't be cost effective for the SIV**
    - **Govt spreads wider and slope of yield curve issues**
  - **SIV would be subject to considerable interest rate risk which is difficult to manage as hedging markets are not available for such long terms**
    - **Implications for SIV equity levels?**

## *Other issues to consider*

- **Is the SIV adding much value to the Crown balance sheet?**
  - **Possibly the structure could end up being an off-balance sheet item for the Crown which would need to be funded by the govt if funding got tight**
  - **Raises the issue of whether it might not be better for the govt to just issue more govt debt directly on its balance sheet and fund infrastructure directly**

# *Conclusions*

- **A decent idea that leverages off international precedents in the US agencies and the mooted Australian Govt backed RMBS fund**
- **The fund would probably add most value to Local Authority issuers where critical mass problems mean they struggle to attract the global investors who demand the bulk of NZ domestic debt**
- **Added value to the government is less clear**
  - **Already has a clientele of investors in NZGB**
  - **The SIV would probably end up back on the Crown balance sheet anyway**
- **In the end issuers of long term securities need to work with investors to structure programmes that meet their needs – this SIV would need to complement the market not be the market**
  - **Fund manager investment mandates need to include long term bonds**
  - **Issuers need to have credit ratings (number and level) that meet the needs of all investors**
  - **Bonds need to be issued in deep tranches to facilitate secondary market trading**
  - **Hedging markets need to be improved to allow a wider array of issuers and investors to access the long term NZD securities market**

**THE END**

