CAPITAL MARKET AS A LONG TERM OPTION FOR FINANCING INFRASTRUCTURE DEVELOPMENT

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1.0 INTRODUCTION

Infrastructure, either social or economical, may be defined as physical assets and services which are fundamental to the growth and development of an economy. The Millennium Developmental Goals and the Vision 2020 agenda of the Federal Government are indeed planked on provision of infrastructure thereby buttressing its importance. However, infrastructure investment needs cannot be met through public resources alone. Private sector involvement is also critical. Nigeria as an emerging economy needs a sound and effective capital market that is properly regulated and supervised to bridge the huge infrastructure financing gap that exists.

Except for some major cities in Nigeria, the country's infrastructure sector is grossly underdeveloped with large sections of the population lacking access to basic infrastructure. This limits access to social services and significantly increases the cost of production and trade. Energy shortages which disrupt economic activities have caused the country a great fortune in the area of real sector development. A recent reference is the exit of some mega companies like Michelin and others who have indicated their interest to move out of the country to other neighbouring countries due to the high cost of doing business in Nigeria and infrastructural decay among other factors. Companies in the textile sector are also struggling to survive as a result of lack of power. The Global Competitive Index (2010-2011) places Nigeria on the 127th position out of 139 countries in terms of conducive business environment. This same index placed Nigeria on the 45th position in terms of investor protection. This is an indication that the situation can and must be reversed to regain the confidence of investors, both local and foreign. This paper shall focus on the fixed income securities issuance as a source of infrastructure development funding.

2.0 WHY GOVERNMENT MUST PARTICIPATE IN INFRASTRUCTURAL DEVELOPMENT

The availability of infrastructure facilities is very critical to the economic, industrial, technological and social development of any country. It is in acknowledgement of this fact that governments would seek to develop infrastructure such as housing, railroad, roads, energy, health facilities and telecommunication among others. Infrastructure is specifically important to improving living standards of citizens, promoting private sector development, country's business perceptions and competitiveness. In a nut shell, Infrastructure is important in attaining a well functioning economy.

Reliance on government revenues like taxes and grants are never sufficient to fund these infrastructural developments. Increase in taxes is a disincentive which places more burdens on the citizens and can cripple an economy. Therefore rather than relying strictly on internally generated revenue, governments can float bonds at intervals for specific developmental projects.

All tiers of government and their agencies have the opportunities to finance their infrastructural projects through the issuance of bond instrument. Different shades of bonds can be structured to suit the project peculiarities, investor's expectations, concerns and issuers requirements. Thus, there is Federal Government (sovereign) Bonds, Government Agency Bonds, State/Local Government (sub national) Bonds and Corporate Bonds.

3.0 THE ROLE OF THE CAPITAL MARKET IN INFRASTRUCTURAL DEVELOPMENT

There is no gainsaying that capital market is a critical pillar to long term fund mobilisation needed for capital formation to fast track economic growth and development. The short term funding profile of the money market makes it unsuitable for project infrastructure investment hence the capital market which creates an enabling environment for the generation of long-term financing and active private sector participation in infrastructure development. In addition, the capital market provides variety of financing instruments and investor categories which could lead to larger pool of funds than other financing options.

The capital market is the market for securities, where companies and governments can raise long term funds. The main function of the capital market is to channel investments from the investors who have surplus funds to the investors who have deficit funds. The different types of financial instruments that are traded in the capital markets are equity, debt, hybrid, insurance and derivative. The capital market consists of the primary market, where new issues are distributed to investors, and the secondary market, where existing securities are traded. Usually the capital market provides relatively cheaper source of fund.

According to World Bank Report (2010), Nigerian's stock market significance measured by total market capitalisation as percentage of the Gross Domestic Product (GDP) was as high as 52.0% in 2007 but declined to 24.0% and 19.7% in 2008 and 2009 respectively due to the impact of the global economic crisis. Table I below shows a comparative position of the Nigerian capital market with other developing and developed economies.

Table I: Market Capitalisation as Percentage of GDP of Some Countries (2005 – 2009)

Country	**2005**	**2006**	**2007**	**2008**	**2009**
Nigeria	17.2%	22.3%	52.0%	24.0%	19.7%
Ghana	15.5%	25.4%	15.9%	20.4%	16.1%
Egypt	88.8%	87.0%	106%	52.7%	47.8%
Kenya	34.1%	50.6%	49.4%	36.0%	35.6%

India	66.1%	86.3%	147.6%	53.2%	90.0%
Belgium	76.6%	99.3%	84.3%	33.2%	55.8%
Brazil	53.8%	65.3%	100.3%	36.0%	74.3%
Malaysia	131.5%	150.4	175.1%	84.6%	133.6%
South Africa	228.9%	273.9%	291.1%	177.7%	246.5%
Tunisia	9.9%	14.4%	15.0%	15.6%	23.1%
United Kingdom	134.1%	155.5%	137.9%	69.6%	128.6%
United States	134.9%	145.7%	142.4%	81.7%	105.8%

Source: World Bank Report 2010

4.0 THE IMPORTANCE OF BONDS

Bonds can attract foreign savings when open to international participation. Bonds are important for private sector housing development. Estate developers can issue well structured bonds for the construction of houses with funds from the sale for the houses directed at meeting debt obligations. Mortgage Backed Securities (MBSs) are keys in this regard. Companies can also issue debentures to finance factories and other fixed assets which are key in the production process and ultimately aids economic development. Transparency and accountability of capital markets can promote proper use of funds generated from bond issuance.

The bond market offers less risky investment and regular returns which guarantee investor patronage. Constant creation of new products that would widen investment horizon, give investors value-based investment options and provide the needed cheaper long-term funding to the real estate sector has been of concern to the Commission. Several stakeholders meetings have been held in that regard and the issue has been a "front burner" at various fora.

New products like, Global Depository Receipts, infrastructural bonds, Exchange Traded Funds, Asset Backed Securities, Mortgage Backed Securities and Real Estate Investment Trusts have been created and some have been used by both governments and corporate bodies.

Permit me to give brief explanations on how some of these new products work.

a. **Mortgage Backed Securities:** Banks and some financial institutions create mortgages in the course of lending activities for house purchases. The borrowers are obliged to make payments in instalments over the life of the mortgage to liquidate the loan. The lending institution may decide to move the mortgage off its portfolio by selling them to another entity, usually a Special Purpose Vehicle (SPV), which then structures the loans into traded securities which are sold to the public or placed privately using capital market platform. The periodic payments of interest and principal by the borrower remains, but the payments move to the new entity which uses them for repayment of the purchaser of the securities. By selling off the mortgages, the lending institution frees itself and is able to take on more lending for house purchases.

b. **Real Estate Investment Trusts:** According to Investopedia, a REIT is "a security that sells like a stock on the major exchanges and invests in real estate directly, either through properties or mortgages". Generally, REITs can be used for developing real estate such as residential houses, shopping complexes, hotels and other commercial properties. The Commission first released guidelines for Real Estate Investment and Trusts Scheme (REITs) in 2007. Other measures to ensure smooth running of the product have been ongoing which include the recent review of the proposed amendment to the Land Use Act 1978 to prevent constraints that may arise in the processing of Mortgage Backed Securities (MBS).

c. **Exchange Traded Fund:** This is an investment fund traded on stock exchanges, much like stocks. An Exchange Traded Fund (ETF) holds assets such as stocks, commodities, or bonds and trades at approximately the same price as the net asset value of its underlying assets over the course of the trading day. ETFs may be attractive as investments because of their low costs, tax efficiency, and stock-like features.

d. **Global Depository Receipts:** A Global Depository Receipt is a certificate issued by a depository bank representing investments in shares of a company. Usually a company that wants to access international funds but cannot meet the listing requirement of an international capital market can do so by issuing a GDR. It is usually denominated in the local currency, and entitles the bearer to any dividends and other benefits associated with the shares. A number of Nigerian companies have benefited from this.

5.0 SECURITISATION

Securitization offers potential new capital to finance critical infrastructure and other project finance needs. Commercial banks have traditionally acted as originators of project loans as they are generally capable of evaluating complex project financing transactions and undertaking the construction and similar risks that are usually involved in most project financings. However, due to the short-term nature of a commercial bank's liabilities, commercial banks are usually limited in amount and closely monitor and control their project finance underwriting.

Since the useful lives of most project assets are quite long (20 or 25 years), the most appropriate long-term project debt capital is provided by life insurance companies given the long-term tenor of their financing. One mechanism for such refinancing is securitization. By refinancing a commercial bank's project finance loan or pool of such loans, the ability of the bank to originate and provide project finance loans is restored.

There are clear indications that the time for securitizing project finance has arrived. Responding to perceived investor needs, S&P has announced its general approach for rating all types of income-producing project finance portfolios. S&P has also set forth its criteria for rating power project financings.

National and regional policies should complement commercial trends by supporting institutional improvements; promoting common standards and applying structured finance techniques. In addition to institutional improvement, the promotion of common standards can both support securitization and provide incentives for improved intermediary practice, especially in data collection, documentation, and credit risk appraisal.

Specific new initiatives to encourage the use of securitization include (i) supporting refunding through microfinance, (ii) providing credit support and refunding for long-term student loans and human resource development, and (iii) securitization of infrastructural risk.

While experience in securitizing project finance is limited, there are examples to confirm that this form of finance can bridge the project financing "gap."
In Hong Kong, China; Japan; and Singapore, commercial and residential mortgage-backed securities dominate, while ABS dominate in Korea and throughout the rest of the region Housing loans have tended to be the most consistent source for securitization based on non-distressed assets, in part due to official support. Thus, housing finance was made part of public policy in Japan in 1950 (following the US); Malaysia in 1985; Hong Kong, China from 1997; and Korea in 2004.22 Thailand's state Government Housing Bank is a substantial mortgage lender and has been planning an inaugural securitized issue.

For the process to work effectively in Nigeria there should be a large scale securitization of mortgage portfolios to create mortgage-backed securities for the secondary market as well as adequate regulatory framework. The Federal Mortgage Bank of Nigeria should become a major player in the primary and secondary mortgage markets to ensure access to adequate funding and create investor confidence in the Nigerian mortgage industry just as is obtainable in the US (Fannie Mae and Freddie Mac) and other developed economies.

6.0 CAPITAL MARKET AS AN OPTION FOR INFRASTRUCTURAL DEVELOPMENT – THE NIGERIAN EXPERIENCE

The Nigerian capital market has performed relatively well in the area of bond issuance. Records show that the capacity of the market for raising long term funds have been put to test by the Jumbo offers of governments and corporate bodies which ran into several hundreds of billions of naira in value. The over subscription of most of these offers were instructive as they suggest that the market can finance many more viable infrastructural projects. The Nigerian capital market is being positioned to play more significant role in the area of infrastructural development with far reaching reforms in the financial sector. Reforms in the bank and insurance sector as well as the pension system among others have promoted investment in this regard. In 2007, the first mortgage backed security by the Federal Mortgage Bank worth N100 billion (about US$670 million) was issued for residential houses.

A review of fund mobilized in the capital market for infrastructural development in the last twenty years showed the dominance of the sovereign bond, which was though reactivated in 2003. However, the Nigerian capital market has been a viable source of financing state and local government infrastructural projects through bond issuance. The first state to use the capital market was the defunct Bendel State which issued a "ten-year N20 million 7% Bendel State of Nigeria Loan Stock" in1978. Since then other state governments have issued bonds for developmental projects. Below is a summary of bonds raised by some state governments between year 2000 and 2009:

Table II: Analysis of States that have Accesses the Capital Market between 2000 and 2009

State	Coupon Rate	Year of Issue	Amount (N)	Level of Subscription	Project
Edo State Revenue Bond	21.0%	2000	1 billion	203%	Development of Ogba River Side Housing Estate
Delta State Revenue Bond	16.05%	2000	5 billion	101.74%	Market, Health care, water and education
Yobe State Revenue Bond	23.0%	2002	2.5 billion	81.28%	Urban road and housing drainage improvement
1st Tranche Ekiti State Revenue Bond	24.5%	2002	2.5 billon	81.28	Financial Urban rural road and establishment of palm plantation, rural electricity, expansion of water project.
2nd Tranche Ekiti State Revenue Bond	24.5%	2002	2.5 billion	100%	Financial Urban rural road and establishment of palm plantation, rural electricity, expansion of water project
Lagos State Bond	4% above TB	2002	15 billion	77.58%	Refinancing developmental projects
Cross River State Tourism Development Bond	20.5%	2004	15 billion	79.69%	Upgrading and expansion of Obudu Ranch
1st Akwa Ibom State Revenue Bond	19.5%	2004	6 billion	100%	To finance infrastructural development
Kebbi State Revenue Bond	14.0%	2006	3.5 billion	100%	Kebbi State University of Science and Technology and Zauro polder irrigation
Lagos State Government Bond series 1 (under the N275 billion Debt Issuance Programme)	13%	2008	50 billion	117.93%	To refinance loans on ongoing infrastructural project
Imo State Government Bond Series 1 (Under the 40 billion Debt Issuance Programme)	15.5%	2009	18.5 billion	100%	Part finance of the rehabilitation of water schemes, and construction of critical roads. The finance of state government equity investment in the Imo Wonder Lake and Conference Centre Oguta
Kwara State Government Bond Series 1 (Under the 30 billion Debt Issuance Programme)	14%	2009	17 billion	100%	Kwara state truck plaza, International Aviation College, ASA Dam Mixed used development, New secretariat, commercial agriculture project (phase II) Kwara State University, Illorin water distribution project, Agric irrigation support project, kwara advance diagnostic centre and loan refinancing
Niger State Government infrastructure Development Bond	14%	2009	6 billion	100%	Rehabilitation and construction of roads

Source: SEC

Between 2003 to date, sovereign bonds auctioned in the market were worth over N3.36 trillion i.e. about 90.2% of debt securities issued in 20 years. Most of issues were largely oversubscribed. Sub-national and corporate bonds only accounted for 7.1% and 2.7% respectively. There was a consistent increase in the amount of bond issuance by the federal government, states and corporate bodies between 1991 and 2005, as shown in the Table III.

Table III: Bond Issuance between 1991 – October 2010)

Billion Naira	1991 - 1995	1996 - 2000	2001 – 2005	2006 - Oct 2010	Total
FGN Bonds	0.00	0.00	290.00	3,070.50	3,360.50
State/Municipal Bonds	0.13	4.50	31.50	227.50	263.63
Corporate Bonds	1.94	10.44	17.61	70.30	100.29
Total Debt Securities	**2.07**	**14.94**	**339.11**	**3,368.31**	**3,724.43**

Source: SEC, DMO

Other state bonds issuances in the pipe line include Kaduna State, Ogun State and Lagos State.

Between 2005 and 2009, six (6) corporate bonds were floated, mainly by blue chips which were well received by investors. These include Cadbury Nigeria PLC issue of an irredeemable convertible zero coupon bonds of N5 billion in 2005. Similarly, Access Bank PLC floated a N1.9 billion and 13.5 billion convertible loan stock in 2005 and 2006 respectively. While Crusader PLC, C&I leasing Plc and Guaranty Trust Bank Plc issued N4 billion, N2.2 billion and N 13.17billion respectively.

Secondary market trading on sovereign bonds is currently active Over-The-Counter (OTC). Over N50 trillion worth of sovereign bonds have been traded since 2006, when trading began on the platform. Secondary bond trading on the floor of the exchange has been very minimal and necessary stakeholders are working seriously to reactivate trading in that segment.

7.0 DRIVERS OF BOND FINANCING IN INFRASTRUCTURAL DEVELOPMENT

To effectively raised and mobilized funds for infrastructural development through fixed income securities, some basic conditions have to be satisfied. They include:

1. Existence of contractual savings institutions to create a pool of long term investible funds;
2. Stable macroeconomic environment;
3. Establishment of credit rating agencies and development of rating culture by issuers. The development of rating culture could be fostered by the market demanding rating of fixed income instruments
4. Strong issuer base
5. Development of a reference bond and yield curve for appropriate pricing of other fixed income instruments
6. Efficient trading and settlement infrastructure
7. Good legal regulatory and institutional framework
8. Market liquidity
9. Low trading cost
10. Tax policies which encourage issuance and participation in bonds
11. Fixed income pricing capacity by intermediaries

8.0 WHAT HAS BEEN DONE TO DEVELOP THE BOND MARKET IN NIGERIA

The development of the bond market especially the corporate and sub-national segment to enhance patronage of the bonds sector is in progress with the introduction of tax waiver granted to investors. The Commission appointed an IFC resident adviser on bonds to assist in improving the efficiency of issuance processes of bonds, legal and regulatory matters, infrastructure and capacity building.

The IFRS has been adopted to boost the international visibility and competitiveness of Nigerian companies and to enable them access capital from the global market. Proposed introduction of custodial services in the Nigerian capital market, to address the risks associated with wrongful disposal/dealings in clients' securities safeguard investor's assets has also been proposed.

Other measures taken to aid bonds issuance include:

- Reduction in registration fees to 0.15%
- Maximum approval time for applications at 6 weeks
- Rules on Shelf Registration and Book Building have been introduced to ease corporate bond issuance

9.0 CHALLENGES IN THE ISSUANCE OF BOND IN NIGERIA

Although we can say that the Bond market in Nigeria has showed some signs of growth over the years, it still faces some bottlenecks that need to be checked. Some of these are:

- Multiple taxation
- Volatile depositor base
- Low level of credit provision to the private sector: crowding out by government debt
- Limited capital market penetration
- Lack of non-government longer-term debt markets
- Lack of "fiscal space"
- Regulatory inadequacy
- Political Risks.

10.0 RECOMMENDATION

All hands have to be on deck to see to the development of active bond market considering its importance in line with international best practices. A well developed bond market would attract foreign investors and improve the overall output of the economy. The Commission has been working on automation of all transaction processes (like e-dividend, e-allotment and e-bonus have been achieved). The implementation of the e-filing process to reduce the bureaucracies involved is underway. In spite of the efforts by the Commission other stakeholders have to play their parts. Other ways of improving bond issuance would be:

- Capacity building of stakeholders on securitization and the bond Issuance process
- NAICOM Rules to allow insurance companies to invest in bonds
- The Tax waiver signed by Government should be adopted
- Roundtables for Market Participants (Issuing Houses, potential bond issuers) should be organized on the benefits to issue bonds
- There is need to add "Securitization Law" provisions to ISA
- There should be ttransparency on post-trade information of bonds

11.0 CONCLUSION

No doubt, the capital market is a vital and efficient vehicle for long-term funds mobilization and channelling. Funds could be mobilized from the market to address the huge infrastructural gap in Nigeria. In many countries bonds, are known to have financed numerous development projects such as colleges and universities, hospitals, power stations etc. Given their potential to accelerate development in Nigeria, bond issuance should be encouraged. Notwithstanding the benefits inherent in the market, one of the major constraints to infrastructure development has been the low level awareness of the capital market as a viable avenue for funds mobilization. The opportunities/benefits offered by the Nigerian capital market are begging to be explored. Governments and corporate should take advantage of same to facilitate their respective infrastructural projects.

A good regulatory environment with adequate safeguards to protect investors and other participant is being pursued by the Commission. It is also important to ensure that projects for which funds are obtained are strictly executed. This informs the on and off-site inspections carried out by the Commission.

The Securities and Exchange Commission is committed to reforming the market and will continue to collaborate with all stakeholders towards repositioning the market to contribute its quota to the country's growth and development.