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Cagamas gets creative with funding base

By Chien Mi Wong | 1 June 2015

Malaysia's national mortgage corporation is actively thinking out of the box to slash funding costs.

A veteran local bond issuer since 1986, it wasn't until 2014 that Kuala Lumpur-based Cagamas turned to international debt capital markets to diversify its funding base and to access finance more cheaply.

Such efforts are greatly appreciated by all players in the value chain — from financial institutions to the average Malaysian homemaker — because Cagamas plays an active role in promoting home ownership by making the cost of mortgages more affordable.

Via the issuance of regular debt instruments, Cagamas is able to inject this liquidity into the financial system at a reasonable cost — thanks to its high-credit rating and government ownership — by buying up banks' mortgages. The liquidity is then passed on to the primary lenders of housing loans.

This encourages further expansion of cheap financing for houses, which was once upon a time unavailable due to the large maturity mismatch between housing loans and the deposits obtained by banks.

While obtaining cheap funding is a priority, so is the need to diversify. Heavy reliance on a single benchmark is a risk, chief executive officer of Cagamas, Chung Chee Leong, told FinanceAsia in an exclusive interview — not least for a borrower of Cagamas's size.

Cagamas is Malaysia's second-biggest issuer of debt instruments, second only to the government, and the country's biggest seller of triple-A debt securities. According to its latest financial statement in April, Cagamas's total outstanding debt securities, excluding residential mortgage backed securities, accounts for 9% of Malaysia's total outstanding corporate debt securities and 22% of its outstanding triple-A debt instruments.


Chung Chee Leong

"We want to reduce our overreliance on a single benchmark for our pricing," Kuala Lumpur-based Chung said. "When volatility increases for that particular benchmark yield curve, investors will demand a higher spread to compensate for that additional risk, which may not be a true reflection of Cagamas's credit quality."

The need to diversify away from one benchmark — in Cagamas's case, the Malaysian Government Securities yield curve — is particularly pressing. That is because the Southeast Asian nation has been going through a rough patch with its fiscal position weakening due to a double whammy of mounting debt and lower oil revenues.

Federal government debt as a percentage of GDP breached Fitch's 50% median for an A rating in 2013 and at end-2014 was officially put at 54.5% or M$582.8 billion ($163.6 billion). The rating agency has had Malaysia's credit rating on a negative outlook since July 2013.

Compounding the oil-exporting country's budgetary problems is the dramatic drop seen in international oil prices since June 2014, given that the commodity accounts for roughly 30% of its fiscal revenues. Although prices for US crude-oil has rebounded to $66.81 on May 15, up 43% from its lowest settlement for the year on January 13, it still hovering below the $100 a barrel.

The MGS market has also been in volatile form. The yield on one outstanding 2021 MGS, for example, traded up to a high of 4.25% on December 12 from 3.92% on May 16, 2014. It has since declined to 3.77% on May 8, according to Bloomberg bond data.

So, accredited with an international rating of A3 from Moody's, Cagamas established a $2.5 billion conventional multicurrency medium-term notes programme last August and a $2.5 billion multicurrency sukuk issuance programme in

November.

“We have a very proactive approach currently,” Chung said. “We continue to monitor the yields of bonds in various currencies and when the time comes, we will look into which is the most competitive.”

In September, Cagamas successfully issued the largest offshore Chinese renminbi bond by a Malaysian issuer —a Rmb1.5 billion ($240 million) three-year instrument. It then sold a HK$1 billion ($130 million) four-year note and a US$500 million five-year bond in November and December, respectively.

Despite being an inaugural borrower in all three currencies, Cagamas — whose practice is to fully hedge its foreign exchange position — was able to achieve substantial cost savings after swapping them back into ringgit.

In the case of the dollar bond, it was able to save approximately 15 basis points to 20bp, Chung said.

Islamic finance factor

Next on Cagamas’s 2015 fundraising target list is a debut international sukuk offering.

Chung said the firm is already in talks with some local financial institutions, without specifying which, about a potential Islamic bond issue. But he said the timing of any sale would be dependent on when the purchases of Islamic type mortgages are made so as to mitigate market risk — a risk that the value of investment will decrease due to market factors.

Cagamas is projected to purchase approximately M$6 billion ($1.66 billion) worth of mortgages in all this year. In 2014, the institution bought M$3.92 billion of conventional mortgages and M$1.19 billion of Islamic mortgages from local financial institutions.

“If any of those purchases come in the form of Islamic home financing, we would do a sukuk,” said Chung. “When the time comes, we will do a comparison in terms of rates between domestic versus issuance in other currencies.”

Cagamas has been rewarded as a result of the funding initiatives that it has put in place, attracting a growing number of investors, raising its market profile, and reducing its borrowing costs
Depending on the tenures, the issuer’s spread over comparative MGS has tightened by about 20 basis points two years ago to about 40bps to 50bps currently, Chung said. The number of investors now holding Cagamas bonds and sukuk has increased from 67 investors in 2013 to more than 200, he added.

“The widening and increasing investor base has given us a sizable liquidity pool. This is good for us, especially in times of tight liquidity,” Chung said. “Also, we benefit from a scarcity factor given that there are not many big corporates from Malaysia raising international bonds or sukuk.”

The Cagamas model is well regarded by the World Bank as a successful secondary mortgage liquidity facility. Since incorporation in 1986 till end 2014, the group has cumulatively issued M$282.8 billion of conventional bonds and sukuk including M$2.9 billion ringgit-equivalent foreign currency issuances and M$10.2 billion of RMBS.

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