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Singapore: Trends & Developments

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Trends and Developments

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Introduction

Soaring inflation, rising interest rates and global supply chain disruption owing to geopolitical tensions saw Singapore's GDP growth numbers halved from 7.6% in 2021 to 3.8% in 2022. The outlook for Singapore in 2023 is expected to remain challenging as Singapore's economy narrowly avoided a recession in the second quarter of 2023, and growth forecasts for 2023 have been trimmed on the back of weak global demand.

The uncertain climate has driven Singapore companies to implement a variety of cost-cutting measures as they look to slow down or put expansion plans on hold and move to stabilise their balance sheets.

The increased borrowing costs resulting from the high interest rate environment have led to borrowers facing challenges in servicing existing loans and being more cautious in taking on new loans, culminating in a contraction in business lending in Singapore by 0.8% in 2022.

The move to risk-free rates as the new benchmark interest rate in the context of Singapore financings (which saw many borrowers in Singapore amending their existing facilities over the span of a lengthy transition period to cater for the introduction of these risk-free rates) has largely been completed, with the Singapore Dollar Swap Offer Rate (SOR), the USD London Interbank Offered Rate (USD LIBOR), and the London Interbank Offered Rate (USD LIBOR) being discontinued earlier in 2023.

Other notable trends and developments in the Singapore financing scene include a general slowdown in the real estate as well as acquisition financing sectors, the increased prevalence of green and sustainability-linked loans, the emergence of transition financing, growing interest in peer-to-peer lending, and the anticipation of an increase in the popularity of Islamic financing in the near future. These trends and developments and others are discussed in more detail below.

Real Estate and Development Financing

Activity in Singapore's development financing sector remains slow, given the state of Singapore's property market. While the market saw some positive developments in the first quarter of 2023, particularly for commercial property sales, the last few months have demonstrated that full recovery in this sector may be some time away (in the second quarter of 2023, real estate investment volume totalled SGD3.495 billion, which was a fall from the SGD6.068 billion invested in the first quarter of 2023. In comparison, the first half of 2022 saw SGD19.193 billion in such investments).

This cautious sentiment has its roots in global macroeconomic factors. Interest rate volatility has made loan financing less attractive to investors, prompting them to adopt a warier approach in the hope that interest rates may stabilise later in 2023. In particular, the collective sale market has been affected by the high interest rate environment, with only five successful collective sales in 2023 (a collective sale involves the sale of multiple property units to a common buyer, and requires consent exceeding a stipulated threshold from existing owners). For private residential collective sales, homeowners have generally been unwilling to price their developments lower given the high replacement costs that they face, with developers being unwilling to match the prices due to the costs of financing. The convergence of these two factors has resulted in the ongoing deadlock between developers and homeowners over collective sale prices. Until interest rates stabilise, more cautious developers may delay investing in projects within the residential real estate market, tempering the demand for development financing.

Despite relative instability in the macroeconomic environment and the general slowdown in the financing sector, development financing is still sought by developers in relation to industrial real estate. With industrial property in tight supply, this presents an opportunity for developers to meet demand by acquiring land launched through the Ministry of Trade and Industry's Industrial Government Land Sales Programme. The participation of such developers in land sales may well provide a boost to development financing in the second half of 2023, when land zoned for industrial activity is put up for bidding.

Green Loans and Sustainability-linked Loans

Green loans and sustainability-linked loans (SLLs) have seen a surge in popularity over the past few years as greater emphasis continues to be placed on the accountability of businesses and corporate actors for environmental, social and governance (ESG) issues (with global credit-rating agencies beginning to differentiate credits based on ESG attributes). The adoption rate of SLLs for development financing in particular has been healthy, with companies and REITs in the real estate sector accounting for 46% of green or sustainability-linked debt in 2021.

Green loans

Green loans remain highly relevant in the market, with Singapore companies borrowing up to USD39.5 billion in green loans as at the end of 2022.

In Singapore, green loans feature prominently in property and development financings owing to a confluence of factors such as the presence of a robust certification scheme for green buildings and the Singapore Green Building Masterplan, under which the nationwide target is for 80% of buildings to be certified green or to have best-in-class energy efficiency by 2030. There has also been an increase in government incentives in the Asia-Pacific region for property developers to focus on sustainable developments, which may be attributable to the growing awareness of the vulnerability of urban areas to climate issues.

Prominent green property financing transactions in Singapore include the largest syndicated green loan financing in Asia as at the date of completion – an SGD3 billion financing of the mixed-use project development at 8 Shenton Way (slated for completion in 2028), which will become Singapore's first supertall building (ie, over 300 metres in height) when completed, redefining the landscape of Singapore.

Sustainability-linked loans

SLLs have seen an increase in popularity across various sectors in Singapore, including real estate and project financing. In the real estate sector alone, SLLs and ESG-linked loans totalled SGD75 billion in 2021.

Growth in these sectors is in a large part attributable to the Singapore government's creation of a regulatory framework within which issuers and borrowers of SLLs can work, particularly in relation to ESG reporting.

The government has also provided numerous incentives to buttress the attractiveness of green loans and SLLs, such as the launch of the Green and Sustainability-Linked Loan Grant Scheme (GSLS) in 2020 by the Monetary Authority of Singapore (MAS) to reduce costs for engaging sustainability advisers and co-funding the development of SLL frameworks for small and medium enterprises (SMEs) and individuals. As at the date of this article, the MAS has announced that it will be injecting an additional SGD15 million to increase and enhance the scheme (which will be expanded to include transition bonds and loans) and be extended up to 31 December 2028.

SLLs are also popular with borrowers because of the sustainability margin adjustment mechanism that is a fundamental feature of SLLs (upon satisfying pre-designated Sustainability Performance Targets, borrowers are able to enjoy reduced margins which will, in turn, reduce their funding costs).

Another key factor is the support of Singapore's major banks, with DBS Bank Ltd., Oversea-Chinese Banking Corporation Limited and United Overseas Bank Limited planning to avail between SGD30 billion to SGD50 billion each in SLLs by 2024. Each of these banks has exceeded their initial SLL projections. Noteworthy financings include the grant of an SGD1.2 billion SLL to Sembcorp Financial Services Pte. Ltd. by a group of banks including DBS Bank Ltd. and Oversea-Chinese Banking Corporation Limited for, amongst others, the financing or refinancing of renewable energy and other sustainable projects. United Overseas Bank Limited has also recently granted a TWD1 billion (SGD42 million) SLL to CHIMEI Corporation, which specialises in producing a variety of high-tech synthetic rubbers, specialty chemicals and performance materials including those covered by EcologueTM. Such loans are indicative of a shift from traditional non-sustainability-linked loans towards SLLs.

Project Finance – Transition Finance

With the Singapore government's commitment to achieving net zero emissions by 2050, it has been recognised that green loans and SLLs, whilst important, are, on their own, insufficient to achieve this goal. Borrowers in high-emitting sectors, such as aviation and energy generation, in particular, would find it challenging to take up green loans and SLLs given the nature of their industries. This has led to the emergence of "transition finance", which generally refers to the investment, lending, insurance and the provision of other related services to gradually decarbonise high-emitting industries such as power generation, buildings and transportation.

At the end of the first half of 2022, 53 transition use-of-proceeds bonds have been issued, with issuance mainly coming from issuers based in Japan and China due to the efforts made by the regulators in those countries to spur transition financing.

The MAS has recently updated and expanded the Green Finance Action Plan, which was introduced in 2019. The refreshed plan is titled Finance for Net Zero Action Plan ("FiNZ Action Plan") and its scope is widened to not only cover green financing but also transition financing. The FiNZ Action Plan envisages four strategic outcomes, as outlined below.

More reliable and comparable climate and sustainability data

First, MAS plans to ensure that climate and sustainability data are more reliable and comparable to allow financial market participants to be able to better assess their exposure to ESG risks and opportunities. On a cross-border level, MAS also seeks to provide clarity on the nomenclature used in the industry to facilitate effective communication and data comparison, which will, in turn, facilitate transition financing flows across jurisdictions. For example, MAS states that a code of conduct is currently in the pipeline. Working hand-in-hand with the industry, the code will require ESG rating agencies and data product providers to disclose how transition risks are accounted for in their products. The greater transparency from the aforementioned measures will help to alleviate greenwashing concerns.

Climate and environmental risk management practices

Second, MAS will reach out to financial institutions to build good climate and environmental risk management practices. More specifically, and more pertinently for our purposes, MAS will supervise the financial institutions' response to climate risks and their transition to operating in a low-carbon business environment.

Transition plans

Third, MAS will promulgate the implementation of credible transition plans by financial institutions. Such a plan is one that not only manages the financial institution's own risks but also contributes towards the decarbonisation of the wider economy. In addition, financial institutions are encouraged to engage with their clients on the measures that they can take to decarbonise their businesses and take reference from sectoral decarbonisation pathways when doing so.

Grant schemes

Fourth, as MAS' existing grant schemes for sustainable bonds and loans proved to be popular (as more than SGD30 billion worth of sustainable debt was issued last year), MAS will be improving on and extending the duration of the schemes to cover transition bonds and loans. So, a company that is obtaining a transition loan with a tenure of at least three years and a loan quantum of at least SGD20 million (or equivalent in another currency) is eligible for a grant of up to SGD125,000 to defray the costs incurred in engaging independent service providers to validate the sustainability credentials of the loan.

Given that Singapore targets to convert 80% of its buildings from "brown" to "green" by 2023 (of which 55% has been completed) and that about 95% of Singapore's electricity is still being generated from natural gas, transition financing is likely to feature prominently in Singapore in the coming years.

Peer-to-peer Lending

While much focus has been placed on how technological advances are streamlining and improving traditional bank lending, it is also worth noting the role of technology in disrupting traditional bank lending. In recent years, alternative lending, for example peer-to-peer (P2P) lending, has seen growing prevalence in the form of digital platforms directly connecting lenders and borrowers. P2P lending involves directly matching borrowers seeking shorter-term financing, which are often SMEs (SMEs may not be able to procure bank financing as they may not have adequate credit standing or collateral to provide), and lenders, which may be institutional or retail investors, through online platforms that also facilitate the collection, evaluation and transmission of the borrower's details to these potential lenders.

The ability of SMEs to obtain financing continues to pale in comparison to that of more established borrowers in the market, with the financing needs of SMEs for operations or development far outstripping their access to such financing. This creates a funding gap for SMEs in Singapore which is estimated to be approximately USD20 billion a year. This gap has allowed P2P platforms to engage SMEs looking for a more expedient borrowing process and less stringent requirements. The digital nature of the P2P financing process greatly streamlines loan applications and approval processes. The types of loans disbursed also vary from product to product and can come with flexible terms depending on the lender. From the lenders' perspective, a big draw is higher interest rates (albeit that this may come with a higher default risk, and a relative lack or absence of security or other credit support).

Several prominent home-grown names in the field include Validus Capital and Funding Societies. Validus, which received contributions totalling USD35 million within five years of its inception from prominent investors such as Temasek-affiliated Vertex Ventures, had disbursed loan amounts totalling over SGD550 million in the same period. Validus has partnered with corporates to enhance the data analytics processes that support the credit assessments of borrowers, eschewing the reliance on traditional financial indicators, which allows them to lend in more volatile sectors that banks typically avoid. Meanwhile, Funding Societies has lent more than SGD3.37 billion across Singapore, Indonesia, Malaysia and Thailand, accounting for one of the largest regional shares in the SME digital financing industry. As a testament to the standing of such P2P platforms, both Validus and Financing Societies have even been approved to disburse government-backed loans under the Enterprise Financing Scheme (helmed by Enterprise Singapore) (EFS), which was crucial in bridging the SME funding gap during the height of the COVID-19 pandemic.

By virtue of their lean operational costs and less stringent credit requirements, P2P lenders tend to benefit from increased popularity when global or regional factors trigger a reduction in credit supply from traditional banks. Interestingly however, Funding Societies noted an increase in traditional banks' lending share on their platform in 2020 while there was a drop in lending share for alternative lenders in the same period, which the platform attributes to increased governmental support for SMEs through the EFS during that period. This shows that the growing role of P2P lenders in the market in relation to traditional banks is not always a given.

Islamic Finance

Islamic financing is on the rise worldwide, with such increase in demand expected to feature more prominently in Southeast Asia, one of the largest markets for Islamic financial services.

A specific area of Islamic finance expected to see major growth is Islamic bonds or Sukuks, which are a form of Sharia-compliant financial product that seeks to mirror the coupon payments in bonds. Indeed, it is estimated that a total of USD21.6 billion was raised from Sukuk issuances in Southeast Asia from July 2021 to June 2022. Riding on the greater demand for ESG financial products, ESG Sukuks, in particular, are projected to almost double from making up 2.6% of the global Sukuk market today, to making up 5% of the global Sukuk market in the next five years.

The general consensus in the market is that Singapore is well-positioned to become a global hub for offshore Islamic wealth in the next five years as Singapore is recognised for its premier financial status in Asia-Pacific and its mature business environment, which is able to provide the secondary professional expertise and support required. This is bolstered by MAS' recent update on the guideline relating to the application of banking regulations to Islamic banking in Singapore issued on 1 July 2022. The updated guideline lays out MAS' general approach in relation to the regulation of Islamic banking, the admission framework for financial institutions seeking to offer Islamic financial services and the regulatory treatment for Islamic banking products.

Acquisition Financing

While there has been an overall decline in mergers and acquisitions (M&A) activity in 2022, there remains some optimism that there will be at least a 20% increase in incoming cross-border M&A activity in 2023. In addition, there have been several noteworthy developments in this space, such as the following.

Enterprise Financing Scheme, M&A loans

The EFS was rolled out at the end of 2019 by Enterprise Singapore to provide newly-formed SMEs the option to make simplified applications with certain participating financial institutions in order to obtain various types of loans. Among such loan schemes, the EFS – Mergers & Acquisitions loan scheme (the “EFS M&A Scheme”) is particularly popular, as it allows local SMEs to tap into funding for international M&A transactions that they would otherwise be precluded from obtaining. Participating lenders are also partially indemnified against the risk of borrowers’ default, with Enterprise Singapore taking on a 50% risk share (with those meeting certain conditions enjoying a risk share by Enterprise Singapore of up to 70%). The EFS M&A Scheme has since been extended until March 2026 and expanded to include funding for domestic M&A activities. This is indicative of the government’s ongoing commitment to supporting growth in the M&A sector, particularly in light of other EFS loan schemes either being discontinued or not being extended.

Covenant-lite loans

Covenant-lite loans are characterised by the paring down or absence of financial or maintenance covenants, such as covenants obliging borrowers to maintain a certain amount of assets or to ensure that their aggregate leverage does not exceed a pre-designated limit. The absence or paring down of such financial or maintenance covenants allows borrowers to focus on other aspects of the loan, particularly value creation. However, in the Asia-Pacific region (including Singapore), banks have thus far shown a preference for stronger covenants, and covenant-lite loans remain uncommon. Instead, other flexible loan structures with covenant-lite features such as Term Loan B (also referred to as institutional term loans or TLB) are more commonly adopted.

Special purpose acquisition companies

Special purpose acquisition companies (SPACs), as publicly listed companies with no business operations, serve as a medium through which investors can look to acquire and list target companies. In the US, SPACs have been immensely popular, with consistent growth in funds raised since 2003, and having raised capital in 613 IPOs and USD160 billion in 2021 alone. In comparison, Singapore only started introducing SPACs (and putting in place SPAC listing regimes) in the latter part of 2021. The relatively late arrival of SPACs together with strict SPAC listing regulations in Singapore (such as a minimum market capitalisation threshold of USD110 million which is significantly higher than the US’ requirement of USD50 million to 100 million), appear to have resulted in the fairly low take-up rate of SPACs in Singapore. Since the listing of the first three SGX-listed SPACs early last year, there have been no new SPACs listed in Singapore. These three SPACs are in the midst of identifying targets to acquire (the “de-SPAC” process), and should these SPACs be successful in meeting their deadlines to de-SPAC by 26 January 2024, the SPAC market may yet receive a second wind.

For further details on the matters discussed in this section, please refer to the Trends and

Developments section of the Chambers Global Practice Guide for Acquisition Finance 2023 (Singapore).

Conclusion

While it appears that there will be lingering uncertainty over the global economic outlook at least for the rest of the year, one may expect with reasonable certainty that the Singapore market will be looking to respond and future-proof itself in the face of such challenges. The trends and developments explored above reveal an industry willing to tackle new challenges through industry-wide initiatives. They also spotlight the growing importance of ESG and sustainability, and the introduction of novel concepts to the lending sphere, such as the greater integration of alternative lending platforms and the increased access to funding for SMEs via P2P platforms. Indeed, set against a backdrop of slowing economies in Southeast Asia, Singapore's three local banks (ie, DBS Bank Ltd., Oversea-Chinese Banking Corporation Limited and United Overseas Bank Limited) posted decade-high profit margins as at the end of 2022, providing some optimism that the Singapore economy will remain resilient and adaptive going into the second half of 2023.

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