

SGD Bonds Strategy

Rising risk of non-calls



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- After a decline in interest rates, the refix structure of callable bonds, such as perpetual bonds, increases the risk of non-calls and may subject bondholders to lower refix rates and longer holding tenors in the event of non-call. Such callable bonds include Bank and REIT bonds that have no step-ups clauses.
- Interest rates are expected to stay low given (i) the Federal Reserve's agreement to hold interest rates for this year, and (ii) low inflation rates from rock bottom oil prices and poor economic conditions amidst Covid-19.
- Choose **vanilla bullet** bonds, **senior perpetual** bonds, and bonds with **step up clauses** to avoid refix and non-call risk. Step up structures help to mitigate lower refix coupons.

Callable/perpetual bonds: Have a higher risk of non-call if they refix at lower rates

Many callable bonds have refix clauses at call date and their coupon rates reset based on prevailing swap rates plus the bonds' initial spread at issuance. This presents a higher risk of issuers not calling on call date and allowing bond coupons to reset if the refix coupon rate is lower than the initial coupon. In such cases, bondholders are left with lower coupon rates and longer holding tenors.

Interest rates have fallen to record lows and are expected to remain so for the year at least. Using SGD swap rates (interest rates) as of 22 April 2020, we show in Figure 1 SGD bonds with upcoming call dates and their refixed coupon rates if any. A lower refix coupon (darker orange shows a greater % fall in refix coupon) could mean higher non-call risk as it presents issuers with a lower cost of debt.

Figure 1: Upcoming SGD callable bonds with refix clauses. The %Chg shows the magnitude of change in refix coupon to the bond's current coupon at the upcoming call date. Larger negatives (darker orange) suggest higher non-call risk.

Issuer	Bond	Call Date	Coupon	Refix Cpn*	%Chg
SEBNCORP INDUSTRIES LTD	SCISP 4 3/4 PERP	20/05/2020	4.750%	4.75%	0%
UNITED OVERSEAS BANK LTD	UOBSP 3 1/2 05/22/26	22/05/2020	3.500%	2.45%	-29.87%
SEBNCORP INDUSTRIES LTD	SCISP 3.7 PERP	22/06/2020	3.700%	3.70%	0%
ASCOTT RESIDENCE TRUST	ARTSP 4.68 PERP	30/06/2020	4.680%	3.30%	-29.43%
WING TAI PROPERTIES FIN	WINGTA 4.35 PERP	24/08/2020	4.350%	4.35%	0%
OVERSEA-CHINESE BANKING	OCBCSP 3.8 PERP	25/08/2020	3.800%	2.31%	-39.14%
ASCENDAS REAL ESTATE INV	AREIT 4 3/4 PERP	14/10/2020	4.750%	3.23%	-31.95%
CITIC ENVIROTECH LTD	CELSP 3.9 PERP	19/10/2020	3.900%	8.05%	106.28%
KEPPEL REIT	KREITS 4.98 PERP	02/11/2020	4.980%	3.51%	-29.57%
JULIUS BAER GROUP LTD	BAERVX 5.9 PERP	18/11/2020	5.900%	4.12%	-30.13%
BNP PARIBAS	BNP 4.3 12/03/25	03/12/2020	4.300%	2.68%	-37.62%
BPCE SA	BPCEGP 4.45 12/17/25	17/12/2020	4.450%	2.96%	-33.43%
GREAT EASTERN LIFE ASSUR	GESP 4.6 01/19/26	19/01/2021	4.600%	2.15%	-53.21%
STANDARD CHARTERED PLC	STANLN 4.4 01/23/26	23/01/2021	4.400%	2.90%	-34.15%
ABN AMRO BANK NV	ABNAV 4 3/4 04/01/26	01/04/2021	4.750%	3.51%	-26.05%
FRASERS HOSPITALITY REIT	FHREIT 4.45 PERP	12/05/2021	4.450%	3.25%	-26.91%
UNITED OVERSEAS BANK LTD	UOBSP 4 PERP	18/05/2021	4.000%	2.84%	-29.06%
SOCIETE GENERALE	SOCGEN 4.3 05/19/26	19/05/2021	4.300%	3.14%	-27.03%
MANULIFE FINANCIAL CORP	MFCN 3.85 05/25/26	25/05/2021	3.850%	2.77%	-27.99%
BPCE SA	BPCEGP 4 1/2 06/03/26	03/06/2021	4.500%	3.25%	-27.72%
FIRST REAL ESTATE INVEST	FIRTSP 5.68 PERP	08/07/2021	5.680%	4.73%	-16.77%
AUSNET SERVICES HOLDINGS	ANVAU 5 1/2 09/07/76	07/09/2021	5.500%	4.06%	-26.23%
LIPPO MALLS INDONESIA RE	LMRTSP 7 PERP	27/09/2021	7.000%	6.05%	-13.61%
SOILBUILD BUSINESS SPACE	SBREIT 6 PERP	27/09/2021	6.000%	4.46%	-25.75%
MAPLETREE LOGISTICS TRUS	MLTSP 4.18 PERP	25/11/2021	4.180%	3.10%	-25.78%

*Refix coupon rate includes any step-up coupon at call date

Source: Bloomberg, swap rates as at 22 Apr 2020 used for refix coupon

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Illustration of refix clause:

OCBCSP 3.8% Perpetual Corp (SGD) has a refix based on the 5-year SGD Swap Offer Rate + Initial Spread (1.51%) on its call date of 25 August 2020. Its current coupon is 3.8%.

Using the current 5-year SGD SOR rate of 0.80%, the bond's coupon will refix to 2.31% (0.80% + 1.51%) if it's not called at the call date. This leaves bondholders with a lower coupon (-39.14% lower vs 3.8%) with an extended holding period.

The SCISP 4.75% Perp, SCISP 3.7% Perp and WINGTA 4.35% Perp have refix dates later than the upcoming call date. Their coupons will remain the same at their upcoming call dates.

In a low interest rate environment, callable bonds with refix at call date will refix to lower coupon rates.

Issuers will have less incentive to call if the coupon rate falls upon refix, giving them lower financing costs and a way to conserve cash during this period.

How to avoid refix risk?

Step up clauses: To mitigate lower refix coupons

Figure 1 includes callable bonds with coupon step-up clauses, one of which is the **CELSP 3.9% Perp** with a step-up of 500bps at its 19 October 2020 call date, resulting in a higher refix coupon of 8.05%. This incentivises the bond issuer CITIC Envirotech Ltd to call and reduces refix and non-call risk for bondholders. This perpetual bond is rare, boasting a Senior Unsecured ranking.

Senior perpetual bonds: With no refix risk

For such bonds, few have been issued in the Singapore bond market and all have been called except for the CELSP 3.9% Perp. Previous senior ranking perpetuals came with fixed coupon and no refix. For example, the CHEUNG 5.125% Perp (SGD) issued by Cheung Kong Bond Securities Ltd in 2011 was ranked Senior Unsecured and had a fixed coupon. This gives bondholders more certainty on their coupons and no refix risk.

Vanilla bullet bonds: Have no non-call and refix risk, however, subordinated bullets do

Bondholders are safe with regards to tenor when choosing vanilla bullet bonds and will receive their principal at maturity barring default. However, bear in mind that some bullet bonds have call dates with refix structures that may subject bondholders to lower refix coupons. Figure 4 shows the list of subordinated bullets that have non-call and refix risk from the list in Figure 1.

Figure 4: Some bullets have non-call and refix risk, such as these with upcoming call dates

Issuer	Bond	Ranking	Call Date	Maturity Date
UNITED OVERSEAS BANK LTD	UOBSP 3 1/2 05/22/26	Subordinated	22/05/2020	22/05/2026
BNP PARIBAS	BNP 4.3 12/03/25	Subordinated	03/12/2020	03/12/2025
BPCE SA	BPCEGP 4.45 12/17/25	Subordinated	17/12/2020	17/12/2025
GREAT EASTERN LIFE ASSUR	GESP 4.6 01/19/26	Subordinated	19/01/2021	19/01/2026
STANDARD CHARTERED PLC	STANLN 4.4 01/23/26	Subordinated	23/01/2021	23/01/2026
ABN AMRO BANK NV	ABNANV 4 3/4 04/01/26	Subordinated	01/04/2021	01/04/2026
SOCIETE GENERALE	SOCGEN 4.3 05/19/26	Subordinated	19/05/2021	19/05/2026
MANULIFE FINANCIAL CORP	MFCCN 3.85 05/25/26	Subordinated	25/05/2021	25/05/2026
BPCE SA	BPCEGP 4 1/2 06/03/26	Subordinated	03/06/2021	03/06/2026
AUSNET SERVICES HOLDINGS	ANVAU 5 1/2 09/07/76	Jr Subordinated	07/09/2021	07/09/2076

Source: Bloomberg

Some bullet bonds also have refix and non-call risk if they are callable. These bonds are usually subordinated in their ranking.

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