

FINANCING OF PPP PROJECTS IN RUSSIA: RECENT TRENDS

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Russia's competitiveness is dependent on quality of its infrastructure. Prime Minister Vladimir Putin noted that demand for new infrastructure amounts to USD 1 trillion. This being said, it is impossible to satisfy such demand without creation of investor friendly PPP climate. Besides, Russian financial system does not have such financial resources and they should be attracted from international financial institutions and key banks located outside Russia.

We have two options when it comes to infrastructure financing. First, use of state public procurement (*goszakupki*) with all their disadvantages (corruption, no transparency, use of rudimentary old technologies etc.). Second, use of Private Public Partnerships where private sector acts as co-investor in new infrastructure. In the second case private sector invests in new projects by means of equity contribution in shares of Project Companies (concessionaires); monies received from bank loans; and infrastructure bonds placed among key pension funds.

Indeed, private sector will need to return its investment with profit in time. In order to do so private sector operates newly created infrastructure within the term of PPP/concession agreement (be that roads, airports, metro, waste and water cleaning plants etc.). Operatorship usually takes around 25 years out of 30 years of the concession term (remaining 5 years are commonly dedicated to financing and construction of infrastructure).

Lenders in infrastructure projects will require from private sector (concessionaire) full control over cash flow from operatorship activities. Such cash is deposited in a special escrow accounts with lending banks. Concessionaire will only be paid reasonable expenses required to cover cost of operatorship, salaries of staff, cost of minimal required repairs etc. However, when the loans are repaid concessionaire will receive full amount of profit from operatorship activities.

In order to support concessionaires in attracting loans and issuance of infrastructure bonds the State issues budget guarantees and also provides minimum revenue guarantees. These are needed to protect interests of the banks and bond holders.

Unfortunately Russian regions have not succeeded in implementing massive PPP programs. Currently only federal Government (namely, Ministry of Transport and State Road Corporation) and St Petersburg Government have successful projects which achieved financial close. In particular, in 2010 two toll roads, Moscow-St Petersburg toll road (First Section) and M-1 toll road (Odintsovo by-pass), have reached financial close. This means that since inception of Federal Concession Law back in 2005, only two concession projects in road sector have been successfully accomplished at the federal

level. In 2011 construction of both roads have started.

It took around 4 years from inception of the project to commencement of construction. In contrast, China builds M-1 (in terms of number of kilometers) over night.

Regrettably, pioneer federal concessions have not been implemented quickly and partially, negotiations and financial close, took too long due to financial crisis.

At St. Petersburg level Pulkovo airport have reached financial close in 2011. Currently negotiations take place in respect of funding of Yanino waste plant, Western High Speed Diameter toll road and Orlovsky tunnel. Those projects are co-funded by St. Petersburg budget and private sector.

Many projects in St. Petersburg were put on hold due to financial crisis.

Couple regions have signed concession agreements for use of water facilities, *Vodokanals*, heat plants and construction of waste plants. This being said those projects are rather small compared to announced regional PPP programs.

What prevents PPPs from being more actively used in Russia?

First, some major international players who actively participated in first Russian concessions are disappointed with implementation of originally reached agreements with their Russian partners.

In particular, we see several winning bidders (consortiums) where shareholding of international players in Project Companies (concessionaires) have been significantly decreased in favor of their Russian partners due to different reasons. This process is not very visible for outside observers. However, decrease of role of big international players in current PPP projects is a big disappointment.

Firstly, this means that they will not be able to implement their new technologies and know-how to the level originally envisioned. Secondly, international players will not have incentives to actively solicit funding from banks in their home countries. Being junior partners in consortiums they have less control over concession/PPP projects which in practice makes such projects more expensive to the State.

Another big issue is absence of interest from major international lenders in Russian infrastructure. Prior to 2008 commercial banks (syndicates of banks) were the main fund providers of PPP projects internationally. Russian banking system does not have sufficient funds and appetite for funding of infrastructure. Duration of loans is currently in the region of 5-7 years and each concession/PPP project will require repackaging of loans in due course. In addition, interest rates are quite high as compared to international practice.

In order to find the solution Russian Government has created

a state development bank Vnesheconombank (VEB). This bank is a major funder of Russian infrastructure.

Another trend in funding PPPs is the increased role of international financial institutions (IFIs) such as EBRD, IFC, Asian Development Bank, EABR. IFIs become the major cash providers for private sector in Russian PPPs.

This being said EBRD decided not to finance Moscow-St. Petersburg toll road, in particular, due to unresolved ecology issues (famous "Khimki Forest" saga). Russian authorities learned a lesson – if you want to go for IFIs money you must resolve all ecology related issues in advance, as well as make sure economics of the projects are in perfect state (i.e. IFIs are not a big risk takers).

Key priority of the Government is creation of lender friendly climate. This can be achieved by reforming Russian banking law. In particular, there are many obstacles in laws which prevent classic project finance schemes from working in Russia. On top of that rudimentary Russian Budget Code does not provide for sufficient flexibility in terms of state budget payments required to run PPP projects (e.g. payments to concessionaires are in practice delayed by more than 1 year which affects financial modeling and makes loans more expensive).

In addition, direct agreements do not fully work in Russia. In particular, substitution of concessionaire in case of potential default requires holding of a new tender which kills the idea of replacing concessionaire available in other jurisdictions.

Banks financing PPP projects as well as pension funds pay specific attention to the quality of local legislation. Therefore, one of the most important factors impacting development of PPP is modernization of local laws. To give another example, in Kazakhstan IFIs experts in the course of implementation of PPP projects identified the

following suggested amendments to their current legislation:

- amendments to the rules of priority of creditors which would allow for more flexibility in this respect and for subordinated credit;
- exclusion of the requirements on public tender in respect of pledged securities and property;
- amendments allowing change of the concessionaire in the project (assignment of rights to creditors so that they could enter the project) without a new public tender;
- introduction of more flexible rules into bankruptcy legislation.

In Russia there is also a number of areas of the legislation which is required to have already been implemented into current laws. This position is supported by many recommendations of banking community and other fund providers.

Finally, success of PPP projects also depends on "Political Will" of the country's leadership and its realization in practice by federal and regional authorities. Support of the Government and its readiness to satisfy reasonable expectations of private sector based on international experience and standards. Such support, including required amendments to current legislation, is absolutely necessary to create a successful market of PPP projects in the state. In Russia the political will was demonstrated at the federal level and in Saint-Petersburg PPP projects which are now on the rise in this region. Governmental efforts have already developed trust on the part of many private investors. We are now expecting for similar steps from the Moscow Government.

Below we provide the table with the investors of PPP projects took place in Russia and the CIS in recent years.

PROJECT NAME	STATE, REGION	TIME PERIOD	TOTAL INVESTMENTS	INVESTORS
Motorways				
Volgograd Bypass toll road	Russia, Volgograd Region	2007-2009	USD 1.7 billion	N/A
Moscow — St. Petersburg toll road (15–58 km)	Russia	2007-2009	USD 2 billion	North-West Concession Company (a consortium comprising the VINCI company and other investors), Vnesheconombank, Sberbank
Moscow Central Ring Road	Russia, Moscow	2007-2009	USD 15 billion	N/A
Volgograd Bypass toll road	Russia, Volgograd Region	2007-2009	USD 1.7 billion	put on hold
Tavrovo-Solomino-Razumnoe road of controlled traffic	Russia, Belgorod region	2011-2012	USD 140 million	Federal funding and regional funding
Construction of 3rd bridge over Volga river	Russia, Yaroslavskaia region	2011-2015	USD 333 million	Extrabudgetary funds
Construction of industrial complex in the city of Novomosk	Russia, Tulskaia region	2007-2016	USD 1.54 billion	Invest fund of Russia – 18,5%; Regional funds – 1%; Private investments – 85,5%
Railroads and Light Metro				
Kyzyl-Kuragino railroad to the world's largest coal deposits in Eastern Siberia	Russia	2007 (7 months)	USD 7 billion	Russian Federation Investment Fund, EIC (United Industrial Corp subsidiary)
PPP project to develop a 375 km railroad to mineral deposits in the Chita region	Russia, Chita region	2007 (8 months)	USD 6 billion	Russian Federation Investment Fund, Norilsk Nickel

Airports				
Pulkovo airport PPP tender	Russia, St. Petersburg	2008-2011	USD 1.6 billion	Northern Capital Gateway (consortium of VTB Group, Fraport AG and Horizon Air Investment SA), EBRD, IFC, Eurasian Development Bank, Nordic Investment Bank, Black Sea Trade and Development Bank, Vnesheconombank
Waste Incineration and Recycling				
Paper waste recycling plant	Russia, Lipetskaya region	2007-2013	USD 224 million	State funds and private investments
Energy				
Boguchanskaya Hydro Power Station and the construction of an associated aluminum smelter	Russia, Krasnoyarsk region	2005-2007	USD 5.5 billion	Rusal, Rushydro, Vnesheconombank
PPP project on financing and construction of an aluminum plant in Kazakhstan	Kazakhstan	2007	USD 3 billion	N/A
Energy efficiency of fuel and energy complex on the basis of a cogeneration power	Russia, Yaroslavskaia region	2010-2015	USD 367 million	Extrabudgetary funds; Regional funds; Vnesheconombank
Social Infrastructure				
Construction of engineering, transportation networks, residential buildings in the living area of "South-West 2"	Russia, Belgorod	2008-2010	USD 295 million	Federal funding (budget allocations of the investment fund) – 11%; Regional funding – 8,5%; Private investments – 80,5% (100% of construction of residential buildings)
Development of regional special economic zone of the industrial type "Terbuni"	Russia, Lipetskaya region	2007-2016	USD 190 million	Federal funding (budget allocations of the investment fund); Regional funding; and Private investments
Development of regional special infrastructure of the economic zone of the industrial type "Chapliginskaya"	Russia, Lipetskaya region	2007-2016	USD 114 million	Federal funding (budget allocations of the investment fund); Regional funds; and Private investments
Construction of residential buildings in Romanovo region	Russia, Lipetskaya region	2006-2011	USD 128 million	State funds and private investments
Construction of social and engineering infrastructure in the residential area	Russia, Lipetskaya region	2006-2011	USD 140 million	Federal funds (Vnesheconombank); Municipal funds; and Private investments
Construction of low-rise buildings in Novoselki region and Vishnevka village	Russia, Ryazanskaya region	2008-2012	USD 100 million	Federal funds; Municipal funds; and Private investments
Construction of "Ozernii" residential area in Rozhok village	Russia, Ryazanskaya region	2010-2015	USD 164 million	Invest Fund of Russia; Municipal funds; and Private investments
First stage of agro-industrial complex program	Russia, Tambovskaya region	2009-2011	USD 498 million	Invest Fund of Russia – 6%; Regional funds – 1,5%; Own funds of investors – 17,5%; and Borrowed funds of investors – 75%
Construction of "Rosinka" low-rise buildings	Russia, Kurskaya region	till 2014	USD 129 million	Municipal funds and private investments
Reconstruction of "Tatarenkovo" residential area	Russia, Kurskaya region	till 2014	USD 132 million	Municipal funds and private investments

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