

Pezco|InfraWatch

Towards a framework on the improvements needed in infrastructure project finance in Brazil – Part I

Governments around the world have traditionally financed the infrastructure sectors given the spill over effect and the positive externalities generated by its services. Yet, due to the increase over the public deficits and governmental budget constraints, the public funds are reduced. Consequently, the need of private investments has been increasingly acknowledged as an alternative to finance the infrastructure developments. Although a lot of attention has been devoted in that matter, few studies are dedicated to debate possible infrastructure cash flow frameworks that may be elucidative to build and map the underlying private financial instruments to finance the sector. In this vein, this article proposes a framework model in order to address the sectoral challenges, that include the high capital intensity and risks related to the high up-front costs and revenues. In Part I, we discuss the framework and its underlying main issues that impact the cash flow of a typical project in the sector, that may foster the adoption of more robust project finance structures in Brazil.

Authors

Frederico Turolla
fredturolla@pezco.com.br

Ana Monteferrario
ana.monteferrario@pezco.com.br

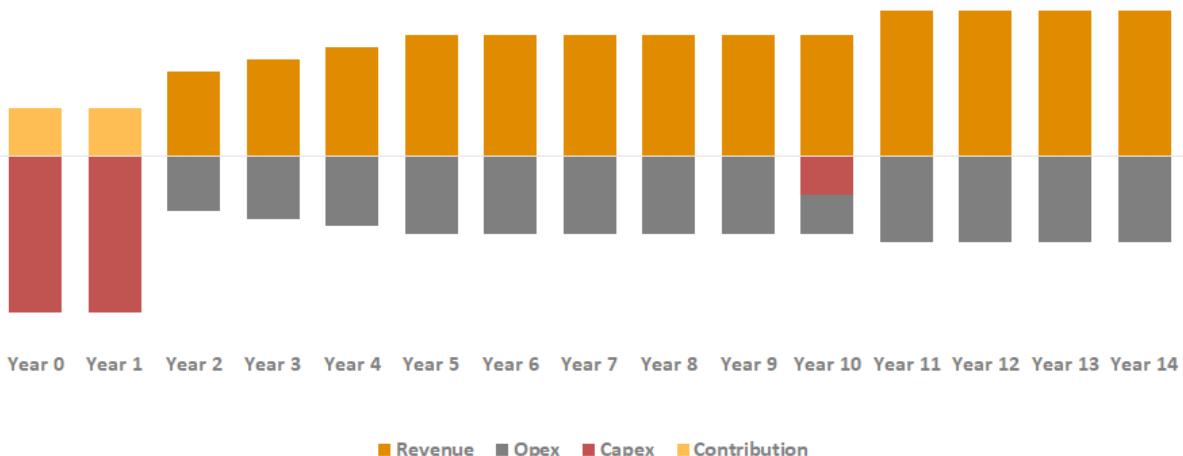
José Marcos Carrera
jmcarrera@pezco.com.br

FRAMEWORK MODEL

The large number of informational asymmetries in the infrastructure sector, along with the long-term intrinsic nature and risks of the sector have posed challenges to private investors, to assess these risk-structures and establish a clear benchmark in order to match their risk-return expectations and liability structures.

In this sense, debate infrastructure cash flow frameworks as policy prescription may be instrumental for mitigating the long-term risk profiles, in ex ante decisions. We detailed this structured infrastructure cash flow framework, as follows:

Figure 1. Typical Infrastructure Project Finance Cash Flow stylised model



Source: Authors.

The key issues regarding CAPEX are related to the licences to build and to the amounts to be spent and underlying risks.

Table 1 – CAPEX challenges versus instruments

Challenge	Instrument	What's going on
Environmental licences	Fast track process	Bill on environmental licensing

Challenge	Instrument	What's going on
Land use and properties	Property rights	Property rights under debate. Critical issue of many projects
Building permits	Harmonised regulations	Regulatory schemes
Cost of construction	Competition	Foreign players accessing Brazilian markets
Cost of inputs	Competition	Trade openness in capital goods
Completion likelihood	Surety / performance bonds	Public procurement bill with 30% coverage
Engineering risks	Insurance	Improvements in contract structuring
Regulatory risk	Regulatory independence	Bill on regulatory agencies

The key issues regarding OPEX are related to the amount to be spent and its underlying risks.

Table 2 - OPEX challenges versus instruments

Challenge	Instrument	What's going on
Cost level of inputs	Competition	Trade openness in capital goods
Cost fluctuation in inputs	Hedge	Financial market mechanisms
Labour risks	Labour reform	Impact on Labour reform
Operating risks	Insurance	Improvements in contract structuring
Regulatory risk	Regulatory independence	Bill on regulatory agencies

The key issues regarding revenues are related to regulation on tariffs and credit risk (public or private).

Table 3 - Revenues challenges versus instruments

Challenge	Instrument	What's going on
CAPEX completion	Surety bonds	Public procurement bill with 30% coverage
FX fluctuation (foreigners)	Contracts and hedge	Contract tied to the FX price fluctuation
Insolvency	Credit insurance	Insurance market development

Challenge	Instrument	What's going on
Regulatory risk	Regulatory independence	Bill on regulatory agencies
Fiscal constraints (PPPs)	Tax guarantee effectiveness	Supreme Court decisions

In addition to beforementioned issues, there are additional challenges regarding the unamortised assets and the rebalancing of the contracts due to new investments or new developments. The rebalancing in contract are related to the regulation on tariffs and credit risk (public or private).

With regards some of financing instruments of the contracts its developments, they will be debated in more details in Part II.

Team

Helcio Takeda

Managing Director, Head of Research

Frederico Turolla

Economic Research, Senior Partner

Ana Monteferrario**José Marcos Carrera Junior****Leonardo Correia****Tulio Marques****Yan Nonato Cattani****João Ricardo Costa Filho**

TERMO DE EXONERAÇÃO DE RESPONSABILIDADE:

Este relatório foi preparado e publicado pela equipe de sócios e consultores da Pezco Consultoria, Editora e Desenvolvimento Ltda ME (“Pezco Economics”), exclusivamente para seus clientes/parceiros. Este documento tem como objetivo servir de base para a discussão de elementos do ambiente econômico e setorial, através da compilação de informações e exposição de análises e de pontos-de-vista. Tomamos os melhores cuidados com a confiabilidade das informações e de suas fontes, mas não podemos garantir a exatidão das mesmas ou das análises realizadas sobre elas. Todas as informações aqui contidas a título de “projeção” ou “previsão” se referem a análises com base em elementos e tendências atuais, cujos pressupostos podem mudar significativamente ao longo do tempo. Este documento não se destina a oferecer ou solicitar compra ou venda de quaisquer bens ou serviços. A Pezco Economics e os profissionais que participaram deste relatório não se responsabilizam por decisões tomadas com base neste. Tanto a Pezco Economics quanto seus sócios e consultores que figuram neste relatório, podem manter posições em ativos mencionados neste documento, bem como podem estar participando ou ter participado de projetos de consultoria/assessoria relacionados a organizações aqui mencionadas – nesse caso, as análises resultantes desconsideram as informações protegidas por acordos de confidencialidade. Este relatório não pode ser reproduzido ou redistribuído para qualquer outra pessoa, no todo ou em parte, qualquer que seja o propósito, sem o prévio consentimento por escrito da Pezco Economics.