Do Brazil's infrastructure plans have a sporting chance?

16/12/2009

There's a palpable sense of excitement about infrastructure opportunities in Brazil. The World Cup, to be held in 2014, and the Rio Olympics, just two years later, will act as catalysts for the government to step up its gummed up spending programme. Long-term lending is opening up and interest rates continue to come down. Investors, however, will need to be patient, as the shadow of presidential elections is already creating a bottleneck in the flow of road concession programmes at state and Federal levels, and threatens to paralyse programs for the sporting events too.

The notional size of projected infrastructure spending looks promising. In five years, Brazilian infrastructure investments will be running at $92 billion per year, compared to $61 billion in 2008 and just $30 billion in 2003, predicts Paulo Godoy, president of the Brazilian Association of Infrastructure and Basic Industry (ABDIB). The National Development Bank (BNDES) has been stepping up and is putting up $32 billion for infrastructure this year, alone, he notes.

"In coming years, there will be a lot of projects through public private partnerships. I'm really optimistic," says Mauricio Portugal, head of infrastructure advisory services for Brazil at the International Finance Corporation (IFC) and former head of the PPP unit at Brazil's Ministry of Planning, Budget and Management. Portugal admits that he left the Federal PPP unit because of slow progress: "I was disappointed with the pace of the programme. I was always pushing to do things more quickly". At the IFC, he has two projects passing through the bidding process – for a hospital and an irrigation project – after just one and a half years against a more typical timeframe of three to four years.

One key factor has been an improvement in commercial debt markets, with banks willing to go out to 13 years. Five or six years ago two to three years was considered long-term in commercial bank lending. "Even in the Golden Times before the crisis, the commercial banks would not go much beyond six or seven years. It's getting better and better," adds Portugal. Today the inter-bank Selic rate is just 8.75%.

International sponsors and other financial institutions that have long been in Chile and Mexico are today focusing on Brazil with its large market, good assets, and stable economy, adds Renato Mazzola, team leader and investment officer at the Inter-American Development Bank. After years of focusing on macro and fiscal policy, Brazil is now ready to work on infrastructure and the next president will achieve a lot in the area, he reckons.

Political logjam

The problem is that the countervailing trend to all this optimism comes from looming Presidential elections, the first round of which are slated for October. That is already having a deadening effect on tendering.

"Because of the election cycle, 2010 will be a dead year," predicts Diogo Castro e Silva, head of the Brazilian arm of Portuguese bank Caixa Geral de Depositos (CGD). Things will only get worse. From March on, state and Federal programmes will be frozen, he adds.

The canary in the mine could be the Federal and state road programs, where progress is already grinding to a halt. The Federal government made one significant award recently, but is unlikely to sign any further deals before the conclusion of elections and even parts of São Paulo's program are running aground.

In October, the Federal government signed a 25-year concession with the Rodobahia Consortium, a partnership of Spain's Isolux Corsan and Brazil's Engevix and Encalso, to improve and expand close to 700km of roads in the Northeastern state of Bahia. Estimated investments of $615 million were destined for two key roads, the north-south BR116 and the BR324, which links the capital city to a port.

Other Federal concessions totalling more than 2,000km concentrated in the heartland state of Minas Gerais are ready for bidding, says Portugal. They include parts of BR-040, BR-281 and BR-116. These are very high traffic roads and so attractive to the private sector. However, the elections are likely to prove fatal: "The Federal government is reluctant to put these out for bidding. If it does, there will be new tolls in an electoral year."

Moreover, the Federal programme continues to attract criticism because of a lack of regularity in offering concessions and limited information. "The Federal government offers insufficient information and predictability," says Mazzola. Worse still, there have also been substantive changes to the type of concession: parts of the BR-116 were planned as a PPP project then shifted to a straight concession. "People can get frustrated. They invest money and time in areas such as traffic studies and feasibility and then the concession doesn't come up," says Mazzola.

There has been a shift away from considering PPPs as a model. In part this is an ideological aversion to what smacks of privatization although there are more sound reasons. The economy is improving fast, leading to higher traffic projections and underpinning the viability for straight concessions, says Portugal. Some also feel burned by the 24-25% rate of return that private investors demanded and got for the concessions of the mid-1990s.

Back then, such high rates made sense as the yield curve was steep and there were significant risks associated with privatizations and the introduction of the new Real, Portugal says.

São Paulo the pathfinder

The level of commitment in São Paulo to new tenders is higher than that of the Federal government, market watchers agree. Even so, the future for planned road concessions has become murky in the state. The state has focused most of its attention on the 182km Rodoanel, the state capital's ring road.

In one of the largest project finance deals in Latin America this year, Companhia de Concessões Rodoviárias (CCR) and Encalso Construções closed the $1.47 billion financing for the RodoAnel Oeste concession on 3 December. The consortium won the concession in 2008 and agreed to pay R$2 billion over two years as well as invest R804 million through the 30-year life of the concession.

The IDB financing consists of a 15-year A Loan of up $150 million and two B loan tranches to be provided by commercial banks. The first B tranche of $200 million will mature in 13 years, while the second B loan will be up to $395 million and could be used to replace R750 million in three-year subordinated debt from Bradesco. The Japan Bank for International Cooperation is also providing a $200 million 15-year loan on the same terms as the IDB, its first ever for a toll road (for more detail on the financing, see Deal Analysis, p.28 this issue).

Mazzola, speaking shortly before the deal closed, said that the level of interest from commercial banks in the long-term financing had surprised him. "I have been receiving calls from banks asking to participate, with big tickets of $100 million for the 13-year loans. It was easy to raise $900 million and we could have raised more," he says. That confirms the interest shown in last October's Federal road concessions in Brazil, in the middle of the crisis, he says. CGD was the first bank to give a firm commitment of $100 million, says Castro e Silva.

Mazzola believes the nearly-complete 61km of Rodoanel Sul, slated for completion at the end of March, may also be bid before the complete shut down before elections. A serious construction accident on 13 November, however, had temporarily stopped works as Project Finance went to press. The basic project for the northern stretch should also be ready in the middle of next year.

The state's ambitious plans for concessions on a series of coastal roads have become bogged down in environmental licensing and may not see the light of day before elections. The State Secretary of Transport announced a new round of concessions in August, which encompassed three roads – Mogi-Bertioga, Tamoios e Oswaldo Cruz – that connect São Paulo to the coast as well as the coastal road itself between the port of Santos and the border with Rio.

Investor participation in the coastal roads was never assured, as traffic forecasts depended heavily on the development of ports, especially at São Sebastião and Caraguatatuba, and the political will to grant licenses for these large-scale rivals to Brazil's largest port, Santos.

Moreover, local media cited the Secretary of Transport as saying that both a 25km link between the coastal towns of Caraguatatuba and São Sebastião and the duplication of Tamoios, between São José dos Campos and Caraguatatuba, have proved particularly thorny thanks to environmental and geological questions. The licensing of the roads is slated to start in 2010, but there is no estimate on when work might begin.

The risks involved in putting this out to tender in the last year of a government are huge. If there's any mistake or anything goes wrong, opposition parties will pounce on it, says Portugal, who thinks it unlikely the government will push ahead.

Concession consolidation

Delays in bringing concessions to market are spurring sponsors to focus on acquisition of existing concessions to bulk up operations. There are 25 players in Brazil, and the market consensus is that whichever has the biggest balance sheet capacity will be in a strong position to lead consolidation, which is attractive thanks to economies of scale from the support function and in light of tight financing conditions, says Castro e Silva. Odebrecht and CCR have both bought concessions in the past and other concessionaires BRVias and Triunfo are looking to take on more concessions.

CCR is already out raising a war chest. The company issued 33 million shares in October, raising R$1.09 billion. For CCR, the downturn represents an opportunity to expand in Brazil at a time when prices are attractive, says Arthur Piotto, financial director and head of investor relations. The company is prepared to spend some R1.5-2 billion on road toll assets in Brazil.

"The market may also attract in more international investors. We have not seen major movements yet, but this could be the calm before the storm," says Castro e Silva. Some of the companies operating in Brazil, particularly Spanish firms, were doing so with aggressive leveraging and have been hard hit in their home market, market watchers agree.

World Cup and Olympics.

The same political inertia affecting the road sector has been afflicting the deadline-sensitive preparations for the World Cup and is likely to affect the first stage of preparations for the Olympics.

The 2014 World Cup will be held in Rio de Janeiro and São Paulo, Belo Horizonte, Porto Alegre, Brasília, Cuiabá, Curitiba, Fortaleza, Manaus, Natal, Recife and Salvador.

More than 1,600 projects have already been identified for the soccer games, according to ABDIB's Godoy. Total spending should be around R100 billion, of which only R5 billion will be spending on stadiums, adds Mauricio Girardello, a partner at PricewaterhouseCoopers (PwC). Four main infrastructure priorities will dominate discussions of the World Cup, according to Leonardo Moreira, a partner at law firm Azevedo Sette in São Paulo. The top priority is inter-urban transport, particularly airports, and roads; construction of stadiums; urban transport and sanitation.

For stadiums, the BNDES will make up to R400 million available to each city to build or renovate a stadium and is prepared to cover up to 75% of total costs, a BNDES spokesman says. For public sector entities, the rate charged will be 190bp over the long-term TJLP rate. The remaining 25% of the money could come from government budgets, loans, or securitisations. For the three private arenas in Curitiba, São Paulo and Porto Alegre, the BNDES will provide loans through an intermediary, which will charge a risk premium.

Girardello is concerned by the bewildering array of different models adopted by cities for their stadiums. Furthermore, a

number of significant changes to FIFA's regulations, including requirements for green certification and the need for a certification on logistics, covering events including evacuation, mean some tender processes will need to be started again, for example in Belo Horizonte. "We find we are in a deadlock in some cases," he says.
The scale of infrastructure needs and difficulties in estimating future earnings from projects have raised the hope that PPPs will be an integral part of the program, although analysts are divided on the likelihood.

Progress on upgrading transportation related to the World Cup, from airports through to light rail, metro and bus lanes is also slow. The Federal government has still not decided on a new framework for managing airports or on a model for investments, says Girardello.

Moreover, many cities that were hoping for light rail will probably need to settle for bus lanes as their business plans are inadequate for securing financing for more ambitious projects, he adds. BNDES has a R5 billion facility for transport, covering metro, train, tram and special bus lanes. The Ministry of Cities will decide priorities and how to spend the money, which will be supplemented by the budget from the states and municipalities involved.

The development bank is also discussing a credit line of R1 billion with the hospitality sector to renovate and enlarge existing hotels. This has not been finalised and will probably be done through the Ministry of Tourism.

Models remain open, but the more time elapses, the more difficult it will be to design PPPs and other concessions in time for the World Cup. FIFA is pushing for rapid construction, ideally by 2012, in case of last-minute delays.

"A tender takes a minimum of four months. States have postponed and now they have run out of time. The schedule is tight and I am very worried about how things will go on from this stage," adds Girardello. The timing issue means that many will need to use simpler structures, such as public works, for many of the projects, with concessions used only after the Cup is over. Restrictions on funding different models and the fiscal responsibility law also tie states' hands and deter them from using PPPs, he points out.

The stronger fiscal situation may also argue against extensive use of PPPs. "In Europe, PPPs were often used to move transactions off balance sheet. In Brazil, we have strong growth and the continuation of a robust budget, which undercuts the need for PPPs," says Castro e Silva.

If financing models for the World Cup are unsatisfactory to date, models for the Olympics are nascent. "We don't have anything concrete yet on the Olympics. We will be involved in the effort but the government has not yet defined how it's going to happen," says the BNDES spokesman.

The budget for the Olympics in Rio de Janeiro is estimated at $14.4 billion, according to a preliminary government study. The city may find it hard to absorb this sum of money, says Girardello. "Even if we spend one third, it will be a lot of investment," he notes.

Ironically, even if the Olympics and World Cup throw out sparse opportunities for PPPs, one large-scale project that has been boosted by the two events will probably require PPP financing. The Campinas-São Paulo-Rio de Janeiro bullet train, with a minimum price tag of $15 billion, looks like an attractive candidate. "I don't see other ways to make it possible to do the volume of investments required without PPPs," says Azevedo Sette's Moreira. The train will almost certainly need to be an availability-type PPP because the government would need to provide comfort with respect to traffic, agrees Mazzola. A host of other areas, from sanitation to energy, may also benefit from the Cup, although it is difficult to disentangle the effect of the Cup from the regular program.