Russia's Pulkovo Airport PPP

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Too many infrastructure projects are saddled with the word "pathfinder" – often by inspiration-sapped journalists late at night. But the Pulkovo Airport project was nothing less: the first PPP project in Russia truly worthy of the name, and the first to be launched off the back of a brand new law.

Unlike previous infrastructure projects in the country, it was delivered without government grants, subsidies or availability payments. And it came as the Russian government planned to direct US$1 trillion of investment into infrastructure – mostly from foreign investment – by 2020. Given the dilapidated state of much of Russia's transport networks, it comes at an important time and as a signal of the country's ability to do business.

On a strict definition, the project has not yet reached financial close, since at the time of writing, lenders are waiting for a contractor to be signed off before disbursing funds. However, the Northern Capital Gateway consortium is confident that this will be in place by the end of the month.

Background and Procurement

In December 2005, the city of St Petersburg passed a local law on PPP procurement which set up a broad framework for delivering projects. No such law existed then or now on a national level in Russia.

One ambition of the city was to transform Pulkovo Aiport – whose domestic terminal building was completed in 1973 and whose international terminal was built in the 1950s – to allow traffic to grow from around 7 million to a predicted 30 million by 2040. The project was launched in early 2008 and Dewey & LeBoeuf were mandated as legal advisers to the authority in February that year.

Inevitably, the guinea-pig PPP faced challenges. "At the start," recall Bruce Johnston and Alistair Wishart of Dewey & LeBoeuf, "lawyers kept raising constitutional problems – did the federal law trump the city law? Eventually they got comfortable with that.

"There was a military airport nearby and military airports are very easy to convert into civil airports. That was a difficult issue: did the government have the power to say there wasn't going to be an airport nearby?" Eventually, after some negotiation with Russia's anti-monopolies agency, a satisfactory non-competition clause was inserted into the contract.

The tender process was split into two parts: construction and management in one package and investment in another, with consortia expected to bid for both. Ten firms sent in pre-qualification questionnaires in April-July 2008 and seven were pre-qualified in August that year. They were:

- GMR Infrastructure
- Petroport-Kontsessia (Flughaven Wien with investors ZAO Lider and Gazprombank)
- Nevsky Aeroport (Changi Airports International with an affiliate of Basic Element as investor)
- Nevsky Sky (Macquarie Capital, Macquarie Renaissance Infrastructure Fund)

- St.Petersburg International Airport (Hochtief Airport, Renova as investor)
- TAV Airports Holding Company
- Northern Capital Gateway (Fraport, VTB Capital and Horizon Air Investments, part of Copelouzos, as investors)

Commenting on the bid process, Alex Moroz of VTB Capital Infrastructure Finance, said: “The high level of competition is attributed to Pulkovo airport being one of Russia's best and most promising transportation assets that can be substantially improved to the benefit of both the City of St Petersburg and the private investor.”

Meanwhile in September 2008 Airport Strategy Marketing presented a traffic forecast report predicting that passenger traffic would rise to 43 million a year by 2039.

By May 2009, the list of seven had become a shortlist of three – Nevsky, Petroport and Northern Capital Gateway - and in June Northern Capital was named as preferred bidder for both the construction and management and the investment tenders. A memorandum of understanding between VTB, Fraport and the Government of St Petersburg was signed in Munich on 16 July 2009.

Freshfields was legal adviser to the bidder, Halcrow provided technical advice and Steer Davies Gleave was traffic adviser. VTB Capital was financial adviser.

For the authority, in addition to Dewey & LeBoeuf, Citi was financial adviser, ASM provided traffic advice, Mott McDonald was technical adviser and the World Bank advised on structuring the procurement.

Project Description

The project covers the building, financing and operation of the Pulkovo airport facilities – including a new international terminal to replace Pulkovo-2 and modernization of the domestic Pulkovo-1 terminal – over a 30-year concession period. The terminal design was itself the subject of a previous contest, launched in 2007 and won by British architects Grimshaw and Partners. When construction is complete, Pulkovo will be the biggest airport in the Baltic region.

The city retains ownership of Pulkovo Aiport Company, and assets and responsibilities are shared between the authorities and the project sponsors. The sponsor is responsible for collecting all revenue from the airport and pays a percentage of revenue to the Government of St Petersburg in a concession fee.

Northern Capital Gateway took over the operation and maintenance of Pulkovo in April 2010, and the construction phase is expected to begin shortly after all contractors have signed contracts. A joint venture of Astaldi and IC were appointed preferreed bidders as general contractors for the first stage of works in February 2011.

Financing

Turmoil in the financial markets was certainly present when procurement for Pulkovo began in early 2008. By late 2009, the consortium was mulling financing options. Talk of a club of 10 banks soon gave way to a syndication deal led by multilaterals and development banks.

Vnesheconombank, Russia’s state development bank, had expressed interest relatively early on, and by April about 20 commercial banks had expressed interest in the B-loan component of a planned IFC-EBRD joint syndication. The planned debt pile was over-subscribed twice over.

Were the sponsors surprised by this interest? Alex Moroz says not: “We were not surprised because the successful completion of syndication was a logical result of a highly experienced team of the sponsors and their advisors undertaking colossal work on every conceivable aspect of the transaction.

“Of course, the process was significantly complicated by the fact that the debt raising was being done in the wake of financial crisis, but we always kept believing in the ultimate success of the project and managed to achieve a mutually acceptable position with a large group of international lenders.”

By July, seven commercial banks and one development bank (KfW) were to take tickets in the B-loan component of a facility jointly arranged by the IFC and EBRD. This proved to be the way to reassure investors, at a time of falling air passenger traffic, that the project and its projected growth was worth investing in. A planned 60:40 debt:equity ratio also helped.

A debt package of €716 million was provided by:

- Vneshekonombank - €230 million (RUB10bn)
- EBRD & IFC syndication - €200 million
- EBRD - €100 million
- IFC - €70 million
- Eurasian Development Bank - €67.67 million (US$90m)
- Nordic Investment Bank - €50 million
- Black Sea Trade and Development Bank - €15 million

The participants in the IFC/EBRD syndication were:

- UniCredit (€55 million) - Bookrunner & MLA
- Standard Bank (€39 million) - Bookrunner & MLA
- Espirito Santo Investment (€23 million) - Bookrunner & MLA
- Nordea Bank (€23 million) as Bookrunners & MLA
- DZ Bank (€17 million) MLA
- KfW IPEX-Bank (€16 million) MLA
- Mediobanca - Banca di Credito Finanziario (€13.5 million) MLA
- Raiffeisen Zentralbank Österreich (€13.5 million) MLA

Financial close, assuming the appointment of a contractor (see above), was reached in April 2010 and the syndication closed in July. Since then, Moroz says, the airport has attracted considerable international interest in the secondary market. “We continue seeing a lot of appetite to the Pulkovo equity and equity-like instruments from financial investors from around the world.

"Pulkovo is one of those quality assets that do not require continuous advertising and pitching in order to generate investors' interest - instead the investors chase assets like that.”

Conclusion

There is no doubting Pulkovo’s landmark status as a large-scale Russian PPP launched and closed without government subsidy and with major international commercial bank financing. Layers of federal and local law were successfully negotiated, along with political sensitivities about the remodeling of a historic airport. Although construction work is taking longer to launch than some had hoped, there is no reason to believe that Pulkovo’s modernisation will not proceed successfully.

In doing so, it may well encourage further syndicated infrastructure deals in Russia. One indication of this may be the project to upgrade Kurumoch airport in Samara, expected to be tendered on a PPP basis later this year.

Ilya Gudkov, General Director of the Agency for Strategic Investments at the city of St Petersburg commented in IJ’s 2010 Russia Market Outlook: “No other project of this magnitude and level of complexity – bearing in mind that this project entails full reconstruction of the existing airport – has been completed in the European airport sector in recent years. The Pulkovo project demonstrates that major infrastructure projects needing substantial long-term commitment from international investors and banks are possible, despite the recent financial crisis and ongoing turmoil in the financial markets.”

Project at a glance

Project Name	Pulkovo Airport PPP
Location	St Petersburg, Russia
Description	The projectco will build, expand, finance and operate the Pulkovo airport facilities (with the exception of cargo terminal and business aviation) under the terms of a PPP agreement signed with the City of St Petersburg and Pulkovo Airport Company on 30 October 2009 for a period of 30 years.
Sponsors	Northern Capital Gateway: • VTB Group • Fraport • Horizon Air Investments (Copelouzos Group)
Lead Operator	Fraport
Total Project Value	€1.1 billion
Total equity	€400 million
Equity Breakdown	• VTB Group - 57.5 per cent • Fraport AG (the owner and operator of Frankfurt airport) - 35.5 per cent • Horizon Air Investments (Copelouzos Group) - 7 per cent
Total senior debt	€716 million
Senior debt breakdown	Black Sea Trade and Development Bank - €15 million EBRD - €100 million Eurasian Development Bank - €67.67 million IFC - €70 million Nordic Investment Bank - €50 million VEB - €230 million EBRD & IFC - €200 million
Debt:equity ratio	67:33
Mandated lead arrangers	• Black Sea Trade and Development Bank • EBRD • Eurasian Development Bank • IFC • Nordic Investment Bank • VEB
Legal adviser to sponsor	Freshfields
Financial adviser to sponsor	VTB Capital
Technical adviser to sponsor	Halcrow
Legal adviser to banks	Clifford Chance
Technical adviser to banks	Scott Wilson
Model audit and tax adviser to banks	Ernst & Young
Insurance adviser to banks	Willis
Legal adviser to government	Dewey & LeBoeuf
Local legal adviser to government	Capital Legal Services
Financial adviser to government	Citi
Technical adviser to government	Mott MacDonald
Traffic adviser to government	ASM
Procurement adviser to government	World Bank
Date of financial close	28 April 2010