

Russia calling, as sanctions bite

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Political decisions will determine how long sanctions imposed by the West must continue to hurt the Russian economy at large, but Russia's transport sector has had to adapt to liquidity constraints. New financing sources from Russian pension funds are vital to ensure that PPPs push ahead.

IJGlobal recently attended VTB Capital's Russia Calling! 2014 Investment Forum and this year it was a bid to attract investors in a time of deep uncertainty. A word on most panellists' lips was "crisis". The rouble is taking a beating over capital control rumours; inflation is over 8%; and the World Bank's growth forecast for 2014 is at 0.5%, equivalent to stagnation. Government ministers pledged to address structural problems and the infrastructure problem.

PPPs in line

Olga Revzina, partner at Herbert Smith Freehills, said, "The good news is that there is a pipeline, even if you compare with one year ago there are significantly more projects. It would be a real problem if there were none, as in 2008 when they were all postponed."

On a federal level [Section Three and Section Four of Moscow Central Ring Road](#) are in the first stage of bidding, at a cost of Rb64 billion (\$1.6 billion). Consortia featuring domestic and European developers are forming for first bids within a month. International advisers and development partners remain vital for conferring necessary PPP credentials, Revzina explained.

Sean Glodek, director at Russian Direct Investment Fund (RDIF), said that they have seen no real indication that major corporates are pulling out. He added they may see more bidders in partnerships, as it is tougher to raise financing – for example major construction firms with the pension funds.

Kirill Dmitriev's, CEO of RDIF, said "We believe that international investors will also facilitate funding for the construction of toll roads. Our Middle Eastern partners have confirmed their desire to invest in the third and fourth stage of the Central Ring Road. We are actively working with the Ministry of Transport and with Rosavtodor to attract investment with another similar co-investor which is a leading non-state pension fund."

The Rb40 billion Kutuzovskiy Bypass represents the first regional level procurement of a PPP for Moscow City. This will be 100% privately financed and has reached the final stage of bidding with final offers due in November from three bidders: Lider, VTB and Gazprombank.

Strained domestic lenders

Aside from enormous state grants, the domestic banks have been and remain the primary funder of infrastructure, especially for toll roads with rouble revenues. Russian banks are strained as sanctions restrict US and Euro bond trading and squeeze capital. The main problem is whether Russian banks will be strong enough to support projects.

Ministers at the Russia Calling! conference denied the National Wealth Fund would be raided for domestic investment but said government will rechannel resources to infrastructure in the next budget. With low national debt, in the short-to-medium term Russian reserves are strong but the country has to hope the economy can recover.

Avtodor awarded [M11 Section 543-684km to VTB and Vinci](#) who have tentative hopes to sign financing in November. Russian banks and potentially pension funds are due to be lenders on the Rb25 billion private component. The European Bank for Reconstruction and Development was lined up for the deal but withdrew from new deals in July and other development banks have followed. Its ability to syndicate to international lenders and reduce costs had been pivotal to Russian pathfinder PPPs - [Western High Speed Diameter](#) and [Pulkovo Airport](#).

For bank lenders the 15 year tenors possible only recently are a stretch. Oleg Pankratov, head of infrastructure capital and project finance at

VTB Capital, said, "I would expect that 10 to 12 year tenors will be more likely next year. In the last six months we have seen Russian Central Bank increasing the base rate by 1%, which has led to a similar increase for project finance debt. In today's market, for federal projects with strong availability commitments we would see leverages at 80-85%." One active borrower for infrastructure projects suggested they are seeing 12% to 13% now for pricing, a rise of over 200bps in the last few months.

Hope to remedy a liquidity dry up is pinned on pension fund equity and debt. Pension funds, notably Lider, have been in the market but there are three new players ready to make hefty allocations to infrastructure - VTB's, Gazprombank's and Russian Railways'.

Three more PPP tenders are planned next year - sections of the M1, M11 and M7. Visibility on the real health of the PPP market should come to light with various procurement deadlines and financial closes coming to a head over the remainder of 2014.

Diverting resources

Russia's aspirations to ally with China are taking shape in the non-PPP transport sector. The new Amur Bridge connecting the two countries is due to achieve financial close in the coming weeks, with roughly \$200 million of investment from Russia China Investment Fund (a partnership between RDIF and China Investment Corp), Baikal Development Fund and OJSC Far East, and support of the national wealth fund and Russian bank debt.

Peter Stonor, head of transport, infrastructure and industrials at VTB Capital, said, "Chinese companies are very keen to be contractors and investors in Russian projects, as we have heard from certain executives at the conference. However for them to bring long-term Chinese bank financing alongside remains some time off, although this is a potentially transformational medium term opportunity. This would require looser capital controls, greater liquidity and longer term currency exchange capabilities for Renminbi."

The Duma has diverted funding over the last few months to the Far East region and the southern region to strengthen ties with Ukraine. The prioritised government-financed [Kerch Strait](#) and Amur bridge projects have received boosts, at the expense of the postponed [Lena Bridge](#) and now unlikely aspirations for the mightily expensive \$27.5 billion [Moscow-Kazan high speed rail](#).

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