

Current trends and future outlook for PPPs in Russia

Date

September 04, 2020

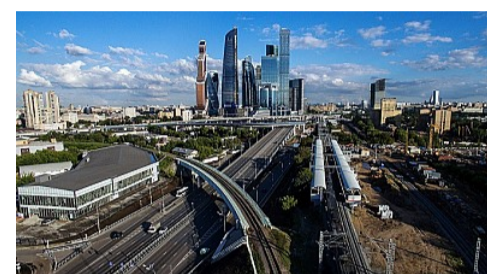
Subscribe to our newsletter and get the latest **news** and **business opportunities** in your inbox

Russian PPP market in 2020: six years retrospective

Six years' timeframe, a period which coincides with a presidential term, may be a retrospective prism to analyse the PPP market in the road sector in Russia through the developments of its significant projects. Where they were in 2014 and where are they now in 2020.

In 2014 important beginnings for major federal level highways were sowed: (1) completion of the tender procedures for the M-11 project, a new toll road connecting Moscow and St. Petersburg with total CAPEX exceeding USD 8.6 bln; and (2) the launch of another significant project in the Moscow region – the Central Ring Road, a new 400 kilometre highway circle around Moscow with total CAPEX exceeding USD 5 bln.

It now feels like an appropriate time to circle back and reap the rewards of those beginnings. At the end of November 2019, the Russian president Mr. Vladimir Putin formally opened the M-11 road, remarking that “there’s never been anything like this in the history of road construction in Russia”. Around the same time, the final facility of the Central Ring Road project reached financial closing, meaning that the project cycle has legally and financially closed.



In light of these project accomplishments, we are motivated to look back at where we were in 2014, deconstruct the PPP mechanism and revise the key market trends and try to ascertain the future of highway and road PPPs in Russia.

Investors: debt dominates capital

In 2014 investor-related problems were already obvious. More specifically, the Russian market struggled lack of professional infrastructure investors among the players in the market. This situation worsened a year later, when the US and EU imposed sanctions against particular individuals and businesses in Russia. As a result, many western foreign investors with relevant expertise decided to leave the Russian market and began to gradually sell their assets. That was the case for Macquarie, an Australian infrastructure fund and the world’s largest professional infrastructure investor, whose investments and support were fundamental to the success of the South Korean PPP transport projects. Macquarie sought to invest in a number of Russian PPP projects, but exited the Russian market in 2017.

When partnerships with Western investors became less affordable after 2015, Russian equity investors could fill the knowledge gap only by gaining their own experience through project execution. An exemplary case is the Russian construction company DSK Avtoban, which has transformed its expertise as a typical EPC contractor to a burgeoning concessionaire’s mandate. Now, DSK Avtoban is a concessionaire for two major federal concessions, with the total CAPEX exceeding USD 2.8 bln.

However, the speed and scale of such business transformations, as demonstrated by DSK Avtoban and some other companies, has not been sufficient to stimulate a greater volume of PPP projects. It is clear that the Russian market requires competent infrastructure investors. The lack of such equity investors has led to the dominance of debt money in the market. In 2014, the median debt to equity ratio was approximately 75:25. After six years in 2020 it has become closer to 90:10. Debt prevails over equity not only in numbers but also in negotiations, which is reflected in the project documentation. In recent infrastructure deals, for example, we have found that lender “superpowers” are frequently incorporated into the project documentation.

In 2014, the problem of financing sources and ‘quasi’ private investments also existed. Despite optimistic predictions, over the last six years we have observed an increase in different types of public funding, with an emphasis on the side of the private partner. Interestingly, the proportion of such investors has increased due to political factors. For instance, today Middle East sovereign wealth funds sponsored the construction of the Central Ring Road, together with the Russian Direct Investment Fund.

The right balance between debt and equity, and public and private money, in funding toll roads could be achieved by increasing the number of equity investors with a deeper understanding of PPP project scoping and execution. The availability of this kind of expertise makes riskier investments possible and leads to more sustainable risk allocation models because the risk typically looks greater to newcomers in 2020.

Risk allocation: pressure on equity investors

The past few years might be characterised as ‘stable’ in terms of project risks, meaning that overall there are no insurmountable obstacles preventing the launch and implementation of new projects. The risk profile for most projects remains predictable, with both the public side and the private side showing a firm understanding of which risks ought to be assumed by each party and which points are negotiable.

However, with the recent shift towards debt financing and the increase in state and quasi-state funding, equity investors in 2020 have little flexibility and often find themselves on the front lines solving project difficulties. This situation can be illustrated in a recent project in the market: the leader of an equity consortium had to start construction before securing debt financing, thereby exposing itself to the

Register now to get access to InfraPPP



Legal structure defines investment strategy

The relationships between the participants of the PPP concession projects have also become more complicated. In the current market of 2020, the documentation required to reach financial closing involves negotiating up to 30% more types of documents. Yet, due to the flexibility of the Russian federal law on concessions, new investment arrangements were made possible by adding new instruments to the blueprint of the PPP project.

- ▶ As mentioned above, lender superpowers are now considered a typical feature of the common legal structure of most PPP deals. In particular, lenders insist on expansive step-in and termination rights, sizeable security packages and guarantees with maximum exposures. Such security packages have been further enriched with corporate guarantees. This instrument became available under Russian law as a form of security from 2015.
- ▶ On the equity side, we see plenty of legal innovation aimed at balancing out contractual structures. For instance, equity investors tend to enter into inter-creditor agreements (available under Russian law from 2015), which used to be a privilege of lenders, and also insist on increased guarantees and the expansion of their exit rights.

Our experience repeatedly proves that, if properly structured, the PPP mechanism has great potential for resilience and flexibility. It can naturally absorb and mitigate risks far more effectively than simpler contractual schemes associated with public procurement.

Legal developments: 2014 - 2020

Since 2014 the legal environment for PPPs in Russia has become far more business and project-focused, following the establishment of highway and road PPPs as a means to implement projects in the sector. Most importantly, the federal law on concessions saw some fine-tuning. First, there was the addition of private initiatives (unsolicited proposals) to officially enable businesses to launch projects. This development was positively received and dramatically increased activity on the market. Second, the law recognised direct agreements between lenders and the public side, which is a crucial requirement for lenders in almost all projects.

The market was also affected by a series of bizarre and controversial court cases and legislative initiatives, which threatened the viability of pending projects by impacting the mechanisms through which PPP projects are implemented. These new legal developments prompted decisive reaction from market leaders. In particular, market activity helped to overrule an ill-fated court ruling in one of the regional road concessions. The ruling effectively prohibited full compensation of project expenses by a concessionaire from the state and excluded concessions from a new federal law on promotion and protection of investments, which was to impose non-manageable restrictions on PPP projects' structuring and implementation practices.

The market in 2020 is yet to see further important developments and court practice, particularly related to termination compensation and the bankruptcy of concessionaires; however, the developments we have seen so far should send reassuring signals to the market.

Future Outlook and Projects Pipeline

Six years ago the PPP pipeline in the road sector was robust and promising. Fortunately, almost all projects survived the following period of economic turbulence and uncertainty to reach their respective financial close. However, the price paid for this achievement was extremely high and, in fact, depleted the existing potential for future growth. On every project, parties were forced to undertake tremendous effort to shorten delays, replace leaving equity investors and ensure actual drawdowns of senior debt.

Acting under such extreme pressure, market participants gained unprecedented experience but did so at the cost of the opportunity to make long-term plans. As a result, the market currently lacks a decent pipeline of good projects for the future. Much preparatory work is to be done, although we note that the recent COVID-19 outbreak will inevitably cause some delay.

Nevertheless, the experience gained in the last few years is of considerable importance and should not be underestimated. Two components are vital for the launch of PPP projects: on the one hand, project initiatives must be originated by businesses; on the other hand, there must be political will and long-term development planning by the government. The alignment of both components guarantees a healthy project pipeline capable of attracting infrastructure investment powerhouses and new players.

Written by:

- ▶ **Yana Ivanova, Senior Associate, HERBERT SMITH FREEHILLS (HSF)**
- ▶ **Grigory Smirnov, Senior Associate, HERBERT SMITH FREEHILLS (HSF)**

Related companies

- ▶ [Herbert Smith Freehills](#)

Related countries

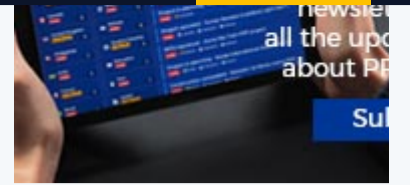
- ▶ [Russia](#)

Share this news



Register now to get access to InfraPPP





The latest news and business opportunities

– Subscribe to our **newsletter**

E-mail

Subscribe

Discover our network –

IPP Journal

Energy Finance & Investment Data

InfraPPP

Infrastructure Finance & Investment Data



iMC worldwide

Infrastructure & PPP Advisory

Most Popular Countries –



United States of America



UK

Canada

India

Brazil

366

Projects

289

M&A Transactions

109

Infrastructure Funds

524

Companies

3

Business Opportunities

8

Reports

About us - Advertising - Contact

2020 Copyright © IMCW Europe S.L. All Rights Reserved - Terms of Use - Privacy Policy



Agencia de Innovación y Desarrollo de Andalucía IDEA
CONSEJERÍA DE EMPLEO, EMPRESA Y COMERCIO

Register now to get access to **InfraPPP**

