

Investment Partnership Program

Is Brazilian infrastructure spending back on track?

The year 2016 proved to be a very difficult one for the Brazilian economy. Along with a presidential impeachment and on-going high profile corruption scandals, Brazil is in the midst of a financial crisis, a byproduct of which has been a lack of spending on infrastructure and infrastructure projects. Brazil is in need of new infrastructure investment in order to help lift it out of its current recession. To that end, one of the key issues on Brazilian President Michel Temer's agenda is to promote the expansion of infrastructure investment and encourage private sector in the country's infrastructure development.

On September 13, 2016 Brazil enacted Law No. 13,334 (the **PPI Law**), which introduced a new Investment Partnership Program (Programa de Parcerias de Investimentos, or the **PPI**), which seeks to prioritize infrastructure projects and increase and strengthen the role of the private sector in infrastructure projects.

Traditionally, the primary source of infrastructure funding in Brazil has been the Brazilian National Development Bank (**BNDES**), a financing vehicle for the Brazilian federal government which focuses on economic development. However, the levels of funding traditionally provided by the BNDES are expected to significantly decrease and this will need to be offset by alternative sources of funding. According to a recent study¹ published by IBMEC (Instituto Brasileiro de Mercado de Capitais), a leading institution in researching capital markets in Brazil, there has been a significant reduction in financing provided by the BNDES to companies seeking funding for infrastructure projects in Brazil. This reduction reflects recent revisions to the institution's credit policies with respect to approving financing. In addition, the Brazilian federal government recently announced a reduction in public funding available to the BNDES which has resulted in a significant reduction in the transfer of funds from the Brazilian treasury to the BNDES.

The PPI focuses on facilitating collaboration between the public and private sectors. The Brazilian federal government has initially pledged R\$30bn to support the long term financing of projects, of which R\$18bn

will be provided by the BNDES, through investments in debentures and traditional loan financing. Funding will also be provided by other state-controlled banks and investment funds.

The Investment Partnership Program

The PPI's main goal is to "expand and strengthen the interaction between the Government and the private sector through the conclusion of partnership agreements for the implementation of public infrastructure projects and other privatization measures."

The PPI Law aims to facilitate the planning and development of infrastructure projects by creating a centralized monitoring mechanism. The two bodies responsible for the implementation of the PPI are: (i) a committee (the **PPI Committee**) to assist the Brazilian President in his decision-making concerning projects and to monitor their development; and (ii) a secretariat to assist relevant authorities (at federal and local levels) to get projects included in the scope of the PPI.

The "centralized monitoring mechanism" was created to promote coordination between the different governmental authorities involved in infrastructure projects. The PPI Law provides for important additional structural measures to facilitate private participation in infrastructure projects, reducing government intervention in the design of the projects and avoiding frequent delays in obtaining the licenses and authorizations required under Brazilian law, which has traditionally been an impediment to infrastructure development in Brazil.

¹ Nota CEMEC – 09/2016 - Relatório Trimestral De Financiamento Dos Investimentos No Brasil; December 2016

The PPI Law provides that both current and future federal and local infrastructure projects can be included as priority projects under the PPI, which allows for a more expedited process with respect to obtaining the requisite licenses and permits needed for the implementation and operation of the projects in question. Some of the first projects within the PPI have already been commenced and have attracted a high level of interest from the international private sector. For example, the concessions for the operation of four major airports (Porto Alegre, Salvador, Florianópolis and Fortaleza) have already been granted to European airport operators, who paid premiums over the prices originally established by the Brazilian federal government in order to win the respective bidding process², which bodes well with respect to how operators are viewing the new infrastructure project concession model adopted in Brazil.

Currently, another 37 projects are being structured and awaiting implementation under the PPI, including new projects as well as existing projects³.

In order to encourage international participation, the PPI Committee now publishes tender documents in both Portuguese and English. Perhaps more importantly, and in order to address a longstanding concern with respect to foreign investors, Brazilian granting authorities have focused on devising hedging mechanisms with respect to concessions (which, by law, are denominated in Brazilian Reais), in order to mitigate foreign currency risks. These mechanisms have been applied in the airport concessions mentioned above and take into account currency variations, on the one hand, and the project's risk of return, adjusted by inflation, on the other, for the adjustment of the variable installments to be paid by foreign investors to the applicable granting authority.

² <http://www1.folha.uol.com.br/mercado/2017/03/1867000-grupos-levam-4-aerportos-em-leilao-com-oferta-de-r-37-bilhoes.shtml>

³ For a description of the current PPI projects, please refer to <http://www.ppi.gov.br/projects>



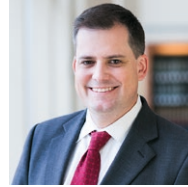
Practical Effects

One of the positive consequences of the BNDES reducing its participation in funding infrastructure projects, coupled with the gradual recovery of the Brazilian economy, is increased financing opportunities through the domestic and international capital markets. According to ANBIMA⁴ (Associação Brasileira de Entidades dos Mercados Financeiro e de Capitais), the leading financial institutions industry group in Brazil, Brazilian companies raised R\$52.2bn in the domestic and international capital markets during the first quarter of 2017, an increase of 139% when compared to the same period in 2016. This increase was mainly driven by issuances in the international markets that reached US\$10bn⁵ during the quarter.

The PPI may prove to be a vehicle that can be used by investors to foster private sector participation in infrastructure funding to supplement the reduced availability of public sources of financing. Through such programs, increased foreign capital and participation could be a significant driving force behind infrastructure development.

The PPI Law is a positive step in the direction of attracting private investment in Brazilian infrastructure. In addition to the hedging mechanisms and dual language versions of tender documents, Brazilian authorities have indicated a willingness to provide realistic rates of return with respect to investments in infrastructure projects. These measures, coupled with the potential recovery of the Brazilian economy and other legal and market developments, should provide for increased opportunities for financing of infrastructure projects in the international capital markets.

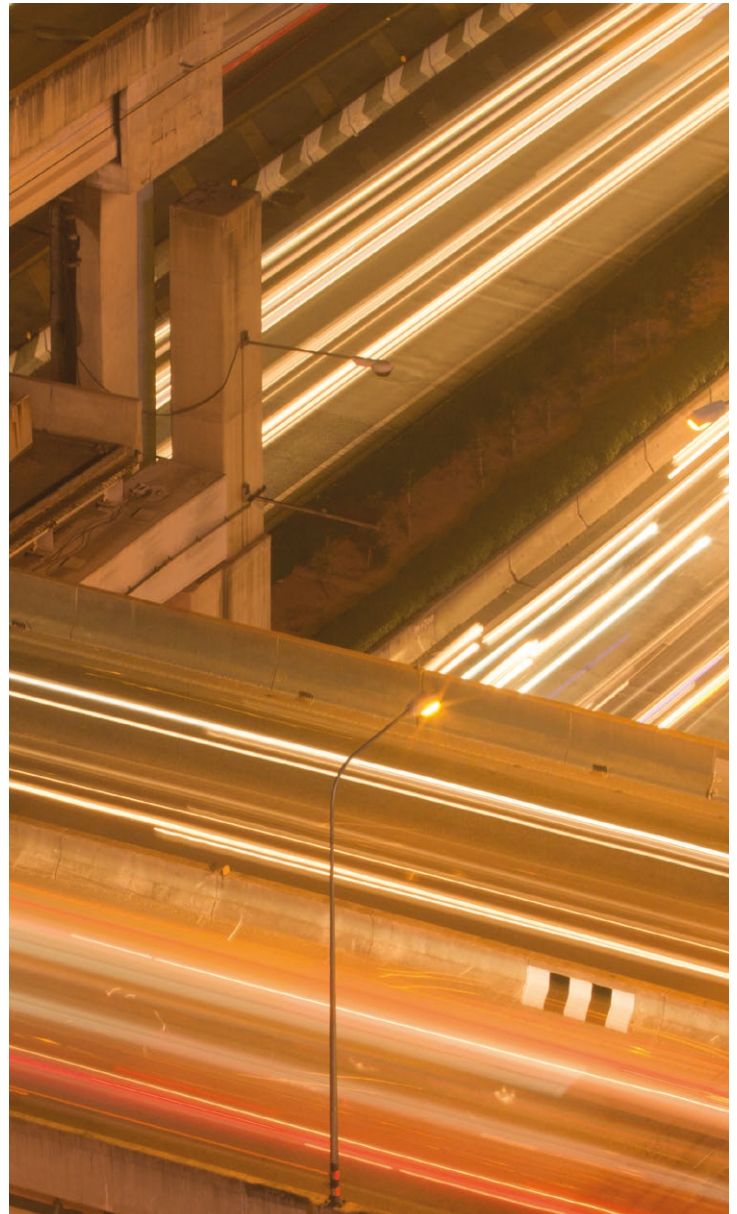
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⁴ The Brazilian Financial and Capital Markets Association – Associação Brasileira das Entidades dos Mercados Financeiro e de Capitais.

⁵ http://www.anbima.com.br/pt_br/imprensa/volume-de-captacoes-das-companhias-brasileiras-cresce-139-no-primeiro-trimestre-de-2017.htm