



FINANCIAL ADVISORY SERVICES

PPP in Russia – policy and implementation issues

Highlights from KPMG Russian PPP conference

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ADVISORY

KPMG's commitment to PPP in Russia

- **As adviser on Public Private Partnership (“PPP”) projects worldwide, KPMG is seeking to contribute to the development of PPP in Russia**
- **At its initiative, KPMG organized a Moscow conference on PPP on 22 September 2005. Its results are the subject of a report and press release, as here highlighted**
- **The conference participants included**
 - senior Moscow City Government and Federal Russian Government figures (e.g. Yury Rosliak and Sergei Generalov)
 - senior representatives of international financial and other institutions engaged in PPP – project technical and legal advisers, Arup and Linklaters, as conference sponsors, EBRD, IFC, HSBC, Standard & Poors
 - British Government connected organizations, the National Audit Office and Partnerships UK, responsible respectively for the audit supervision and the development and implementation of PPP projects

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PPP Policy Issues

PPP Policy Issues

- **Growing Russian Government Interest in PPP**
 - PPP is seen as a mechanism to bring about long and much needed large scale infrastructure investment in Russia, through the attraction of private sector capital and management expertise
- **Priority Areas for PPP and State Financial Support**
 - Commitment of significant state financial resources to infrastructure investment (eg 2006 Investment Fund allocation of Roubles 600 bn - \$ 22 bn), with transport identified as a key priority area (Federal Program 2006 – 2010 also allocating Roubles 300 bn (\$ 9 bn) of state funds in a Roubles 736 bn (\$ 26 bn) total program)
- **New Concession and State Procurement Laws**
 - New Concession and Procurement Laws a positive development along with planned further related legislative action (standard concession agreements and sector specific PPP facilitating legislation). Russian Government commitment to and recognition of the importance and necessity of transparent tendering procedures for implementing PPP projects

PPP Policy Issues

- **Benefits and Risks of PPP**

- International experience shows that PPP projects mostly bring significant economic benefits (good record of projects being completed on budget and on time, through private sector management expertise and project risk participation)
- PPP projects can and do also on occasions go wrong and contain significant potential financial and reputation risks for both private and public sector participants, with political and public opinion being important considerations
- The public sector needs to have the ability to resolve any private sector performance failures and private sector requires the public sector to be consistent and effective in implementing PPP programs

PPP Policy Issues

- **Need for Political Will and Governmental Co-ordination for PPP to be effective**
 - International experience shows the need for real political will and central governmental PPP units in order to lead the implementation of PPP programs in an effective manner, given the complexity and difficulties of intra-governmental coordination
 - The role of central governmental PPP unit is also to support and train the governmental authorities at non federal level that are responsible for implementation of non federal projects at local level
 - PPP transactions are highly complex, and government's role is to ensure that the public sector's capability to negotiate these is at least equal that of the private sector, that PPP knowledge is coordinated across the public sector and that experience is retained over time

PPP Policy Issues

- **Need for Political Will and Governmental Co-ordination for PPP to be effective (continued)**
 - This represents a major challenge for the Russian Government authorities, which, at this stage, do not have in place the requisite institutional capability and experience base of a PPP program
 - A key part of the challenge of PPP programs for the public sector is the development of a capability to define its own requirements from infrastructural projects in design, cost , maintenance and service terms, and of the associated capabilities in project procurement and implementation monitoring terms
 - Constant consultation between public and private sector is very important for developing the federal and municipal PPP policies. This is yet to be established in Russia



PPP Financing Issues

PPP Financing Issues

- **Need to Attract International Capital**

- The capital intensive nature of infrastructural investment requires large scale, long term finance, and necessitates the attraction of international capital
- In a global financial markets context, Russia will be competing to attract capital, and its PPP projects will need to compare favorably with PPP projects in other markets in terms of their thorough preparation, transparency, financial returns and risks
- International Financial Institution (“IFI”) participation in PPP projects (eg EBRD and IFC) will be a key factor in the attraction of international bank project finance
- The attraction of international capital should, in turn, assist the development of Russia’s financial markets, including ultimately of a secondary market for PPP debt and equity finance, and address the absence as yet in Russia of medium and long term bank lending as a major constraint upon the financing of PPP projects

PPP Financing Issues

- **Role of International Construction Groups and Operators**
 - The participation of international construction groups and operators will significantly de-risk PPP projects (eg construction completion guarantees) and thus assist their financing and the attraction of international capital
 - In order to invest the significant required risk resources, including PPP project tendering costs, to develop the Russian market, international construction groups and operators will need to be convinced that the Russian government authorities are really committed to developing and implementing a long term PPP program in an effective manner, with a resulting stream of projects
 - They will also wish to see clear and transparent competitive procurement procedures for PPP projects, as will international providers of capital

PPP Financing Issues

- **Focus on Smaller Scale Projects**

- International experience shows that smaller scale projects, with lesser overall complexity and risk, can be more readily financed. PPP projects typically range between \$ 50 mn and \$ 150 mn in the size of their financing requirements

- **Public Sector Creditworthiness**

- Where PPP projects generate private sector user revenues (eg toll roads), international experience shows that the inherent private sector revenue start up risks of such projects can be mitigated and project financing costs reduced by the public sector initially sharing and / or underwriting such risks (eg financing on a partial recourse basis, with subsequent refinancing on competitive terms on a stand alone limited recourse basis)
- Where the public sector shares in project revenue risks, the creditworthiness and credit rating of the relevant public sector entities are also key to the feasibility and terms upon which a PPP project can be financed. This applies even more where PPP projects are reliant solely upon public sector capacity and availability payments to service their bank debt finance, as is the case in many PPP projects



Legal Related PPP Implementation Issues

Legal Related PPP Implementation Issues

- **Concession Law**

- The provisions in Russia's new Concession Law for related "immovable" assets to remain state property may be a significant potential problem area to the extent that it may not be possible to pledge project assets as a conventional form of security for bank loan finance
- Tax treatment uncertainties (VAT etc)

- **Public Sector Budgetary Commitments**

- The most important requirement for financing PPP projects, both in private sector bank finance security and equity investment terms, is the ability of the public sector to enter into long term and legally enforceable user payment commitments and to be able to fulfill these
- For these purposes, Russia's federal and non federal annual legal approval requirements for state budget expenditure represent a significant potential problem area
- The use of federal and non federal "non budget" funds, however, as Russia's budgetary system permits, may provide a mechanism for overcoming such problems



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