To regain its fast track towards becoming one of the largest economies in the world, Brazil has recognised that it must undergo a strong process of modernisation and expansion of its transportation and logistics infrastructure.

Over the past several years, Brazil has gone through a period of rapid and sustained economic growth, which, among other things, was mainly driven by its abundant commodities, natural resources, and growing middle class; in addition, Brazil’s strong exports of beef, poultry and tobacco have also contributed to its economic development. Though the most recent global financial crisis slowed down the country’s development, the Brazilian government expects that the local economy will accelerate in the foreseeable future. However, the existing infrastructure – particularly transportation – is insufficient to sustain more domestic growth and the dynamism and speed of local and foreign trade.

Brazil lacks an efficient transportation system to integrate the various regions of the country. Roadways account for 58% of the total national transportation system, whereas railways take only 25% thereof, and the remainder is water and others.

If compared with other large countries, such as Canada and the US, it is noticeable that there is an imbalance in the Brazilian transportation system.

These numbers show that Brazil has become over-dependent on road transportation, without alternative methods, such as rail and waterways, to move goods to and from strategic locations. To regain its fast track towards becoming one of the largest economies in the world, Brazil has recognised that it must undergo a strong process of modernisation and expansion of its transportation and logistics infrastructure.

The federal government has recently launched the Logistics Investment Programme: Highways and Railways (Programa de Investimentos em Logística: Rodovias e Ferrovias, in Portuguese) (the programme), which, among other things, has the purpose of promoting infrastructure in transportation, and creating an investment model that promotes partnerships between the public and private sectors for development of highway and railway projects.

To structure and execute the programme and other logistics projects, the Brazilian Ministry of Transportation created the

---

Infra Investment Opportunities in Brazil

This article was originally published in the June 2013 issue of Project Finance International.

by Paulo H.C. Varnieri

Mr. Varnieri is an Associate and a member of Pillsbury’s Corporate & Securities and Latin America groups.
state-owned company Empresa de Planejamento e Logística SA (EPL) in 2012. This entity will also be a partner in the proposed concession of a high-speed train system between the cities of Sao Paulo, Rio de Janeiro and Campinas, and will enter into contracts with the private sector for services associated with these projects, such as research and development.

By implementing the programme, the government expects to build 7,500km of highway and 10,000km of railway over the next 20 and 25 years, respectively. For these two projects only, the government expects investments in the amount of R$133bn (approximately US$66bn) over the next 20 years, with the majority of it being raised within the first five years.

In addition to the programme, the state has also launched plans to build and improve port facilities and airports in Brazil. The country’s congested ports have become a bottleneck to its capacity to bolster national imports and exports. In the past few years, Brazil has more than doubled its foreign trade; however, investments in ports have not followed the same pace of growth. In the port of Santos, located in the State of Sao Paulo and one of the largest ports in Brazil, trucks often wait, sometimes for several days, to be unloaded. Such long delays result in the loss of shipped, perishable goods.

To address ports issues, the Brazilian government’s modernisation programme for port facilities will require approximately US$26bn in capital investments over the next five years. Among other complexes, this programme includes the Port of Suape, in northeastern Brazil. Located in the state of Pernambuco, this port facility has increased in importance due to its proximity to energy, petrochemical and shipbuilding plants, as well as to the discovery of new oil reserves in the Brazilian pre-salt layer. Santos and Suape are expected to receive approximately US$2bn and US$700m in new investments, respectively.

Although air freight does not account for a large portion of the Brazilian cargo transportation system, airports became a big concern for the government as the country will host the 2014 FIFA World Cup and 2016 Summer Olympic games. In light of these two major events, coupled with Brazil’s growing population and popular touristic destinations, the government included investments to boost runways, terminals and services in airports nationwide. Last year, the government granted concessions to a few airports, including Guarulhos and Viracopos, in the state of Sao Paulo.

Under the new logistic investment programme, the government is expected to grant concessions for projects at the airports of Galeão, in Rio de Janeiro, and Confins, in Belo Horizonte. The estimated investment required for these concessions is approximately US$5.7bn.

For these infrastructure plans, the federal government will introduce new public concessions and promote public-private partnerships. Under the programme, for example, the government has proposed two different partnership models: concessions (for highways), in which the concessionaire will be responsible for the construction and maintenance of the roads under concession, and public-private partnerships (for railway projects), in which a partner from the private sector will be contracted by the government to build, maintain and operate the railroads.

Both concessionaires and partner companies will be selected through public bidding processes, which are expected to take place by September of this year. The bidding process for the other infrastructure projects is also expected to begin between the second semester of 2013 and the beginning of 2014. To attract investors in the railway projects, the programme provides that the government will purchase the full railroad capacity from the partner companies in order to reduce the demand risk associated with such projects.

Financing of the programme and other infrastructure projects

Historically, infrastructure projects have relied heavily on debt financing provided by BNDES, Brazil’s national development bank, due in large part to the low interest rate it offers to borrowers. The government, through BNDES, will continue to offer special financing features for these projects. The programme, for example, will be mainly financed by BNDES, which will provide 65% to 80% of the investment required for each project.

With this lower cost financing, it will be difficult for commercial lenders to compete with the state-owned bank.

Additionally, many times private investors have to compete with multilateral institutions as well, such as Corporación Andina de Fomento (CAF) and the Inter-American Development Bank (IDB). However, given the substantial capital required for infrastructure, the federal
government is keen to have investors from the private sector participate in the funding of these programmes.

The federal government has enacted a number of tax and other benefits – some specifically designed for foreign investors – as well as financing instruments, aimed at drawing private sector financing and capital markets, including the Brazilian tax-exempt infrastructure bonds and the Receivables Investment Funds (FDICs), which invest in infrastructure receivables. The infrastructure bonds were created in 2011 through the enactment of Law 12,431 by the Brazilian government. For foreign investors, the amount received from interest payments under such bonds will not be subject to income tax and the financial operation tax (IOF).

But, in order to make use of this innovative financing instrument and take advantage of its tax benefits, a few requirements must be complied with, including: the issuer must be a special purpose entity created to operate the infrastructure project; the proceeds must be used towards future payments or reimbursement of costs, expenses or existing debt related to the project (only projects in certain sectors, such as logistics and transportation, will qualify for the tax benefits); no repurchase of the bonds in the first two years following issuance; and no redemption before its maturity date, except in cases to be regulated by Brazil’s National Monetary Council (CMN). Law 12,431 also regulates the issuance of a Real Estate Receivables Certificate, which has similar benefits and requirements associated with its use to finance these projects.

Though it is still uncertain whether private investors will significantly use these capital markets instruments, these actions by the federal government show that it desires to expand the private sector’s share in the financing of new infrastructure projects. Also, in an effort to encourage foreign investors, representatives of the federal government have recently undertaken a roadshow to these investors to present the various infrastructure projects that it plans to start in the country, including the programme.

**Investment opportunities for foreign investors**

Through new concession bidding, the federal government is opening a space for foreign private companies to construct and operate infrastructure projects. The terms of these concessions will range from 25 to 35 years, with the possibility of extensions. But in addition to constructing and operating such projects, the federal government hopes to attract foreign capital to finance the infrastructure expansion.

Once the winning concession in these public auctions is defined, the project company will be in need of capital. In other words, the new entity will need to raise money through either equity or debt finance. Typically, equity sponsors of such projects include companies that operate in that particular industry (either private or state-owned companies), multilateral agencies, and private equity funds with a focus on infrastructure investment.

Private equity funds raise capital from a limited number of institutional investors before selecting the project in which they invest. These funds usually acquire a minority share of the project company. Although it remains to be seen whether private equity funds will participate in these projects as sponsors, the market in Brazil has seen an increase in the number of asset managers raising capital for their private equity funds exclusively focused on infrastructure. However, these investors still have to adapt to certain features of such investments that are different from a typical deal, particularly the life of the investment (which is much longer than the usual five to seven years) and the project’s construction and completion risks. Also, it may take several years before the project company pays any dividends to its shareholders.

As another way to attract foreign investors, at the end of 2012, the federal government extended to Fundos de Investimentos em Participações em Infraestrutura (Infrastructure Private Equity Funds) the same tax benefits associated with the Brazilian infrastructure bonds; that is, provided that certain requirements are complied with, income received by foreign investors in connection with their interest in these funds will not be subject to income tax and IOF.

BNDES also participates as equity sponsor via BNDES Participações SA, the bank’s holding company. Such sponsors will generally obtain additional equity financing through private placements to third-party investors, and foreign investment funds and pension funds are highly sought after.

On the debt finance side, despite the dominance of BNDES in the financing of infrastructure projects in
As such, bridge financing is often necessary when the project company obtains foreign investors may be part of the BNDES financing, and due to the government indicated that there are opportunities for private capital – both domestic and foreign. Also, because borrowing costs in Brazil are still high, loans provided by Brazilian banks are generally short-term, and tenors of debt securities issued in the local capital markets are shorter than in most other countries, foreign banking institutions have the capacity to offer financing terms that borrowers cannot obtain in the local market.

Furthermore, smaller companies do not always find it easy to obtain BNDES financing, and due to the bank’s bureaucratic procedures, the funds may take up to 12 months to be released. This period waiting for the release of BNDES money is sometimes crucial for the development of many projects. As such, bridge financing is often essential. Foreign investors will be able to provide such short-term financing necessary to start the project, which is typically paid off when the project company obtains permanent, long-term loans.

In addition to “filling the gap” between launch of the project and the receipt of BNDES funds or other types of long-term financing, foreign investors will also have the opportunity to provide the structured finance to serve these capital-intensive projects. In the roadshow to foreign investors last February in New York, the government indicated that it expected the private sector to participate in the provision of long-term financing, such as syndicated loans.

Foreign investors may be part of the consortium of banks, which could comprise both public and private financial institutions. Notably, the government is considering the possibility of providing its subsidies directly to private lenders rather than having BNDES as intermediary. Foreign investors will have the ability to be the direct source of capital to the project sponsor, as well as the opportunity to structure and underwrite the financing of the projects in the capital markets, including bonds. It will also allow foreign investors to obtain the local expertise from BNDES and other local commercial banks for future projects.

Project bonds have been a constant subject in discussions among market participants in Brazil and elsewhere in Latin America. Though these bonds present certain challenges and are still relatively new to project owners and institutional investors in the region, they have recently gained popularity among local players due to some of their features, including access to another source of financing (since bank loans have historically been more common) and longer maturity for sponsors, and long-term cashflows for investors. These bonds can also be an important tool for refinancing bank loans after completion of the project. Foreign project sponsors have used project bonds in the international market. Thus, they could apply their own expertise with such lending instruments to the financing of infrastructure programmes in Brazil.

Additionally, even when a project is already generating revenue, the project company does not necessarily have enough cashflow in order to continue developing its work. As such, there will be opportunities for foreign investors to participate in alternative methods of financing, such as structured products and securitisations. Financial institutions that provided the initial capital to the project may take advantage of their pre-existing relationship with the company or its equity sponsors to invest in these products or arrange such financing.

Just like the instruments created by the Brazilian government for the domestic capital markets (ie, FIDCs and Real Estate Receivables Certificates), private investors may invest in or structure other types of asset-backed securities and vehicles used in the international market to provide additional funding to the project. Under the highway projects, for example, concessionaires will be entitled to charge tolls after 10% of the construction is completed. The future cashflow generated by these charges could be used as backing for securities issued to third parties.

**Conclusion**

As discussed above, the federal government, through BNDES, has been the main provider of finance to infrastructure projects in Brazil, particularly due to the terms and rates of its loans that are hard to compete with. However, the government and BNDES have recently given notice that they intend to expand private investment opportunities across all infrastructure sectors. In addition to recognising that Brazil lacks the logistics (especially those for transportation) necessary for the ongoing development of the domestic economy, the government is aware that BNDES’ lending capacity will not be sufficient.
to finance its programmes. Therefore, there will be opportunities for private investors – foreign and domestic – to join the government in such projects and take advantage of the potential financial returns associated therewith.

And even though it is still to be seen whether these newly government-created financing measures will in fact attract foreign investors, Brazil has featured well in other factors associated with foreign investment, including economic stability, low political and expropriation risks, and a fairly well developed capital market. Considering that the concessions discussed above will each contain different kinds of risks and undergo different stages of development (eg, pre-operational, initial, completion and output production), they will attract various types of investment profiles throughout the life of the project. Foreign investors will certainly have an important role in these infrastructure developments in Brazil by adding management and funding resources.

Endnotes


2. In Canada and the US, railways account for 46% and 43%, respectively, of the transportation system in each country. This data was obtained from a presentation by the Brazilian Ministry of Transportation in September 2011 that can be found here: http://www.transportes.gov.br/public/arquivo/arq1318615138.pdf.


4. See the programme’s fact sheet.

5. Some of the challenges related to project bonds include preparation of a more extensive disclosure document, construction risk, and negative carry costs, since the proceeds of the bond offer are paid on one day rather than in instalments as and when project’s needs arise.