KPMG

Foresight

A global infrastructure perspective

46th edition — September 2016

Brazil's pragmatic new infrastructure program

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With the announcement of 34 infrastructure concessions and privatization programs, Brazil's government hopes to kick-start its flagging economy and attract cautious private investors.

Anyone visiting Brazil cannot fail to notice the creaking state of its airports, roads, rail, power and water facilities. Despite the recent investments for the World Cup and Olympics, the World Economic Forum still ranks the country 120 out of 144 for the quality of its infrastructure.[1] A large budget deficit restricts the government's ability to fund improvements, while concerns over corruption, political stability, and a history of curtailed projects, along with high borrowing costs have deterred investors.

Amidst this uncertain atmosphere, President Michel Temer's 13 September 2016 announcement of a package of infrastructure concessions and privatization programs offers both hope and caution. Hope, because the details of the programs suggest that the administration is building on past learnings to try to create a robust, transparent, level playing field for investors. Caution, because the full details are yet to be revealed, including how these projects will be financed.

Laying the groundwork for successful projects

The projects include concessions for logistics infrastructure (airports, ports, highways, and rail), mining, plus the privatization of sanitation companies along with assets in the power sector. There will also be auctions in oil and gas (please see chart). In all, there are just 34 projects – far less than in earlier years. Total investments for these various projects is forecast to exceed 12 billion US dollars (US$). This is encouraging news, given that many previous infrastructure programs failed to deliver, so a more modest objective should increase the chances of getting most or all the projects over the finish line.

A considerable amount of thought has gone into how best to develop infrastructure projects. One notable change is the creation of a new body called The Investment Partnership Program (Programa de Parcerias de Investimentos, or "PPI"), which will be responsible for the project governance and delivery. PPI is part of the President's office, reflecting the high priority the administration attaches to infrastructure.

A major infrastructure project is no small undertaking, yet past Brazilian tenders were often rushed affairs that left insufficient time to study the details and prepare a robust proposal. As a consequence, many interested parties either held back from making a bid, or prepared a proposal based on very preliminary information, in some cases leading to project failure. To overcome this barrier, the minimum time period between tenders and auctions has been increased to 100 days (potentially going to 180 days), allowing more time to analyze the project, carry out due diligence and prepare for a bid.

Securing finance

Historically, financing for Brazilian infrastructure projects has been via public sector banks, in particular the national development bank BNDES, which lent the full funds at a government-subsidized rate. The precarious state of the country's finances, brought about by negative gross national product (GDP) growth, has made such a practice unsustainable.

[1] *The Global Competitiveness Report, 2015–2016,* World Economic Forum, 2015.

But with interest rates still high, investors require some incentive to choose infrastructure (a relatively risky vehicle) over the safer option of government bonds. Brazil's government has responded by offering more attractive rates of returns and funding of up to US$9 billion, 5.5 billion of which will come from the BNDES (as well as Banco do Brasil and Caixa Economica Federal) and 3.5 billion from the Workers Compensation Fund (FGTS). These entities will purchase debentures from the winning concession holders.

In the longer term, the government wants to diversify its sources of financing. If and when interest rates start to come down, the role of BNDES should be scaled back to a degree comparable to other national development banks, certainly not of a sole financier.

The devil is in the detail

Despite the government's best efforts to make Brazil an attractive destination for infrastructure investors, several challenges remain. Not least is the continued fallout from the "car wash" investigation.

Some projects are expected to be prone to delays, with public sector officials understandably hesitant to progress projects that might come under the radar of corruption probes – and could leave responsible individuals personally exposed to possible investigations and legal action.

In spite of these obstacles, the majority of the 34 concessions are expected to be awarded by the end of President Temer's term in 2018.

Brazil's PPI program is at an early stage, with the final concession and privatization models, and the wider procurement process, yet to be fully defined. As always, the devil is in the detail, and interested investors would be wise to follow developments closely, to give themselves the best possible chance of making a robust, competitive bid. The coming months should see some changes to legislation and regulations, with a strengthening of regulatory agencies and a new framework for issuing environmental licenses.

Infrastructure is key to the rejuvenation of the Brazilian economy. If successful, this modest, pragmatic program could restore faith in the country's ability to deliver major projects, and open the door to a renewed surge of foreign investment that could further boost economic growth prospects.

The programs at a glance

Program	Timeline for bid	Timeline for auction
Four airports concessions: Porto Alegre, Salvador, Florianópolis and Fortaleza	4th quarter of 2016	1st quarter of 2017
Two port terminals: Santarém and Rio de Janeiro	4th quarter of 2016	2nd quarter of 2017
Three railways: EF 151 SP/MG/GO/TO, EF 170 MT/PA and EF 334 BA	1st semester of 2017	2nd semester of 2017
Two highways: BR 364/365 GO/MG and BR 101/116/290/386 RS	2nd semester of 2017	2nd semester of 2017
Nine power distributors and hydro power plants	2nd semester of 2017	2nd semester of 2017
Three water and sewage companies	2nd semester of 2017	1st semester of 2018
Three bidding rounds of oil and gas	2nd semester of 2016	2nd semester of 2017
Assets of CPRM – Companhia de Pesquisae Recursos Minerais	1st semester of 2017	2nd semester of 2017

Talking points

- What is the likely impact of the heightened anti-corruption environment on the bidding process?
- How easy is it for foreign investors to navigate the regulatory landscape?
- Will project financing in Brazil get closer to international practice?
- When will interest rates drop to a level that opens up opportunities for private finance?

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Designed by Evalueserve. Publication name: Foresight. Publication number: 133821-G. Publication date: September 2016