

The Use of Project Financing Factory at Implementation of Infrastructure Projects in Russia

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Abstract—The use of project financing techniques as a means of financing large-scale infrastructure projects continue to enjoy popularity in Russia. The article considers project financing as an effective vehicle for the implementation of priority investment projects in order to develop the country's infrastructure. The advantages of project financing over traditional lending are determined, and the main forms of state support of infrastructure projects are investigated. The mechanism of functioning of the Project Finance Factory was studied, and an assessment of the conditions for its practical implementation was presented.

Keywords—investment project; project financing; infrastructure; project financing factory; state support of infrastructure projects

I. INTRODUCTION

Project financing is considered to be one of the most effective ways to implement the large-scale and capital-intensive investment projects in the world. This mechanism has a great potential for using in Russia [1]. After the energy, oil and gas industries, where there is a large proportion of investment projects implemented with project financing, nowadays the Russian government pays a special attention to the development of infrastructure. In the context of the trend to reduce budget expenditures for infrastructure and the urgent need for the construction of new and modernization of existing facilities of the industry, the mechanism of project financing is becoming one of the most important tools for financing investment projects.

II. FEATURES OF PROJECT FINANCING OF INFRASTRUCTURE

Infrastructure development is a priority investment area for the Russian economy. Among the strategically important goals of the Government of the Russian Federation there is the construction of new roads, hospitals, schools, kindergartens, increasing the capacity of transport hubs, improving the living conditions of citizens, creating capacities for environmental processing and waste disposal. But the state funds for these purposes are not enough. It means that the way out is to attract investment from private and external resources. In this situation project financing techniques can be the right alternative.

In the Decree of the Government of the Russian Federation No.158 dated 15.02.2018 on the program "Factory of project financing" project financing is interpreted as the type of a long-term (for a period of not less than 3 years) financing of the investment project in the form of a loan, in which the source of debt repayment is income from the use or sale of the property created and (or) acquired during the implementation of the investment project" [2].

In the modern economic literature there is no universally accepted definition of project finance. A typical definition of project financing might be: "The financing of the development or exploitation of a right, natural resource or other asset where the bulk of the financing is to be provided by way of debt and is to be repaid principally out of the assets being financed and their revenues." [3]

According to E. R. Yeskombu, "... Project finance is a method of raising long-term debt financing for major projects through "financial engineering," based on lending against the cash flow generated by the project alone; it depends on a detailed evaluation of a project's construction, operating and revenue risks, and their allocation between investors, lenders, and other parties through contractual and other arrangements" [4].

According to I. A. Nikonova, "...project financing is a multi-tool form of financing specially created for the implementation of the project company (PC, SOPF, SPV, SPE), in which future cash flows generated by the project are the main source of settlements with creditors and shareholders of the company" [5].

It should be noted that in all above mentioned definitions there is the main idea that unites them - to attract investors' funds for a long term project, and the subsequent reimbursement of investments is expected from cash income generated by the project.

One of the primary advantages of project financing is that it provides for off-balance-sheet financing of the project, which will not affect the credit of the shareholders or the government contracting authority, and shifts some of the project risk to the lenders in exchange for which the lenders obtain a higher margin than for normal corporate lending. [6]

The historical retrospective of infrastructure projects in Russia takes us to the XVIII - XIX centuries. The concession was used in industry and infrastructure: thus in 1717 the banks of the river Una (Primorsky area of the Arkhangelsk region) and the river Shlina (Tver region) were granted as a concession for the construction of mills; in 1869 a metallurgical plant in Donbass on the territory of modern Ukraine was granted to the Englishman John Hughes on the terms of concession; in 1897-1901 within the framework of the concession agreement between Russia and China, the Chinese-Eastern railway (CER) was built [7].

Nowadays according to analysts of InfraONE Research, the major volume of project financing (hereinafter PF) belongs to the oil and gas sector, as for the infrastructure it needs 2.3 trillion rubles (by the most optimistic forecasts). The volume of private funds invested into this section does not exceed 0.09% of GDP or 83 billion rubles, although the market investment niche is liquid, and financial income can be increased multiple times [8].

Comparing the features of PF and traditional lending, it should be noted that the project creates a special project company (SPC), which acts as a borrower of funds. Unlike the traditional borrowing, the amount of attracted resources significantly exceeds the assets of the SPC, as creditors expect a return of investment from the implementation of the project itself, and not the property and experience of the SPC. In order to recoup investment in the conditions of PF, a thorough structuring of the financial model of the project is required, a large number of participants are involved, complicated schemes and combinations of financial instruments are used such as private investors' own funds, Bank loans (including syndicated), bond loans and corporatization.

"Lenders rely on the future cash flow projected to be generated by the project for interest and debt repayment (debt service), rather than the value of its assets or analysis of historical financial results. The main security for lenders is the project company's contracts, licenses, or ownership of rights to natural resources; the project company's physical assets are likely to be worth much less than the debt if they are sold off after a default on the financing" [4].

In the world practice insurance companies, pension funds, special infrastructure funds, sovereign funds, state bodies (including regional and municipal) dominate as investors of infrastructure projects. As for the Russian practice sovereign and special funds are not so active in the process. Insurance companies and pension funds participate in project financing as institutional investors through public or quasi-public funds in which infrastructure projects can be found, but they are not basic.

The State Corporation "Bank for Development and Foreign Economic Affairs (Vnesheconombank)" (hereinafter VEB) is defined as the authorized Bank in the implementation of the PF. Its participation includes providing loans, leasing operations and their financing on a return basis, the issuance of guarantees and sureties, including export transactions, participation in the authorized capital of the created companies.

III. THE MAIN FORMS OF STATE SUPPORT FOR INFRASTRUCTURE PROJECTS

According to analysts of InfraONE Research, from 2007 to the present time in the Russian market there were about 130 transactions in the PF format for a total of more than 4 trillion. More than a half of these transactions were done by concessions and state-private partnerships (SPPs), which are almost always functioning in the infrastructure sector. In monetary terms, the share of concessions and PPP comes only to 25% [8]. The global trend shows the opposite situation, where concessions and PPPs are the predominant form of financing and implementation of infrastructure projects.

In addition to the state participation in concessions and PPPs, the Executive authorities use other mechanisms of state support for investment projects.

First, state guarantees that can be provided for loans or bond loans attracted for the implementation of investment projects. Usually the cost of the project in infrastructure section is not less than RUB 5 bn. The guarantee is provided by the loan of the authorized Vnesheconombank for an amount not exceeding 50 % of the cost of the investment project. At least 20 % of the total cost of the project should be financed from the investor's own funds. The term of the loan or bond issue is from 4 to 20 years.

Second, credit support of PF investments on special terms:

- loans are provided in Russian rubles;
- the size of the interest rate for the lender is not higher than the level of the interest rate established by Bank of Russia at providing credit to authorized banks for the purpose of refinancing the credits issued by authorized banks to final lenders plus 2,5 percent per annum (at the moment no more than 10,0% per annum);
- the location of the industrial site of the investment project is on the territory of the Russian Federation;
- the total cost of the investment project is from RUB 1 bln to RUB 20 bln;
- financing of not more than 80% of the total cost of the investment project is at the expense of borrowed funds.

Third, the use of special investment contracts (SPICs) for certain industries as a non-financial mechanism. SPIC is contracted to achieve the target indicators of the state programs of the Russian Federation for the industries which the investment projects are implemented in.

SPICs' conditions: first, duration is up to 10 years; second, operate under a special legal regime and with the use of comprehensive support based on tax preferences and other measures; third, a guarantee of invariability of investment conditions and a set of support measures for the entire term of the contract [9].

The first SPICs were organized in 2015. According to Industrial Development Fund, an operator of special investment contracts, 33 special investment contracts were signed with an investment of 438.3 billion rubles. These include projects in pharmaceuticals, automotive industry, chemicals, machine tool manufacturing, etc. (see "Fig. 1")

As can be seen, there are no contracts in infrastructure section. We can assume that one of the reasons why it happens is connected with the new conditions and regulations on special investment contracts adopted by the Government of the Russian Federation in 2018.

DATA ON SPICs SIGNED

KEY INDICATORS



438.3 bln RUB
total volume of investment



520 bln RUB
volume of tax contributions



17 669
number of jobs

DISTRIBUTION BY ECONOMIC SECTORS

(PCS.)

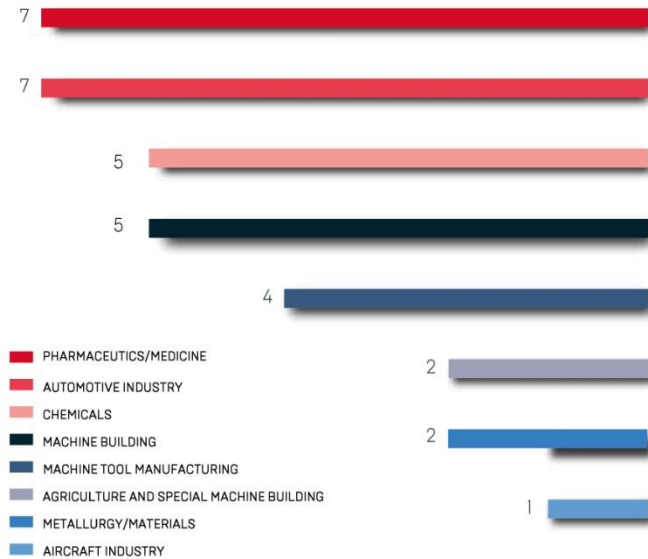


Fig. 1. Data on SPICs signed. Key indicators [9].

SPIC can be concluded in relation to the already started project or its new stage, with the provision of a separate business plan and a minimum amount of investment - 750 million rubles. This amount can include the investment which has been already made. Legislative changes expand the list of spheres for the conclusion of SPIC. Consequently, SPIC will extend to infrastructure section. It is proposed to change the term of the contract, not to limit it to 10 years, and equate it to the payback period of the project. With these amendments, SPIC could become one of the most important elements of complex infrastructure projects in the coming years.

Life cycle contracts (LCC), one of the forms of PF, can be rather interesting for infrastructure projects' implementation. The project is carried out entirely at the expense of budgetary funds, but the state saves money on procurement procedures, optimizes personnel costs, as the process of operation of the facility (repair and maintenance costs) is already included in the contract.

Under this scheme, public transport is bought and maintained in the city: for example, Moscow authorities have signed contracts to update the fleet of metro cars, trams and buses. The total volume of agreements in this area with the participation of the state is about 300 billion rubles. "...LCC, as long-term service contracts, can be an element of complex

infrastructure projects, as well as to optimize the costs of large state companies and municipalities to maintain the stable operation of infrastructure. For example, using this mechanism Russian Railways renewed its locomotive fleet in 2018" [8].

IV. PROJECT FINANCE FACTORY

To push the process of project finance implementation in Russia, the Russian Government approved the Program "Project Financing Factory" in February 2018, the operator of which was appointed Vnesheconombank (VEB) [10].

The purpose of the Program is "...creation of the mechanism of project financing of investment projects based on contracts of the syndicated credit (loan) realized by using the following measures of the state support:

- subsidies from the Federal budget for reimbursement of expenses for lending within the framework of the "Project Financing Factory" (PFF);
- the state guarantee of the Russian Federation on the bonded loans attracted by the specialized project financing company (SPFC)" [11].

Currently, Sberbank, VTB, Gazprombank, Eurasian Development Bank, International Investment Bank, All-

Russian regional Development Bank, Sovcombank, Bank Zenit, URALSIB, Alfa-Bank, AK Bars and Bank Saint Petersburg are involved in syndicated lending “Factory”. The number of participating banks is expanding [12].

The conditions of the project participation include the following items: the cost of the project is from 3 billion rubles, loan term is up to 15 years, financing - 80/20, means that 20% belong to the investor, and 80% - syndicated loan funds allocated in the form of tranches A, B and B to reduce the risks of project participants.

The scheme of work of the project financing factory involves several stages. VEB together with the participants of the factory organizes the competence centre, which conducts industry selection, marketing analysis, helps in creating a business model of the project, and assesses possible risks. The structuring centre develops the optimal structure of the transaction and the financing mechanism, makes decisions on the process of lending and determines the pool of investors. The monitoring centre monitors the implementation of the loan agreement and the market situation, manages the project at all stages of its life cycle (as is shown in “Fig. 2”) [10].

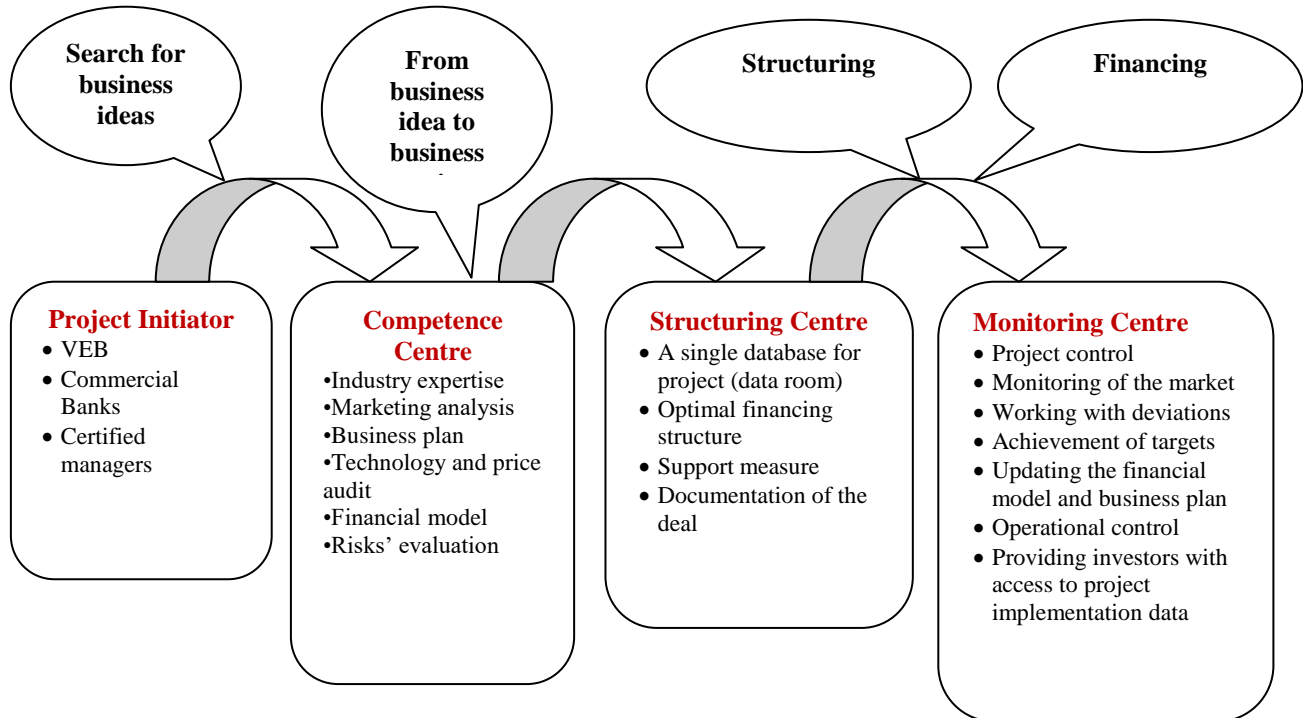


Fig. 2. Model of Project Financing Factory.

There is no universally accepted attitude towards the practical implementation of Project Finance Factory. Thus, according to InfraONE Research report, nowadays there is no key difference between PFF and the traditional lending as not only project companies, but also other legal entities, free from debt burden, are allowed to get a loan [8].

Moreover it should be noted that the common industry nomenclature for investments is rather questionable. This fact, undoubtedly, will put the infrastructure sector in unfavorable position.

There is another obvious reason for limiting PF implementation: the present financial position of VEB, the project coordinator. By the end of 2017, the bank had the loss of 287.7 billion rubles. In 2018 the amount of outstanding public debt exceeded 167 billion rubles. Even having the government support in the form of grants, budgeted up to 2020, the Bank will be able to finance not more than from three to five projects per year before it is in a position to see a favorable return from the public debt.

It should be noted the important remark of Sprout Force Capital specialists on PF issues in Russia. Initially, the project selection system used by Russian banks is erroneous. There is a conflict of interests between investors and credit institutions. Investors are focused on creating new businesses, new jobs, getting new goods and services. The overriding aim of the Bank is to avoid losses and default. Credit institutions are included in the process of investment projects selection at the initial stages. They choose investors based on a retrospective analysis of financial indicators, and one of the criteria for future income is the guarantee of sales. But what can be guaranteed now, can be significantly changed in the long term."...It happens so often when the Bank's focus on avoiding losses decelerates implementing projects which are really promising or even breakthrough" [13].

V. CONCLUSION

The prospects of using the new method for financing the investment development of infrastructure can be estimated from the standpoint of an optimist, which is the authorized

VEB. But as practice shows, approach based on taking into account possible problems, contradictions and finding the best solutions, will be more effective. For the successful implementation of infrastructure projects, it is important to change the criteria for the selection of applications for their financing and evaluation methodology, as well as to rethink the interaction of participants in the project financing program: entrepreneurs – applicants, the investment banking community and "architects of business projects".

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