InfraLatinAmerica

www.infra-latinamerica.com
13-May-2016
For **Joice Alves** at Inframation Group

Counting the infrastructure cost of Brazil's political chaos

10 May 2016

Joice Alves

The ousting this week of president Dilma Rousseff could be the turning point in a corruption scandal that has reverberated beyond Brazil's border. But for Brazilian infrastructure and its investors the damage has already been done. Joice Alves reports.

The Brazilian lower house's decision last month to begin impeachment proceedings against president Dilma Rousseff and the Senate's subsequent decision on whether to approve the motion this week, will be remembered as moments of high drama in the country's continuing economic and political crisis. But for infrastructure investment the uncertainty of the last few months has had a particularly negative impact.

It was around this time last year that Rousseff launched the country's second Logistics Investment Program (PIL) which envisaged BRL 198.4bn (USD 55.7bn) of investment in new highway, railway, port and airport concessions which were to be tendered in 2015 and 2016. Now, with Brazil in the grip of one of the world's biggest ever political and corruption scandals, delays have piled up and the PIL is on hold.

Compromised market

Renato Sucupira, CEO at infrastructure consultancy firm BF Capital, says many of Brazil's ills, from rating agency downgrades, to the appeal of projects to technical issues, could have been solved by a strong government. But the reality has unfortunately been very different. "Since the election [when Rousseff secured her second mandate in 2014] all the government has been doing is trying to save itself," Sucupira says. "If you don't have an operating government, the PIL is not going to happen."

Brazil's political crisis has also triggered another issue for infrastructure investors and developers in laying bare Brazilian institutions' lack of credibility. Brazil's Senate has today agreed to launch the trial which could lead to Rousseff's impeachment, after the senate speaker Renan Calheiros earlier rejected the lower house's acting speaker Waldir Maranhao's attempt to halt the process. Sucupira likens each new development to a new episode of a Brazilian political telenovela or soap opera which makes Brazilian infrastructure less and less attractive and difficult to take seriously. "The more we have things like this happening, the farther from Brazil investors go," he says.

> "If you don't have an operating government, the PIL is not going to happen,
>
> Renato Sucupiara, BF Capital

And Brazil is desperate for foreign investors. Even if impeachment passes and is seen to resolve the current political impasse it is far from certain that the government will be able to persuade the local private sector to invest in the PIL anytime soon. The massive Lava Jato probe into corruption at state oil company Petrobras is keeping politicians, bankers and businessmen busy. Fernando Marcondes an infrastructure partner at law firm L.O. Baptista-SVMFA says the involvement of Brazil's five largest construction companies (Construtora Norberto Odebrecht, Queiroz Galvão, Camargo Corrêa, Andrade Gutierrez and Galvão Engenharia) will likely prevent them participating in procurements. Marcondes doubts smaller groups have the capacity to take over these massive infrastructure projects. "There is a huge difference between the big and medium construction companies," Marcondes says. "What we have now is a suspicious business environment," he adds. "The problem is not only the political economic crisis."

Vice president Michel Temer, who will succeed the president if she goes, could quickly rebuild the investor confidence crucial to the PIL success. Even though important details of the Temer plan have not been disclosed, investors would likely allow Rousseff's successor a honeymoon period though much would depend on how the plan is developed. "Temer will mean an immediate positive impact," he said but added that, "positive signs could be sustained only if actions will follow," he says.

Temer is already drafting a plan to unite all the country's infrastructure-related ministries -excluding energy- in a single infrastructure office, which would include the port secretariat (SEP), the civil aviation secretariat (SAC) and the transport ministry. And he has appointed Wellington Moreira Franco, aviation minister from 2013 to 2015, as head of the infrastructure office. Moreira Franco would be leading the concession program of all logistics and transportation projects except urban mobility.

Postponed projects

But in the meantime, Brazil's concession pipeline is clogging up. On 6 May, Brazil's civil aviation authority (ANAC) launched a public consultation for four international airports, with an estimated combined required investment of BRL 6.04bn. The government expects to raise BRL 4.1bn in upfront payments. The federal accountability office (TCU) approved the projects on 20 April, allowing the Ministry of Aviation to move forward with the concessions. The government had promised it would complete the RFIs for these projects by the end of 2Q15 with the auction taking place in 1Q16.

In March Brazil's federal waterway transportation authority Antaq postponed until June an auction for six port concessions in the northern state of Pará citing technical problems. Some market sources said the real reason was because there were no interested bidders.

The auction included the concession of two port terminals in Santarém, one in Vila do Conde and three in Belém. Five out of the six areas is to be dedicated to grain transportation, the remaining one to shipping fertilizers.

Announced on 22 January by the SEP, the tender is part of the PIL program and involves BRL 1.8bn in investment over 25-years, which could be renewed for an additional 25 years. The SEP has rescheduled the auction for the 10 June at Sao Paulo Stock Exchange BMF & Bovespa. But the replacement in April of ports minister Helder Barbalho with Mauricio Carvalho is likely to cause additional delays, sources say.

Cases like these have become very common in Brazil, with the government announcing plans to issue a tender for a multi-billion dollar pipeline of projects and then repeatedly rescheduling the same tender or sometimes simply scrapping the project entirely. "We [Brazil] already don't have a reputation for sticking to our commitments, then you start to create projects that get lost on the way, you lose your credibility," Marcondes said.

Investment in highways was planned to reach BRL 66bn, which included toll road investments in projects that had already been allocated such as the BRL 1.3bn Rio-Niterói bridge which was awarded to Ecorodovias on 18 March 2015. For 2016, there were 11 projects in the pipeline worth a total of BRL 31.2bn, which also included BRL 15.3bn of investment in existing concessions. Up to now no new concessions have been awarded. "Timing [of the PIL announcement] didn't help, as turbulence last year and a political crisis this year interfered with the projects," says Moody's credit officer VP for infrastructure Alexandre Leite.

> "We already don't have a reputation for sticking to our commitments. If you then start to create projects that get lost on the way, you lose your credibility,"
>
> Fernando Marcondes, L.O. Baptista-SVMFA

The government said it plans to finalize feasibility and technical studies for 13 projects and to hold auctions for another six toll roads in 2016.

One banker said he is confident the Chicken Road, which connects Lapa, in the state of Paraná, to Chapecó in the state of Santa Catarina, could be the only project to be awarded this year, because the project is further along in the procurement stages. Sucupira thinks only the airports package has potential to happen this year, because the tender documents are already under analysis and international interest from potential bidders is high.

With railroads things get more complicated. The total investment in railways according to Rousseff's announcement, would be BRL 86.4bn by 2016, including the ambitious BRL 40bn

Bioceanic railway which aims to connect Brazil to the Pacific Coast and is to be carried out in partnership with governments and companies from both Peru and China.

Railroad project tenders are also planned for the Anápolis-Estrela D´Oeste-Três Lagoas and Palmas-Anápolis, Barcarena-Açailândia da Ferrovia Norte Sul lines, which are both part of Ferrovia Norte Sul. The government said it will tender the grain railroad Lucas do Rio Verde-Miritituba. All of these projects are pending approval from Brazilian accountability court TCU.

But the second PIL plan for investment in railroads included just five proposed federal railway concessions and is a shorter list than the 14 announced for the first PIL in August 2012. None of the railway concessions programmed in the first PIL made it further than the RFI stage.

The government has not yet published a substitute proposal for the financing model for railroad concessions. Rail development's key stumbling block in the 2012 PIL was the so-called open access model, which depended heavily on federal railway company Valec. The model involved Valec committing to buying all the cargo transport capacity on each line from the concessionaire and reselling it to users and independent railroad operators. But investors were sceptical that Valec would have pockets deep enough to assure the feasibility of the model; the government's reliance on federal insurance and reinsurance agency Agência Brasileira Gestora de Fundos Garantidores e Garantias (ABGF) foundered when the fund was not properly capitalised.

The cost of correction

The government has blamed Brazil's accountability office TCU for the majority of the delays, saying the office has not authorised the procurement process of some of the concessions as fast as expected. For it's part the TCU maintains it is just following constitutional procedures.

Whatever the reason for the delays in greenfield pipelines, investors cannot look to the secondary market for alternative Brazilian infrastructure opportunities. With most assets, seller or local investment partners touched or embroiled in the Lava Jato investigation the PIL still offers the legal security they need to do a deal. Though Leite says developers are not losing sleep over the delays since cash for investment in Brazil is sparse and capital markets remain difficult to access for financing.

"The expectation once used to be higher. Companies are now focused on the concessions that they have already won," Moody's credit officer VP for infrastructure Alexandre Leite says. Since 2012 , when Rousseff's government started the concession program, airport, toll roads and ports were awarded.

The cost of debt in Brazil has almost doubled since the PIL began in 2012. At that time interest rates stood at 7.25% but now the rate is 14.25%. The cost of capital is twice what Brazilian development bank BNDES, the main financier of the first PIL, charges. But while the bank used to finance up to 90% of these projects needs it is now scaling back and it is unclear how much it will offer to the next concessions. BNDES charges infrastructure investors two percentage points more than its long-term interest rate, the TJLP, which is currently 7.5%. In the same period last year it was 5.5%.

But with interest rates this high, the promising returns to invest in treasury bonds could be just as rewarding as investing in high risk infrastructure and investors have seen in this a reason to call for higher returns. "No one will ever invest in an airport if he will make less than with a treasury bond," Sucupira says.

Because the Brazilian economy has deteriorated and the cost of capital is higher, investors' interest in the PIL could return only if the government offers higher rates of returns, Leite says. Sucupira agrees saying the expected return will vary from project to project, but overall the PIL will meet bidders only if rewards will be high. "Whoever is going to invest here [in Brazilian infrastructure] will be after big money. It won't be charity," Sucupira says.