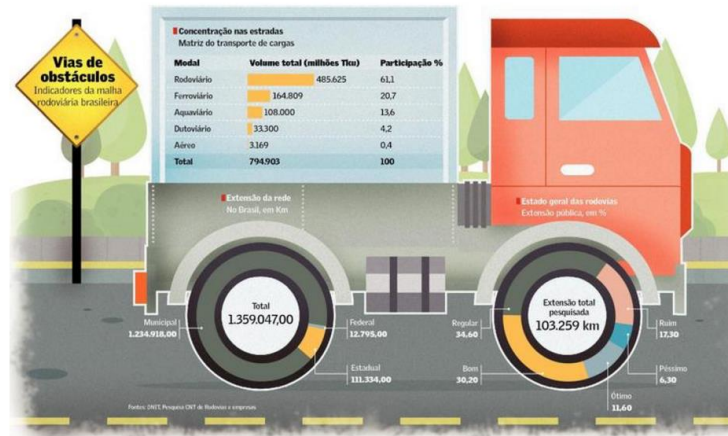


PRIVATE ROADS

By Roberto Rockmann



The coming months will be busy for lawyers and businessmen in the road sector in Brazil. Federal and state government concessions, renewal of concessions tendered in the 1990s and the discussion of problems on contracts signed between 2012 and 2013, subject to Medida Provisória 752, are part of the private sector's agenda.

The private sector, currently responsible for managing about 20,000 km of highways in Brazil, is set to grow, with new companies arriving and interested on the sector, which accounts for the handling of 60% of cargo. Of the almost 1.7 million km of roads that cut Brazil's five regions, 87.9% have no paving. São Paulo is an example: the state network has a little more than 20,000 km, while adjacent roads, administered by municipalities, exceed 160,000 km, the majority of which are dirt roads.

The Federal Government intends to tender in the coming months a set of highways, of which the first two will be BR364/365, between Goiás and Minas Gerais, and BR101/116/290/386, in Rio Grande do Sul. The official announcement is expected to be made in the first half of 2017 and the auctions are scheduled for the second half of the year.

These two lots are already attracting potential investors. "The Spanish are the most interested, and they include both financial institutions and concessions operators," says the advisory of the Secretariat of the Investment Partnerships Program (PPI), which coordinates the process. The government believes new players will be able to get involved in the sector in the upcoming concessions, such as medium-sized contractors.

One of the innovations in the tender documents, to increase interest in the concessions and to encourage growth on the number of participants, will be the relaxing of requirements. For example, the stipulated time period to duplicate a relevant portion of the tendered highway will increase from five years to up to eight years. Other requirements to be eased include the length of the network to be duplicated – in previous concessions, attempts to duplicate more than 400 km was requested, this will now be reduced. Further, concessions may adopt a trigger mechanism,

by which investments are made only according to the volume of traffic. As such, less investment will be required.

In addition to the aforementioned two highways, whose studies were more advanced, others should be offered to the market in the coming months. Such progress is not limited to the Federal Government. State governments are also working to transfer stretches to private capital. São Paulo is expected to offer for bid 16,000 km of roads, while the Bahia government has created a state-owned company that will consolidate state government assets such as buildings and receivables, such as water and sewage bills from Embasa and the gas company for auction.

With these resources, the Bahia company is able to issue debentures to support infrastructure projects. For example, for the construction of a bridge of just over 10 km between Salvador and Itaparica, the idea is that the investor can also, in addition to toll revenues, also obtain revenue from real estate projects around the 13 cities impacted by the project, which can be made through a Public Private Partnership (PPP). "We are working on solutions," says Carlos Martins, Secretary of Urban Development for Bahia.

The fiscal crisis and the prospect of having fewer resources from the Federal Government have broadened the search for solutions from the private sector. The governments of Minas Gerais, Mato Grosso and Rio Grande do Sul are also studying the bidding of stretches of highways, which could create new business opportunities.

"There is interest in the assets that are being offered, such as the São Paulo highways, whose process is more advanced," says Paulo Dantas, infrastructure partner at Demarest Advogados.

Among those who knocked on the door of his law office are both groups that have been present in the Brazilian market and now want to return, and investors who want to debut in Brazil, with European and Asian capital. "A major European international operator with no participation in Brazil, but with concessions in South America, such as Peru, Uruguay and Colombia, is interested," says Karla Bertocco Trindade, Undersecretary of Partnerships and Innovation of the São Paulo government. It is not only companies that are seeking to enter Brazil for the first time that are watching these assets, but also concessionaires that are already operating in the market, such as CCR and Ecorodovias.

These projects will increase private capital's participation in the sector. Today, private companies run 18,992 km of highways in 12 states, which corresponds to approximately 10% of the national paved road network. The new road concessions will take place for the first time in the context of Operation Lava Jato, which should reduce the appetite for participation from the large Brazilian construction companies involved in that investigation.

Also in play for the first time are new BNDES credit conditions, which will only support up to 50% of projects' financing. BNDES estimates infrastructure debentures may represent an additional 10% and 20% of the financing for concessions to be tendered.

Private sector appetite should only be generated by projects that present good returns, good quality and good corporate governance that mitigates risk and reduces possible conflicts between

stakeholders, such as builders and shareholders. "The negative interest rates in the world create liquidity that should be able to finance these projects," says Rodrigo Bacellar, superintendent of BNDES. For projects starting from scratch, demand could come from domestic or foreign institutional investors, who may be attracted by lower interest rates and well-structured finances.

The market will closely watch the new rules, stipulated in Medida Provisória 752, published late last month. The financing was one of the problematic issues of concessions tendered between 2012 and 2013, in which some works stopped due to lack of promised financing or problems arising from Lava Jato.

Another issue to be resolved is the need to present collateral. The situation has worsened with Lava Jato, where the large construction companies are in a fragile position, with insufficient additional equity available on the balance sheet to offer as collateral, which also will hamper the participation of private equity funds.

"We need to change the guarantee structure, with better risk mitigation and in which insurers play a more active role," says Venilton Tadini, president of the Brazilian Infrastructure and Base Industries Association (Abdib).

The long-term potential remains promising. According to Paulo Resende, logistics coordinator of Fundação Dom Cabral (FDC), Brazil will still have for 10 to 15 years at least with an unbalanced transportation matrix, where most freight will be transported through highways, where competitiveness is lower. In their estimates, little more than 50% of cargo transported in country travels in roads now under private sector administration.

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