

***1520 STRATEGIC PARTNERSHIP:  
CENTRAL EUROPE***

**ASPECTS OF INFRASTRUCTURE  
FINANCING IN CEE AND RUSSIA**

February, 21 2018

# CEE in a snapshot

EUR 210 billion has been spent on transport infrastructure in CEE on EU member states (1995-2015)

CEE is expected to outpace Western Europe over the next five years with construction market growth of 3.1% p. a.

Still considerable disparity in both availability and quality of road, rail, air and port infrastructure across CEE

CEE infrastructure investments (incl. CIS) are estimated at **EUR 615 bn** through 2025

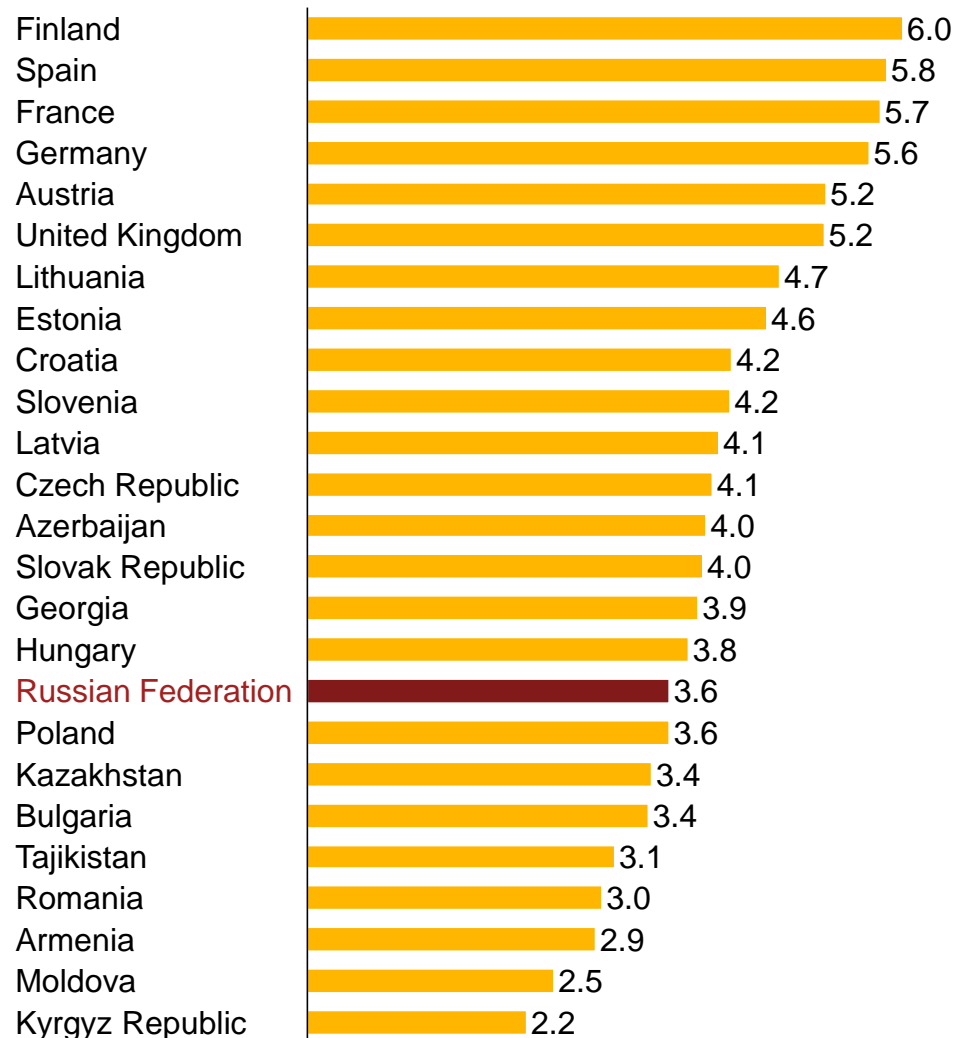


Source for projections: Oxford Economics

# Disparity between CEE (incl. CIS) and EU15 is still notable. However the region has made unprecedented progress

## Quality of transport infrastructure

1 (worst) –7 (best)

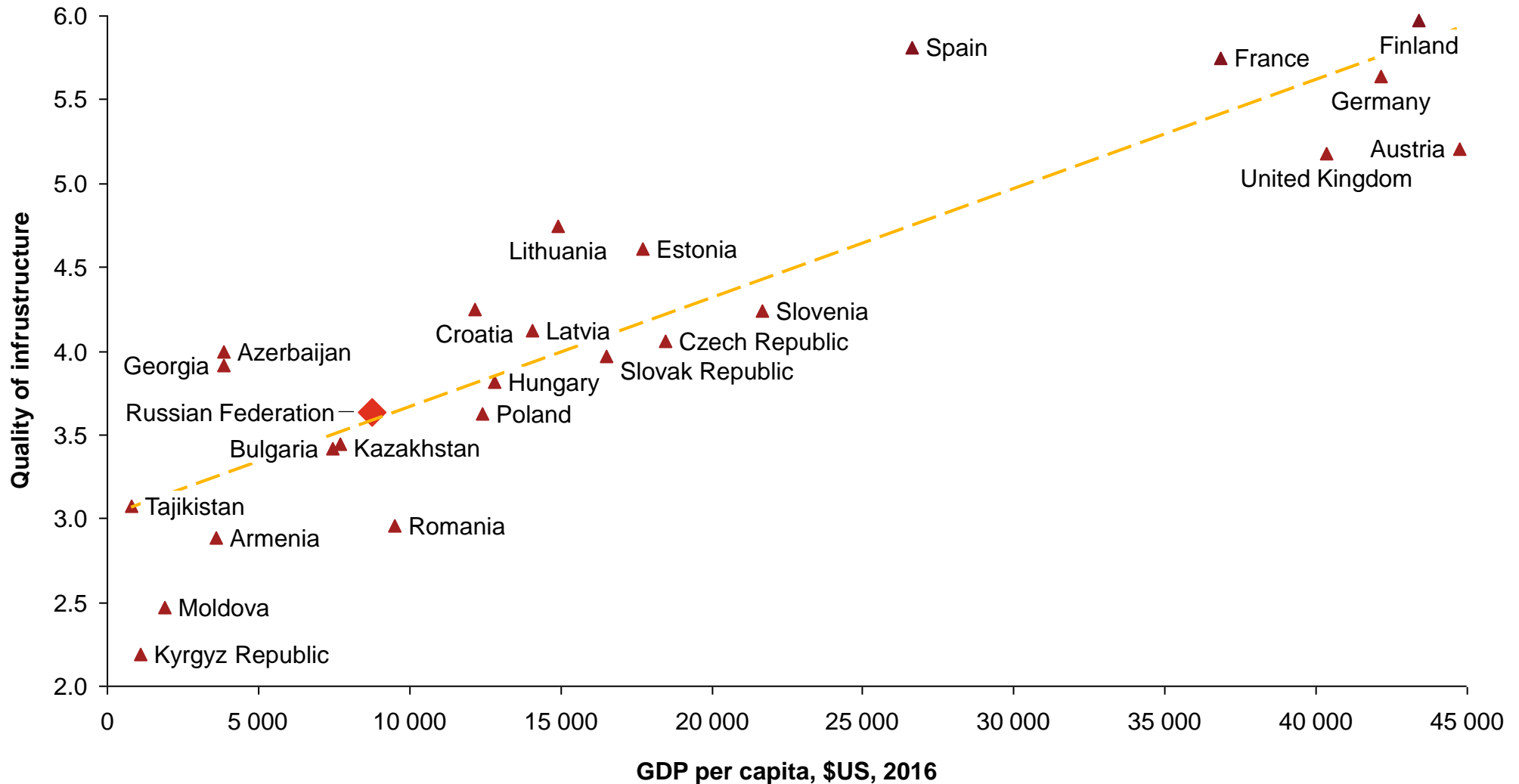


Countries	Quality of motorways	Quality of rail roads	Quality of port infrastructure
1 Finland	5.8	5.8	6.4
2 Spain	5.8	5.9	5.7
3 France	6.1	5.8	5.3
4 Germany	5.7	5.6	5.6
5 Austria	6.1	5.3	4.0
6 United Kingdom	5.2	4.8	5.7
7 Lithuania	5.0	4.4	4.9
8 Estonia	4.5	3.9	5.5
9 Croatia	5.6	2.7	4.5
10 Slovenia	4.7	3.2	5.0
11 Latvia	3.3	4.0	5.2
12 Czech Republic	4.0	4.5	3.6
13 Azerbaijan	4.0	3.8	4.3
14 Slovak Republic	4.0	4.6	3.2
15 Georgia	3.9	3.9	4.0
16 Hungary	4.2	3.8	3.4
17 Russian Federation	2.7	4.3	3.9
18 Poland	3.8	3.1	4.0
19 Kazakhstan	3.1	4.2	2.9
20 Bulgaria	3.3	3.1	3.9
21 Tajikistan	3.6	3.4	2.1
22 Romania	2.8	2.8	3.4
23 Armenia	3.8	2.6	2.1
24 Moldova	2.4	2.7	2.2
25 Kyrgyz Republic	2.6	2.4	1.5

Legend: Yellow - selected CEE countries, Dark Red - selected CIS countries February 2018

Source: The Global Competitiveness Report 2017-2018, World Economic Forum

# Correlation between GDP per capita and level of infrastructure development of European countries is high



Source: The Global Competitiveness Report 2017-2018, World Economic Forum, WorldBank

# *The CEE region heavily relies on EU funding and financing instruments*

Almost EUR 210 billion has been spent on transport infrastructure in CEE over the past 20 years of which over EUR 150 billion has been spent from EU funds

<i>EU Instrument</i>	<i>Type of funding/financing</i>	<i>Focus</i>	<i>Available funds (2014-2020)</i>
Cohesion Fund (CF)	Grants (plus financial instruments)	Transportation, Environment	€ 63.4 billion
Connecting Europe Facility (CEF)	Grants (plus CEF debt instrument)	Infrastructure	€ 24 billion
European Fund for Strategic Investments (EFSI)	Loan and equity	Infrastructure, Health, ICT	€ 34.5 billion (as of 2018)
Horizon 2020	Grants	Innovative Transportation & Energy	€ 2.3 billion (2018-2020)

## *Key EU funding trends in the future*

- ✓ EU (transport) budget beyond 2020 likely to be reduced (Brexit, European Defense Fund, etc.)
- ✓ Funding of infrastructure projects moving away from EU non returnable grants
- ✓ Stronger bond between the European Commission (EC) and the European Investment Bank (EIB) which is acting increasingly as the financial arm of the Commission (eg. EFSI instrument)
- ✓ Launch of new instruments to ensure funding of innovative solutions in transportation, energy, utilities. telecoms is expected

# *Main challenges for Infrastructure Investment in CEE*



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# *Lessons learnt – requirements for successful project in CEE*

- 1** Political stability and support (more important than in Western Europe)
- 2** Insurance for political and other non commercial risks, especially for countries with lower credit ratings is needed
- 3** Capacity building at national institutions to facilitate preparation of well developed projects
- 4** Qualified and experienced financial and legal advisors (and experience in their selection)
- 5** Projects not too large to raise affordability concerns or complex technical solutions
- 6** Coordination with financial institutions (EBRD, IFC, EIB) and local stakeholders
- 7** Adoption of internationally recognized documentation and procurement processes
- 8** Proven, bankable, commercial terms and risk transfer – no full traffic / demand risk transfer to private sector

# ***Challenges of infrastructure financing vary in CEE depending on the country/sub-region***

## **Central Europe**

- ✓ Red tape, permits, EIA
- ✓ Shortage of well-developed projects

## **Baltics**

- ✓ Small projects
- ✓ Lack of mature project finance market
- ✓ Shortage of well-developed projects

## **South Eastern Europe**

- ✓ Political risks
- ✓ Transparency of financing
- ✓ Country ratings

## **CIS (except Russia)**

- ✓ Insufficient PPP/Concession laws
- ✓ Lack of mature project finance market
- ✓ Lack of successfully completed projects
- ✓ Political instability



# ***Opportunities of infrastructure financing in CEE mainly result from political support and external drivers***

## **Central Europe**

- ✓ Secondary market
- ✓ Impact of Fiscal Stability Treaty
- ✓ Strong political support

## **Baltics**

- ✓ Untapped pipeline of bigger project opportunities
- ✓ Capacity building
- ✓ Political drivers (self-dependence)

## **South Eastern Europe**

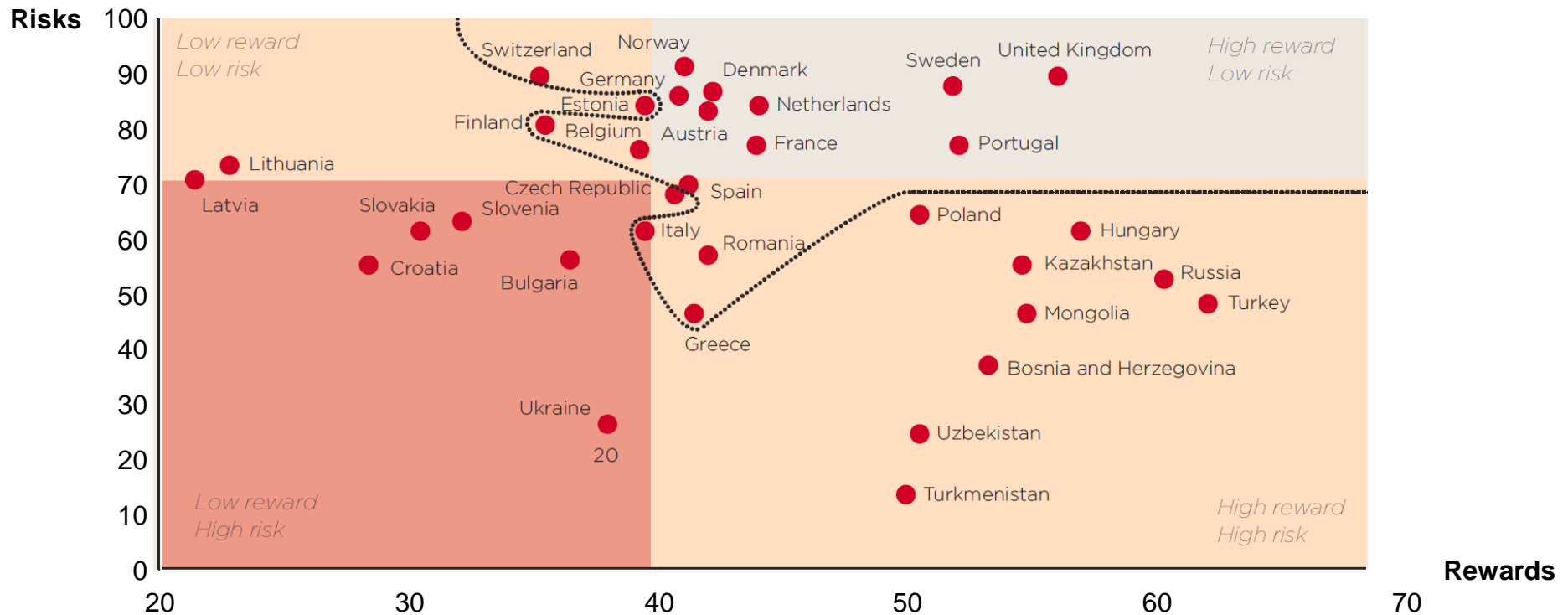
- ✓ Use of EU funds
- ✓ Projects of interesting size
- ✓ Unsolicited proposals

## **CIS (except Russia)**

- ✓ IFIs interest in funding projects in the region
- ✓ High returns on investments

# ***Russian challenges. Despite the high potential of the market, existing foreign and domestic investors remain passive regarding infrastructure investments in Russia***

- Relatively immature framework
- High political risks
- High ForEx risks
- Lack of international investors and equity investors
- Limited practice of projects development



Source: Oxford Economics, PwC analysis

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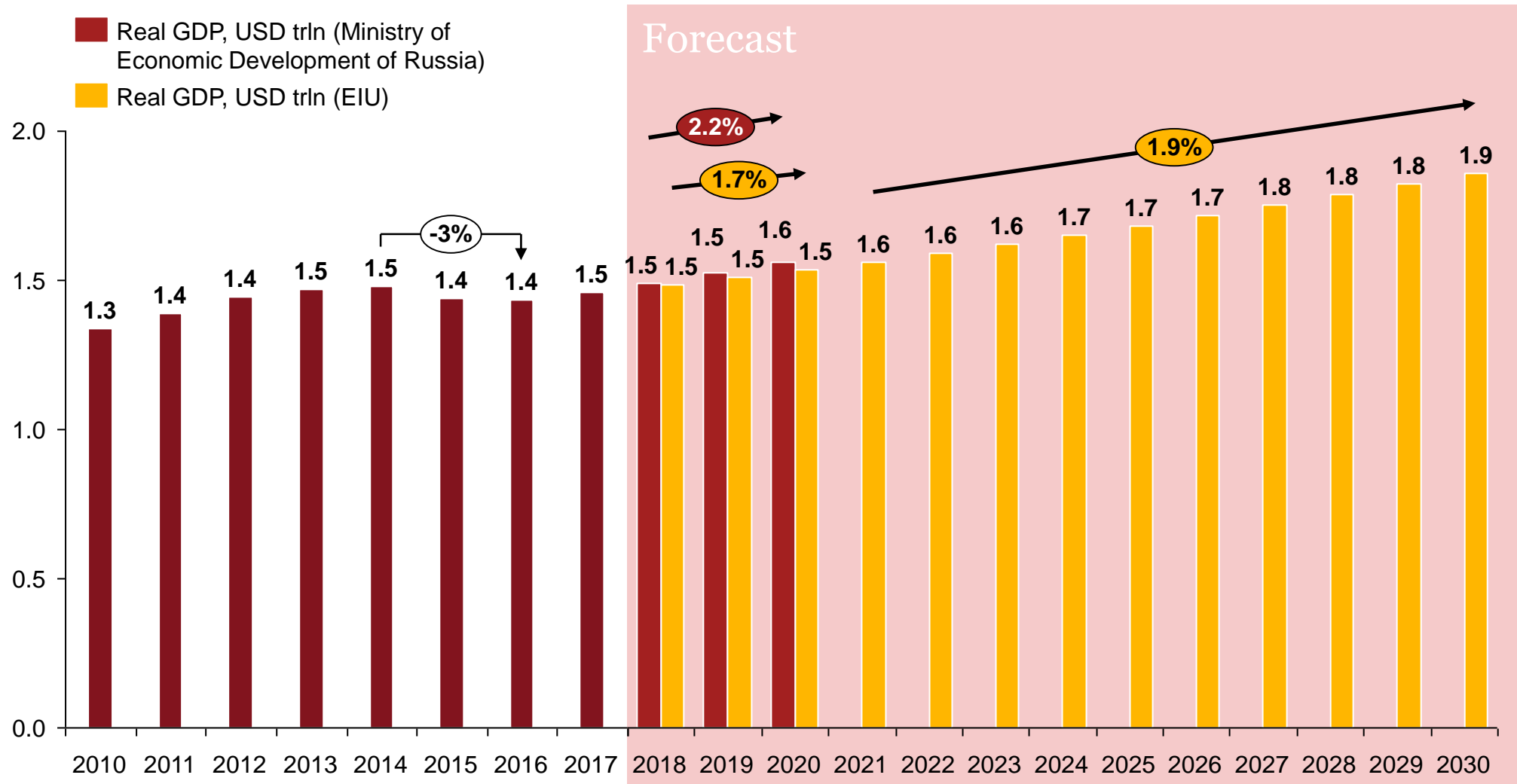
# *Opportunities of infrastructure financing in Russia are substantial*

Government support measures shift from subsidies to indirect instruments like PPP and blended financing

Infrastructure project investments are expected to grow as an area of strategic government focus

Large territory, geographic proximity to both Europe and Asia as well as potential of transportation capacity further development stimulate new infrastructure projects for the years to come

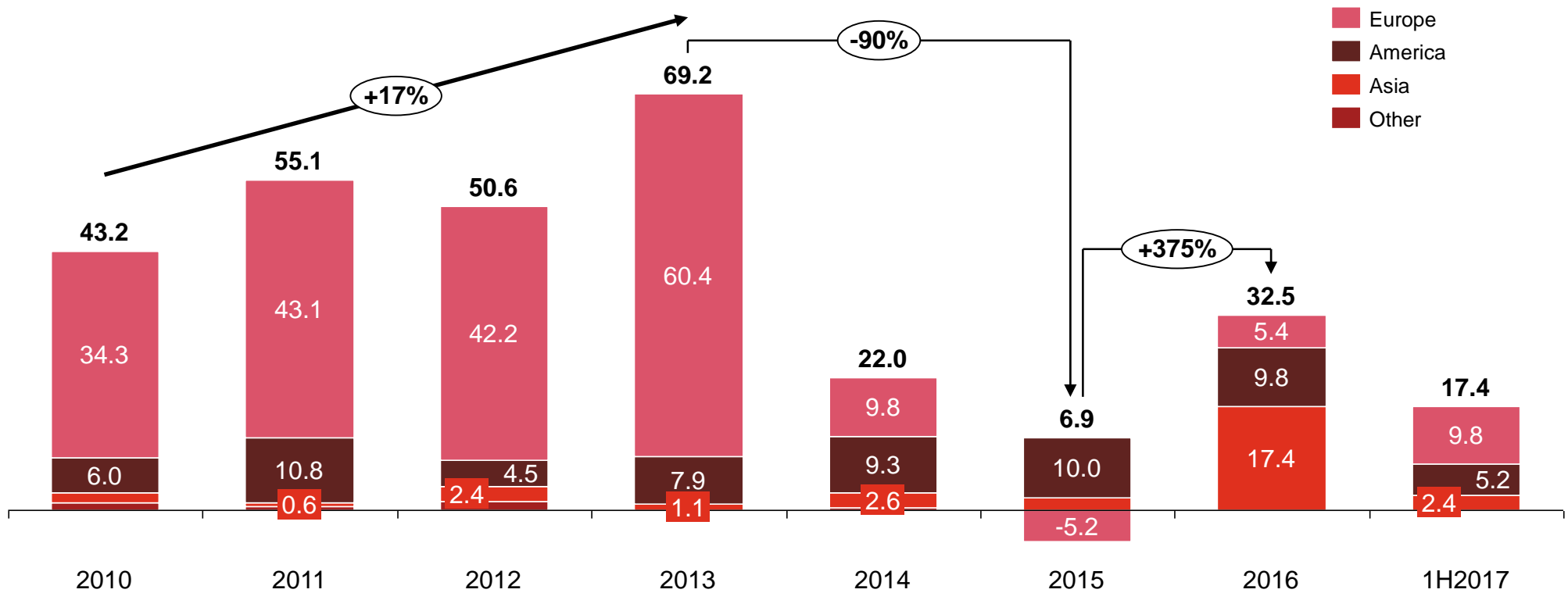
# Russian economy restored from the recent drop and is forecast to grow in the 2030 perspective



Source: Short-term strategy of economic development of Russia, EIU, PwC analysis

# After the 2014-2016 recession in Russian economy, the share of Asian direct investments rose more than two times, investments from European countries dropped tenfold

Net foreign direct investments flows in Russia 2010-2016, USD bn



Source: Rosstat, CBR, translated into USB at fixed rate of 60 Rub per 1 US\$

# As of 2018 major sources of funds for infrastructure financing in Russia are domestic

## Sources of infrastructure project funding

Source of funding	International / Domestic
State-controlled banks	● Domestic
VEB	● Domestic
Eurasian Development Bank	● International
New Development Bank	● International
Pension funds	● Domestic
Commodity exporters	● Domestic
Construction companies	● Domestic
Other*	● Domestic

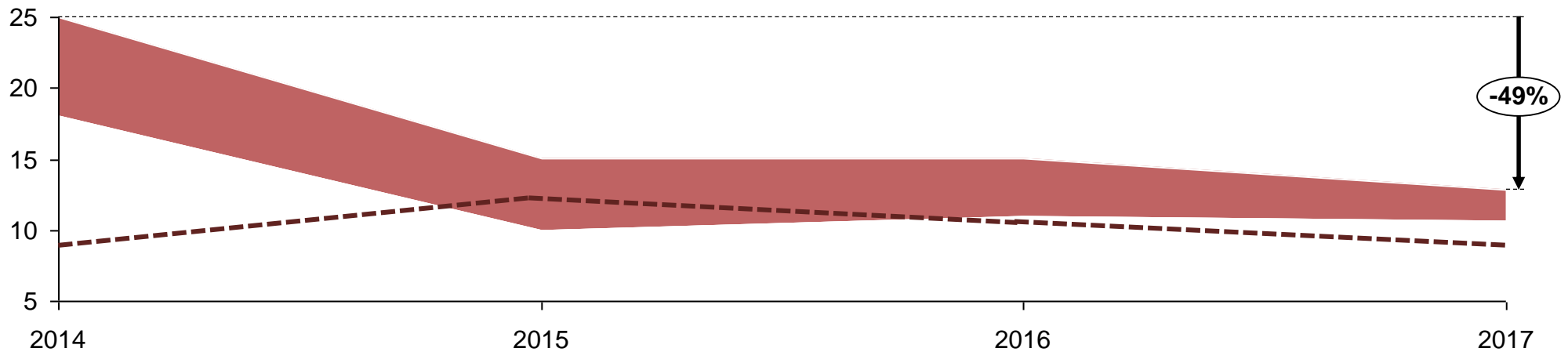
- International
- Domestic

\* - other sources include private equity, commercial banks, insurance companies, smaller government banks, etc.

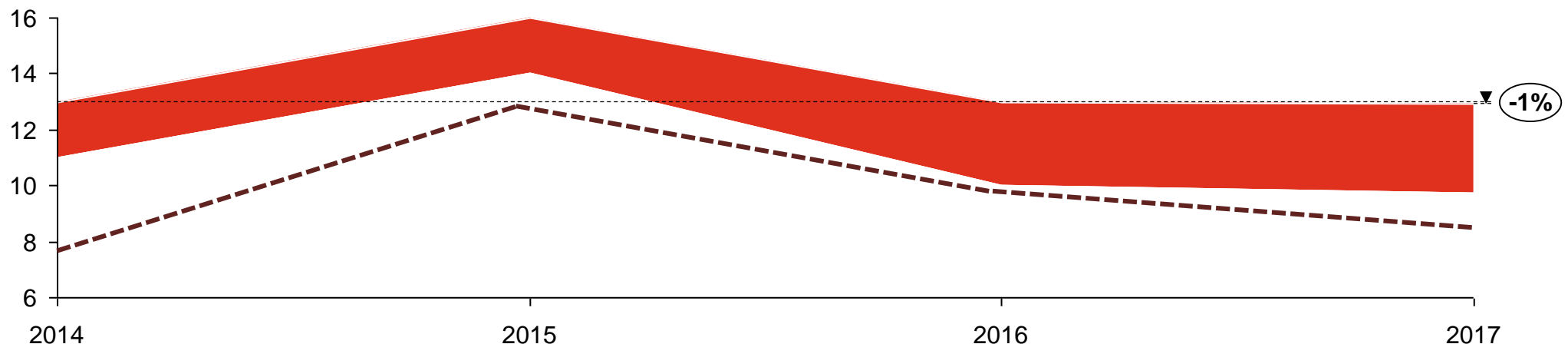
- By 2018 EBRD investments in Russia amounted to **EUR 24,1 bn**
- By 2018 EDB investments in Russian projects exceeded **USD 1,5 bn**
- By NDB investments in Russia amounted to **USD 0,1 bn**

# Whether cost of equity reached effective cost of debt for infrastructure projects in Russia ?!

## Cost of equity for infrastructure projects 2014-2017, RUB %



## Cost of debt for infrastructure projects 2014-2017, RUB %



Source: PwC analysis on selected infrastructure projects, CBR

--- Key rate annual average, %CBR

February 2018

# Mosaic of state support for investment projects in Russia looks comprehensive, but process of getting them is odd

## Indirect measures

- ✓ The State Guarantees (resolution №1016)
- ✓ Tax reliefs
- ✓ SEZ/Territories of advanced development
- ✓ Regional tax reliefs and support programs
- ✓ Limitation of competition

## Industrial Development Fund

Resolution of the Government of the Russian Federation №1044 approving the program for supporting investment projects implemented in the Russian Federation on the basis of project financing

## VEB

- ✓ Providing guarantees
- ✓ Participation in the authorized capital of business entities
- ✓ Guarantee support for exports.

## Russian National Wealth Fund

According to point 4 of article 96.11 of the Budget code of the Russian Federation means of NWF can be placed in debt obligations and shares of legal entities

## Industry-specific

e.g.:

### Resolution № 419

Subsidies to the organizations of light industry in the reimbursement of expenses on service of loans

## Regional measures

e.g.:

### Russian export center

- ✓ Lending
- ✓ Insurance support
- ✓ The provision of state guarantees

## Industrial Development Fund

The program «Development Projects»

- ✓ Targeted on import substitution projects

## Industrial Development Fund

Leasing loans program

- ✓ Stimulation of purchasing of industrial equipment

## Industrial Development Fund

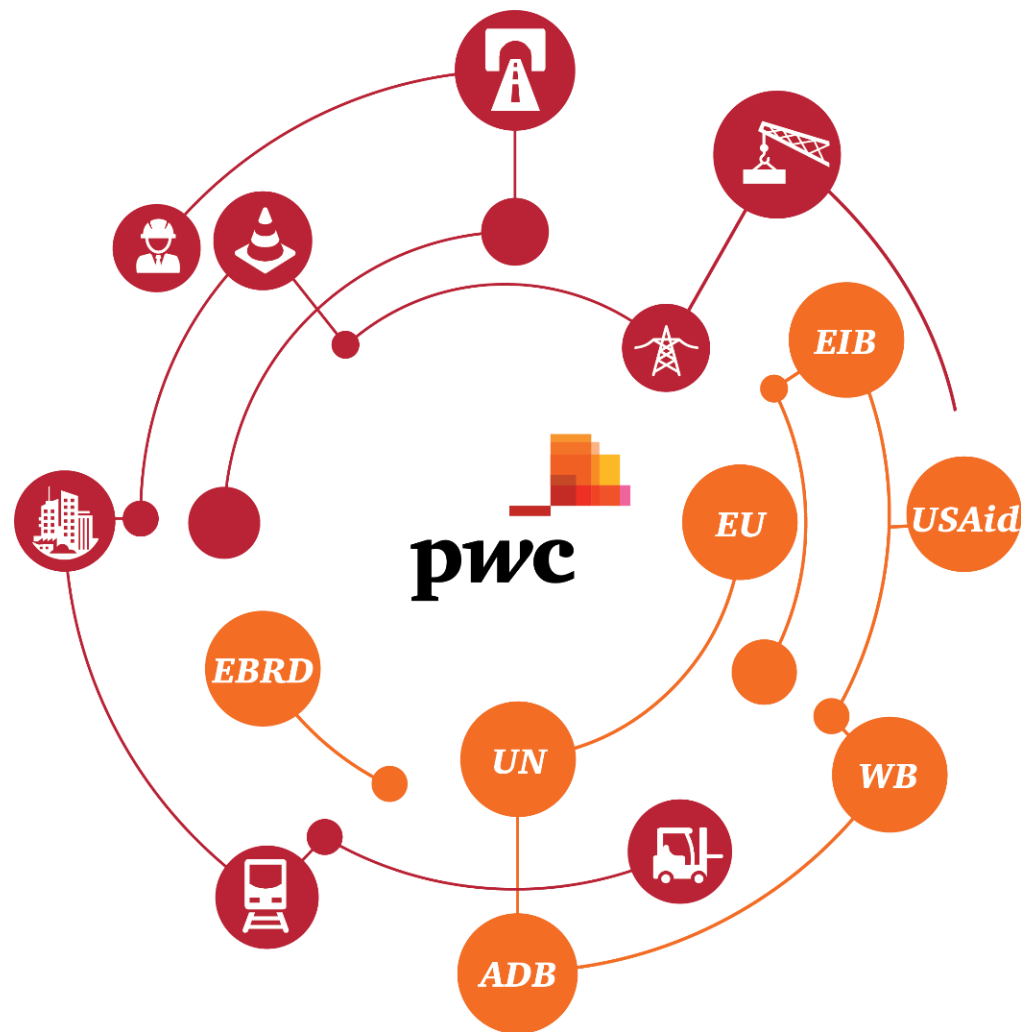
Program, "Joint loans"

- ✓ Targeted on import substitution projects

**+Many others**



# Thank you!



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