



# CYCLE OF REGIONAL EVENTS AND CONCESSIONS APPS

Volume I



## CREDITS

### CYCLE OF REGIONAL EVENTS AND CONCESSIONS APPS

#### Volume I

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We thank everyone involved. We are sure that these discussions on Concessions and Public-Private Partnerships will sow seeds in many Brazilian cities, fostering the generation of new businesses, jobs and income to support the resume of Brazil's economic growth and development.



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**José Carlos Martins**  
Chairman, CBIC

## Time for Concessions and PPPs

After promoting a large international event in Brasilia, in April 2015, to discuss Concessions and Public-Private Partnerships, CBIC, along with members and partners, have decided to organize training for disseminating knowledge and opportunities on this topic in Brazil's five main regions.

The Public Work, Privatization and Concession Committee (COP/CBIC) hosted two cycles of a seminar titled "Concessions and Public-Private Partnerships (PPPs) - Expanding Business Opportunities."

Overall, we had 120 speakers, more than 2,200 attendees, 12 hosting partners and 78 institutional supporters.

We have realized that at every new round, the participation and interest of both companies and the Public Administration would grow, as this is a feasible path for resuming growth in Brazil.

All topics discussed in these seminars were structured and then divided into two publications that will be benchmarks for those interested in expanding their knowledge on Concessions and PPPs. In this book, we present fundamental concepts, concession models and possible arrangements, contract structures and compensation systems, as well as relevant aspects of the legal framework, such as limits (object, value, term), Procedure for Express of Interest, risk allocation and guarantee systems (public guarantees and guarantees to lenders).

We hope to bring more players from public and private sectors to this business modality, which is strategic to all parties: to the company, as it has expertise and is fast to complete activities; to the Public Administration that can redirect costs on employees to regulation and oversight, and specially for the Brazilian population, who will benefit from more and better services.

# Introduction



**Carlos Eduardo  
Lima Jorge**  
Chairman, COP/CBIC

## Benefits from Concessions and PPPs to the Brazilian economy

At the end of the 11 event cycle that comprised the Regional Seminars on Opportunities in Concessions and PPPs, COP/CBIC has one thing clear: Other events covering this topic will remain in the Committee's agenda.

This is because we have found a large area for institutional efforts that can and shall be carried out by the industry associations, aiming to better prepare public and private sectors, identify market niches in different social infrastructure and logistics areas (such as sanitation, solid waste treatment, parking lots, hospitals, public lightning, housing, prisons) and also to identify the main barriers to financing and guarantees, which must be overcome to make access to a larger number of companies possible to projects.

And such efforts have a schedule date: this is the hour. In the first day of his term, president Michel Temer signed the Provisional Measure 727 that creates the Investment Partnership Program (Programa de Parcerias de Investimento, PPI), which is a clear signal to the market that Concessions and PPPs would be used as the main tools for generating jobs and reactivating the economy. Also, his administration created a Secretariat of Infrastructure that, similar to countries like Chile, Peru, and Mexico, will coordinate all efforts in this field, thus accelerating the implementation of Concession and PPP projects.

In line with these measures, CBIC aims to consider how to add more cities to Phase III of events on Opportunities in Concessions and PPPs, to be launched in the second half of 2016, in order to provide these cities with appropriate training to structure partnership projects so that more public and private agents are interested in this business model, which may foster corporate growth, generating job and income, in addition to deliver quality services to the population, thus promoting Brazilian social and economic development.

**Enjoy!**

# Hosts



**José Eugenio Gizzi**  
Chairman, Sinduscon-PR

“This topic is extremely important for companies, especially the smaller ones, that need to be fully aware about this topic to realize new business opportunities, as well as for the Public Administration - which has dramatically lost its investment capacity and now relies on the private sector as a partner to conduct urgent works to promote Brazil’s development.”

“Concessions and PPPs are critical for improving public service, as concessionaires are compensated by performance and user assessment, who are Brazilian citizens, support this process. The ideal is that this business model becomes a State Policy and not a government”



**André Montenegro**  
Chairman, Sinduscon-CE



**Carlos Alberto de Paula Moura Júnior**  
Chairman, Sinduscon-GO

“I expect that we have launched an important seed for all of us, businessmen, investors and public agents can see Concessions and Public-Private Partnerships under a new light and realizing that such projects are feasible. What we need to do now is to move forward, enhance our knowledge and leverage this range of opportunities being opened up.”

“We do not see another path to face Brazil’s infrastructure deficiencies than the Concession and Public-Private Partnership path. For this reason, this CBIC initiative to promote a broad national debate on the topic is quite timely. We believe that this debate is critical for Public Administration representatives and companies in the construction industry have a clearer vision of the challenges and opportunities beneath this topic.”



**Aristóteles Passos  
Costa Neto**

Chairman, Sinduscon-ES



**Luiz Fernando  
Santos Reis**

Chairman, AEERJ

“The State of Rio de Janeiro has become a national benchmark in Public-Private Partnerships, critical to develop the state and the nation’s infrastructure in times of poor economic performance. Here some of the largest and best successful experiences in this model, such as Porto Maravilha, AP-5 (sanitation concession in the West area of the city of Rio de Janeiro), VLT and so many others. We need to ensure that this model remains fruitful and extending the participation of companies.”

# Hosts



**Alex Dias Carvalho**  
Chairman, Sinduscon-PA

“We are absolutely optimistic and convinced that all entities representing the state of Pará and the Amazon societies in relation to the topics or interested in these topics as potentially agents of change have leveraged this opportunity and contributed a great deal while debating over this topic. We hope that these discussions have awakened interest in public agents and companies in our region about this topic and that new business opportunities can happen.”

“We are facing a complex political and economic scenario in Brazil, but in such bad times also rise some opportunities. If the State cannot invest in urgent works and services, especially in infrastructure, health, education, and security, make partnership with the private sector is the feasible solution for not leaving the Brazilian population without such basic services. This way, we are not only executors, constructors, but somehow, we are contributing with ideas and projects that will support Brazil’s social and economic development.”



**Gustavo Miranda**  
Chairman, Sinduscon-PE



**Ricardo Sessegolo**  
Chairman, Sinduscon-RS

“The Concession and especially the PPP topics are a bit weird for us, who basically operate with real estate - it is a work business. I salute CBIC for embrace and promote across Brazil how a PPP works, and mainly by show to small and mid-sized companies that this is a hiring model for all. So I believe that a new market until now unknown to us is being unveiled, and we are willing to learn and invest on it.”

“We from the private sector have to see this business model as a huge opportunity for our companies. For this reason, it is important to have these events CBIC has been promoted all over Brazil, bringing experts on this topic to each city to guide both government officials and businessmen on how to structure these contracts, what is the builder’s role, the investor’s role, and the State’s role. As small and mid-sized companies can ensure the financial structuring of this business and how to provide legal security to awake investors interest as well? Questions like this shall be discussed so that more companies can get ready to work in projects of this nature.”



**Carlos Henrique de Oliveira Passos**  
Chairman, Sinduscon-BA



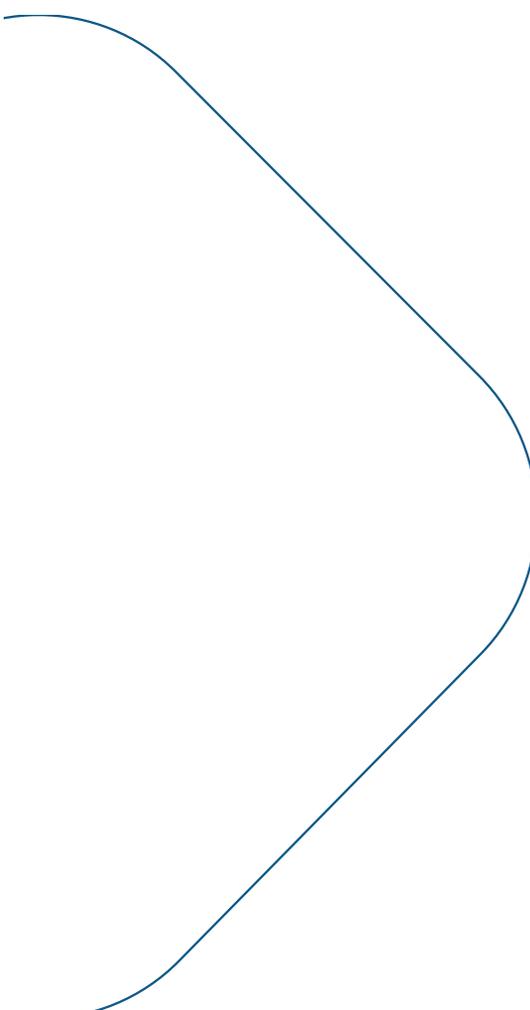
**José Romeu Ferraz Neto**  
Chairman, Sinduscon-SP

“We believe that PPPs and concessions are really the solution for Brazil in the coming years. In 2015, only 1.8% of GDP were invested in infrastructure, while the minimum required would be between 5% and 7%, just to maintain and keep operational all investments already made. This means that we are virtually destroying all we have built over the years. For this reason, we believe in this agenda of change through PPPs and Concessions, progressing in the debate both from the private sector standpoint and the Federal, State and City administration standpoint.

“Our goal is to show that PPPs and concessions can and should have the most varied types , sizes , and can meet various segments , not just the roads, ports and airports. Certainly , this business mode is a great outlet for our industry and for our State and needs to partner up with the private sector to viable urgent works in many areas ( infrastructure, education , sanitation, health , etc.) as well as quality services for the population.”



**Ricardo Portella**  
Chairman, Sicepot-RS



# Training 1



# Introduction to PPPs and Concessions and their essential legal and regulatory aspects.



## Critical legal and regulatory aspects for Concessions and PPPs



**Fernando Vernalha**  
Partner, Vernalha Guimarães  
& Pereira

The public service concession model and the differences in relation to contracts for Engineering works and services.

It has been noted lately a growing interest from the construction industry on public service concession contracts and Public-Private Partnerships (PPP).

There is a large number of infrastructure programs being prepared that will give birth to a new cycle of concessions and PPPs. But companies in the construction industry are used to conventional contracts for Engineering works and services that are very different from concession contracts (concessions and PPPs). For this reason, in order to bring this sector closer to concessions and PPPs, it is useful to make initial comparisons between the conventional contract model for Engineering works and services and the public service concession contract model.

The first distinction is related to the need for public payments. Conventional Engineering work and service contracts necessarily depend from public resources and their sole compensation source are public payments. For this reason, a budget shall set aside in all cases to launch a bid for hiring Engineering works or services. It is not possible that in this contract type there is some external or alternate source of income to public payments.

In the other hand, on concession contracts the concessionaire revenue comes from the payment of fees by service users and eventually from alternative revenue streams generated by the exploration of an-

cillary businesses in relation to the delivery of the public service. The Public Administration transfers to the concessionaire the rights to explore the delivery of the public service, who is, in turn, responsible for building the required infrastructure for making the service available to users. In this model, revenue from fees, already considered ancillary revenues, will always be enough to cover concession costs and to ensure profits for the concessionaire. For this reason, it is said that these contracts are financially self-sustainable.

Another important aspect of this model stems from this. In a public service ordinary concession, there will always be the delivery of a public service under a fee. This means a service that may be divided into fee units so that users can pay for its use on a individual basis. Public services that are used collectively, such as cleaning streets or public lightning) are not possible, in principle, to be objects of an ordinary concession of public service.

Another distinctive aspect between models is the coverage of contract's object. Conventional contracts have a single object, i.e., the law forbids adding to Engineering work contract other objects, such as service delivery or the provision of goods. This limits the compensation model which will be always tied to the execution of the work. In a concession, the object is always complex as the concessionaire has to execute a work and equip it properly, in order to make the service available to the user. For this, deliveries of different types will be integrated in the concession's object, such as



the supply of goods and the execution of Engineering works and services. As the compensation system is based on the payment for services, the compensation for the works and other investments will be always incorporated in the payment for the service. This allows the Administration to dilute the price in the service-linked compensation for the work execution and for the acquisition of other assets, that will be returned to the Public Administration by the end of the contract. Furthermore, the complexity of the concession object allows for integrating risks, aiming to enhance the hiring's efficiency. One example is the integration of risks from project, construction and for maintaining the work for a long time (bundling), creating incentives for the concessionaire to pursue the most efficient format for the project, once project failures will translate into higher costs during execution of the work, or to prevent the concession-

aire to make excessive savings in the construction, as potential defects will pose higher maintenance costs that the concessionaire will bear for a long period. The concession creates a long-term responsibility for the maintenance of public assets to the concessionaire.

The economic-financial structure of these contracts is also different. While Engineering work and service contracts have a relatively simple structure, in which public payment flow is enough to "self-finance" the contract by covering its production costs, concessions demand complex structures, where investments are concentrated in the beginning of the contract and depend on a longer period for delivery the service to its amortization. The execution of a concession or PPP is divided into two main phases: There is a preparatory phase or preoperational phase, where the concessionaire must make investments enough to build the infrastructure required

“Every Concession and PPP must necessarily have a service delivery, as they are not a model only for the work phase, hiring workforce or the provision of goods.”

for service delivery, and the operational phase, when the service is on delivery and the revenue stream starts. It is precisely in the pre-operational phase that the biggest risks are concentrated, as the infrastructure is not completed yet and the concessionaire is not getting any revenue at this point. For this reason, guarantees are demanded to supplement the grant of receivables from the project itself until the physical completion of works or the financial completion is reached.

### The rise of PPPs

Until 2004, there were only two models for public hiring in Brazil: (i) the conventional hiring model (governed mainly by Law 8.666/93) and the public service concession model (governed by Law 8987/95). But there was an interest to allow the integration of public subsidies in loss-making public service concessions (where the expected fee revenue would not be enough to cover concession costs and ensure profits to the concessionaire) and to extend the economic-financial structure of concessions to other services that could not charge a fee (whether by legal or technical restrictions). For this reason, the Public-Private Partnership was introduced, originating two new concession types: (i) the Sponsored Concession, quite similar to the ordinary concession but allowing the integration of public subsidies to enable financial feasibility for the project; and (ii) the Administrative Concession, that extended the concession model with its economic-financial structure to other activities beyond public services for a fee. It was now possible for Public Administration to model a concession for public lighting, delivering accommodation services for prisons, health services and so on.

In all these cases it is common that the delivery of these services,

always compensated by Public Administrations and not by users, is preceded by works and investments on the creation of the required infrastructure for such delivery.

### Benefits of PPP in comparison against conventional hiring

PPPs, once properly modeled, can provide a great deal of efficiency gains to Public Administrations. So it may justify a gradual replacement of the conventional hiring model for the PPP model to some administrative services and needs.

### Some of efficiency gains brought by PPPs:

- Integration of multiple deliveries, which allows for allocating and integrating risks able to increase efficiency to the hiring, in addition to generate savings on contract management and renewal of bids.
- Longer duration of contracts, which combined with a proper risk allocation, allows for the creation of a long-term responsibility (for the concessionaire) in the management of public assets. Furthermore, longer terms for service delivery allow for amortizing expressive investments for the creation of the required infrastructure determined by the PPP project.
- Payment system based on service indicators, which creates more incentives for the concessionaire to improve service's qualitative and quantitative standards and levels of delivery.

### What is the legal aspect for PPP duration?

The maximum term for a PPP is of 35 years, and the minimum service delivery time is five years. The purpose to set up a minimum term for the delivery of service is to allow for a minimum period of amortization of investments made during the preparatory phase.

As for ordinary concessions, there are no maximum or minimum terms, unless in very specific cases of concessions in Energy.

Extending the concession or PPP term is always proportional to the need for amortizing investments demanded. But in many cases, such definition is difficult as there are investments tied to certain triggers, that may or may not be activated or the time for investing is not possible to be determined. In such cases, these investments are excluded from the concessionaire business plan, deciding for using the economic-financial rebalance system if such investments are necessary later, or such investments are tied to triggers, ensuring the concessionaire's right to claim indemnification for investments that were not amortized at the end of the contract.

### Compensation by performance

An interesting tool in the PPP's compensation system is the so-called compensation by performance, which ties concessionaire's compensation to certain service indicators. If the concessionaire meets more demanding levels and standards, the compensation increases; if lower levels are met, compensation decreases proportionally. This system is based on service indicators. PPP contracts will contain, as a rule, service indicators that will reflect several fulfillment levels for outcomes and goals expected for the contract execution. Concessionaire's compensation may increase or decrease in line with fulfilling these goals. The goal of linking performance to compensation is to increase efficiency on executing the PPP contract, raising incentives for the concessionaire to pursue more demanding levels of quality for the service delivered.

As for the assessment and measurement system, it is advisable

that the PPP contract determines an entity to oversight that is not related to any party.

It is not desirable that the Public Administration itself carries out such measurement as it is a vested party on the counter payment due to the concessionaire. The entity carrying the measurement and the assessment out must be unbiased and impartial, helping thus to reduce transaction costs and decreasing PPP's overall cost.

### Risk matrix

This is one of the most important topics in the setting up Concession and PPP programs, as it is key for gauging the efficiency of contracts. Stabilizing the effects caused by the risk matrix ensures the maintenance of the contract's economic-financial equilibrium.

In order to define the risk matrix of such contracts, there are legal rules and economic assumptions to be followed. The legal discipline is not specific about this topic and does not impose a previously defined risk allocation. Only in very specific cases, such as the risk of inflation, change of tax structure and legal charges, risk of unilateral change (by the Conceding authority of the object, the Law determines some risk allocation.

Furthermore, the General PPP Act arbitrated the sharing with the public partner of the benefits derived from the reduction of risk from financing used by the private partner. This way, the PPP legislation ensures that the conceding authority and the user can also benefit from the reduction of credit-related risks.

### Economic assumptions to risk allocation in concession and PPP contracts

The critical economic assumption that drives a risk matrix is the al-

**“The maximum term for a PPP is 35 years and the minimum term for service delivery is five years to allow for a period to amortize assets performed during the preparatory phase.”**



“A PMI is a procedure through which Public Administration obtains studies, projects and surveys from the private initiative to support a future concession or PPP program.”

location of risk to the party that is best able to manage its prevention or to mitigate losses if such risk occurs.

This means to allocate the responsibility over the risk to the party which will effectively will charge less to manage it, helping to reduce all hiring costs.

Insurance is a widely used tool to prevent risks. Having insurance policies in the market at an affordable cost for certain risks may facilitate risk allocation to the private partner. In the other hand, risks against which the concessionaire has no protection (including for a lack of insurance affordable and available in the market) shall always be placed under the Public Administration responsibility.

#### Procedure to Express Interest

A PMI is a procedure through which Public Administration obtains studies, projects and surveys from the private sector to support a future concession or PPP program. It is a resource that has been used as a previous step to structure concessions and PPP, many times launched by the private sector or by the Public Administration itself.

A PMI can be originated by a public request - when a public invitation is made for the private sector to submit studies, projects, surveys, research and so on, as can derive, depending on the local regulation for some cases, from an spontaneous and independent act of the private sector, when, depending on the regulation, its subsequent processing will require a public invitation to grant publicity and ensure to all stakeholders the opportunity to make similar proposals.

This allows one to classify both types into natural PMI, that is formalized under a Public Administration request, and induced PMI, that arises from the private sector's

manifestation (also called Unsolicited Proposals).

The Brazilian legislation has not disciplined more specific aspects to the PMI, which is regulated by regional and local laws and their respective regulations. In addition to the Federal Administration, that issued Decree # 8.428/2015 for this purpose, a great deal of states and cities already have legislation on PMI.

It is worth stressing that unifying the several PMI models is required. It is also important to reduce PMI's market risks, that is currently open to several companies.

Unfortunately, many Processes to Express Interest fail, especially at a city level, because city teams do not have technical capacity to run the required analysis for evaluating processes and, in many cases, there is no planning. This implies in a low conversion rate of PMIs into contracts, which causes the market to lose faith in a tool that is so relevant to make new projects feasible in Brazil.

#### Project Finance

A pure Project Finance is not a reality in Brazil yet. In addition to the fiduciary grant of project's receivables (which will be generated only at the operational phase), it is quite common that lenders demand corporate guarantees from the concessionaire (SPE) for the concession's pre-operational phase or until the project's physical or financial completion is reached. This is because lenders see higher risks at the preparatory phase, when there is no revenue and the works are not completed yet.

#### Questions

**We have seen some concerns from some businessmen in relation to the legal insecurity around Concession and PPP projects, inquiries from the Public Attorney**

**about the process and the contract and so on. Would you agree that such excessive insecurity can deter the adoption of this model?**

**Fernando Vernalha:** Perhaps one of the biggest issues damaging the attraction of investments to Brazil and the development of infrastructure programs is the legal insecurity and the regulatory instability. This encompasses three aspects: first, the lack of long-term planning by the State, i.e., the renewal of public planning in the short term; second, the lack or outdated legislation on several issues, such as the excess of Public Administration rights on administrative contracts, the lack of symmetry in the contract-based relationship between the Public Administration and the private sector, the public contract cancellation regime, the poor definition of competence between authorities in charge of oversight and apply fines and penalties etc.; and third, the abundant interpretation that controlling entities have been performing for several important questions in the public hiring space. In my opinion, such control system has been operated without the understanding of the negative consequences and externalities that may arise. The excess of intervention by Accounting Courts and Public Attorneys on public hiring, many times motivated not by findings of misconduct but by holding to a different legal interpretation from the one adopted by the Public Administration, has generated intense legal insecurity and elevating transaction costs. The way I see it, it is an absurd that a company is condemned by administrative misconduct just because it has participated and won a bid that was later deemed invalid by the Accounting Court. Or because it has joined a direct hiring by assuming that the reasons provided by the

Public Manager were valid and true. It is clearly excessive to penalize companies in situations like these. It is obvious that the risk of being involved in condemnations of this nature have prevented serious companies from joining public bids, causing damages to the administrative hiring market.

Another factor is the multiple interpretation arising from the controlling world. Accounting Courts and Public Attorneys do not have a coordinated action to unify understandings. This is not found even within Public Attorneys. The Public Attorney functional autonomy allows them to sponsor independent interpretations, which causes legal insecurity and, why not say it, institutional insecurity.

Thus, it is necessary a legislative reform to ensure clearer and precise rules about these interpretations, putting more value on the contract and aiming to improve standardization of relevant topics by the controlling entities.

**The PMI is a method to legitimate the presence of the private sector in formatting public projects, allowing for companies to express interest in doing it under Public Administration's authorization, ensuring also the participation of other stakeholders. If such broad participation is ensured would not a proper level of competitiveness be reached that is able to mitigate or eliminate the risk of the public interest being captured by the private sector? Would not it be wrong to put too many barriers and creating a protected market that benefits large financing groups that would select their best options for financing?**

**Fernando Vernalha:** The risk of arrest problem is not only related to the competition at the PMI level, but also to the lack of technical capacity of Administrations

**“There must be a cultural change to prevent the overall mistrust that the market is stealing public assets, which is a short-sighted view.”**



PMIs are moving the market, making infrastructure programs happen, so for this reason we cannot allow that this tool loses credibility”.

(specially city administrations) to assess and choose between studies and projects in a PMI. There is a clear technical ascension in the market against several Administrations. Without expertise or capacity to proceed with such assessments and selections, one of two situations will occur:

The Administration will be arrested by the bidder, carrying on a project without proper analysis and technical diagnosis; or will not conduct the project due to the lack of capacity to do so. In both cases, consequences are not good.

An alternative to mitigate such lack of technical capacity of Administrations is hiring consulting and auditing firms to technically assess projects and to ensure the propriety of economic-financial studies that will be submitted.

As for exclusive permissions, I don't see them as a proper choice to foster the project market. Remember that such permissions, mostly, shall be followed by the bidder waiver to join the future bid for executing the project. The State of São Paulo has legislation about this topic, as well as PPI. The underlying argument is that there is a competitive edge for the entity performing these studies for participating the bid. If this is an issue, we would have to review non-exclusive permissions, that assume for all cases that the project owner joins the bid. I don't think so. I think that the competitive edge, which in fact exists, can be reduced or eliminated from the bid depending on the bid's format and rules. The proposal to hire audit and consulting firms to “validate” or “certify” the project arising from the PMI would also help to reduce information asymmetry and the competitive edge for the project owner.

**With regard to foster the participa-**

**tion of small and mid-sized companies in PPPs, how do you see the threat of outsourcing firms that are specializing also in this model?**

**Fernando Vernalha:** CBIC has commissioned a study to Gesner Oliveira containing many interesting ideas and proposals to open the infrastructure market to mid-sized companies. The time is now, as a cycle of city-run PPPs is coming and we will have gains of scale in programs of this nature, with projects requiring less technical capacity and economic-financial structure. The rise of city PPPs by itself will improve access to this market, as projects will be smaller.

There are other challenges, such as improving the quality of public guarantees and loan conditions to projects. Lending is where most problems lie, as loans depend on the availability of proper public guarantees for projects. I think that for improving conditions to finance projects for mid-sized companies, we would have to improve quality of projects, with well-balanced risk matrix, reduce the level of investment concentration in the project, spreading investment as much as possible across the duration of the contract, provide higher legal security to certain guarantee structures, such as liquidity reserve of resources from federal transfers to states and cities, like the FPE or FPM, and creating new financing tools and improve the development of incentivized bonds, and so on.

**We understand that there is legal insecurity when assessing projects at the PMI level. Such insecurity is due to the lack of clear, transparent criteria and the composition of assessment panels. What is your view on that?**

**Fernando Vernalha:** It must be clear, first, that the technical as-

assessment of a project involves subjective evaluations, as it is a matter requiring technical discretion. It is very hard to translate such project assessment into objective analysis criteria. But I also fully agree with the fact that Public Administrations do not have capacity to carry these assessments, which is another problem. I repeat that we need to hire independent consulting and audit

firms to “validate” or “certificate” studies and projects submitted within a PMI. This would reduce insecurity or mistrust towards the quality of studies and the consistency of figures presented to Public Administrations. But the creation of mixed assessment councils would also be a supplemental solution that could contribute to transparency and control over assessments requested at PMI.

**“The Public Administration can design its needs and goals, but in many cases there is no technical capacity to assess the technical quality and propriety of economic-financial studies for a project.”**



# The evolution of PPPs in the United Kingdom, the Brazilian context and proposals for the participation of small and mid-sized companies in the PPP market.



**Carlos Nascimento**  
 Director, LSE (London School of Economics) Enterprise UK in Brazil

The London School of Economics, headquartered in London, United Kingdom, is considered as the main university focused on Social Sciences in the world, relying experience in analyzing Public-Private Partnerships. The institution has been supporting projects to states in Brazil's Northeast region since 2012 as well as providing training, partnerships, events, seminars, workshops including the State of Bahia, which is a long-timer partner of LSE.

By the end of the 1980s and the beginning of the 1990s, the United Kingdom was facing a shortage of investments in maintenance and long-term operation on the existing infrastructure, especially in new works in social infrastructure (schools, hospitals, housing, prison and other public equipment). And there were budget restrictions preventing the State to make new in-

vestments, as the public debt level was quite high.

To make things worse, the efficiency of public works was very limited, with delays on the delivery of works and budgets overspent. As an example, Guy's Hospital, in London was budgeted for 36 million pounds but was concluded at a cost of £124 million.

How did the British government react to this situation? The Project Finance Initiative (PFI) was created in 1992 with the goal to engage the private sector on the design, construction, financing and operation of the public infrastructure. The idea was to deliver assets of high quality and in good conditions, that offered Value for Money to the British taxpayer with the support of the private sector, in the hopes that companies would bring advantag-



## UMA OUTRA FORMA DE ENXERGAR ISTO

Value for Money – VfM (Vantagem Monetária)

=

$(\text{Insumos} \div \$) \times (\text{Produtos} \div \text{Insumos}) \times (\text{Resultados} \div \text{Produtos})$

=

$\text{Resultados} \div \$$

De acordo com o National Audit Office (NAO) do Reino Unido, para se alcançar **Value for Money** é necessário **maximizar economia, eficiência e eficácia**. Há diferentes metodologias para se mensurar VfM.

es, add value, innovation and efficiency on the delivery of public services through public infrastructure projects.

Value for Money is the core concept to understand the reason for using PPPs as a mechanism to hire infrastructure projects.

To hire through a PPP, the government needs to justify the Value for Money: Why is it deciding for a PPP against other hiring methods, like Law 8666? It is important to indicate how much the State can improve performance by combining savings, efficiency, and efficacy. According to the National Audit Office, NAO, (equivalent in the UK to Brazil's Accounting Court), to reach the Value for Money it is necessary to maximize savings, efficiency, and efficacy.

### PFI (or PPPs) in the United Kingdom

More than 730 projects hired, totaling 55 billion pounds or approximately 275 billion BRL. PPPs, or PFI in the United Kingdom, represent almost 11% of investments in public infrastructure, but around 85% of investments in this area are made with some form of private financing or participation. Compa-

nies perform large investments in energy, communication, and water.

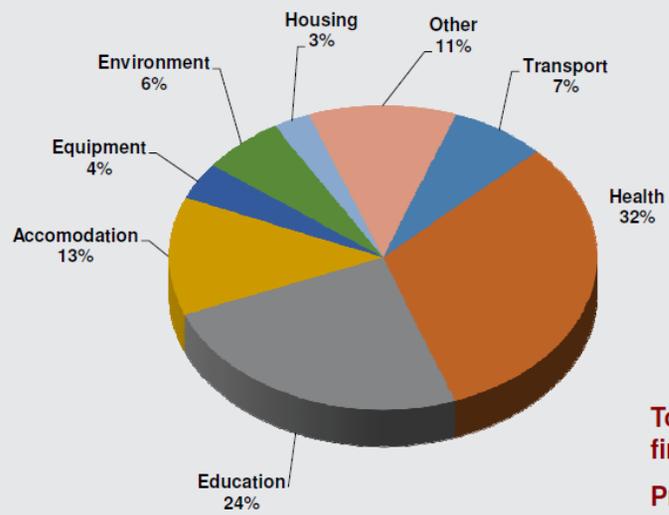
PFI is one of the instruments accounting for more than 10% of the total of public investments. It is not the largest, but it is a very important instrument that gained a lot of traction. Such PPP projects are significant to several sectors of the British economy, namely transportation, health, and education. Currently, the UK leads PPP experiences and is the benchmark for this hiring method.

### Strengths of the British PFI model

- It aggregated the private sector abilities: project management, risk management, and innovation.
- Public equipment delivered with high quality.
- Satisfactory outcomes in general: projects delivered within agreed deadline and budget.
- Assets are maintained in high standard throughout its life cycle.
- Users generally satisfied.
- More than 90% of project heads in the public sector say that the PFI meets agreed requirements.

“Value for Money is the core concept to understand the reason for using PPPs as a mechanism to hire infrastructure projects.”

## DISTRIBUIÇÃO DE PROJETOS POR QUANTIDADE

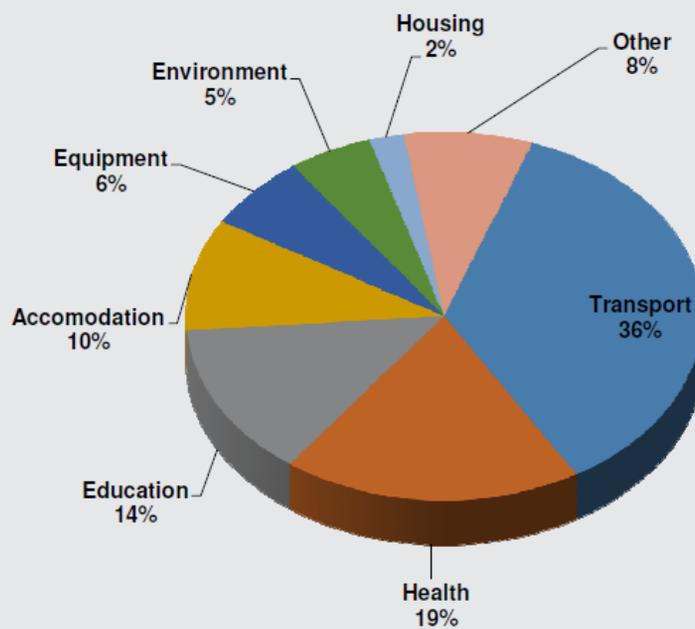


**Total de proyectos firmados: 730**

**Proyectos Operacionales: 665**

Fonte: Base de projetos PUK, via Javier Encinas

## DISTRIBUIÇÃO DE PROJETOS POR VALOR



Fonte: Base de projetos PUK, via Javier Encinas

## The evolution of PPPs in the United Kingdom, the Brazilian context and proposals for the participation of small and mid-sized companies in the PPP market.

- Incentive mechanisms for the private sector usually work.

### Weaknesses

- Slow, expensive bids
- Contracts not always flexible - not much room for changes across the project's life cycle.
- Insufficient transparency to identify future financial liabilities caused by PFI.
- Private sector has hidden, embedded gains in the contract.
- Undue risks transferred to the public sector, increasing risk premiums.

### Evolution of the British model

- By failures and successes, the British Government is constantly enhancing its model.
- It has created the PF2 Model (Private Finance 2) in 2012.

### Main changes:

- The British Government can input equity and join private funds (providing return over investment, increasing the ratio to 70;30 and improving collaboration between public and private).
- Public participation can help to get financing from institutional investors.
- Limitation of operational services to maintenance services only.
- Ongoing verification of quality of services.
- Increased transparency on amounts invested and future liabilities.
- Faster, cheaper bids (centralization, standardization, training to select winner in 18 months).

### The context of PPPs in Brazil

- What are the similarities between the current Brazilian reality

## CONTRATOS ASSINADOS POR SETOR

- 87 contratos de PPP assinados até março/2016
- PPPs em Resíduos Sólidos (21%), Saneamento (20%) e Saúde (12%) tem se destacado



Fonte: Material de Leitura do Seminário Boas Práticas de PPP. Radar PPP (Março/2016).

**Governments shall get rid of fear and enhance interaction with the private sector.”**

and the context in which the British created the PFI?

- Brazil has a huge gap on social and economic infrastructure.
- Existing infrastructure is limited and poorly maintained.
- The State has low capacity to invest in infrastructure.
- Budgetary restrictions and growing debt levels at all Federation levels.
- States and Municipalities in frail fiscal situation.
- Even though, PPPs are flourishing in Brazil - now, it is perhaps the only choice for many Public Administrations.

**Lessons learned and challenges to the Brazilian PPP model**

- Time is ripe for enhancing and consolidating PPPs in Brazil (fiscal adjustment and social demand for better public services).
- PPPs are not the final solution, but evidences are in favor (see the United Kingdom).
- Cost is not the only matter: Successful experiences abroad show that the cheapest not always bring best outcomes in the long run.
- Many challenges: Political, fiscal, regulatory, external control, organizational, human.
- High death toll for PMIs (around 85%).
- Need to enhance institutional capacity of governments and private sector.
- It is critical to support governments on building their capacities and financing to hire project structuring.
- It is critical to incentivize efforts on sharing public experiences

among public managers, political leaders and businessmen.

- Governments shall get rid of fear and enhance interaction with the private sector.
- Creation of manuals and procedures nationwide to support States and Municipalities PPP projects (United Kingdom).

Could have a better moment for small and mid-sized companies in the Construction industry to enter this market? There is no doubts this is the best time. There is a serious structural problem, that is the economic and political crisis, and large companies are weak, facing big troubles to enter new projects. This situation opens a range of opportunities.

**Proposals to companies willing to enter this market**

Learn. There are currently a lot of information about PPPs, Concessions and business opportunities in this sector.

Learn, this is critical. If you own a company but has no time to study the aspects of a PPP, appoint someone in your team to do so. Such individual needs to be really informed to understand all phases of a PPP project and lead this into a good business.

Group yourselves in consortia. Develop as a group to speed the learning curve up and reduce entry costs, especially PMI's high costs. By forming a consortium, it is possible to reduce entry costs, share risks and it helps to obtain resources for projects that a single company would have trouble to get.

Partner with foreign companies. There are many foreign companies with good practices willing to enter the Brazilian market. Have a foreign partner is a positive sign for lenders, helping to obtain financing for projects.

## The evolution of PPPs in the United Kingdom, the Brazilian context and proposals for the participation of small and mid-sized companies in the PPP market.

Social infrastructure may be the best shortcut to enter this market. Join PPPs for hospital, schools, housing, these are areas poised for expansion and will open opportunities for projects that are faster and a smaller value.

**Sávio Andrade - LB Engenharia:** How is the British Guarantee Fund structured? Here, companies are afraid to join some ventures due to the guarantee fund.

**Carlos Nascimento – London School of Economics:** A scheme for guarantees was created in Britain but it is not something relevant as there are other institutional mechanisms to ensure payment by the Public Administration, projects are well executed and there is a culture of trust, in other words, it is completely different from what businessmen experience in Brazil. This is undoubtedly one of the largest barriers for the private sector to join the game.

Here, participation funds and federal voluntary transfers are being very used, who has got some asset also put is as a guarantee, but new methods must be created. Bahia has been using voluntary transfers a lot.

**Leonardo – Santa Helena Empreendimentos:** You said that Britain allows the government to join as a partner. How has this been working in relation to elections and political changes? Here, you know how it works, we never know what is going to happen.

**Carlos Nascimento – London School of Economics:** Their biggest concern over there is about a conflict of interest if the government joins a project as a partner, as the government will have a financial return and at the same time is the authority running the bid. Right? So if you joined a project as a partner you would have a conflict of interest to approve that project. The private sector asks itself if the government is a partner in a project but not in another, will it benefit the project in which the government is a partner? So how did they solve that? To make strictly clear that there is a separation between the bid owner and who is a partner in a project. The government wants that equity match 30% of a project, but these 30% must not be government's.

**“Social infrastructure may be the best shortcut to enter this market. Join PPPs for hospital, schools, housing, these are areas poised for expansion and will open opportunities for projects that are faster and a smaller value. ”**

# How to overcome barriers and progress in Concession and PPPs?



## Márcio Galvão

Former Executive Secretary of the Federal District Public-Private Partnership Management Council, Executive Manager, CAIXA ECONÔMICA FEDERAL

Concessions and PPPs are the path to make investments required to promote Brazil's growth happen.

Demands from Public Administration for investments, based on traditional hiring as per Law 8.666, require a long path from the elaboration of a preliminary draft, determining a budget, hiring a architecture design, a structural project, terrain studies - and everything must be hired by a bid process.

Next follows the execution of works, that usually go for two years and when completed, then the government has to hire service vendors to operate, run security and maintenance, for instance.

All this work involves a series of professionals from Engineering and Architecture, supplemental projects and all these companies must undergo by a bid process, and then the Public Administration must manage all these vendors.

Through a PPP, operation gets simpler. The government places the demand, launches a PMI or a MIP and start developing the projects with a private partner, that may join the bid later. After the PPP bid, the winner starts activities with a contract that may last 5 to 35 years.

### In this case, the benefits for the Public Administration are:

- Dilute expenses over a longer time (between 5 and 35 years).
- Participation of a single company at the PMI phase, which will carry out studies.
- The company winner of the bid is the same that will build, opera-

te and maintain the infrastructure (management of only 1 contract).

### How to overcome difficulties

- If each government's entity thinks and develops their own PPP, it is not going to work. It is important to coordinate project analyses and model studies to standardize processes.

- Prioritize. Every administration relies on a series of projects that are relevant, whether for public lightning, sanitation, urban mobility - but it is required to define which one is the priority. It is necessary to centralize the decision of priorities to avoid the risk of go beyond the limit of net current revenue.

- Find creative methods with low financial impact (use of non-cash counter payments, such as other State assets).

- Open a single communication channel with the internal audience and the market so the Public Administration is aware of all efforts going on.

### PPP Law and Guarantees

The PPP Law determines that Public Administration's cash obligations can be guaranteed by:

- Revenue linkage as per item IV of article 167 of the Federal Constitution,
- Creation of special funds (or usage of existing ones),
- Acquisition of a guarantee insurance policy from an insurer not controlled by the Public Administration,

- Delivery of guarantees by international entities or financial institutions not controlled by the Public Administration,
- Guarantees delivered by a Guarantee Fund or a state-owned company created for this purpose.

### What is required at the pre-bid phase

Article 4 of Law 12,766, that changed Law 11.079, clarified doubts about how to analyze a PPP project in the pre-bid phase. Legislation determines that Engineering studies to define the amount to be invested in the PPP shall be preliminary drafts and removing the need for a basic project as determined by Law 8.666.

### The law determines that:

- Engineering studies for the definition of amounts to be invested in a PPP shall take the form of a preliminary draft.
- The amount of investments to define the benchmark price of the bid will be calculated based on market value, considering the overall cost

of similar works in Brazil or abroad.

- Amounts calculated based on cost systems using market prices for the project's specific sector as input,
- Synthetic budget drafted by expedite or parametrical methodology.

### Perspectives

We are optimistic and watching a cultural shift portrayed in Brazil's press, with headlines like this: "Government wants fast-track to PPPs; Ministry of Economy prepares legislation to create a consortium of public entities and speed up processing of some projects with the implementation of Fast Track; Jet PPP; Contract shielding and hiring of infrastructure designing companies without a bid process.

We can also mention the announcement that the government plans to create a state-owned company with a special regime for hiring infrastructure projects outside the scope of Law 8666, with more room for hiring consulting firms without homologation rules.

**“In order to overcome barriers, find creative methods with low financial impact (use of non-cash counter payments such as other State assets).”**



## Legal issues related to Concession and PPP processes



**Bruno Werneck**  
Partner, Escritório Mattos Filho

Based on EscritórioMattosFilho's 23 years' experience in representing local and international, public and private corporations (financial institutions, investors, multilateral entities, investment funds, pension funds, insurers and reinsurers) in several industries, as well as non-profit organizations, I present below a legal view on Concessions and PPPs.

I criticize the interpretation and the application of Law in this partnership area, where an excess of "legal risks" has been taking place. I mention the interpretation, for instance, that the amount of 20 million BRL is not considering the counter payment, but the CAPEX size. I stress that the hired price is the price paid for it. But it is necessary to apply the law with some sense.

The hiring method adopted by the Public Administration must follow the same methods used by the private sector - by requiring three quotes, the company gets different prices and will decide by the best proposal, considering each service vendor's price and competence as lower price is not the same as quality service. Unfortunately, the Brazilian public administration with some exceptions, hire only by considering price.

The PPP for São Paulo Subway's Line 6 and the PPP for the city's public lightning sued the price as the criterion for selection. But for the Public Administration to hire like the private sector does - is it necessary to change the law?

No. The Bid Law already determines technique and price as criteria for selection, so it suffices to apply the law and change the culture of controlling entities.

About economic incentives, I stress that Law 8.666 created incentives in several models for the concessionaire to be ineffective. If the Public Administration hires a company for dredging, for instance, and then after some work a collapse happens, this is something good for the company, as it must be hired again. So incentives provided by Law 8.666 are terrible.

The main advantage of the PPP model is to work with long-term contracts and compensation mechanisms linked to results, driving the winner company to invest in technologies to increase efficiency.

When PPPs started in Brazil, the focus was solely upon new works and constructions, which was positive, but PPPs were set aside on the operation and maintenance areas.

Brazil could have more partnerships between Public Administration and the private sector on highway maintenance, in long term contracts of 20 or 30 years. The same is valid for education and health, as there is a large room for PPPs destined for school and hospital management.

Another factor is that the application of the 5% limit of the Net Current Revenue should be applied only to new expenses. If the Public Administration is already spending resources with lightning, the best would be to create a PPP instead of a bid governed by Law 8.666, as it will be cheaper and there is no sense in placing this within such limitation. In this case, I defend a change in the Law to make this point clearer.

## Guarantees from the Public Administration

Although clever, strategic solutions for the Public Administration, Concessions and PPPs are being proposed by many governments that have lost the capacity to invest but need to go on with projects for developing cities, states and the nation.

If the Public Administration lacks resources, how can they provide guarantees? Brazil has consolidated mechanisms to provide guarantees, such as FPM (City Participation Fund) and the FPE (State Participation Fund).

The Federal Administration also receives resources transferred from States due to taxes to cities. A state with a PPP could operate as guarantor for city PPPs, so in case of default the state will make the payment using the tax resources that would be transferred to the city. Thus, the State is not spending that resource but is managing that flow

and guaranteeing the partnership at a city level. The same could be done by the Federal Administration in relation to the FPM and the FPE.

## IRR

No one will invest in a PPP project with a return rate from 7.5% to 9.48%. The IRR (Internal Return Rate) for Concession and PPP are higher than the return the government pays.

## Why PMIs?

Despite the fact that not all PMIs turn into projects, this is an instrument required to make a PPP happen.

I would say that a poorly executed, managed PPP that resulted in a poor outcome is still better than a successful bid process governed by the Law 8666. A long-term contract that will allow the private sector to invest in efficiency and get paid for results is much better than the model adopted by Law 8666.

**“Although clever, strategic solutions for the Public Administration, Concessions and PPPs are being proposed today by many governments that have lost the capacity to invest but need to go on with projects for developing cities, states and the nation. ¶¶**

# How to improve project structuring to eliminate the bottleneck in infrastructure



**Fernando Camacho**  
Head of Department, Project Structure, BNDES

The Brazilian market for project structure is still very shy if compared against other emerging economies, as structuring projects is a very complex activity. The flow for any infrastructure project starts with the Public Administration planning and the identification of priority projects.

Then the project is prepared, as well as the procedures for the bid. Products originated from both activities are critical. It must be considered that a well-executed auction notice will bring good competition to the auction, i.e., it will succeed. Still, a good contract for Concession in a PPP is required, with risks allocated efficiently and clear provisions.

When one mentions studies for the bid procedure, what is being said is broad, comprehensive studies encompassing several areas: demand, engineering, environment and legal (which will provide the foundation for the contract rules in the bid's notice).

What we can see is that part of structuring a project is in fact a very complex activity. For this reason, it is a bottleneck for investing in infrastructure not only in Brazil but in many other places.

International experience in structuring projects

To provide context to his explanation, Mr. Camacho considered the international experience in structuring projects by analyzing the countries below: Australia, New Zealand, European Union, Britain, and Canada.

- The main instrument to structure PPPs in the benchmark countries

is the Solicited Proposals model, where government finds and prepares the project with support from external consultants.

- In some countries, the law forbid PMIs (Unsolicited Proposals). Other consider PMI as exceptions and allow their adoption only under very specific circumstances (innovation and intellectual property rights).

In short, projects are prepared by the government of these countries with support from independent consulting firms. In the other hand, in emerging economies, the behavior is a bit different.

We have found a very large utilization of PMIs and more recently, the emergence of project structuring facilities.

Two elements were critical in the comparison of developing nations against Brazil:

- Results are poor out there. Of all PMIs launched abroad, only 4% matured to the contract signing phase. Apparently, a very low success rate.

- The problem of these countries is similar to Brazil's: there are no good infrastructure projects, which is a bottleneck for investing. And PMIs are not a solution for this problem.

The BNDES representative says that this bottleneck was crucial for the emergence of facilities. There are several initiatives, from multilateral banks and development banks providing technical expertise and funding. He argues that the new method has become a reference and was seen in development banks in Asia, Africa and in a development bank in Eastern Europe.

BNDES traditional activity has always been financing but from 2007 on, we also operate in project planning and structuring.

At the planning phase, BNDES applied the Project Structuring Fund (FEP) that uses a part of the bank's profits to finance studies. BNDES works in partnership with IFC, BID and EBP for structuring projects.

### Projects stamped by BNDES

There are 43 projects in the bank's joint portfolio with EBP and IFC; 24 of them were concluded with a 75% success rate, which I rank as relatively high in comparison with other countries. In terms of projects, we estimate to invest 67 billion BRL.

Among completed projects, there is the whole airport program created by EBP and BNDES, and structured by this team; the third round of highways and important sanitation projects. A highlight in Health is the Hospital do Subúrbio, in Bahia, the first PPP in the medical area and that today has become a global success case.

### Considerations on PMIs in Brazil

From 2010, several public entities at the state and city level passed laws that increased the number of PMIs, as it was a "magical solution" to structure projects.

However, the success rate has not been apparently much high. Of all PMIs launched, the rate of signed contracts is only 18%.

The Brazilian model, compared to other PMI models in developing nations, pursues competition in the project preparation phase. Governments authorize several companies to perform studies at the same time, at their own expenses. In our view, this may bring unnecessary transaction costs to the process, as the most important thing is not being homologated in the project preparation phase but in the bid process for the PPP concession.

This way, it ends up that governments must redo studies to choose the one most appropriated, which doubles costs and increase processing time.

### What would be the solution to adjust the current model and eliminate the bottleneck in infrastructure?

- To have a PMI model where on-

ly one company is authorized to produce the studies. The company would have to be independent, i.e., it cannot have a vested interest in the future bid. This measure is already determined in a federal decree issued this year and the full model is also established in the new regulation the State of São Paulo passed in 2015.

- It is critical that governments have internal training, irrespective of the model selected to structure projects.

- To enhance mechanisms that allow the support from independent consulting firms, whether by reforming Law 8666 or by enhancing current PMI models.

- Create and strengthen facilities. This is a risky market for independent consultants.

By adjusting the PMI model, we can indeed create an environment with more project structuring entities. We believe that by this way Brazil would have more projects, the government will really manage to have a trustful group during the process and will unlock investments in several areas.

## Desenbahia: Focusing on Bahia's economic growth



**Paulo Costa**  
Director of Operations, Desenbahia

The State of Bahia Development Office (Desenbahia) was created to drive economic growth and identify local demands. It is strongly focused in financing very small, small and mid-sized companies and to provide the so-called microfinancing.

It is not news that traditional bank financing in Brazil is rare and expensive, being virtually out of reach for small and very small companies. Desenbahia is willing to contribute to fill this gap in the State, with productive credit at affordable costs for those who need it most.

Within Concessions and PPPs, the Office financed Bahia Norte Concessionaire (along with Banco do Nordeste), the Arena Fonte Nova stadium (along with Banco do Nordeste and Santander bank) and the Hospital do Subúrbio. We are analyzing and probably will finance the Hospital Couto Maia.

The Office is also part of the PPP compensation mechanism, between the State's Economy Secretariat and Banco do Brasil, which is the financial institution that gets resources from the State Participation Fund to pay partnerships with the private sector.

### Desenbahia and PPPs

Upon the PPP or Concession contract signing by the SPE, a new project step begins: financing. Depending on the contract complexity, its structure may take more than one year to complete. For instance, the Arena Fonte Nova took one year and a half to complete the financial structure between Desenbahia, BNB, Santander and BNDES.

The financial structure is complex even with the help of an advisor, as it is necessary to review all calculations performed by the advisor or expert in concessions.

Why is this necessary? Because project guarantees in the project finance model are the project itself, so the lender must be totally certain about what is being financed.

Additionally, to this issue related to the bank, there are other issues before starting the work, like getting building permits and licenses. Depending on how specific the project is, like working with something radioactive, for instance, a permit from the Army is required and these steps are usually very slow, delaying the work schedule.

Such slow pace damages the project, as the Concession term starts when the contract is signed. The paperwork jeopardizes deadlines and causes financial impacts. In these cases, it is possible to obtain a bridge loan by submitting guarantees.

Past this step, when financing is approved, the work starts and is completed and finally, when it is time to deploy water, sanitation, power and bandwidth services, which are out of the concessionaire's scope, some delays may occur, postponing the start of operation and consequently, the compensation scheme.

When these challenges are overcome and the concessionaire starts operation, one of the main risks is the possibility of significant changes in policy. When government changes, the project seen befo-

re as well done and well structured is now considered troublesome and the new government goes to the Court to stop paying the counter payment.

Not to mention that, in Brazil, controlling entities search thoroughly

for problems in the ventures (sometimes this is good, but other times not as there are not many technicians able to analyze all Concessions and PPPs). When projects are revised downward, this is a huge risk for lenders.

**“The paperwork jeopardizes deadlines and causes financial impacts. In these cases, it is possible to obtain a bridge loan by submitting guarantees.”**



## Efficient budget management and quality services



**Bruno Pereira**  
Partner, Radar PPP

By implementing Concessions and Public-Private Partnerships, the management rationale is changed. The Public Administration signs long-term contracts that may last for decades (up to 35 years) with the company (or a consortia of companies) that won the bid and will be in charge of managing the whole supply chain, working efficiently to achieve the revenues expected in the PPP contract. In an Ordinary Concession model, as governed by Federal Law 8987/1995, all revenues to the winning bidder comes from fees paid by the user, such as tolls in a highway.

### Ordinary Concession

In PPPs, which are also long-term contracts such as Ordinary Concessions, the concessionaire's revenues come partially or fully from the Public budget by regular payments. There are currently 82 PPP contracts in force in Brazil, with billions of BRL in public resources allocated. Panel 1 Experiences in Concessions and PPPs in the Northeast Region

By progressing in Concessions and Public-Private Partnerships, the Public Administration will be able to manage public resources more efficiently, which benefits society as a whole as it will be served with quality services in relevant areas, such as Health, Education and Safety. Public Administrations usually spend most of the resources in

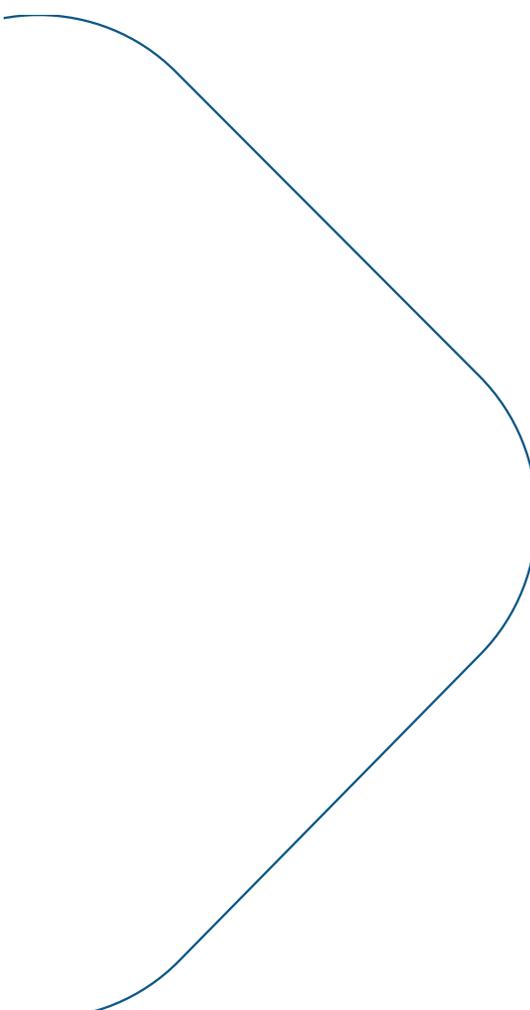
short-term contracts based on Law 8666, fulfilling a role as integrator of a chain of vendors.

### Contract models

But we are not talking about huge contracts, there are also contracts with smaller amounts. Mostly important is to bear in mind that the PPP is a vehicle to spend public money with higher quality. There are consolidated PPP programs in the Northeast, in states like Bahia, Pernambuco, Ceará, and Alagoas, with contracts signed and feasibility studies being performed for other projects.

There are other states planning to strengthen their PPPs, such as Piauí, Rio Grande do Norte, Sergipe, and Paraíba. Some projects being considered: Camaçari considers a PPP to build a commercial center; Rio Grande do Norte aims to structure a project in Healthcare; Caxias, in the state of Maranhão, is analyzing a PPP on public lighting; Feira de Santana is studying a logistics center coupled to a wholesale market; Fortaleza is considered to build an administrative center; Jaboatão dos Guararapes plans to build a public market; Salvador considers several projects, such as the Brazilian Music Museum, and São Luís shall conduct a public invitation for a PPP in a hospital soon.





# Training 2



# Fundamental economic and financial aspects



## Fundamental economic and financial aspects



**Gesner Oliveira**

Partner, GO Associados, and Professor at FGV-SP

The main goal of this Seminar on Concession and Partnership is to generate instruments to equip companies to a new phase Brazil will be going through and where private investment will be a key player.

### Three points are critical in this context:

- Investment as the keyword to end recession;
- Encourage investments in infrastructure and how partnerships support such investments;
- Foundations for a new culture on partnerships and concessions as for competition rules.

### Investing in infrastructure is critical to end this crisis

#### Brief summary of the Brazilian economy

A survey indicated that the Brazil's GDP average growth during the Fernando Henrique Cardoso administration, from 1995 to 2003, was 2.2% per year. Next, during Lula administration, it went up to 4%. Dilma Rousseff current administration saw a deceleration and the fall has confirmed: IBGE data show a fall of 3.8% in the last quarter of 2015.

The question is: did we reach rock bottom? It is expected that Brazil will face a new recession this year and improvements will be seen by 2017, as per Focus Bulletin data.

An important reflection: such cyclical variations to the economy do not directly impact projects, as Concessions and PPPs are projects from 5 to 50 years. But it is obvious

that a company starting a project naturally has concerns about the economy's behavior.

When the economy will grow again? Such recovery will not be led by consumption as families are saving their money in this period. Income fell, debts rose and more people fear unemployment, so everyone is carefully buying and making new debts.

Exports are good news nowadays. A strong US Dollar damages and makes the fight against inflation harder. In the other hand, a weaker BRL encourages exports and restricts imports.

In 2014, there was a deficit of US\$ 4 billion, which increased in 2015 to almost US\$ 20 billion and it is expected to reach US\$ 40 billion by the end of 2016.

However, the key variable to energize the Brazilian economy is investment. How is that possible? The right answer would be to create the required conditions for resume investing. It will a gradual process running in tandem with austerity measures. If restrictive measures for public spending are intelligent and financing methods are well structured, it is possible to create such conditions.

#### The need for a spike in investments

Investment rate in Brazil is around 19% and declining. It is below several countries and below the average of 26 countries.

By observing investments in Brazilian infrastructure, one can see the situation is much worse. The North region, for instance, is a showcase

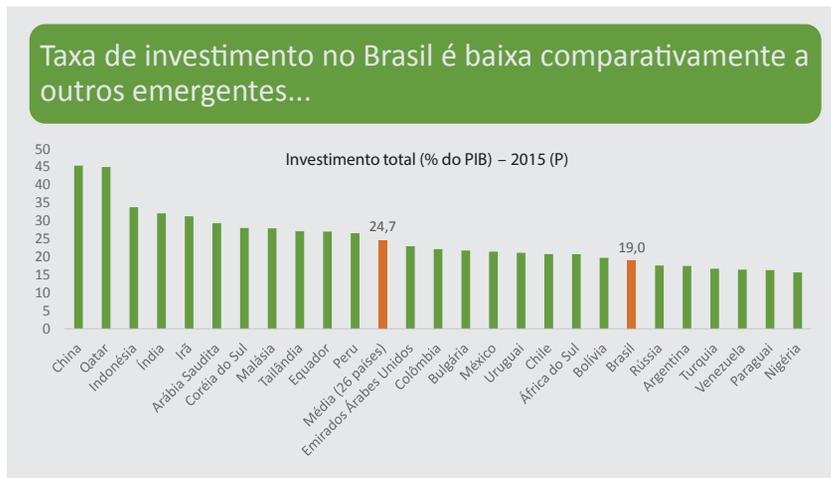
for the lack of a better logistics in Brazil, in terms of waterways, railroads, highways, ports and airports. Existing infrastructure is well behind what Brazil needs to grow.

Brazil did not invest in infrastructure for two decades, which is a barrier for the nation's development. The situation is even worse in sanitation. This is one of the most problematic items in infrastructure, as Brazil is not universally served by a public water network.

Half of Brazilian population is not served by sewage systems. And less than half of sewage generated is treated, which reflects in diseases, outbreaks and other problems to the whole population, whereas contamination takes hold the Brazilian coast, reflecting poorly in tourism and the overall development.

The North region faces a huge challenge in sanitation. Collection levels, for instance (SNIS data) is very low - below 10%.

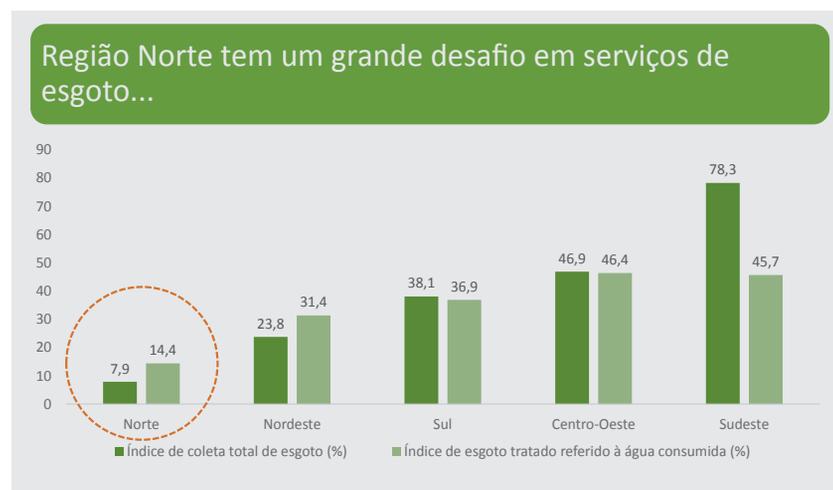
Water losses are also a concern across Brazil and require a closer look from governments as these are physical, commercial losses. Commercial losses include poor metering, with improper or adulterated meter parks, steal of water, leakages in improper and/or old grids. Average loss in Brazil is 37%.



Japan is an example to be followed, as only 3% of water is lost in that country. If comparing Brazil to the OECD 30 countries average, such percentage ranges from 10% to 15%.

There is a positive association evidencing that richer countries have broader sewage coverage. However, countries at the same GDP level as Brazil, such as Argentina, Uruguay, Chile and even China, have coverage levels higher than ours. Brazil has a tax burden higher than countries with our income per capita level, but also has small sewage coverage than similar countries in terms of income. How much losing water cost? It costs 8 billion BRL a year.

### Positive correlation between infrastructure and growth



“Data from India show 847 projects with private partners, and the government must provide full cooperation at several phases of the partnership, establishing simple, robust criteria for the bid.”

All problems aforementioned reflect opportunities in Concessions and Public-Private Partnerships.

- When one flies over a city and notices the traffic jam: Here is an opportunity in urban mobility.
- When one sees all Brazilian capitals, the polluted Guanabara Bay, the Tietê River, the large Brazilian metropolises with sanitation issues: Here is also a huge opportunity in this field.

By the time Brazil has performance-based contracts, where companies mitigate losses and share revenue with the Public Administration, there will be real progress in this field.

### PPPs and Concessions to unlock investments

#### Global trend on partnerships

The study commissioned by CBIC to GO Associados, some experiences are shown, like India's, where the number of partnerships was much increased; the UK, where such experiences were born; in Australia, that developed several partnerships namely in social infrastructure.

Data from India show 847 projects with private partners, and the government must provide full cooperation at several phases of the part-

nership, establishing simple, robust criteria for the bid.

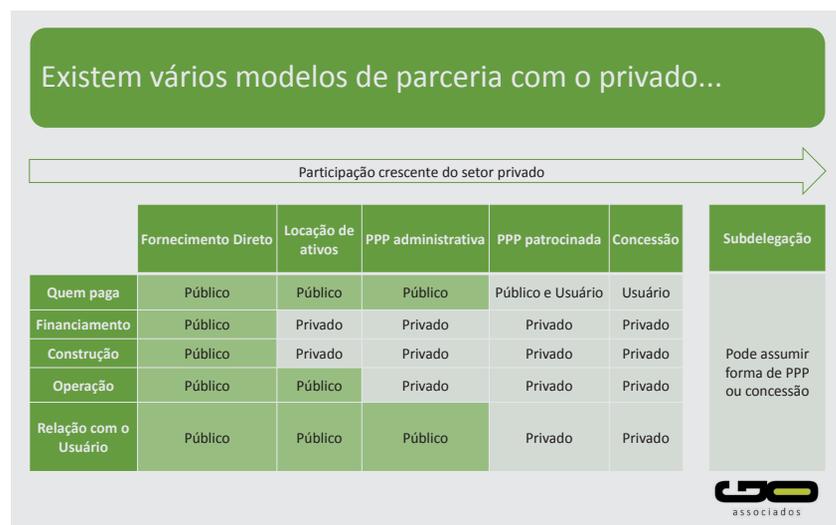
The UK pioneered PPPs: More than 700 projects carried out. The Building Schools for the Future project started in 2004, with some 3,500 schools and 3,3 million students in attendance.

The State of Victoria, in Australia, suggests that mature institutional models go forward in social areas, hospitals, prisons, highways, research centers, schools, and sanitation Brazilian scenario for PPPs and Concessions.

#### Partnerships with the private sector may take several forms:

- Service delivery and performance (operational improvement, people training, technology, among others);
- Traditional concessions;
- Administrative or sponsored concessions or PPPs;
- Asset leasing;
- Special Purpose Entities (SPEs).

Models also vary significantly. It is possible to be directly provided by the Public Administration, where the Public Administration designs, pays, finances and builds.



In times of tight fiscal policies, such as the one Brazil experiences now, it is probable that Concessions become more common than other partnership models.

It is possible to mention some examples for each model:

- **Ordinary Concession:** BR-163/Ordinary Concession: BR-163/MT/PA Highway
- **Sponsored Concession:** Nova Tamoios Highway, operation of SP099 Highway and Access to the cities of Caraguatatuba and São Sebastião;
- **Administrative Concession:** prison (AM);
- **Asset Leasing:** Sabesp in the city of São José dos Campos;
- **Subdelegation:** Saneago – Odebrecht Ambiental.

Studying each case is worth to understand what works and don't work from the standpoint of security for new projects.

On what concerns to opportunities, there is an area with expressive growth is public lightning. There are several Public-Private Partnerships in public lightning in mid-sized and large cities.

Another area open for opportunities is garbage collection, which must be solved urgently. The private sector is able to help and provide smart solutions through partnerships.

Other areas also present opportunities, such as parking, public buildings, urbanization, parks, prisons, schools - several examples in different sectors.

**PPPs and Concessions in the North region: Lessons learned and potential exploration Saneatins regional delivery in Tocantins**

An interesting regional model of de-

livering sanitation services is the company Saneatins, in the State of Tocantins. The company is a spin-off from Saneago, a privately-owned company with state-wide operation (all other companies with state-wide operation are state-owned or majorly controlled by the State).

Here, the regulating entity for the State of Tocantins is ATR, that provides safety to the investment. This makes several projects feasible or provide security to the investor to execute projects, as everyone knows the rules of the game.

Another example in the sanitation industry is Aegea, sanitation holding company operation nationwide and bringing health and quality of living to the communities where it operates - relatively small cities.

The company won the largest number of sanitation contracts in 2015 (8 out of 13) operating in cities like Barcarena/PA, Novo Progresso/PA, Buritis/RO, Pimenta Bueno/RO, and Rolim de Moura/RO.

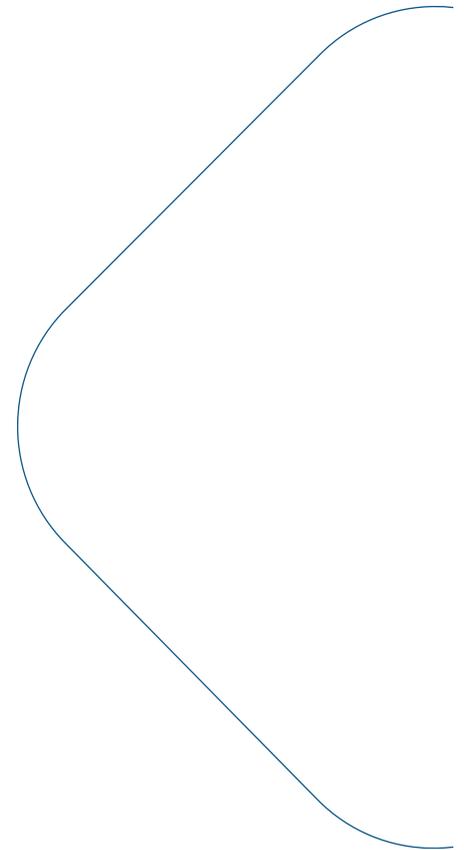
### PPPs for Parks

Another industry with potential for the private sector are parks. Taking South Africa as an example, one can see the country has found feasible solutions for parks, leveraging its touristic potential to a maximum and providing preservation solutions, creating ancillary revenue streams and enhancing the project's cash flow.

Larger preservation areas and urban parks are possible, creating relevant areas for the cities and for the well-being of citizens. As these areas need to be properly maintained, a well-structured project with economic-financial feasibility is required.

### PPPs for Schools

An example of "almost successful" PPP in schools is the Amazo-



nas Military College. The school is in the historical center of the city and failed to meet several needs for the military school system, so the Army decided to create a Public-Private Partnership to build a new school. Unfortunately, the PPP failed because there were no resources and willingness to take the project ahead.

It is worth pondering, in this special case, if the Public Administration was willing to use its real estate portfolio that many times is not used at all. These measures reduce the counter payment amount.

Operation of the Logistics Investment Program (PIL)

The government announced the so-called PIL - Logistics Investment

Program in June 2015, with amounts close to 200 billion BRL.

GO Associados run a simulation using 69 billion BRL (input-product methodology) and reverting this amount into feasible highway, railroad, airport and port projects that may generate a dramatically impact to the economy. Such impact is calculated by using parameters from the so-called input-product matrix, used by the IBGR to relate each sector to the industry it buys inputs from.

When a highway is built, this implies that expenses will be revenues for some companies, which will hire staff and other companies and so on, with multiplying effects through other industries.

What does that mean? Impact over GDP is above 200 billion BRL and the generation of more than 4 million jobs.

There is a lot of interest in investing, despite the hardship and the investigation large local contractors are passing through the Car Wash Operation.

This way, it is also required to expand participation, bring in more companies, make sure that companies implicated by the "Car Wash" investigation solve their legal hurdles and go on with their corporate life. One thing is punishing criminals, but another is allowing the company to remain operational and keep on generating jobs and investments.

Three points for a new culture on partnerships and concessions

- More resources
- Adjust guarantees
- Reduce paperwork

In the aforementioned study commissioned by CBIC, 10 measures that might help increasing participation in concessions and partnerships are listed above.

### Debate, comments and final remarks

#### Is there a market for urbanization through PPPs?

**Gesner Oliveira** - The possibility for the private sector to make expropriations is positive as it accelerates many projects. I believe that urbanization projects have a huge potential, I mean the gains and savings that may be generated from urbanization projects are huge and if projects in this area are well designed, then they will be a tremendous source of resources and benefits for the city or state. In this regard, the housing project in São Paulo is interesting as it was a joint initiative between the state and the city and I think it deserves a very detailed study. It met some disbelief at the beginning, but in fact there was a lot. Not in the coverage as initially intended, but it is being implemented. I think it is a huge expansion front.

**What are the guidelines you would give for institutional managers, as**

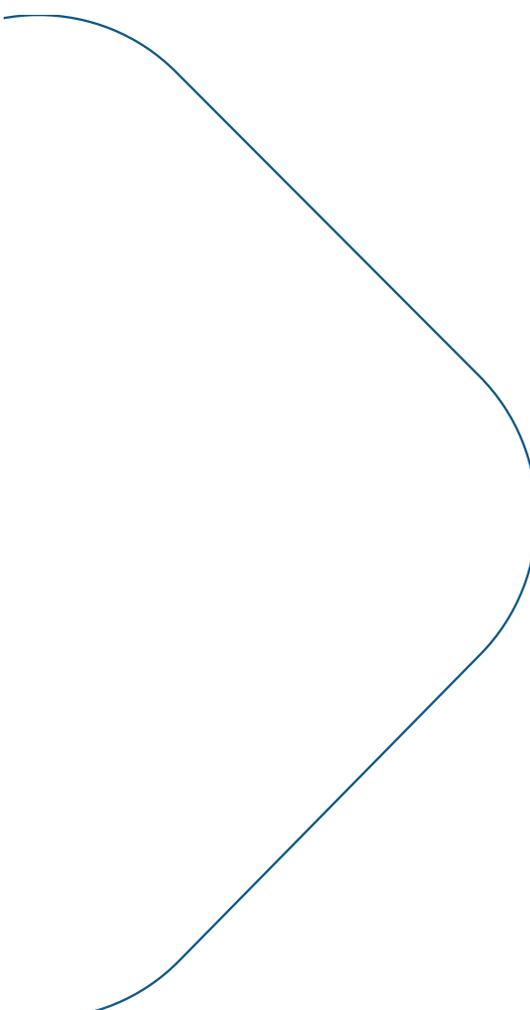
### **a first step for this new partnership model between private sector and Public Administration?**

**Gesner Oliveira** - A very important point is to establish clear behavior rules. We have elaborated a competition behavior code for CBIC. For instance, what is forbidden by Law? What is a cartel? You cannot fix a price nor share markets, you cannot exchange sensible information with competitors. Sensible information is commercial proposals, Bid suggestions, exchange of information that lead to some type of price rigging. This seems to us as very important

items for a Don't Do List.

### **And for a To Do List. Are all employees familiar about these rules? Is the Anticorruption Act known by all employees? What is the company policy on the relationship with officials?**

**Gesner Oliveira** - And as for agenda for meetings, encounters with officials with some type of offer for gifts, invitations to speak in seminars, things like that? The Car Wash Operation sent a definitive alert that is necessary to rely on a code of behavior.



# Training 3



# How to organize to do business in Concessions and PPPs



## How to prepare to work in a Concession or PPP?



**Letícia Queiroz**

Partner-director, Queiroz Maluf  
Sociedade de Advogados

The goal for expanding participation not only for large companies, but also for small and mid-sized companies in infrastructure works bring positive effects not only to the parties involved, but also to Brazil, which is encouraging if we consider that the current moment requires some heating in order to resume optimism.

Concessions and PPPs may play this role as they are large ventures so necessary for Brazil's current and future development and have as object businesses with duration up to 35 years.

As these are complex and lengthy projects, companies are required to be organized and familiarized with specific concepts in 3 steps of the hiring process:

- Influence on the Concession or PPP model, as in Brazil these contract types allow for more influence by the private sector to the business modelling process.
- Preparation for the participation in the bid.
- Celebration and execution of the contract.

The influence on modelling the business may take place through the Procedure to Express Interest, although only half of contracts with such model are preceded by a PMI.

In addition to PPPs, this process is also possible in contracts for concession, as legal devices supporting PMIs are in the Concession Law (article 21 of Law 8.987/1995) and in a law passed right after that about concessions (article 31 of Law 9.074/1995).

### But what is a PMI?

Within a Procedure to Express Interest, projects, studies, surveys and evaluations (including suggestions about the bid and contract) to support the Public Administration's analysis on the feasibility and proper description of the concession's grant (article 18, XV, of Law 8.987/95);

These devices break the logic of Law 8666 that forbids the author of the basic project to compete in the bid, a restriction that is not determined in Concessions and PPPs. In these models, the PMIstcompany may join the competition because the project risk is borne by the concessionaire.

Another relevant device in the Concession Law is the possibility that all studies, projects and surveys required to open a bid process may be reimbursed by the winning bidder if used by the Public Administration.

Although there are legal devices nationally valid for conducting PMIs, it is considered convenient to pass decrees by states and cities to regulate this procedure, as Government regulates this practice, the procedure becomes widely used and more transparent, safer and easier to be used.

It is not necessary to draft a basic project to open a Concession's PPP bid. The law requires that the object is precisely described and the project to be submitted in a PMI is as detailed as a preliminary draft.

Experience shows that the better projects and studies are, better hiring and execution will also be. For

## I. Influência na Modelagem:

### II Procedimento de Manifestação de Interesse – PMI/MIP

#### Art. 21 da Lei 8.987/1995:

*“Os estudos, investigações, levantamentos, projetos, obras e despesas ou investimentos já efetuados, vinculados à concessão, de utilidade para a licitação, realizados pelo poder concedente ou com a sua autorização, estarão à disposição dos interessados, devendo o vencedor da licitação ressarcir os dispêndios correspondentes, especificados no edital”. (D/n)*

#### Art. 31 da Lei 9.074/1995:

*“Nas licitações para concessão e permissão de serviços públicos ou uso de bem público, os autores ou responsáveis economicamente pelos projetos básico ou executivo podem participar, direta ou indiretamente, da licitação ou da execução de obras ou serviços”. (D/n)*

this reason, it is important that the process is preceded by good studies, projects and assessments.

The PMI goals is also quite connected to the offer of necessary elements to allow for the bid to happen, but also to something that is typical of the private sector, i.e., to see businesses that are feasible.

The PMI may be an important element for any company that is willing to get ready to join a PPP, thus performing studies on the object of the future bid.

The PMI forces the company to do so. Even if the company does not join a PMI, my advice is that the bidder always perform their studies, of course.

In this regard, bid notices are always clear that all studies made available in the bid as a reference, not binding the bidder or the Public Administration.

Thus, the bidder is encumbered to perform their own studies. Thus, whether in a PMI or not, the good organization of a company to make business in concessions and PPPs goes necessarily through doing several studies, projects and surveys.

### Content of a PMI study

It is worth stressing that these studies are not simple, because they must cover a period of approximately 30 years.

Demand studies to calculate CAPEX and the OPEX and other required studies, including legal ones, are helpful to consider the business model and the feasibility of the business itself.

An aspect of Concessions and PPPs, which is different from contracts governed by Law 8,666 is that the responsibility for obtaining environmental permits and expropriations is borne by the concessionaire.

In this case, the concessionaire is also liable for providing all required projects for such permits. The concessionaire performs all evaluations and this study phase is also important, environmental studies, to mitigate liabilities a bit and to be aware of measures to be taken.

Considering how rigid the Brazilian legislation on the environment is, I would say that this is a very relevant study that impacts designs, feasibility, cost and the execution of large works.

Furthermore, other studies included in the PMI cover required expropriations. Normally, the role of the

“Experience shows that as good as projects and studies, studies, both hiring and execution will be better. For this reason, it is important that this project is preceded by good studies, projects and evaluations.”

“ Usually, the cost of such studies to carry out infrastructure works, that are complex and large, runs around 2 million BRL.”

concessionaire is to prepare the elements for the Public Utility Decree submitted to the Conceding Power for approval and issuance and then the concessionaire shall perform expropriations according to the decree.

The concessionaire also has the task to friendly negotiate expropriations and/or conduct legal proceedings, which is the most suitable way to regularize expropriations. The idea here is that the concessionaire is not only in charge of expropriations but also to submit these properties to the Public Administration according to the legislation by the end of the concession.

The concessionaire is also liable for removing people from the plot, which is more concerning as in many highways and railroads, there are many people living illegally in the domain area, so the study to estimate required expenses to solve these issues is quite complex.

#### Cost of studies and the consulting market

Usually, the cost of such studies to carry out infrastructure works, that are complex and large, runs around 2 million BRL.

For this reason, the PMI model allows not only that the interested party in the bid performs the study but also to be reimbursed for such studies, if authorized by the Conceding Power.

This is about a mere reimbursement, reason for which this is a market for consulting firms and not for the company itself, whose interest lies in the business related to the PMI.

#### Such reimbursement is not usually in full for several reasons:

- Many times, the PMI's notice itself determines a threshold for reimbursement

- The central administration cost is never reimbursed. Costs with legal fees (internal lawyer) for instance, to analyze such studies from a legal standpoint are not reimbursed as it is impossible to detail how much was spent.

- Every reimbursement depends on the submission of an accounting documentation usually specified (details and characteristics) in the PMI notice.

- Usually, the participation of the PMIst in the bid is allowed but without rights to preference or exclusivity. The amount to be reimbursed is determined by the evaluation committee and may be subject to a limit pre-determined in the notice and it is borne by the bid's winner.

- It is usually required to provide evidence the experience in elaborating similar projects and studies, although the hiring of third parties or joint elaboration is allowed.

#### Conditions established in the Procedure to Express Interest - PMI/MIP

- Performance of projects, studies, research and evaluations (including proposals about the bid and contract) to support the Public Administration in the feasibility analysis and fully description of the concession's object (article 18, XV, of Law 8.987/95).

- At the expense of the interested parties, with claims to reimbursement of costs if and at the extent they are used in a future bid.

- It is usually required to provide evidence of the experience in elaborating similar projects and studies, although the hiring of third parties or joint elaboration is allowed.

- The PMIst is usually allowed to join the bid but with no rights on preference or exclusivity

- The amount to be reimbursed is

determined by the evaluation committee and may be subject to a pre-determined limit in the bid, and it is paid by the winner of the bid.

### International experiences

Examples of PMI in Latin America and Europe show us similarities and differences to our legislation.

In Chile and Italy, for instance, the company in a PMI can join the bid and also has preference rights in the future bid. This is a procedure that is culturally refused in Brazil.

And finally, it is worth mentioning that usually notices determine that the Public Administration would select only one study, from one company, to avoid using the preliminary draft from a company and the legal model from another.

The objective is to select only one PMist. So, in this regard, this is a competitive procedure without the rigidity and formality of a bid, as it does not request so many certificates and other documents. In practice, the experience in executing is enough to be accepted as evidence for the company in the study.

### Another way to influence the business model

In addition to PMIs, that not always see the light of day, another means to influence the business model is by participating in public consultations that always take place in Concessions and Partnerships, as determined by the PPP Law.

In this process, the Public Administration collects relevant proposals to add to the bid and contract notices, and to studies.

The influence in a public consultation will be certainly more eventual than it is possible in a PMI, where a company performs studies and has a competitive edge in terms of knowledge on the topic.

### How to proceed in the bid

The Concession and PPP Law allows broadly the outsourcing of activities and it is common, in order to optimize the proposal, that groups are created to participate in the bidding process, as ConsórcioPlanalto.

Although the law mentions consortia, there is no need to constitute a formal consortium as determined by the Stock Corporation Law.

Companies may form a group that agree to constitute a SPE - Specific Purpose Entity, usually a stock corporation, with the sole difference that it will operate only what is allowed by the concession or PPP contract.

The company has, as it is implied by its name, a specific purpose: It is born and dies with the concession contract and is aimed to execute only the activities determined by the contract.

For projects where ancillary revenues are expressive, such as airports - where ancillary revenues are more relevant than fees charged - the concession grant usually grants permission for the future bidder to constitute another SPE.

The idea of a Specific Purpose Vehicle was conceived to ease asset segregation, the control of cash flow inputs and outputs for that firm and thus, to make the project more financially.

Also, lenders demand that the concessionaire be a SPE. Lenders also require SPEs to better understand what is the concessionaire's income and what is the income of the SPE's shareholders.

A frequent question is: The participation in the Consortium shall be the same as the participation in the SPE? It depends on the bid's notice. Usually, the notice requires that at least people are the same

**“Normally, notices allow for issuing a guarantee by all members of a consortium or solely for one company, and this is another advantage to constitute a group. ”**



Normally, notices allow for issuing a guarantee by all members of a consortium or solely for one company, and this is another advantage to constitute a group.

and sometimes requires that the participation be the same, at least for a certain period. But both demands do not prevent companies to agree on diverse capitalization method among themselves.

### Group

**In this context, synergy and proximity between the group is what matters.**

Companies also have to organize themselves to meet the bid's requirements, whether those related to homologation - they must fulfill their labor and tax obligations, be properly registered in the Trade Association and have no legal restrictions and be qualified technically and financially.

Here, the benefits of forming a group is the possibility to add up all partner's technical experiences, especially when the project's object is complex.

Add to this economic qualification. Net assets required from groups is usually higher than those required from a company and it is necessary that all group members reach the minimum PL in line with each member interest in the consortium. The lawyer stresses though that the composition of the consortium to elaborate the PMI may not be the same for constituting the future SPE.

To join a Concession or PPP, companies also need to be organized to prepare their proposals, including the price proposal. Some bids have not required the submission of a business plan, which are all economic studies and calculations that support the offered price.

Companies also need to get ready to submit some guarantees. The amount of guarantees is limited to 1% of the contract amount. This is the so-called Bid Bond, to guarantee the bid and make sure the winner of the bid will sign the con-

tract. This guarantee is usually submitted by an insurer or a financial institution.

Normally, notices allow for issuing a guarantee by all members of a consortium or solely for one company, and this is another advantage to constitute a group.

Some bid notices demand commitment from an insurer or financial institution that if a given bidder wins the bid, the insurer or bank will submit the contract's guarantee, the so-called performance bond and also the completion bond, that is additionally required when these concessions require the completion of a large size work. So the bidder for a Concession and PPP must be ready to submit relevant guarantees to allow for the hiring.

To celebrate and execute the contract it is important that the company is prepared to constitute the SPE and fulfill all the financial engineering required (input of capital, equity share and own capital input).

It is also required to have skills and capacity to get loans, whether it is a bridge loan or long-term loans, as well as to be prepared to execute the contract as turnkey - global price regime and concession rationale, where the company creates designs, hire, provide materials and everything else required to execute the work.

Furthermore, the company is subject to regulation, going beyond its own contract, and must be willing to establish a series of legal relationships with third parties stemming from the concession, as it will be a proxy of the Public Administration, establishing relationships with many entities but mainly with the service's end users.

So there is a relatively complex relationship grid and the detailing level of this memo and attachments will change according to the group's attitude.

Sometimes this memo has attachments such as EPC contracts, partnership contracts, that will be celebrated with those group members that will execute the works in the future.

Or sometimes the group's attitude is that no one will build the works - a third party will be hired to speed it up.

But the truth that the harmonization of the group is a very important step to get ready for a bid.

### QUESTIONS

**Is there a requirement for lenders provide financing, for a SPE to hire a consulting firm, a contractor consortium or the SPE itself can proceed with the works?**

**LeticiaQueiroz:** As it is a project finance, the lender is tempted to over-analyze the project and its risks, i.e., its sustainability. So yes, the lender usually makes such requirements. For instance, BNDES usually acts this way and also analyzes the EPC contract. What is the understanding? It is that if the EPC contract is well structured, the project will have less risks and so it is financeable.

**PMI studies are increasingly expensive and demanding and after all studies, previous meetings with federal entities and regulating entities, hearings, consultations and adjustments, these are questioned by Public Attorneys and there is a signal for that group to not be favored. In other words, it goes against the Law. How can this situation be avoided? And how do you see the possibility of these so expensive PMI studies to be financed by state-owned banks, such as BNDES and Caixa Econômica Federal?**

**LeticiaQueiroz:** Well, as for the first question, this is really an issue deriving from the PMI and covers how the control is coordinated. This is because the Conceding Authori-

ty has a type of control, based on merits, and the Accounting Court has a different control, basically related to the economy.

The Constitution also states that Accounting Courts control legitimacy of acts and based on this, Accounting Courts have behaved as true Courts without the rights to do so. They are not Courts in the formal sense, they are not the Judiciary. This is something relevant that the Public Administration has to act upon, as Accounting Courts do not have the final word.

The power of Accounting Courts comes from the fact that they apply personal penalties to officials so the Accounting Court can be quite threatening at the beginning and officials are afraid as they know legal proceedings will be started against them and as officials, they will have to hire lawyers to defend them, pay fees, and to prove they made the correct decision.

It is quite common in the Administrative Law field that the official make decisions where there is no rule, i.e., nothing illegal, evidently, but something depending on an interpretation made in a certain way. And then comes the TCE saying that there is another interpretation, usually a conservative one, which shall prevail. So it is a really threatening issue as whatever the Accounting Court says, it is the law. This serious problem needs to be solved, as one thing is the Accounting Court discuss technical aspects of the model and another thing is to say it is not approving the PMI as it understands the PMI is going against the Constitution. At this point, having a conversation is really difficult.

As for financing the PMI, BNDES offers the Project Structuring Fund (FEP) through which the bank promotes the idea that independent consultants perform such PMIs

**“The formation of a group allows for a company to submit itself the guarantee in behalf of other companies, if that company has surety from a bank or funds enough for that.”**

## How to prepare to work in a Concession or PPP?

“ **The formation of a group allows for a company to submit itself the guarantee in behalf of other companies, if that company has surety from a bank or funds enough for that.**”

along with Caixa. This is a feasible mechanism for federal projects and projects from the State of São Paulo, but the majority of concession and PPP projects are being launched by cities.

Municipal PMI are the majority in the pipeline. And here, financing

capacity is very limited. What concerns me a bit about PMI is really the critical capacity, which in reality is not only a PMI problem but also for concessions and PPPs as a whole. When we talk about Brazilian cities with different realities, it is important to pay attention to the technical capacity to assess such studies.

## Facing the crisis, this is the natural way for Brazil

Prevent barriers, reduce paperwork and tread possible paths to approve Public-Private Partnership projects in Brazil are inevitable ways to the country.

Opening opportunities to contractors through Concessions and PPPs has become critical to the country.

If this was already necessary due to the lack of public resources to meet huge demands for infrastructure, today enhancing this model has become imperative for the Public Administration, for companies and the society as a whole, which is correctly demanding improvement of public services and the enhancement of this model to face the grave crisis the country is going through.

The entity, which represents most companies operating public works in several industries in São Paulo, brought consultants from Britain that presented a successful model being applied there, considered as the top in PPPs worldwide since that time, but here we are still trying to promote the relevance of Concessions and PPPs in Brazil, which is something we regret.

Few was achieved in all states, city and nation. It is like we are praying, repeating the same things to no change. The country undergoes a terrible instability and the scenario could be different if we had progressed in this field.

The economic crisis facilitates concessions in detriment to PPPs, but in another moment this situation may change as Brazil needs to grow and adopt both models.

Unfortunately, in August 2015 the Geraldo Alckmin administration denied 32 PPP projects in infrastructure for the State of São Paulo. Six of these proposals, amounting to 13 billion in total, had already studies or bids announced by the government but the decision was reverted due to changes in the economy and regulations. Although it was the right decision, as the State would be at the mercy of companies that if left would compromise tax collection for the next 30 years, this event also causes large concerns.

Situations like these support the lack of corporate trust in this project model, so companies would rather join standard bids even if this means submitting itself to fierce competition, many times bidding not feasible prices.

For this reason, APEOP has been focusing since last year in facilitating company groups willing to join PPPs with the Incentive to Study Opportunities in PPPs and Concessions Program. The model can be a foundation for trade associations and other entities in several Brazilian states, with the following stages:

- The first step is bringing companies together by providing information on PPPs and Grants that create a real commitment with the program.
- Such training consists of a broad explanatory meeting where scenarios, opportunities and hardships are shown, in addition to APEOP's institutional role. In addition to contractors, law firms, project structuring companies, financial advisors,



**Luciano Amadio Filho**

Chairman, Public Work Companies  
Paraná State Association (APEOP)

“The thing is, it is not easy for none of us and seems to me it won't improve any time soon, but initiatives like this bring us close to our goals and help companies to survive and remain active during this journey.”

design companies and even staff from investment funds and concessionaires are invited to the meeting.

- Second step is the identification of opportunities. Through several meetings with state and city secretaries, and Federal Administration officials, we identify areas or projects of interest that may be executed in partnerships (concessions and PPPs), with asset leasing and all other models currently available. We incorporate to these areas or projects those announced by the Federal Government, such as the phase 2 of Logistics Investment Program that entails investments of 69 billion BRL between 2015 and 2018 in highways, railroads, ports and airports.

- Third step is the formation of an interest area matrix that is forwarded to all companies so they can point to areas where they would be interested to develop studies. Here we open the provide the chance to companies to suggest new topics.

There are 35 areas listed in the Incentive to Studies of Opportunities in PPPs and Concessions Program's matrix, as follows:

- Projects to expand reutilization of water in treatment plants and small cities.
- Projects to regulate and implement water reutilization in industrial parks, condos, and gated communities.
- Desalinization projects across the Brazilian coast (some of them already have MIPs submitted in the respective State).
- Projects to recover water and for utilizing dams, lagoons and lakes.
- Projects to regularize (water and sewage networks) in large slums. Minimize losses and leakages, stuff like that.

- Projects to Recover Pinheiros River;
- Construction of water and sewage networks and treatment plants by PPPs or Asset Leasing.
- Projects for PPP to recover water losses (there we have old networks with 40 or 50 years old).
- Concession, operation and maintenance of CPTM railroads.
- Concession for expanding monorails.
- Concession for operating and maintaining existing subway lines in São Paulo.
- Concession, construction and operation of new subway lines in São Paulo.
- Concession for seized vehicles parking.
- Renovation, expansion and upgrading of Fundamental, Basic and Technical Schools.
- Small hydropower plants.
- Thermal plants.
- Federal railroads; Concession of areas in ports, rivers and canals, regulation, access.
- Concession, expansion and operation of large airports;
- Concession, construction and operation of small airports across Brazil.
- Wind farms/ wind energy.
- Construction of bus-only lanes.
- Dredging works and services.
- Concessions of prisons.
- Concessions of hospitals.
- PPPs for housing in the State of São Paulo.
- Dredging for maintenance of ports and rivers.

- Photovoltaic solar energy studies;
- Construction of daycare centers.
- Public lightning infrastructure.
- Poupatempo.
- Administrative grants for public buildings
- Gas pipelines.

### Commercial vs. Institutional Context

The Incentive to Studies for Opportunities in PPPs and Concessions Program is strictly applied, establishing clear limits between the entity's institutional action and the commercial aspects around each group and each company, once these groups will compete at a later phase of some bidding processes.

APEOP works as a comprehensive umbrella, providing full institutional support to working groups within its attributions and limitations, with the basic duty to provide tools for companies to develop and conduct studies and proposals adapted to their reality and interest.

Working group meetings can take place at APEOP headquarters once they are previously scheduled and the entity will follow regularly the

progress of works, but will not join such works and studies.

In the case of the first opportunity matrix compiled by APEOP, 79 groups were formed with 6 to 7 companies in average, providing some homogeneity. Separate meetings are summoned for each group, with the following script:

- We present a tentative script to develop the works, consisting of conditions of the hiring party, mainly financial institutions, yearly net revenue, debt levels and other PPPs hired or being studied, i.e., groups who will also analyze the Conceding Power potential.

- We advise that it is critical for making PPP projects happen, to constitute Guarantee Funds by Conceding Powers, to increase security for bidders and their lenders. Without such funds, properly defined in the notice phase, companies will not be interested in investing in these projects. Such Funds can be created by the Hiring Party or by escrow accounts.

- Another step is prospecting projects: To analyze the industry and implementation field; Value creation for the client; Implementation site; Reason and justification for the project; Potential clients; Hiring conditions by the Conceding

Power; Project's positive aspects, as well as risks and mitigation; Basic information on revenues, costs and cash flow; Preliminary feasibility studies, considering construction phase and other investments and financing.

- After this stage, the works are structured, defining within each group a project manager or leader, elaborating an implementation schedule for the project from the prospection phase to the date forecast for the bid, clearly indicating each activity required to develop the works; those in charge of each activity, consultants to be hired (legal, technical, and financial); costs of each activity and steps, with milestones for each activity.

### Current situation

At the current situation, new groups are meeting and starting to structure their works. Institutional demands common to all groups are being directed to APEOP for entity's intervention.

Our conclusion is this: This is not easy times for anyone and it seems to me that it won't improve any time soon, but initiatives like this bring us close to our objectives and help companies to survive and remain actives during this journey.

## How make parternships to participate in large projects throught PPPs?



**André Romero**

Finance Department, Gel Engenharia

How to engage in partnerships to participate in large projects, identifying possible partners? How to include representatives from small and mid-sized companies in this context?

How to identify the profile of companies with more chances to fit into Public-Private Partnership bids, pursuing partnerships and business models with larger companies?

BNDES defines a small company as having yearly gross operational revenue above 2.4 million BRL and less than or equal to 16 million BRL; mid-sized company as having revenues above 16 million BRL and less than or equal to 90 million BRL; and mid-to-large company as having revenues above 90 million BRL and less than or equal to 300 million BRL.

By partnerships with large companies, Gel Engenharia joined PPPs - which has been developing in Brazil since the 1970s and becoming more apparent now, from the 1990s.

Thus, talk about PPP is almost something new, once Brazilian regulations are recent.

In Paraná, for instance, one of the largest producing states in Brazil, the relevant legislation was passed in 2014, so it is virtually an unexplored field requiring a lot of learning, but extremely important for Brazil's development.

The success case of Gel Engenharia, founded in 1983 in Curitiba, state of Paraná, is evidence that partnerships may be an alternative for small and mid-sized companies to join large infrastructure projects.

Operating in several Brazilian states, the company focuses in public and private works, investments, concessions and asset leasing especially in sanitation, mining, gas pipelines, wind farms, ports and highways and residential and industrial buildings.

**Some of the main issues for creating partnerships with regard to PPP contracts are:**

Financial strength and leadership - Through partnerships it is possible to get access to larger businesses, some in area of billions BRL, due to the leverage power and financial strength of large companies. At the time of hiring, the association to solid companies can be a decisive factor to obtain cheaper financing and then reduce your costs on any project.

Professional expertise - To be able to rely with more robust structure of large companies, such as lawyers, accountants, experts in every topic is critical to add more expertise to very specific subjects - where obviously smaller companies can "bandwagon".

Institutional benchmark -Partnership with larger companies usually provide access to leaders at higher ranks in the Government, providing help in licensing, access to information and so on.

Risks - Your capacity to negotiate risks with financial institutions also increases with the participation of smaller companies.

Cost control - As smaller companies are lean and economical, any amount is very important to them, which helps to control costs.

Management capacity – In general, smaller companies drive projects faster, once executives in a larger company is not so fast on decision-making.

Operational certificates - Certificates for similar service deliveries may be a valuable asset to expand participation in projects and are attractive to larger companies.

Local knowledge and reputation - For large companies, it is strategic to rely on partners that know local reality and culture, aware of channels and validating processes based on their reputation in the region.

Corporate governance – Partnerships are an incentive to corporate governance, regulating company's management and preventing future troubles.

SPE model - The Specific Purpose Vehicle model (SPE) is the best suited model for this type of partnership. Paraná's first Public-Private Partnership contract to duplicate PR-323, between Maringá and Francisco Alves, was signed by a consortium, called Rota 323, who will be in charge of works. This SPE

was created to process the PPP contract and a large company is the main shareholder, with 70% of the company, while three smaller companies hold 10% each - one of them is Gel Engenharia. The PPP is not generating profits enough from toll fees to return investments to shareholders, so the State of Paraná is providing a periodical counter payment that is additional to the fee at the initial stages of the work until the project is fully developed, and this is an important resource to support operational costs and debt service, which is quite high. The SPE shall offer contract guarantees to a Development Bank and if all guarantees suffice to the financial institution, the Project Finance is established, i.e., the project will be the sole debt's guarantee for the company. At this time, the participation of shareholders becomes more relevant to obtain financing and reducing costs. The amounts are quite high, above billions, and the bank inputs from 50% to 80% of these amount. Only when the contract is approved that the contractor consortium starts working so that PPP begins to accrue revenue by charging a fee upon its operation.

**“The success case of Gel Engenharia, founded in 1983 in Curitiba, state of Paraná, is evidence that partnerships may be an alternative for small and mid-sized companies to join large infrastructure projects. ”**

## Going beyond rationality's border



**André Barbosa**

Assist Consultores Associados

How to prepare feasible projects for concession of public services, identifying which are the main challenges to avoid a Public-Private Partnership sinks?

Irrespective of the type of study developed, no project can start from an individualistic standpoint.

I support my statement upon the Rationality Border concept: The idea that when individuals make decisions or issue an opinion, their rationality is limited by information available, cognitive limitations and time for decision-making.

For this reason, professionals always tend to print upon their research or projects a vision that reflects the expectation of their knowledge, experiences and interests and so many projects are not feasible, richin only one analysis perspective.

To model a PPP means to draft a business plan that is able to align interests from the parties in a project whose results are acceptable to all, through the balance in risk sharing and responsibilities.

An infrastructure project is the object of integration of competencies and capacities of the parties to serve society.

The key assumption for the success of this model and its broad application in Brazil is based on obtaining trust between public and private partners, above all.

It is important to apply efforts to incentivize and make concessions feasible, as they are high-amount investments, such as concessions for highways, sized for some decades of operational life.

Soon, when the first investment cycle on these projects get completed, there will be infrastructure with higher quality and less costs in Brazil.

For this reason, hiring a PPP cannot be compared to the model regulating bidding processes, Law # 8.666/93, where the main criterion is lower prices, with no regard to ensure the work's feasibility.

In this case, "what is going to be the life cycle of this project if it was not planned and executed with quality in mind?"

So what do PPP have it differently and what are their benefits as a mechanism for hiring public services?

Some Concession models are only feasible if they generate ancillary revenues.

The first one is the so-called Ordinary Concession, where the government does not input capital but only gives permission to the process.

The user itself finances this service. There is also the Sponsored Concession, which requires capital input from the government, as fees paid by the user alone do not generate a financial balance.

But for a project to be feasible within a PPP model, it also must be economically beneficial to society, feasible for the private sector and public administration, with the true interest of both on the project and establishing mutual trust.

For this reason, the optimal match of interests within feasibility limits is based on feasibility perspectives, benefits for society as a function of risk management and inte-

rest of parties involved. Irrespective of the project's complexity, the strategy adopted by all parties needs to be in harmony so that the team will be formed aligned to the group's interest.

### How to start a PPP?

There are two ways to launch a PPP. The first one is the Expression of Interest on a Project (Manifestação de Interesse por Projeto, MIP), that is sent by the interested party to the Public Administration. The other is the Procedure to Express Interest (Procedimento de Manifestação de Interesse, PMI), a public invitation by notice where one or more interested parties are selected.

The biggest risk for a PPP is the constant threat of government quits the project and this concern must

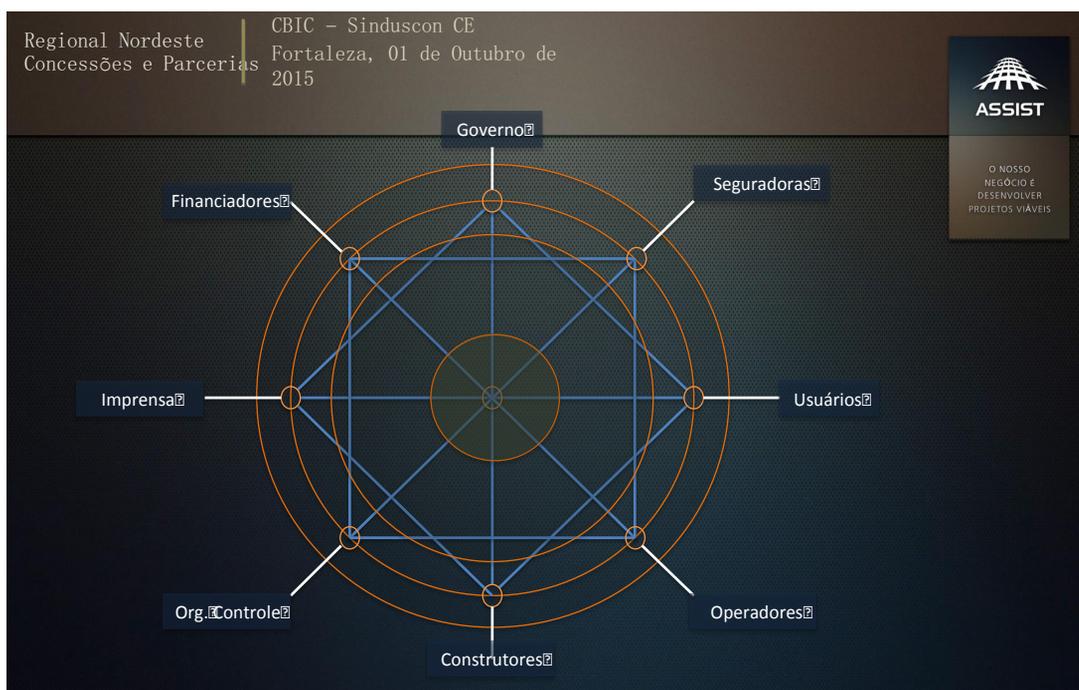
be taken into account by whomever is preparing a PPP.

The products comprising preparation and modeling of PPP and the service delivery shall be based upon analyses and risk mitigation efforts to prevent barriers, and contracts shall cover all main risks as agreed by participants.

It is also necessary to have demand studies and service protocols, financial, operational and legal models, strict feasibility studies, institutional arrangements and, of course, project guidelines and elements.

Based on this model, all interests from the contractor, operator, government, insurer, controllers, entities, media, lenders and users are integrated according to social and economic perspectives and public transparency assumptions.

**“Soon, when the first investment cycle on these projects get completed, there will be infrastructure with higher quality and smaller costs in Brazil.”**



## Grupo Marquise's vision and expertise in Concessions and PPPs



**André Pontes**

Commercial Director, Marquise

The GrupoMarquise, comprised of 11 companies and almost 40 years of operation in infrastructure engineering, development, environmental services, hospitality, finance, communication and malls in 12 Brazilian states, recently launched a new business division to develop PPP in service to citizens, hospitals, public lightning and solid waste.

VaptVupt, for instance, is an Administrative Public-Private Partnership formed by Construtora Marquise S/A and Shopping do Cidadão, forming the "CearáCidadão", and the State Government of Ceará. Its scope is to implement, maintain, operate and manage 5 Citizen Service Centers units.

The VaptVupt Service Center is a project replacing the former Casa do Cidadão and offers more than 300 services performed by some 27 public and private entities. The first unit was opened in August 2014 in the city of Juazeiro do Norte. In Fortaleza, the Messejana unit was opened in December 19. Our goal is to provide services that are fast and efficient, such as issuance of documents (ID, driver's license, job registry), voting certificates, cards for transportation, individual services and other service deliveries.

The contract has 100% private capital and the service concession is for 15 years. Delivery is assessed by an external audit that takes into account waiting time, service quality, infrastructure and service personnel qualification.

### Hospital Regional Metropolitano

Construtora Marquise, a Vivant e a PB Construções formed the SPE CearáSaúde to sign a contract with Ceará government for the Administrative Concession for the Hospital Regional Metropolitano during 25 years. The companies performed the model studies to size the hospital, that focuses on urgent and emergent care, and the project's scope was to build, provide medical imaging equipment, maintenance and other services, such as cleaning, feeding, laundry and building's maintenance.

Overall, there 432 beds - 270 for stays, 60 for emergency backup, 20 for emergency observation, 40 for adult ICU, 30 beds for semi-intensive care, 11 surgery rooms, 12 beds for day clinic, 13 recovery rooms after anesthesia in a useful area of 37,000 square meters and 13 floors.

The participation of the State government was critical for the success of the project, starting at the study phase, passing by risk analyses, Value for Money and finally getting to economic, social and political analyses.

We are in charge for maintaining the whole hospital, from cleaning, reinvesting across 25 years, medical equipment that we need to keep operational and updated every 10 or 5 years. There are performance assessment criteria based on availability, services, and quality. If a medical equipment has a malfunction we have a deadline to get it

fixed, and if we miss that deadline we are penalized. In addition to results, it is worth mentioning that the project has no public capital and provide an efficient and quality service to the population.

### What companies must consider

- The economic capacity of the State or City to not waste time and money on a project that is not feasible
- If there are enough guarantees.

In general, companies obtain loans to enter such projects and banks require proper guarantees.

- Proactivity of the Public Administration. If the government does not

prioritize Concession and PPP projects, the company loses time and the project is doomed.

- The political context must also be taken into consideration. Changes to political offices may occur during studies and if there is no favorable scenario, the risks of failure are big.
- Check if the Public Administration fulfills their obligations and have a good reputation. Unfortunately, there are many instances of default by governments, causing a series of balance issues, contract arguments - which are not interesting to any project.
- To rely in an experienced technical team throughout the operation, especially at the time of project's preliminary draft.

**“The political context must also be taken into consideration.**

**Changes to political offices may occur during studies and if there is no favorable scenario, the risks of failure are big.** ”



## State of Bahia creates Rede PPP to share information



**Camila Aguiar Silva**

Legal Assistant, PPP Department,  
State of Bahia Economy Secretariat

The RedePPP (Intergovernmental Network to Develop Public-Private Partnerships) was constituted one year ago by the State to perform the required efforts to create related policies, determine guidelines and to align procedures and rules, as well as to increase mutual support among PPP Units in Brazil.

This is the most important and innovative articulation, knowledge management and training in Concessions and PPP initiative in Brazil. Although many states and cities have progressed far in this subject, the majority of Brazilian cities do not even have legislation on this area.

The network's goal is to share such knowledge and work in a collaborative environment to exchange experiences, leverage successful experiences and projects and increase sharing.

Currently the organization has more than 30 members between states, cities, state-owned companies, development banks and state-owned banks.

### What can be expected from Rede PPP?

In September 2015, RedePPP signed an agreement with the United Nations Office for Project Services (UNOPS), an operational arm of the United Nations that supports the implementation of humanitarian and development projects all over the world. The goal is to disseminate Public-Private Partnerships in Brazil through the network, with 30 state, cities, federal entities and development entities as members.

The partnership with UNOPS will make feasible some priority projects, such as the creation of a database to support federal, state and city governments to develop new PPPs.

Resources will be primarily invested on the development of systems and training.

RedePPP also signed a cooperation agreement with the LSE (London School of Economics), FESP-SP (São Paulo School of Sociology and Politics Foundation) and the British Embassy in Brazil to develop a MBA in Concessions and PPPs next year, which currently have 200 interested students.

### The scenario for Concessions and PPPs in Bahia

The State of Bahia has modelled seven PPPs, out of which six are already hired and five are operational. One of the main aspects in this business model is to have experience not only in structuring PPPs but also in contract management, which is where errors are usually found.

In Hospital do Subúrbio (second PPP created in Bahia), for instance, a mistake was the lack of a demand restriction mechanism as the unit is always opened to full absorption capacity. It is necessary to make clear in these contracts the mechanisms to shut the door in critical situations.

The lack of efficient mechanisms to appropriate excessive costs, due to the excess of demand, is a fact that always generates an adjustment process, where costs must

be calculated, which is a time-consuming thing.

In the other hand, the stability of the State's institutional environment is positive factor as there are consistent laws, decrees and rules to regulate operation in this business front.

Furthermore, the State of Bahia has been strictly respecting contracts, and there is not delays on counter payments until now, improving the Public Administration's reputation.

#### How does the State encourage Concessions and PPPs?

- The government has adopted resources from the State Participation Fund for meeting counter payments, and allowing for revenue binding with bank account blocking. This is an efficient mechanism that prevents delays of even one day to pay partners.

- The Bahia Partnership Guarantee Fund as created similar to the federal guarantee fund.

- We expect to pass in 2015 the new PMI Decree to allow for the execution of a MIP (Private Interest Statement) so that companies can submit their projects straight to the government.

- The State government is working in a bill to create a new state-owned company to encourage investments in infrastructure. The goal is to raise assets, structure operations to get resources from capital markets and consequently to encourage investments in infrastructure.

- The State is also developing a line to support liquidity similar to BNDES's line, aiming to guarantee infrastructure bonds issued by the private partner.

#### 4 main projects structured in Bahia

- Construction and operation of the Sistema Viário do Oeste, also known as Salvador-Itaparica bridge. The bridge has 12 km and there is a road with 150 km connecting the bridge and the BA001 highway to the BR242 highway, to develop the Low South area. McKinsey & Company was hired to do the model and probing studies, sea hydrology, preliminary draft, environmental studies for licensing, cultural impact, intangible assets and review of urban plans for the cities of Itaparica and Vera Cruz. Estimated value for investing by the PMI is of 7.3 billion BRL.

- Renovation and maintenance of BA-052 highway, also comprising BA-148, BA-432 and BA-160 highways, totaling 685 km and the construction of a bridge between Xique-Xique and Barra. This project has BNDES/IFC as partners and shall be bid in October 2016.

- The government is also working in another two projects - the construction and operation of a new Convention Center in the State of Bahia and the other being a PMI (already in execution) for urban solid waste comprising filter, transportation, solid waste treatment and final disposal, covering some 62% of residue generation in the state.

**“The goal for the network is to share knowledge and support to exchange experiences, leverage successful experiences and projects and increase sharing.”**

## What are the main barriers faced by companies?



**Rafael Salazar**

New Business Director,  
Construtora Aterpa

Some of the main barriers faced by the private sector to work in Concessions and Public-Private Partnerships are timing and required resources to develop studies and draft projects.

Every Concession and PPP proposal requires engineering, financial modeling and legal studies and the companies must hire experts for this job.

In general, mid-sized companies are able to focus on two or three project studies, no more than that.

Have a well performed study is critical to join a bid process. Otherwise the company loses the bid by the redundancy of risks, making the proposal less competitive or wins the bid at the risk of future issues.

Another barrier faced by mid-sized companies in the Concession and PPP market is the exposure of own capital and long-term financing guarantees. Projects under such model demand shareholder's own capital.

I believe that Concessions are good businesses as they are long term investments.

Guarantees for financing are also a barrier. He explains that sometimes BNDES asks for a bank guarantee

for smaller companies, which is a problem especially at the present time, when Brazil is facing a credit crunch and banks are not willing to compromise their books with guarantees.

Changes to the economic environment taking place after a long-term project is won may also cause trouble to the progress of work. Some changes can be offset but others are concessionaire's risks.

As an example, I mention the PPP of Serra, that is facing a water crisis in the State of Espírito Santo.

Cesan was forced to promote a campaign to reduce water consumption, which hurt us.

In the highway sector, a projection of traffic increase linked to the GDP is performed and then the country sinks in a crisis, changing all assumptions. Such are the risks that have to be faced.

A significant benefit from Concessions and PPPs is the fact that they have a different model from the hiring model determined by Law 8666 or RDC, as the former allows for a long-term revenue stream.

## Read bid's notices carefully is critical

The Ordinary Concession is a contract model where the project fully compensates the concessionaire by charging a fee. Sponsored PPP is a Public Service Concession contract model imposing to the private partner the planning, execution and operation of a public activity where compensation for service delivery is partially paid by the user, through a fee, and the difference required to complete the private partner's compensation is paid by the Public partner.

Concessions are defined by delivering services and executing works not below 20 million BRL with minimum term of 5 years and maximum term of 35 years, through an agreement entered by the private sector and federal, state or city governments, and at the expiration of such agreement all assets will be returned to the Conceding Authority.

For this reason, it is important that bid's notice may foresee how to cover non-amortized assets by the end of concession.

### PPP MAIS

This is draft bill prepared by lawyers under the Ministry of Economy request, aiming to simplify PPP processes and attract more foreign investors.

### Main items:

Foreign companies will always be admitted and may lead consortia;

Get rid of homologation rules:

- Evidence of having performed large works (Certificates).
- Evidence of Liquidity Index.

- Minimum Net Asset requirements.

### Submission of Balance Sheet.

- Public Administration is forbidden to change public fees alone.
- Arbitration Panel to solve all controversies.
- Financial compensation to concessionaire in case of losses caused by change to fees.
- Creation of a council to manage the program.
- The council will select strategic national projects from all proposals.
- Selected proposals will be recognized as of public interest by decree (passed by federal, state or city government) and will be qualified as strategic national interest;
- The Conceding Authority is not able to prevent, postpone or reduce the collection or the adjustment of fees and prices.

### Relevant issues to be considered by a company in the bid notice's structure:

- Does the bid's notice determine a Regulation and Oversight entity?
- Treatment of overlapping of different proposals and concession models during the PMI.
- Location of tool booths (highway concessions)
- Guarantee Funds – PPP (rules for execution, independence, liquidity and so on).



**Francinett Vidigal Júnior**

Partner and Director-President, VAE

**Due to amounts required, it is worth highlighting that a detailed PPP or even PMI study costs more than 1 million BRL.”**

- Guarantees to be demanded from bidders by the Government: (Bank Guarantee, Insurance etc).
- Requirement of economic-financial indexes from bidders.
- Existence of subsidies to the fees through public works.
- Existence of short, mid and long term financing guarantees from state-owned banks (BNDES/CEF/CAF/BID etc).
- Participation of state-owned companies in concessionaire's capitals (as it is the case of Galeão, Cumbica airports)
- There are technical parameters in the Bid's Notice that allow for the expansion of infrastructure Capacity (Performance Indicators – QID).
- Definition of a mechanism to adjust the economic-financial balance.
- Possibility of an Arbitration Panel.
- Internal Return Rates, payback-etc aligned to the market.
- Current environmental liabilities, expropriations and so on.
- Definition of quantities/location of critical services of the concessionaire: highway facilities, scales, ambulances, Operational Control Center (CCO), User Service Center (SAU) etc.
- Definition of ancillary revenues and their proper treatment.
- Charge of fixed/variable encumbrance.
- Geologic/hydrologic/environmental/social/financing risk

#### **And the structure of a Concessionaire - SPE?**

After the procedure to define the bid's winner, a new company must

be created as a Specific Purpose Entity (SPE), contemplating:

- Concessionaire's new management, organization and operation models, subject to regulation, control and oversight rules from several Public Administration entities:
- Regulation office or another entity, if any, selected by the Conceding Authority to perform such activity;
- Conceding Authority's Technical Departments;
- Accounting Courts, State Congress and Public Attorney;
- Cities;
- External Audit and Labor Unions.

The Concession basically depends on a capital structure that must be financed. What is the own capital and third party capital ratio: 20-80, 70-30? Without financing and financing guarantees, there is no bid's notice.

A well structured risk matrix is critical to determine responsibilities for each party. All these security rules shall be incorporated to the bid's notice in order to make it attractive to the private sector.

#### **Warning**

Due to required amounts, it is worth highlighting that a detailed PPP or even PMI study costs more than 1 million BRL.

#### **And will the company have these costs reimbursed?**

An example occurred in Minas Gerais, where government was clear that no reimbursement would take place as it was not obliged to bid what the candidate submitted. In other words, the government owns the intellectual property. So read bid's notices carefully.



**COMO UMA EMPRESA SE ORGANIZA PARA DESENVOLVER CONCESSÕES e PPPs.  
UMA ABORDAGEM PRÁTICA**

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## Culture shift is key to small and mid-sized companies



**Carlos Zveibil Neto**  
Businessman, Director, Ponte Di Ferro Participações

I am an enthusiast of Concessions and Public-Private Partnerships, but small and mid-sized companies will only find their space if a dramatic cultural shift takes place in Brazil. Companies must unite to reach their goals.

Based on my experience of 45 years in the construction business, I sense that the current crisis Brazil is undergoing will bring as answer a new nation poised to grow.

It is not news that Concessions and PPPs mean large companies and huge financial amounts. Although discussions around the Seminars are focusing on opportunities to small and mid-sized companies.

Cost is the main barrier here, once amounts are quite high to allow these companies to participate from a PMI study until winning a project.

In the case of Rodovia do Franço highway, crossing the states of Paraná and Santa Catarina, many demands were excluded but it was necessary to submit a guarantee worth 180 million BRL. This made the participation of smaller companies impossible.

### A cultural shift must take place within companies

A solution for small and mid-sized companies start participating in Concessions and PPPs. "We need to group companies by affinity or by need to participate in this kind of work. For a consortium with five members, a PMI study would cost 200,000 BRL and not 1 million BRL anymore. We group together or we die.

APEOP's example, of which I am a

former chairman, is this: 20 groups were formed, each group with at least seven individuals, with companies interested in PPPs in several areas: Sanitation, highways, power generation and so on. Each participant researched projects in order to share costs and results.

**In the US, a company with 3% of 4% of the project is the major shareholder. Why can't we divide it into five, for instance, each one having 20%?**

I invite small and mid-sized companies to change. To change their thinking.

There is no lack of demands in Brazil to improve infrastructure, health, education, sanitation and these are huge opportunities for companies.

We need to make use of the debate started by CBIC and Sinduscon Espírito Santo to join strengths and conquer new objectives.

The Public Administration has to be challenged

CBIC and Professor Gesner Oliveira wrote a paper listing several suggestions to the Federal Administration to solve financing issues.

One of the alternatives is the creation of a remunerated bond at IPCA +9%, similar to Caixa loans. Also, the bond holder would have participation in profits.

This means that if the project can be financing, its compensation would be higher than Government bonds pay.

The proposal was submitted to the Ministry of Economy, Joaquim Vie-

ira Ferreira Levy, who at that time said it was difficult to implement the model.

Considering this and other cases of interest for companies, I suggest that supporting entities and companies unite to use their political power to get results, claiming for projects.

### Positive experience

I got great news about the homologation of a large bid on water losses in Belém do Pará.

Such good news meets a series of concerns, foremost financing.

Caixa has a program call Sanitation For All but there are so many re-

quirements and documents to be presented, and the time for analysis is quite long. The main issue is to do this in timely fashion, as the schedule for starting the work.

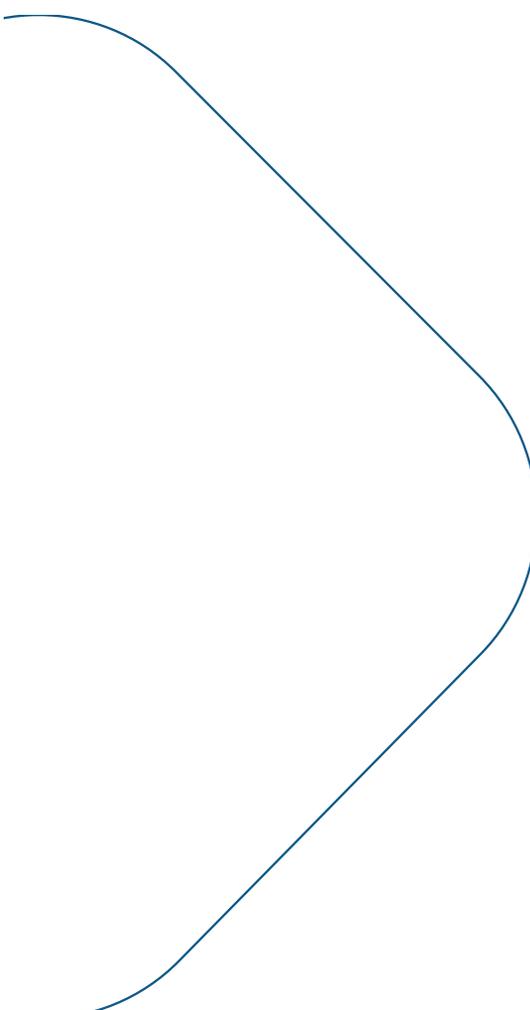
A huge benefit from grouping companies is the security of long-term projects ensuring revenues for 20 or 30 years.

I am still a big fan of PPPs, asset leasing and concession. I think this is the solution and we need to get together to share.

We are losing so much with the postponement of economic changes. So we have the legitimacy to submit proposals. We will do it. And we will fight for them.

**“I invite small and mid-sized companies to change. To change their thinking.”**





# Training 4



# How to organize to do business in Concessions and PPPs



## Guarantee analysis from the investor's standpoint



**André Dabus**  
Executive Director,  
AD Corretora de Seguros

Analyzing guarantees from the investor's standpoint is required to be successful in infrastructure projects. They need to be properly adjusted as for financiability, mitigation of risks and guarantees, whether from the public to the private partner or vice-versa.

To make these three elements work properly, it is critical to understand that projects like these have different aspects than hiring processes of public works (by hiring regimes governed by Law 8666 or RDC).

Concession and PPPs projects demand project finance that is different from corporate finance - an aspect that shall be considered before making the decision of joining such process.

Risk mitigators shall be carefully analyzed in contractual terms, which are provisions that must be properly interpreted before starting the process, such as economic-financial adjustment.

There are also the extra-contract mitigators, such as insurance policies (even insurance-guarantee) or bank guarantee.

### So how do I calculate the risks of an infrastructure project?

In the public-private relationship, there is a legislation, a bid's notice and a contract and these risks need to be properly identified. In these cases, there is a risk matrix determining the responsible parties for the economic and financial consequences of every risk, if it comes to happen.

There are non-manageable risks, hard to measure, price and control

and as a consequence, can't be insured against (such as political risk, exchange rate variation, expropriation, hidden vices and other) and there are manageable risks, which insurers can absorb in their contracts in technical and transparent way.

When the risk matrix is conceived, additionally to risk identification, qualification and pricing, it is also relevant to indicate what insurance type is suitable, what is the insured amount at the forecast rate, so that every insurance costs are identified at a yearly basis. Such previous analysis can be used to build the technical proposal to be submitted in the bid.

In a contract-based relationship among companies, the percentage of guarantees to be demanded from the Hired party is directly proportional to the risk of having to replace that company in case of default, for instance. It is not possible to do so in the public-private relationship, as the Bid Law (8666) established the conditions to define such guarantee percentage.

There is a bill draft being studied at Congress to raise guarantees to 30% in projects properly justifying such amounts, as from the Public Administration's standpoint, a 5% to 10% guarantee today may not be enough to pay fines in case of default.

BNDES is tempted to accept again the Completion Bond to finance wind farm projects.

This is great news to all of us, as it can change BNDES previous position that is to refuse this Insurance-Guarantee in pre-completion phase.

Long-term financing demands differentiated guarantees, such as corporate guarantee and bank guarantee, more expensive than the Completion Bond and also commits companies credit limit.

### Mid-sized companies shall invest in training.

The main problem is that many executives working in the infrastructure sector remember of risk mitigation, business plan and risk matrix by the time of drafting the technical proposal, when actually these issues should had been discussed at the beginning of the process.

In a PPP project, all players have to be well prepared and analyze each item carefully since its conception phase.

At a first moment, companies with different sizes or even activities get together to start working on an idea, analyze political, commercial, and technical questions and then form a work group that would be transformed into a SPE in the future.

Next we have the public invitation phase, when it is necessary to discuss amount of guarantees, if insurance rating is needed, if the provision defining the amount of the guarantee is in line with Susep (Private Insurance Superintendence or Superintendência de SegurosPrivados) instructions and other aspects.

Also, the lender wants to make sure that the insurance and risk mitigation process is suitable if something happens that may “shake” the project structures and guarantees.

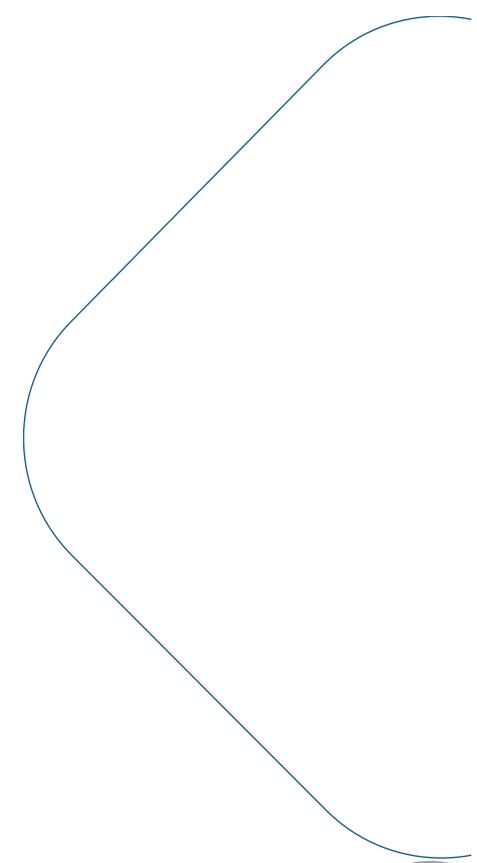
In the operational phase, there is also a required package of insurance policies and guarantees, as many bid's notices and contracts clearly specify what risks there are at that point, while others only identify risks in a matrix delivered at the time of proposal.

When the whole engine works properly, the process financiability improves, the shareholder is happy, the insurer is aware of all that is taking place and is also extremely comfortable, resulting in the success of the project.

Grouping supplemental companies in infrastructure consortia is a healthy and strategic practice, as it dilutes costs and risks inherent to projects of this nature.

Another key element in Concessions and PPPs is the importance of having a business plan equipped with suitable insurance policies and guarantees, making clear to all involved what the idea and the strategy are for mitigating risks during the concession period, especially in relation to guarantees.

The fastest way is not always the safest way. I heard recently about a case where a company lost the bid because it missed a requirement in the bid's notice for insurance rating and delivered an insurance policy that did not included such rating as determined by the bid's notice. The company lost the rights to the contract, which enabled the second best ranked company to sign the concession, as it was able to identify the bid's rules probably because it has done the homework.



## City of Curitiba works in seven concession and PPP projects



**Fábio Scatolin**  
Curitiba City Planning Secretary

Analyzing Brazil's economic cycles under the example of Lula administration's mistake to encourage consumption and importing in 2008, disregarding urgent investments in infrastructure and compromising Brazil's production capacity, we find that the State currently is not able to improve social expenditures, family consumption and the required investments in infrastructure.

In other words, the Public Administration lacks resources to keep an investment rate near 23%, which is the required percentage to keep investments at 5% or 6% per year.

The cycle the government starts from now on shall be based in investments, infrastructure and export promotion.

These structuring pillars may expand demand and then the supply capacity may be increased with investments in infrastructure.

It is in this context that PPPs come up, as Brazilian states have negative budgets and need, both at a state and city levels, to work efficiently to perform a fiscal adjustment and then get ready to progress in this hiring method.

PPP projects being structured by the City of Curitiba, such as the subway project, which has been considered by previous administrations and shall be put in practice through a partnership with the private sector, was launched in the administration of Gustavo Fruet in 2014, when a Procedure to Express Interest was opened to validate data and information and then a bid's notice was sat up and the bid was published.

Due to issues raised by the Federal and State Accounting Courts, this process was interrupted and is being resumed just now, in 2015.

We are discussing the last technical details with Caixa Econômica Federal and the Ministry of Cities to relaunch the bid's notice as soon as possible.

This is a project worth almost 5 billion BRL that is expected to be bid still at Gustavo Fruet administration.

Another issue being tackled by the City of Curitiba is risk management. The concession for garbage processing, stalled for seven years now due to legal proceedings, is one example.

The city hired a British consulting firm specialized in risk management to analyze the financial engineering of this project on solid waste and the technology required to implement it.

The goal is that this concession or PPP is launched in Curitiba in the first half of 2016.

### There are other four projects being studied:

- A zoo, worth between 50 million and 100 million BRL, that will be modeled as concession, following the steps of cities like Rio de Janeiro, Foz do Iguaçu and Fernando de Noronha.
- Project for a shared electric car, such as some European cities that have vehicle fueled by sustainable power. Several tests were conducted with electric cars in Curitiba and currently the city is exchanging information with the city of Rio de Janeiro to structure a PMI and launch it still in 2015.

- The Convention Center is another project being structured by Curitiba and has alloted 50 million BRL for CAPEXs from the Federal Government. According to the secretary, as soon as an integrated RDC is launched, the city will also launch a concession to operate this project, aiming to become a business center to serve not only the State's capital but also cities in the metro area.

- There is a project to build an administrative center. The city government spends some 40 million BRL a year with rent, travel between offices and building maintenance costs. With the new project, the city would be able to pay in 10 or 12 years an administrative center at 400 million

or 500 million BRL in CAPEXs.

- In healthcare, there is a project for operational management, encompassing from hospital management to diagnosis systems. The city is analyzing the possibility of launch a PMI in this healthcare field.

I would say that the hardest part for cities is not financing but structuring an effective guarantee fund, as cities lack support from State and Federal Administration, which creates difficulties to process to make concessions and PPPs happen.

If there were any entity to support such guarantee funds at a city level, certainly cities would have more conditions to make their projects flow.

**“The new cycle the government starts from now on shall be based in investments, infrastructure and export promotion.”**



## What PR did to convey dependability to the market



**Samuel Suss**  
Director, Fomento-PR

Convey trust to the market is critical. One of the main problems related to dealings with public administrations is that the private sector feels insecure about the government's capacity of payment of commitments made in the contracts.

Concessions and PPP open a new phase to this relationship as they demand guarantees from the Public Administration, improving security for companies to make long-term projects with the State.

In this regard, any public manager intending to launch a PPP program in Brazil needs to show the market that it is a good payer and that is willing to fulfill agreements irrespective of whoever may be leading the public administration as contracts will be valid through many terms.

Paraná government, due to a decision from governor Beto Richa, decided for a PPP structure that would show a list of guarantees that are effectively compatible with the security expectations from the private sector.

One of these instruments is the PPP guarantee fund. He explains that a law governing PPPs was passed in Paraná in 2012, listing the public-private partnership guarantee fund.

In 2014, the State created an alternative model for guarantees based on net resources that may be executed immediately by the private partner.

In the same year, a law appointing Fomento-PR as manager to the

PPP guarantee fund was passed. A decree regulating the PPP guarantee fund was issued and a management council meeting took place to approve the fund's bylaws and regulation.

Fomento-PR took an important role in this context. Until 2011 there was a huge potential for the institution as it owned net assets originated from the sale of state-owned Banestado bank in the light of bank privatization under Fernando Henrique Cardoso's administration, which provided an expressive volume of resources in sovereign debt.

But this potential was not much explored by previous administrations. Thus, across a decade, Fomento was being capitalized and building up net assets. As CVM (Brazil's Security and Exchange Commission) did not authorize Fomento to manage funds as Fomento does not qualified staff for this, it was decided that Foment would manage the fund and an administrator (Caixa Econômica Federal) was hired to directly manage fund's assets and obligations.

The guarantee fund is of private nature and has assets segregated from their quota holders - the State of Paraná government itself and the Economic Development Fund, with the sole purpose to deliver guarantees for payment and cash obligations to private partners.

It was structured to be independent, avoid interferences from the administrator and as waterproof as possible to decisions and government changes that may impact its dependency.

## Several revenue levels

There are resources from the Economic Development Fund - 5% of the revenue from the State Participation Fund goes directly through the escrow account to the guarantee fund.

A D+1 term is given to check whether a valid contract has any outstanding obligation.

If no obligations have to be paid to a private partner or PPP, these resources are returned to the State's Treasury. Such flow is controlled by the fund's own administrator.

Another source is preferential shares of the state-owned power company Copel and the state-owned sanitation company Sanepar.

Dividends from ordinary shares and the preferential shares themselves are bound to the fund. Dividends are also sent to the escrow account, and the administrator checks if there is any contract in default or any execution of any private partner. If there is none, such resources return to the State's Treasury, also D+1 or D+2 deadline.

The escrow account in connection with the guarantee fund is under fiduciary alienation to the private partner. If a company is not paid by

the State government, it relies in an execution mechanism that does not require any action by the manager. As Mr. Suss explains, if the Public Administration enters default, the private partner sends a notification to the fund manager, who withholds resources and transfers required for each contract.

Under this model, the State government conveys to the market that has the intention to pay all commitments made in the PPP system.

## But would the State government lose 5% of the State Participation Fund?

The answer is no. By behaving responsibly, all resources are returned in the next day. Such model can also prevent future administrators to agree with obligations above their capacity, as such guarantee mechanism impacts the State revenues if excesses are made, since we are talking about economic rights of virtually all ordinary shares in possession of the State of Paraná.

Within PPPs, Samuel Suss highlights that there is currently one contract signed - the duplication of PR 323 highway. The transfer of highway's management is about to take place, waiting for some paperwork on the grant of shares owned by the State.

**“Concessions and PPPs bring a new aspect for this relationship as guarantees are delivered as guarantees from the Public Administration, enhancing security for companies to engage in long-term projects with the State. ▾ ▾**

## Banco do Nordeste performance in long-term financing



**André Bernard Ponte Lima**

Director de Negocios del Banco del Nordeste

The role of Banco do Nordeste, manager of Northeast Financing Constitutional Fund (FNE), is to support long-term financing to develop and increase revenues, job creation and income in the region. FNE is the main Banco do Nordeste's funding. SUDENE is in charge of managing FDNE (Northeast Development Fund), because Banco do Nordeste is a financial institution. The bank owns a multiple portfolio and also provides short-term financing in several lines to supplement long-term financing.

### PROINFRA - Infrastructure Financing Program

The institution develops two programs, one of them is called PROINFRA (Infrastructure Financing Program).

#### This program finances:

- Works for expanding the power grid only for the venture's own consumption.
- Transportation and logistics infrastructure, i.e., the construction and maintenance of streets, avenues, highways with the goal to move produced goods and/or passenger transportation;
- Offer of high quality water for multiple uses (urban consumption, irrigation and so on).
- Sanitation work.

The target audience for this program are corporations registered at the Trade Association, consortia constituted to manage the financed venture and state-owned companies not depending on financial transfers from Public Administration.

### Program for Financing Commercial and Service Sectors

Another program provides financing to Commercial and Service sectors, also using FNE resources to support private sector's investments carried out through Public-Private Partnerships, such as schools, hospitals, prisons and many more.

This resource can be employed in expenses with construction, renovation and expansion of facilities; acquisition of machines, equipment and utility vehicles; furniture and utensils; elaboration of environmental studies and investments determined by conditions in the venture's environmental permissions.

The target audience for this program is companies registered in Trade Associations of all sizes.

#### And what are financing conditions?

In relation to the maximum financing amount, the Business Director explains that the bank can finance up to the approved limit or according to the investment to be made, considering capacity of ability to pay, the venture's location and the size of the company.

Maximum payment term is 12 years, including 4 years as grace period. Charges are basically a couple of fees, depending on the company's yearly gross revenue. The rate is 8.24% p.a. without a bonus - the rate is 7% p.a. with bonus included, for companies with yearly gross revenue up to 90 million BRL.

The rate is 11.18% p.a. for companies with yearly gross revenue above

90 million BRL (no bonus) and 9.50% p.a. (with bonus).

### What are bonus?

It is a 15% discount for paying installments in time over the interests applied to the moment of payment. If paid in time, the rate falls from 8.24% p.a. to 7% p.a. and from 11.18% p.a. to 9.5% p.a.

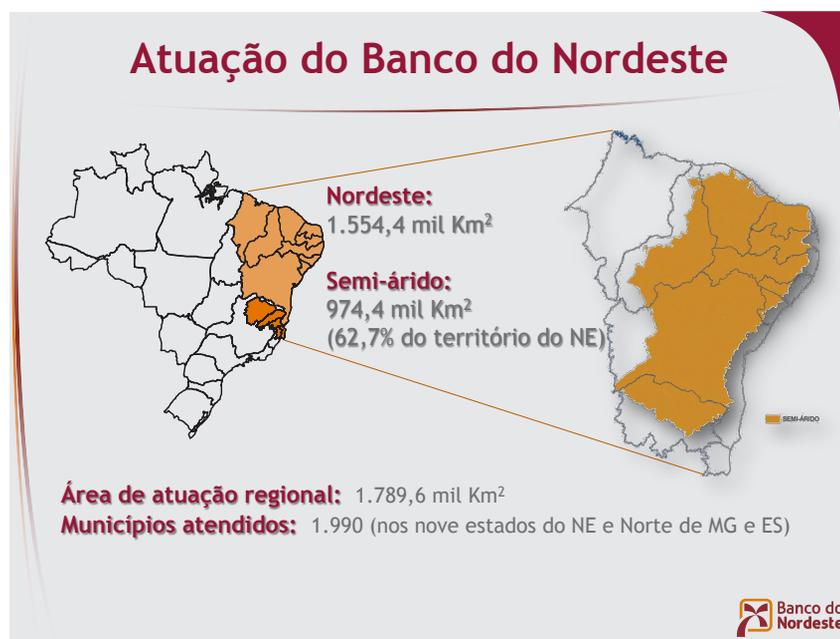
As resources are transferred from FNE, taxes such as Tax on Financial Transactions (IOF) applying on all financial operations in Brazil, are not applicable.

### Guarantees

Banco do Nordeste provides traditional guarantees (that may be cumulative or used alternatively) and is willing to discuss non-traditional guarantees according to each case and aspect.

- Mortgage.
- Bank guarantee.
- Fiduciary alienation.
- Pledge.
- Guarantee with surety from partners.

**“The role of Banco do Nordeste, manager of Northeast Financing Constitutional Fund (FNE), is to support long-term financing to develop and increase revenue generation, job creation and income in the region. ”**



## The importance of relying in expert, experienced insurance advisors



**Bruna Timbó**

Partner-Director, LTSEG Corretora e Administradora de Seguros

The relevance of insurance to PPP projects is increasing especially with the participation of expert, experienced advisors in this topic in the service, brokerage, consulting, and management of insurance policies.

Insurance must be seen by companies and risk managers as an investment as opposed to an expense, but unfortunately many companies only realize the need for getting insured after win the bid, when the project is already planned financially - not adding insurance costs to the budget - or when an event causes significant losses.

It is worth mentioning that the insurance shall be included in the daily corporate management in every projects (from the budgetary phase), as it can save not only a specific PPP project but the company itself in case of a large event.

Insurance policies available in the market for concession and PPP contracts are created specifically for each case, i.e., tailor made, by deep analysis of all project's characteristics.

What every agent (public and private) involved in the process needs to know is that a specialized consulting firm is required in this areas.

### It can be approached twofold:

- The first one is the lack of a clause on insurance in the PPP contract minutes or the inclusion of a clause simply mentioning the need for hiring this service without any specification of product and/or coverage.

This method, less complicated, is quite common because usually

the State plans or modulates the project and also forgets to include insurance.

The consequence of this approach (lack of a provision on insurance or an insufficient clause on that matter) are insurance policies without parameters, poorly elaborated, hired and budgeted for, generating doubts and uncertainties as for the effectiveness of its coverage in the case of an event, which is, finally, the event for which the policy was bought.

Ideally in this case, is to look for a broker or an expert in the matter, familiar not only with project risks but also with the details of Public-Private Partnership and public bid projects.

It is interesting that such broker or subject-matter expert have a legal department in the organization, as PPP and public bid projects are generally based in documentation analysis and legal questions, which have legal relevance and many times outline insurance policies required by the projects.

An expert in this type of demand knows, for instance, that lacking an insurance clause then it is necessary to analyze at least the obligation and responsibility clause, where risks to be insured must be detailed.

The other approach would be the existence of an insurance clause in the PPP contract minutes, which may also be presented in two ways - the first a clause with a comprehensive list of insurance policies for every phase of the project - construction and operation - which would be unseen, as it was

said before, the Public Administration would not only leave insurance aside as is not staffed with experts to advise in this matter.

- The second approach would be a more comprehensive clause but with an illustrative list of insurance policies considering some items as a minimum for mandatory acquisition to protect against project's risks.

LTSEG has participated on the modulation and hiring of more than 20 PPPs nationwide and until not have not seen a clause with a mandatory list of insurance policies for all project phases - construction and operation, which the companies credits to the lack of specialized advice and technical capabilities by the Public Administration to foresee risks and insurance policies to be sold later, as concession periods are usually long.

**For informational purposes, she highlights that a comprehensive list of insurance policies elaborated after deep study of the project aspects shall take into account the following products as a minimum:**

**Bonds (guarantees)** – bid bond, performance bond, completion bond, forward guarantees, legal guarantees, and so on.

**Benefits** - collective life insurance, healthcare insurance, dental insurance and others.

**Property and Casualty** - protection of assets of all parties, especially creditors, investors, Conceding Power, SPE for all project phases (construction and operation).

**Financial losses** - ALOP (Advance Loss of Profits), DSU (Delayed Start-Up), and others.

**Responsibilities and Financial Lines** - D&O (insurance policies for officers), E&O (professional civil responsibility insurance), among others.

**LTSEG presents projects under the PPP model**

Among PPPs that LTSEG helped develop is the Porto Maravilha project, first concession (under Public-Private Partnerships) in urban areas in Brazil, with a 15-year contract to renovate, operate and maintain Rio de Janeiro's port district (Rio de Janeiro Special Urban Interest Area) and investments totaling 8 billion BRL. It is a 5 million square meters' area encompassing three districts (Santo Cristo, Gamboa e Saúde). legally designed for the concession area.

In the contract minutes for this project, there were an insurance clause that mentioned the list in the bid's notice Appendix 10, but such appendix never existed. In this case, a meeting with the SPE, comprising three companies, was necessary to understand the concession structure, identify relations that would require insurance contracts both at the construction and operation levels - that would be extraordinarily performed concurrently - and finally elaborate the best insurance program, considering the project's specific risks.

The insurance program that was structured was implemented and is still in force, and its effectiveness was evidenced by paying 100% of claim indemnifications for all events that occurred.

**“It is worth highlighting that insurance shall be added to daily corporate management in every project (since the budgetary phase) as it can save not only a specific PPP project but the company itself in case of a large event takes place.”**



“ **Companies and public managers shall pay attention to insurance and hire brokers and consultants as projects of the size as the ones I mentioned must be analyzed and elaborated by specialized, experienced professionals to obtain an excellent insurance program, efficiently suited to the proposed risk.”**

#### Line 6 of São Paulo subway

Line 6 of São Paulo subway was bid in 2014. This is a concession under the Public-Private Partnership for the public service of transporting passengers through Line 6, contemplating implementation, operation, preservation, maintenance and expansion within the terms and conditions determined by the concession contract (25 years). It is a fully underground line with 15.3 kilometers and 15 stations (from Brasília to São Joaquim), two Shields and investments estimated in 23 billion BRL.

For this project, our team analyzed all available documentation, elaborated a comprehensive risk matrix considering all technical, legal and operational details and, according to the results in the matrix, developed a series of reports such as the Potential Maximum Loss in case of catastrophe, that were used to structure the insurance and coverage program.

In this project, construction and op-

eration would be performed in sequence, which initially simplified the insurance program. However, the investment in the project was so large that in addition to the relationship between the SPE and the Conceding Power it was also necessary to analyze the relationship with investors and lenders, which have determined on top of all insurance policies specified, the acquisition of ALOP insurance with coverage for loss of expected profits and a DSU insurance, that protects against financial consequences of an event occurred with transportation of materials, equipment and inputs that may delay the start of project operation.

I urge you, businessmen and public managers, to pay attention to insurance, to hire competent brokers and consultants, as projects of the size as I mentioned must be analyzed and elaborated by specialized, experienced professionals to create an excellent insurance program, efficiently suited to the risks proposed.

# BF Capital's view on financing and guarantees

Based on a deep view on the topic, working for a company that has implemented financial solutions and advised more than 48 PPPs executed or being executed in Brazil, providing consulting services to infrastructure projects and operating throughout the business cycle, from the concept until the financing, I stress that the time is ripe for this model in Brazil.

These are usually long-term projects with 25 to 35 years long, with significant investments (ranging from millions to billions as in the case of PPPs).

But to make projects feasible, the company has to mitigate all risks and pursue return rates in line with large projects.

BF CAPITAL has been working with BNDES and Caixa Econômica Federal, leading institutions in financing large projects in Brazil and largely influential on defining procedures and allowing for other development banks to operate in this segment. Also, aligned to this, regional banks have relevant participation in this context.

In the relationship with Caixa and BNDES, the financial consultancy proposes new financing lines with higher leverage and also at better rates to develop these infrastructure projects, usually reducing debt costs when compared against other commercial banks, and with longer period for payment.

### Project Finance

It refers to financing an economic unit where the lender considers economic unit's cash flows and rev-

enues as source of payment and the unit's assets as collaterals for the operation.

It is very difficult to finance projects in Brazil without any resources from the shareholders, in terms of guarantee.

In Britain, for instance, they can develop a project finance within three months, and the shareholder gets the money within two or three months, not to mention the bid that may last for two or three months as well. In six months, the British can develop a project and have the money - a reality that is very distant from us here in Brazil.

### Assessment of risk and guarantee of financing

Pre-completion - existing guarantees in the period before construction.

Post Completion - guarantees required for construction.

There are potential, significant risks during the construction phase that are inherent to engineering processes, that may be protected against with the acquisition of insurance.

It can happen, for instance, that the work is a bit larger than expected, which occurred with some stadiums built for the 2014 World Cup - and the result is Brazil having the more expensive stadiums in the world, even if compared against Germany, adjusted to inflation and exchange rate.

### Guarantees

What banks can request at the Pre-completion phase:

- Pledge of SPE shares, a basic assumption,



**Jacy Prado**  
Partner, BF CAPITAL

**“ We have advised an important PPP in São Paulo, related to My Home, My Life (Minha Casa, Minha Vida) program requiring 1 billion BRL in investments and the bid winner was a company with revenues of 500 million BRL. Usually there would not be room for this company in projects that large.”**

- Corporate Surety, Bank Guarantor ESA
  - Insurance Pack for the Construction Contract (“EPC contract”)
  - Opening of Reserve Account (debt service for n months)
  - Fiduciary equipment property
- And in the Post-Completion phase:
- Pledge of SPE shares
  - Fiduciary grant of receivables
  - Insurance Pack
  - Operation and Maintenance contract pledge
  - Opening of Reserve Account (debt service for n months)
  - Fiduciary equipment property
  - Covenants

#### Scenario of opportunities for smaller companies

Some large Brazilian companies filed for bankruptcy because they got involved in corruption cases investigated by Lava Jato Operation.

As contracts for PPP projects demand that the company must have a healthy balance sheet free of le-

gal issues, this opens a range of opportunities for small and mid-sized companies.

We have advised an important PPP in São Paulo related to the My Home, My Life (Minha Casa, Minha Vida) requiring 1 billion BRL in investments and the bid winner was a company with 500 million BRL in revenues. Usually there would not be room for this company in projects that large.

#### Project Rating Company Rating

Although many companies go to development banks after establishing their Concession or PPP, but the best to do is to go to the lender when the project is being designed so its financial feasibility can be analyzed early on.

Financial institutions shall be contacted to rate the project and the company before the auction. Supplements for the project's debt shall be aligned to this, as the new scenario for infrastructure bonds has been quite promising to enhance a project's financial solution. BNDES has moved towards this goal by encouraging such projects and adding these bonds to its portfolio when ever possible.

# An infrastructure project is a large network of contracts

Based on the broad experience of Albino Advogados Associados law firm, working for 25 years in this sector, I can say that the PPP model is based upon a large network of contracts.

Our law firm works in this segment even before the passing of the PPP law and have actively joined partnerships by working with several states, such as the PPP for Hospital Regional Metropolitano, in Ceará, Arena Castelão stadium and others, having a wealth of knowledge about the process.

For this reason, based on such expertise, I compare an infrastructure project with a large network of contracts.

To have a successful PPP project it is necessary to gather stakeholders from the beginning of the process, at structuring the project, harnessing all required competencies, insurance brokers, financial advisors, legal advisors - everyone shall input their analyses for the feasibility of the project.

Usually, this is one of the biggest mistake made across the process: To believe that experts are necessary only at the end. "It is necessary to add up expertise to maximize the potential for success."

He highlights that it is critical that the Public Administration, SPE shareholders the project lenders feel comfortable about the project risks, that must be previously mitigated, to provide several security mechanisms in the contract for all players.

He stresses that everything starts at the Conceding Authority, as the concession contract shall make the

whole contract network feasible:

- 1) Allowing whenever possible that project's revenues are obtained directly from users or segregated in an escrow account with restricted movement, to pay for hired services;
- 2) Allowing lender's access to all project revenues (offering emerging rights as a guarantee, grant of future receivables);
- 3) Allowing that SPE shares are used as guarantee to lenders;
- 4) Authoring that lenders take temporary control of SPE in case of repeated defaults by the SPE, in order to restructure its financial positions;
- 5) Acquiring an insurance plan to mitigate risks that the project does not become operational (non-completion risk);
- 6) Providing contract guarantees if the payment mechanism fails for any reason (political risk, budgetary restrictions and so on) The best would be building up a "liquidity net" in an escrow account off limits to the Conceding Authority, with an adjustment mechanism from revenues that may linked (public fees or prices paid by service users; FPE/FPM; grants of other concessions; royalties; etc.)

It is worth stressing that there is a political risk, as political cycles last for four years and in many cases attempts to renegotiate contracts are made.

Thus, it is important to create contract mechanisms that work as guarantees, segregating those resources in financial institutions that



**Fabio Sertori**

Partner, Albino Advogados Associados

“ **The idea is to outsource management to financial institutions and to contracts with linked accounts, allowing for some protection.**”

guide the Conceding Authority and mitigate the risk of a mayor or governor to not pay debts made before his/her term.

The idea is to outsource management to financial institutions and to contracts with linked accounts, allowing for some protection.

A mechanism that helps in case of default and can mitigate risks is the permission to lenders to get SPE shares so these can be offered as guarantee and in case of default, lenders can temporarily and automatically manage the SPE, being freed from requesting assets to the Conceding Authority. Or still, the mandatory hiring of an insurance plan that mitigate pre-completion and post-completion risks.

#### PPPs for Hospitals

As a practical example, I mention the administrative PPP for three hospitals in São Paulo, detailing

how guarantees were structured:

1) Base guarantee (CPP Surety - 5 monthly counter payments, guaranteed by pledging Investment Fund quotas) and supplemental guarantee (commitment of Health Fund resources). Both guarantees were conditional to start counting the Concession's period and then the SPE was mandated to build the hospitals.

2) The Supplemental Guarantee is fueled by resources from the Health State Fund that are not transferred to cities, structured by pledging the Fund's revenue and segregated in an escrow account for making counter payments - only if the Main Guarantee is extinct (used but not refueled).

From a legal standpoint, is it possible to use Fund's resources to guarantee a PPP? Of course yes, as the Constitution allows reserving money to be spent in healthcare.

## Quality guarantees are critical for PPP projects

The experience of Azevedo Sette Advogados, which participated on large PPP projects in Brazil, such as São Paulo's subway Line 4, the first PPP in Brazil, allows to say that quality guarantees in projects under this model are critical.

The current fiscal crisis and the lack of capacity by the Federal Administration to inject resources into BNDES - the main source of financing for infrastructure projects - have generated some apprehension about the financing of these projects in the coming months.

Although the development bank will keep its relevant role, the participation of other financial institutions and the capital markets will be enhanced.

One solution would be infrastructure bonds, which has been used by the government by exempting income tax for profits made by individuals from acquiring such bonds.

Another solution is a supporting line for liquidity recently opened by BNDES, which is a new instrument to finance infrastructure projects and to support capital markets, where the bond issuer may finance interests paid to buyers of these bonds. The government says that the more companies access capital markets, more access they will have to long-term interest rates offered by BNDES.

Facing the current economic and political scenarios Brazil is undergoing, reflecting in more expensive and scant resources, PPPs still have an important role in developing the nation.

This because PPPs expand the eco-

nomny, generating more jobs, income and taxes. And they are a good solution for infrastructure gaps. It is known that the private sector wants and can leverage the necessary resources.

But the question is: How to attract resources for infrastructure projects, considering that Brazil has one of the highest interest rates in the world?

The answer is simple: Structuring good, attractive PPP projects. If resources are scant, then allocation is key.

### How is a good guarantee structure established?

However, a PPP needs more than good projects. It is necessary also to allocate risks properly, with clear rules about compensation, adjustment indexes and performance criteria that will be required from the concessionaire. Another relevant factor is that contracts determine quality guarantees. This is because these are long-term projects requiring project finance, a financing method through which lenders see the project's cash flow as the primary source of resources to meet the debt's service and to amortize the principal.

Public guarantees have also been used in PPP projects, which became necessary in Brazil due to Public Administration's history of delinquency, the need for mitigating risks arising from changes in political orientation and being subjected to payments ordered by courts.

They ensure payment of all cash obligations in PPP contracts.



**Bruna Bouissou**

Lawyer, Azevedo Sette Advogados

**“In my view, a good guarantee structure should ensure not only counter payments in cash and capital inputs from the Public Administration, when appropriate, but also the payment of indemnifications and possible adjustments to economic-financial balance.”**

What does the public guarantee law say? It has established that cash obligations from the Public Administration can be guaranteed by the means below:

- Revenue binding in compliance to the Federal Constitution prohibition to bind tax revenue.
- The institution or usage of special funds.
- The acquisition of guarantee insurance policies.

The legislation also saw the possibility of such guarantees being delivered by other entities than the Conceding Authority, for example international entities or financial institutions, as well by a guarantee fund or state-owned companies created for this purpose.

The benefit of a proper guarantee structure for PPP projects is enhancing value for money and benefiting all other players: For lenders, a good guarantee structure cuts financing costs and interest rates; for the private partner, a good guarantee structure is more attractive and

less demanding for getting the loan; and for the Conceding Authority, a good guarantee structure ends up in lower counter payments.

In my opinion, a good guarantee structure should ensure not only counter payments and public capital inputs, when applicable, but also the payment of indemnifications and potential adjustments to the economic-financial balance.

It is also necessary that a proper guarantee structure is able to ensure a constant flow towards the project.

In case of default, it is recommended that a fiduciary agent may transfer to the private sector the resources to pay the debt, upon being notified of Public Administration's default. And the model must also be robust, i.e., it must be able to mitigate political risks and the risk of the debt fall into the court-ordered payment regime.

But it is important to say that despite everything, there is no ideal model for structuring guarantees. This is because an acceptable, safe guarantee structure depends on the quality of available assets.

# Application of guarantees in Concessions and PPPs

Applying guarantees in Concessions and PPPs is part of the Navarro Prado Advogados expertise - something critical against the risk of public counter payment default.

First, the starting point of any investment process depends on financing, whether by its own capital or third parties' capital.

As Concessions and Public-Private Partnerships are quite new and many companies still have doubts, a convenient question is:

## Why would someone invest money in an infrastructure project?

It is certain that no one is willing to invest in unsafe projects without guarantees.

It is then mandatory to map and manage project risks, taking two factors into account:

- Concessions and PPPs are subject to many uncertainties: Demand, availability, public counter payments, unilateral change of contract by the Public Administration, project errors, lack of execution or poor performance by the Hired Party, exchange rate, inflation, interest rates etc.
- Aggravating factors
- Long-term contracts
- Large amounts
- Fragile institutions

He says that the only way to make investments feasible for infrastructure projects is to mitigate risks.

Having a proper risk management

process is critical. I would say that when we talk about guarantees we are talking about instruments to manage risks.

## Risk of Demand

The risk of demand is one of the main problems in infrastructure projects. For the BR 163 highway, from Sinop to Marituba, in the North of Brazil, there is a PMI in discussion.

There are two large risks for this project: Demand risk as it is unknown what will happen in that region in the next 20 or 30 years; and the other risk is the deployment of a railroad, as there is a proposal for a railroad next to the highway.

The risk of demand in highways is quite related to agribusiness growth and in this region, specifically, there are positive expectations. If this is confirmed, it is expected that cargo (namely soybeans) is transported by railroad, which theoretically would be cheaper.

To determine demand guarantees, Navarro states that some projects in Brazil are using demand bands (demand sharing mechanisms), such as MG 050, one of the first projects to introduce such concept.

## Public counter payment availability

In the list of most relevant risks, payment availability is the top - above all in Administrative Concessions, where the payment core comes from the Public Administration. But there are solutions for this issue. The PPP Jardins do Mangueiral housing project, in the Federal



**Lucas Navarro**

Lawyer and Partner, Navarro Prado Advogados

When the subject is guarantees, there are two very important issues to analyze: Guarantee's liquidity (the capacity to be quickly activated and the money is available) and robustness, in the sense that such guarantee covers all risks involved".

District, where Terracap (development company that is considered as the largest Brazilian company in the real estate industry) had large availability of assets and created a plan where the plot available to the concessionaire itself ended up as its main guarantee. The possibility of commercially exploring that area or some parts of it allowed for mitigation of the investment risk.

#### Counter payments

When the subject is guarantees, there are two very important issues to analyze: Guarantee's liquidity (the capacity to be quickly activated and the money is available) and robustness, in the sense that such guarantee covers all risks involved.

One of such concerns is counter payments. An example mentioned by Navarro was São Paulo subway's Line 4, which counter payment was relatively low. CPP (São Paulo Partnership Corporation) invested in public bonds within an investment fund and delivered the fund quotas in its possession as guarantee by pledging such quotas in benefit to the Concessionaire so that 100% of the counter payment was guaranteed.

This is one of the best guarantee models. São Paulo created a mechanism with a single account where all resources from Subway, bus companies are deposited and it is also determined a priority list for withdrawing - Line 4's concessionaire is the first with withdrawing rights.

#### Economic and financial adjustment

Some methodologies pursue an offset for specific risks emerging from the contract.

Other methodologies focus on inspection, disregarding specific risks and analyzing if the cost was necessary and efficient as spent by the Concessionaire.

#### Incentives for fulfilling the contract by the concessionaire

It is important to introduce incentives in the contract for its proper fulfillment.

#### I would say that two strategies bring the best results:

1) To demand commitment at the start of the project, by determining that initial capital inputs will be made in cash, which usually works best than the simple contract guarantee demand (performance guarantee), although the latter must also be demanded; other interesting thing is binding compensation to a performance assessment system.

2) It is possible to bind compensation to performance through the application of performance indicators even in Ordinary Concessions, as it was seen in the BR 116/324 highway concession project in Bahia

#### Arbitrage as guarantee

Arbitrage is a relevant issue in a PPP, although many times disregarded as a guarantee. Project finance would be the best to finance projects as its cost is low.

However, one of the largest risks is that the money is unavailable at the due time to pay the debt service, for instance. What does happen, for instance, when there is an economic-financial adjustment which is not performed seriously and quickly?

The concessionaire does not have the money to meet debt service.

One example is Goiás power company, CELG, which had a significant increase in electricity - in the area of 80%. Distributors do not generate energy but buy instead, which means that most money it gets have to be transferred. In other words, when an increase in electri-

city occurs, the concessionaire goes belly up if the transfer adjustment mechanism is not quick enough.

Arbitrage is critical for this project type. We need to work this out with public officials from states and cities, so that everyone understands that projects without robust arbitrage tend to carry higher costs.

**“When the subject is guarantees, there are two very important issues to analyze: Guarantee’s liquidity (the capacity to be quickly activated and the money is available) and robustness, in the sense that such guarantee covers all risks involved.”**



## Federal District Administrative Center - Case Study



**Anna Claudia Nascimento**

Coordinator, Federal District Administrative Center

A good example of PPP, the Federal District Administrative Center can be analyzed by several aspects: Guarantee structure, the building of a bus terminal, several proceedings that prevented counter payments, licenses cancelled and other situations that can occur in this model.

The Federal District Administrative Center was a challenging project and a model for other cities, as it is a 182,000 square meter project where all public employees in Brasilia will work, placing the Federal District administration in a single place.

The project aims to accommodate 15,000 public employees, reducing costs, improving work conditions and enhancing the quality of services delivered to the population. It is also good news for the public budget: It is estimated savings of 9.5 million BRL a month, which could be spent in other demands in the city.

Environmental concerns were also taken into account in the Administrative Center, such as saving water and power. The Administrative Center is located in the Southwest area in Taguatinga, some 20km from Brasilia's downtown. Another highlights are the Convention Center, Event Rooms and a Gathering area with leisure and stores.

The project was launched in 2007 by a Procedure to Express Interest; the bidding process occurred next year and then the contract was signed in April 2009. Works started in January 2012 and guarantees were granted in December of the same year.

### Guarantees for the

### Administrative Center

Works had already started by December 2012, as the contract was signed in 2009. The two concessionaires decided to start the works with their own capital, as financing risks were borne by the SPE.

In 2013, the Federal District government granted the service order and loans were granted by Caixa Econômica and Santander. By mid-2014, 31% of the works were delivered, corresponding to the project's first phase. By the end of that year other buildings were completed, corresponding to 56% of the whole expected built area. However, works were interrupted in February 2015 at 98%. In September, guarantee contracts were terminated.

Article 8 of PPP Law allows that a guarantee be provided by a state-owned company created to this purpose. That is what happened in this project, where guarantees were provided by TERRACAP, Federal District Development Office, a state-owned company that executes real estate transactions in behalf of the Federal District, comprising the use, acquisition, administration, disposal, development, and asset encumbrance or alienation.

The bid's notice requested guarantees at 900 million BRL in plots of land and 508 million in receivables, which corresponding roughly to 60 counter payments (5 years) at that time. It would be the best of both worlds if a guarantee covered the whole period, but the practice are shorter periods for guarantees. In our case, guarantees provided cover counter payments for the period of five years.

In this guarantee system, clients acquire plots of land from TERRACAP and pay the company through an escrow account. Receivables to complete 508 million BRL are deposited in a CENTRAD escrow account and after that amount is reached, resources flow to TERRACAP. The Federal District makes the counter payment to the CENTRAD escrow account, which pays lenders.

#### There are two possible scenarios for guarantees:

1) Federal District payment: TERRACAP grants CENTRAD an amount corresponding to 60 counter payments that is deposited in the escrow account and before the operation starts, a “liquidity net” is built up to match three counter payments. This reduces the stock of receivables to 57. A monthly deposit of an amount corresponding to one counter payment and a half is done, reducing the counter payment to 55.5. At the payment date, the government makes a counter payment to CENTRAD and then the amount in the escrow account (equal to 1.5 times the counter payment) is transferred automatically to a TERRACAP’s account. The escrow account remains with a balance corresponding to three counter payments. According to the contract, such receivables can only

reach the equivalent to 54 counter payments, when TERRACAP has to return to 60 counter payments.

2) District Federal defaults: TERRACAP grants 60 counter payments before the start of the operation, deposit the three-counter payment “liquidity net” and also one counter payment and a half on a monthly basis. If a counter payment is not made to CENTRAD, then an amount equal to the counter payment in default is withdrawn from the escrow account and transferred to CENTRAD. This way, the escrow account holds the resources until the Federal District government resumes payment. Again, it cannot reach 54 counter payments. When the amounts reach 54 counter payments, TERRACAP has to constitute again the amount corresponding to 60 counter payments.

#### Project financing

Federal District Administrative Center is an Administrative Concession encompassing construction, operation and maintenance. The project contemplated the best and most updated Engineering techniques, already considering the maintenance that will be performed during 21 years.

The LEED certification was one of

the main aspects of financing. One negotiation for obtaining financing took place with BNDES, which was very interested to provide financing works based on sustainability concepts internationally certified.

#### Barriers

There was a bus terminal next to the Administrative Center. It had to be rebuilt in another place to give room to the Center. This raised questions from CaixaEconômica which ended up complicating the work financing. The Concessionaire borne the costs for speeding the process and now awaits reimbursement from the Federal District - who should deliver the area ready to build.

The companies that won the bid invested almost 220 million BRL without financing until June 2013, when CaixaEconômica and Santander granted their loans.

Finally, I believe that the Conceding Power does not understand how guarantees work.

The Conceding Power believes that TERRACAP must make counter payments. They do not understand that the amounts are withheld and are used only if the Federal District defaults.

## How to create financing mechanisms in addition to traditional ones?



**Maria Eduarda Gouvêa**

General Director, Estruturadora Brasileira de Projetos (EBP)

EBP is a non-public stock corporation headquartered in Rio de Janeiro that supports governments at all levels to structure projects considered as of public interest.

The organization coordinates and integrates efforts on surveys, research and feasibility studies for Concessions and Public-Private Partnerships to be bid by the State.

Structuring projects under this model is a complex process involving technical, economic-financial and legal analyses as well as the ongoing articulation with several players to understand their interests and potential conflicts.

All these jobs cover a single context, which must interact across the structuring process to reach a suitable outcome. Such interaction and integration of several fronts requires the coordination of an information flow among all players in a project.

There is no PPP without clarity on financing, for starters, and if the government does not structure guarantees properly. When a project is forwarded to the EBP Board of Directors, comprising members from nine banks, the first issue an-

alyzed is the range of guarantees from the State.

In my opinion, as Brazil faces a liquidity crisis caused by politics and the economy, it is necessary to create a financing model with larger participation by the private sector. Recently, BNDES is tying loans under the Long-Term Interest Rates to bonds, which is a win-win situation that enhances capital markets.

There is a series of challenges that needs to be sorted out, such as high interest rates that add extra costs to projects. Investors are submitted with greenfield projects, with a large risk from construction until completion, and they require a proper return rate that is compatible with the investment.

There are also brownfield projects, a series of concessions that have already progressed to the construction phase, where risks are mitigated and investing becomes attractive as the works are mature.

So there is a need to create financing mechanisms other than traditional ones to allow for Brazil to diversify the profile of investors.

## Potential solutions to finance infrastructure projects in Brazil

Challenges are plenty, as well as solutions to finance infrastructure projects in Brazil. When looking at the situation of the financing market in Brazil, with BNDES as the main lender, we see that the bank's loans have grown at an average yearly rate of 17% since 2005, and the pace shall be maintained in the coming years.

Infrastructure got the lion's share of loans, with 37% of 190 billion BRL lent by the bank in 2014.

Unfortunately, such growth is not sustainable as interest rates rise. By comparing the evolution of SELIC and TJLP, it is possible to see a gap widening among both interest rates curves, causing loans on TJLP to become unsustainable.

Despite the hardship Brazil is going through, mainly due to the so-called Brazil's Risk, Faria proposes that the BNDES can facilitate private lending, following an international trend for development banks.

There are other financing sources than the BNDES, but these are still limited. In 2014, bonds had a significant growth, but those were issued for existing or brownfield projects, with the construction phase completed. Their usage for greenfield projects is still low and will remain low in the next years.

Also, infrastructures bonds compete against Treasury bonds, which have attractive yields.

Why would an investor buy an infrastructure bond with risks (which become bigger in construction phase) if the Treasury Bonds yield inflation plus 6% or 7%?

Facing such situation, I highlight a set of factors to overcome current bottlenecks for financing infrastructure projects:

1) Improve the environment to develop infrastructure projects.

It is very important to improve project structuring and its risks. This reduces the need for lenders and the BNDES to demand guarantees during the construction phase. For this, a strong Public Administration is required, with resources to hire good consulting firms to reduce the dependency on PMIs.

2) Share financing models with limited resources with BNDES.

Standard & Poor's reported by the end of 2014 a history of all ratings for projects in 20 years (573 ratings), where defaults were found in project finance contracts without resources or resources limited to shareholders in 7% of the sample - a percentage quite similar to another study from Moods dated to 2012, which also considered a 30-year history and found that defaults on projects structured without guarantees or limited guarantees were very small.

Thus, there is a point to be made to convince lenders as BNDES to release guarantees even during the construction phase. This is a potential path once the quality of projects improves.

3) Guarantee models to ease private financing

The third way is to improve guarantees offered by the Conceding Authority or by lenders.



**Fernando Faria**

Partner, Infrastructure and Projects,  
KPMG

“**We understand that there is a transition to a liquid private market.”**

There are some solutions that may meet the BNDES desire to scale down its liquidity efforts in infrastructure projects to encourage the private market, where the bank takes the role of insurer of credit from the private market.

In his view, this measure may attract individuals to invest in greenfield projects, as such credit improvement - whether by an institution like BNDES, state government or the Ministry of Economy, creates better conditions for individuals to invest in bonds like these. “We understand that this is a transition to a

liquid private market,” he believes.

4) Tax incentives to investors in infrastructure projects

Commercial banks, as in other countries, must be encouraged to participate in the infrastructure market. Such incentives may be tax related or by easing the regulatory capital of banks, as infrastructure projects weigh on in their balance sheets.

The impact on fiscal adjustment would be offset by the impact of larger investments in infrastructure over the economy.

## BANDES bets in Participation Investment Funds

The operation of the Espírito Santo Development Bank (Bandes) that for 50 years has been the government's main instrument to attract investment and develop the economy of the state will be the foundation of my speech.

I explain the mechanisms adopted in this period, as the DL-880 - a federal-state fund for financing and subscribing bonds - and the FUNDAP, a financial fund fueled with resources originated from import taxes.

in my view, currently BANDES is facing the challenge to reinvent itself to remain relevant in the Espírito Santo development for the next 50 years. I don't believe we will rely on tax resources.

BANDES is focused on financing low average tickets and to be an intermediary for BNDES. We are a bank with a 1 billion BRL portfolio and assets near to 400 million BRL.

Our yearly budget is almost 380 million BRL with an average ticket ranging from 100,000 BRL and 150,000 BRL, focused on smaller, rural operations.

The institution lives basically in administration fees charged from intermediary services between BNDES and Finep (Study and Project Lender) and the remaining FUNRES balancem now named FUNDES.

For the next years, I believe in risk operations such as FIP (Participation Investment Funds) operations. He mentioned some FIPs in his state - both created by BNDES, such as the CRIATEC - one of the best private equity funds created by the BNDES to capitalize very small and small innovator companies.

There are resources to invest in new markets with yields above SELIC, but the problem is to convince the investor that the product is well structured and profitable, even the long-term ones with regulatory risks.

With fiscal resources exhausted, we need to learn how to work with the capital markets and to negotiate risk operations. There is money, there are several funds, even abroad, willing good, profitable projects with legal security and proper guarantee funds. That is what we need to do.



**Luiz Paulo Vellozo Lucas**

Director-President, Banco de Desenvolvimento do Espírito Santo (Bandes)

## BNDES creates department to study Concessions and PPPs



**Marcelo Marcolino**  
Representative, BNDES

Based on the assumption that infrastructure problems in Brazil depend on long-term investments, that may largely take place as Concessions or Public-Private Partnerships, the BNDES has created a department solely to foster and structure projects that has been eight years in operation. Facing the complexity of such ventures, the department provides technical advising and support to governments for developing and implement public policies.

The department's mission is to foster Concessions and PPPs, enhance mechanisms that allow for the support from independent consultants (PMI and Hiring) and to create facilities focused on the preparation of infrastructure projects to strengthen government internal teams.

PPP's has to be seen as a real solution for the nation, but not as a universal remedy. This is a concession of a service of public interest that is executed by a company, which has evidenced that has conditions to add more efficiency and agility to the service than the Public Administration has and for this reason shall be properly compensated.

I call your attention to the need for implementing structures processes and proper technologies to make projects that large to happen, which always involve several risks to the Public Administration, the private sector and the lender. So the BNDES has created this department that is able to identify investment needs, to foster the performance and structure of public concessions and PPPs and create conditions to make infrastructure projects happen. According to him, this also demands a sea-change on companies and the time is ope-

ning a huge opportunity for small and mid-sized companies.

We cannot allow that only a handful of companies are benefited as they are better prepared to meet the complexity of these projects; we must fulfill our role to open the market for the participation of as many companies as possible.

Facing this challenge, BNDES follows the workflow below to structure projects:

- Strategy to identify projects.
- Project preparation.
- Bidding procedure.
- Contract is signed off.
- Execution.

From the project preparation to the bid procedure, there are a series of phases to be met, starting from two large outputs:

- Bid's notice.
- Concession/PPP contract. To arrive at the steps mentioned above, a list of activities needs to be checked to make the project happen, and feasibility studies are critical at this point.

### Elaboration of feasibility studies

- Technical studies (Market, Engineering, Environmental, and Operational).
- Financial model
- Legal studies (to support Government when arguing with Accounting Court/Public Consultation).

Another relevant issue is the im-

plementation of good management practices and corporate management to drive small and mid-sized companies to participate in Concessions/PPP and remain in the process.

There is the interaction with stakeholders, that occurs out of the sheer public work contract but it is critical for players to interact at the same competency and efficiency levels, from the industry technical support until the model of the Concession/PPP itself.

To create these procedures, BNDES technicians used several practices from Australia, New Zealand, Canada and the UK as benchmarks. Solicited Proposals were identified as the main instrument to structure PPPs, through which the government identifies and prepares projects with the support of external consultants. In some reference countries, there are legal provisions preventing the adoption of PMIs (Unsolicited Proposals).

Other countries consider PMIs as exceptions and accept their adoption only under very specific circumstances (innovation and rights to intellectual property). In developing nations, such as Brazil, it was recently seen the use of PMIs and the emergence of facilities.

However, the Hiring Law (8666) is very weak and don't even allow us to hire external consultants to improve a project's quality. This is a huge concern for the Public Administration. In some reference countries, there are legal provisions to prevent unsolicited proposals, which are called PMI in Brazil, and despite there is a government request, we understand that it starts from a express of interest by the private sector and follow

the flow of Requested Proposals, such as happens abroad.

### Worldwide ranking

But the lack of good projects is not happening only in Brazil as bottlenecks in infrastructure investment happen at a global level. Governments around the world using PMIs reach a success rate of 4% in their projects, according to a World Bank study carried out in 2014. This means that PMIs (Unsolicited Proposals) have not yet consolidated.

We saw the lack of a pipeline of good projects as a problem for financing infrastructure projects that could be reviewed and followed by the private sector and then companies could make their proposals and compete for concessions.

Today, differently from 2007 and 2008, we also have the problem of fiscal tightening, creating more difficulties to the process.

There is a trend worldwide to create and finance facilities by national and multilateral development banks to provide technical and financial support to structure projects.

### BNDES role

It is precisely this operational model for the Project Structuring Department (Área de Estruturação de Projetos, AEP) that was intended by BNDES, based upon:

- Long-Term Planning, and Project Identification;
- Project Structuring (PPPs and Concessions);
- Project Execution and Follow-up

**“Another relevant issue is the implementation of good management practices and corporate governance to drive small and mid-sized companies to participate in Concessions and PPPs and remain in the market.”**

(from the signature of the Concession/PPP contract).

BNDES proposes the creation of structures conducting independent studies, once a project's execution and follow-up are included in the bid process, when the company that won the bid needs to knock at BNDES or Caixa Econômica, or any other lender door, to proceed with the structuring of its project.

BNDES has been operating this department to cover planning and structuring phases with differentiated and highly qualified partners.

Some nationwide studies performed include those for ports and airports sectors.

The Mobility Plan for the Florianópolis Metro Area, for which independent consultants with large expertise and knowledge (DOM Strategy Partners, consulting for corporate strategy, LOGIT, focused on the transportation industry, and the Meyer Machado law firm).

Through a completed study, it will be possible to plan efforts until 2040, based on origin-destination surveys, population growth and the proposal of models.

It is worth mentioning the recent public invitation for a study on highway concessions as the Federal Government is conducting several concessions in this sector.

BNDES technicians assess that the most attractive segments are being exhausted and there is the need for a systemic planning, considering the current Brazilian highway network as an integrated system - which will be focus of a new study to be delivered within a year to the Federal Government.

We aim with that to create a rationa-

le for planning the sector and to launch a pipeline with projects that are more attractive to the private sector.

## Financing and guarantees

Some financing entities comprising BNDES projects, Marcolino mentioned the Project Structuring Fund (BNDES FEP), the Brazilian Structure Project Company (EBP) and a multilateral fund in partnership with the Inter-American Development Bank and the International Finance Corporation (IFC).

BNDEs now works in 43 Concession/PPP projects, out of which 24 are completed, 11 are in progress and 8 were halted. The impact of these infrastructure investment projects is of almost 70 billion BRL, at a success rate of 75% and average structuring time of 20 months.

This is a very short timeframe if compared to similar practices, which proves that we are in the right way, reinforcing the need for competition in auctions by the participation of several market players.

Everything becomes quite clear when the study is performed independently and not with a single interest party at the second step, which is the concession.

## For this reason, Governments need to get ready for:

- Interact with all interested parties
- Analyze all studies delivered
- Define criteria and justifications to select studies
- Consolidate all studies, which demands longer timeframes for structure.

## Lack of alignment

A huge barrier we have found is the

lack of alignment between the private sector (potential bidder) and the public interest, which gets worse by the asymmetry of information and is a Government's concern.

This may harm the auction isonomy and the private sector's commitment to deliver studies and perform changes.

Conflict of interests and asymmetry of information will always exist, once the private sector performing the study is not aligned with the Government.

But we cannot only criticize the PMI model; we need instead better regulation to use PMIs to the best of public interest and changes a bit the whole structure of barriers to fulfill the Law, which was always pursuing transparency at the internal phase of the bid by making public all conditions that based the concession assumptions upon.

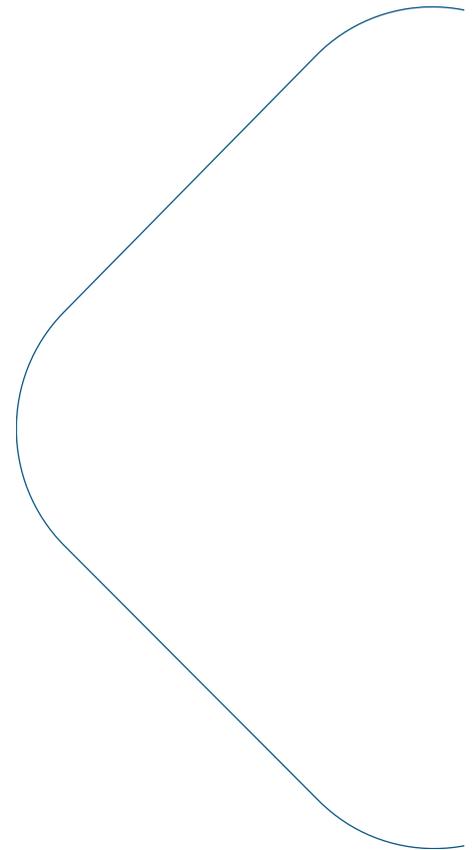
Delays in Federal Government's PMI, like the Rio-Niteroi Bridge, that was launched in January 2014, were

caused by asymmetry of information and barriers from a complex legislation, which has been systematically contributing for delays and lack of hiring of a large number of concessions in Brazil.

To prevent this, the State of São Paulo developed a platform that grants the study to an independent entity provided that such entity is not joining the bid, thus enhancing competition.

Finally, I highlight the need for enhancing government's internal teams that remain with low execution capacity; enhancement of regulation mechanisms, such as PMI and the Hiring Law itself; and financing guarantees, which is another big issue.

The nation undergoes a critical moment to change paradigms and small and mid-sized companies shall enhance their governance and the structure of their projects so that we manage effectively to develop Brazil. Otherwise we will remain with low numbers and decreasing rates of investment in infrastructure



## The importance of insurance of concessions and partnerships in Brazil



**Luis Claudio Galvão  
Barretto**

Vice-president, Odebrecht Corretora de Seguros

The importance of the insurance-guarantee market for infrastructure projects in Brazil is the core of my speech due to my job at OdebrechtCorretora de Seguros (OCS), that supports all business from the Odebrecht conglomerate in the area of risks, insurances and guarantees for more than 35 years.

As happens everywhere, companies cannot provide corporate guarantees to Project Finance. In a country so big as Brazil, where projects are extremely large and complex, this becomes even more critical.

The Brazilian insurance and reinsurance market is critical for infrastructure projects to succeed, not only on potential terms but also for designing a framework for an investment project where it is possible to allocate risks to all stakeholders in the project, as it is done in several countries. This way, guarantee instruments found in the insurance and reinsurance markets are used to mitigate risks to lenders to these projects, especially when they are implemented.

This is not so a complex topic but it requires the interest of the parties to allocate risks in a balanced way both for the private investor and the lenders, and for other project's stakeholders that have a participation with a proper risk tolerance levels.

The issue of guarantees in the construction phase affects private lenders, private banks, commercial banks and also potential capital market investors to finance infrastructure, mentioning the critical role of BNDES in this process - despite its efforts, BNDES will always

face limitations to serve the continental dimension of Brazil.

Despite the agenda that has been deployed for years to attract private lenders to infrastructure projects in Brazil, construction risk aversion is still a barrier due to lack of knowledge, lack of domain or simply to the lack of guarantees that the project will be operating within the timeframe established and at the costs it was budgeted.

In a PPP, there is demands for public counter payments where rating agencies manage to precify and rate the project risks during the construction phase, but that is the phase that is seen as the big problem as complexities and peculiarities of each infrastructure sector may increase or decrease risk, generating a large aversion to risk on private lenders and capital market investors.

Construction, in terms of cost and deadlines, is the main risk for the majority of infrastructure projects and such risk is transferred to the contractor by the concessionaire.

For this reason, it is important that the BNDES works before the IADB to finance projects, as this is critical because the risks are transferred from the concessionaire to the contractor through a turn-key or EPC (engineering, procurement and construction) contract. In this regard, issuing performance bond by the contractor in in favor of the concessionaire mitigates the non-completion risk of the project a great deal. Such performance bond shall be a percentage of the EPC contract amount that will be benefit all project stakeholders, lenders included.

We see that there is a discussion in repeat: Private lenders will demand a performance bond guarantee at 100% or even 130% of the construction value, and the contractor is willing to provide 0. We understand that there are conditions to achieve a guarantee percentage that effectively reflects the risk the private lender is under if such contractor do not fulfill the construction contract.

It is worth highlighting the insurance market in the US, which for public works (not concessions or PPPs) has been operating for more than 100 years with guarantees at 100% of the construction contract value - the only country in the world at that percentage, as they have data that allow estimating what exactly is the risk that the insurer is under for the construction, depending on the infrastructure sector and the region.

A 2010 study, updated in 2013, conducted by the US Insurers Association, analyzed a database containing 1,785 claims (or contracts ranging from USD 5 million to above USD 500 million) where contractors could not complete the works and were removed from the projects, transferring the conclusion of the work to that suffered losses around 5% to 45% of the whole value of projects ranging from buildings to highways, hydro-electric plants and so on.

The survey is important because it brings a database from an extremely mature market from the work resuming by the insurer with many players (from the smaller, regional ones to the large multinationals) with more than 100 insurers providing this type of insurance; this market also counts on contractors specialized in taking over projects with issues in execution.

The same reality in Latin America points to a construction risk that

is transferred from the concessionaire to the contractor around 10% to 30% of the EPC contract value, in some cases a bit more, but not much far from that. I guess that this study supports this notion.

### Guarantee on Demand

Barretto mentioned another type of guarantee requested by lenders - the unconditional guarantee or guarantee on demand, usually issued by bank surety and not an insurance policy, allowing for the retrieval of the money invested. However, this model conflicts with the interests of all parties to have the project concluded and not that a check is paid every end of day.

### Performance Bond

As for the Performance Bond (Insurance-Guarantee for Contractor, Vendor and Service Provider) it is considered the guarantor, up to the limits determined in the policy, of losses arising from the Hiring Party's default to obligations agreed upon in the construction, supply or service provision contract signed between the borrower and the insured party. Risk percentage in this phase ranges from 25% to 35%. In addition to some eventual residual risks under the concessionaire's, or the concessionaire's shareholders - the so-called sponsors - responsibility, such as the equity input commitment (capital input) that these investors had to make on the concessionaire or other eventual obligations that the concessionaire did not transferred to the contractor for some reason.

### Equity support agreement

There is also the "equity support agreement" (ESA), which are commitments to input capital if problems arise in the works. Concessionaires will also have to provide performance insurance, which ensures the progress of works within the agreed timeframes. The bene-

“If the government drives Concession and PPP programs, it will be possible to minimize this recession.”

fit for construction companies is that the agreement for capital input does not directly affect the company's balance sheet.

### Insurance advisor

All of these are residual risks, and the main one is the construction risk, that is transferred to a construction company and is insured, making sure that the project will be completed, mentioning the relevance of the insurance advisor's role.

We do not see this much often in Brazil but out there it is quite common and considered as critical to attract the private sector to finance infrastructure - the hiring of insurance advisors by lenders. In this context, he also alerted to the importance of good practices in compliance for companies and the relevance of corporate governance.

The insurance advisor is nothing more than that, i.e., to bring a consultant from outside the company with experience in that industry, who knows the regulation environment and is aware of the reinsurance structure, where risks are shared throughout the market.

Finally, the insurance advisor is hired by the lender and will defend the lender's interests by present-

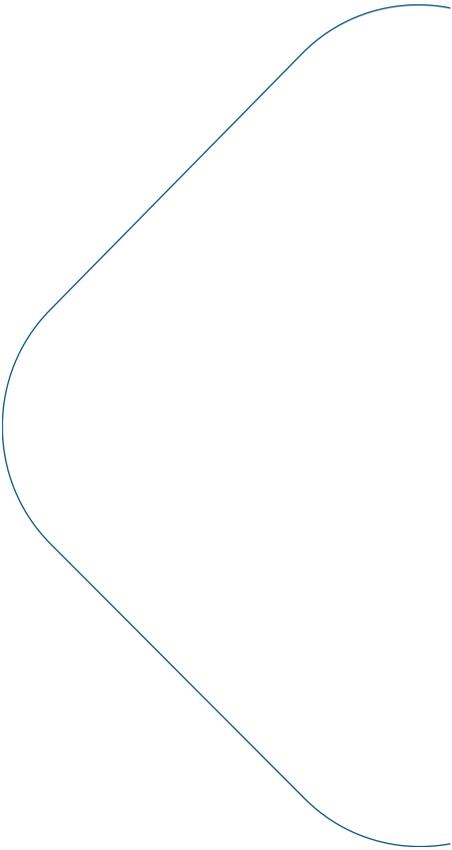
ing an engineering risk insurance program, in addition to insurance against incidents and guarantee insurance, in compliance with legislation and market practices, providing peace of mind and bringing compliance to the table, which in his opinion is really critical to attract private financing.

If the Government drives Concession and PPP programs, it will be possible to minimize this negative scenario and present by the end of next year some recovery perspectives, albeit slow.

Unfortunately, if compared against 140 countries, Brazil is the last in the infrastructure investment ranking, trailing behind Mexico, Chile, and Colombia, and it is only above Libya.

### And this reflects poorly in several and important segments:

- Water supply network does not serve 100% of the Brazilian population
- Less than half of the population is served by sanitation services
- Less than 40% of sewage is treated
- Average loss of water in Brazil is 37%.



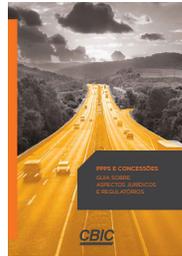
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PPPs and Concessions – Guide on Legal and Regulatory Aspects  
Year: 2016



PPPs and Concessions – Proposals to Expand Application in States and Cities  
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PPPs and Concessions – Guide for Organization of Companies in Consortia – Year: 2016



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PAC – Potential Economic Impact Assessment  
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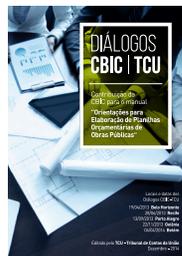
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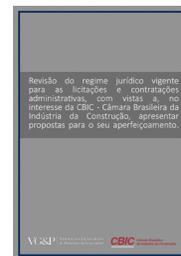
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TOPIC: ENVIRONMENT AND SUSTAINABILITY



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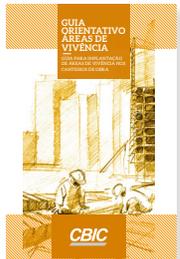


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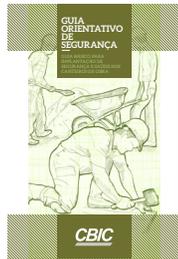
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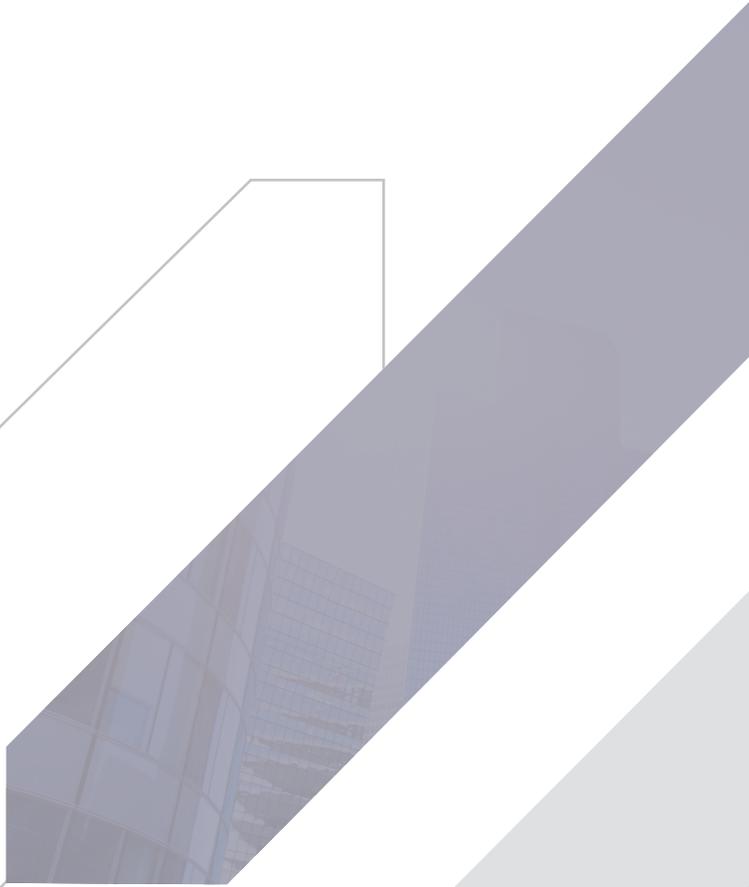
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