



Brazilian sanitation companies consider project financing for increasing investment needs

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Brazilian water and sanitation companies such as Aegea Saneamento e Participacoes (Ba1/BB) are likely to consider limited or non-recourse project finance as an option to fund massive investments needed to reach the universal coverage by 2033 outlined in their new regulatory framework, according to two lawyers, an industry representative and a consultant.

The sector has close to BRL 50bn (USD 10.7bn) in projects approved for the next 35 years, following the new regulatory framework enacted in July 2020, said Rodrigo Bertocelli, a partner at Felsberg Advogados specializing in the water and sanitation sector.

Traditionally, investments have mainly been financed by development banks, but now traditional credit lines might not be enough to meet such a large amount of investment needs in the short term, Bertocelli said.

“It is a new chapter for the Brazilian sanitation sector,” Bertocelli said. “Companies will have to seek other financing sources in the capital markets to raise the cash needed for such a large amount of investments.”

Project finance is an option for indebted companies with no room to increase debt or without enough assets to give as collateral in new loans, the consultant said. That is the case for Aegea, which won two of four concessions from the state of Rio de Janeiro in the Cedae privatization, the largest project auctioned in 2021, which will require BRL 30bn investments in the next 35 years. Another example could be BRK Ambiental, which won the auction to provide water and sanitation services in Maceio, Alagoas.

“The sanitation sector has been considered promising since the early 2000s, but it seemed to never take off — first came highways, roads and airports,” said Rogerio Yamashita, head of infrastructure for Project Finance at Itau BBA.

The time has now arrived, and there are projects requiring financial structuring in Rio de Janeiro, Amapa and Ceara, among other state concessions, in an effort that will need to bring together several sources of funding, Yamashita said. Some three or four groups that won recent concessions auctions will have BRL 45bn in debt needs.

“Project finance will be essential, because this is a heavy burden to put on the companies’ balance sheets,” Yamashita said.

 PROPRIETARY
Latin America

Utilities (Other)
Brazil

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Aegea Saneamento E Participacoes SA



The advantage is that, in general, these aren't complex engineering projects and most of them will already have cash generation from the first day under the new operator, he said, adding that this is a sector that has attracted his bank.

Although government development bank BNDES has been offering project finance lending since the mid-1990s, more recently it has been seeking to make it feasible, along with the private market, to finance operations that are less dependent on traditional guarantees, with greater risk assumptions in the pre-completion phase, a BNDES spokesperson said in an emailed response to questions.

BNDES expects to approve a BRL 25bn pipeline in sanitation, transportation and logistics that could be structured using the project finance model in the next two years, the bank spokesperson said. In the last two years, it structured two non-recourse project finance lines for urban mobility and airport sectors, taking more project risk.

Concessions already awarded and new auctions foresee large investments concentrated in the initial years under a single contract, the BNDES spokesperson said. Lenders such as government banks, the capital markets and multilateral organizations need to implement ways of co-financing these projects, considering volumes, terms and rates compatible with a long-term maturity.

Sharing and performance of guarantees, extension of terms, and loans in local currency are some of the challenges faced when structuring credit in the sector, the BNDES spokesperson said. There are also difficult characteristics in the space, such as companies that don't use an EPC agreement, projects that don't have a defined physical completion, and different municipal and state regulations, the BNDES spokesperson said.

BNDES has acknowledged that Brazil doesn't face difficulties accessing capital, but the main bottleneck is project structuring, Fabio Abrahao, its Director of Concessions, said in February at a Credit Suisse online event.

"The bank is actively seeking to attract investment, and if it is a well-structured project, it opens space for project finance, for other agents to lend, for co-lending, for other multilateral organizations, and for private banks," Abrahao said.

It is an important paradigm shift for long-term project financing in Brazil, Aegea CFO Andre Pires said at the same event. "We are closely monitoring these pioneering projects that the BNDES has been putting in place," he said.

However, there are challenges to be overcome with this kind of financing in Brazil, said Fernando Vernalha, partner at Vernalha Pereira Advogados.

“Historically, Brazil didn’t have non-recourse project finance, not because players in the market didn’t want it, but because for long-term financing, banks weren’t satisfied with the flow of projects and always demanded additional guarantees,” he said.

The main challenge is that additional corporate guarantees required of the controlling partner increase the financing costs, Vernalha said. This ends up reducing the capacity of these operators to take part or invest in new projects, because their assets are already encumbered.

“This is bad for the development of infrastructure in Brazil,” Vernalha said. “The expectation was to have a minimum encumbrance of the assets of these companies in each project so that they can participate in a greater number of projects,” bringing more competitiveness to the sector.

It is still difficult to see sanitation projects isolated from the sponsor in the recently auctioned concessions, said Gustavo Mueller, director at Fitch Ratings. There is most likely going to still be continued corporate support, even in cases where there is a separation of the concession in an SPV.

Aegea is always attentive to new opportunities, a spokesperson said in an emailed comment.

“Today, resources for investments in concessions and new businesses come from the company's cash and from diversified sources of financing, which are studied and evaluated in a way that respects the company's business model, through a detailed study of each project and responsible investments,” the spokesperson said.

by Fabiola Gomes

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