3 April 2013

Roundtable on some aspects of public-private partnership development in Kazakhstan

The topic
Kazakhstan has yet to see public-private cooperation result in the implementation of socially important projects in transport, power, municipal services and social infrastructure – the sectors the Government is traditionally responsible for. The state has yet to structure projects with a balanced allocation of risks and rewards, costs and benefits or rights and obligations.

Currently, some 20 transportation and social infrastructure projects are in the Government’s pipeline, with total investment volume estimated at KZT660 billion. However, given Kazakhstan’s geographical and demographic properties, one cannot expect private capital to finance large-scale industrial and infrastructure projects without substantial support from the state. Fair risk allocation in these projects, if achieved, would open a host of new opportunities for private investors, financial institutions, the Government and the public.

The Roundtable
In order to discuss this topic, on 3 April 2013 Ernst & Young jointly with the European Bank for Reconstruction and Development (EBRD), legal firm Salans and Kazakhstan PPP Centre held a roundtable attended by representatives of private companies from Kazakhstan and Europe, local and foreign banks and governmental organizations.

The participants of the Round Table discussed three of the key aspects of PPP development in Kazakhstan, namely: (i) availability payment, (ii) bankability elements, and (iii) latest legislative initiatives. More detailed recommendations from the Roundtable are presented on the following page.
Availability payments

With regard to availability payments, the participants of the Roundtable came to the following conclusions:

1. To support the intentions of the Government to introduce availability payments as one of the most promising mechanisms of state support capable of providing a fair balance between the interests of private investors and the state.

2. To note that careful articulation of the project goals, their study and the high-quality tender process will be fundamental to the successful implementation of availability payments in a wide variety of transport, power, utility and social infrastructure projects.

3. To note that the setup of a clear, predictable and transparent budget platform for the future support of PPP projects is a pre-requisite for the success of such projects among the potential investors and financing organizations (a budget program).

During the Roundtable it was also noted that the first PPP projects would most likely require the use of availability payments or other similar mechanisms of state support, such as minimum revenue guarantee, for example.

Bankability

With regard to ensuring the ban financing of the projects, the participants of the Roundtable have come to the following conclusions:

1. To note that local banks, due to the nature of their funding sources and high interest rates, in the near future are unlikely to provide local currency financing in the required volumes and tenors. Pension funds, unable to assume the high risks of initial project implementation stages, will most likely be only be able to refinance projects at the operational stages.

2. To note that for foreign banks and international financial institutions, the predictability of cash flows in PPP projects is the basis for bankability. However, for foreign currency financing to become possible, it is important to envision foreign exchange rate risk mitigation mechanisms (hedging).

3. To support the intention of the Government to introduce legislative changes allowing pledging of project assets to financing organizations.

4. With local currency financing only available from the state budget and pension funds, to consider the possibility of structuring Government credit enhancement instruments aimed at lowering bank interest rates, as well as the participation of national development institutions in the financing of PPP projects.

When preparing “pilot” projects the state authorities may have to co-finance them through equity participation, budget grants and the provision of sovereign guarantees.

Legislative changes

With regard to the legal issues of structuring PPP in Kazakhstan, the Roundtable participants came to the following conclusions:

1. The legislative environment for governing PPP type relationships is the key reason for the reluctance of the private sector to invest the time and resources in infrastructure and social projects in Kazakhstan.

2. The draft law on new forms of PPP in Kazakhstan has the potential to shift the legal field for structuring and implementing projects to a new level. Specifically, if adopted, the legal structure of “concession” will be capable of encompassing any civil-legal relations, provided they aim at creation or reconstruction and the subsequent operation of the assets under concession. With this in mind, the initiative deserves full support and an expedient adoption.

3. However, the proposed legislation does not address all the problems standing in the way of private sector participation. For instance, among the unaddressed issues is limiting state support, the possibility of indexation of long-term tariffs, use of international arbitration for disputes related to real estate, etc. It is therefore important to either continue refining the proposed draft legislation during the parliamentary debates, or make necessary revisions after it has been adopted.
Suggested next steps

The package of legislative changes currently under discussion in the Parliament, as well as other initiatives aimed at improving the legal environment for PPP, requires thorough discussions among investors and financiers. However, only the implementation of a “pilot” project with the use of new and improved state support mechanisms will allow their sufficiency to be tested. Moreover, to attract the attention of reputable investors and to ensure the further development of PPP, the country should demonstrate a robust pipeline of attractive projects going forward.

With this in mind, the organizers and the roundtable participants are prepared to assist in the discussions of the proposed legislative initiatives as well as engage in dialogue with the state authorities seeking further improvements in this important area.

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Ernst & Young PPP Financial Advisory Services

Ernst & Young Global Project Finance team comprises about 380 professionals and focuses on PPP projects and on structuring and raising project finance for infrastructure and industry projects.

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Ernst & Young has been ranked number 1 for PPP and Project Finance deals closed in the Dealogic Global Project Finance Review 2012 as well as Top Firm in the Project Finance International league tables for 2012 in 3 categories. Ernst & Young participated in the project “Western High-Speed Diameter” which has received the PFI Award (Thomson Reuters) for the "Road Deal of the Year in Europe" category. The deal is nominated for several other international awards.

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