Financing basic sanitation projects

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Brazil's newly-minted New Basic Sanitation Legal Framework, Law 14.026/2020, has been commemorated by society in general because it both provides for universalization of access to sewage systems and potable water in this country by 2033 and at the same time injects a good measure of legal certainty into the sector. This last factor, together with the fact that investors are looking for alternatives to fixed income investments at a time of low interest rates, will certainly encourage the entry of private players.

Brazil's Social and Economic Development Bank – BNDES, the federal savings and loan bank Caixa Econômica Federal, and the Ministry of Regional Development have announced that they will present structured projects to make new investments viable, and it is expected that the major banks and their vehicles will also be involved in basic sanitation financing, as has occurred in other sectors – especially in the context of incentive programs.

Because the sector has great importance from the social, economic, environmental, and human development perspectives, another source of funds for basic sanitation projects may be international organizations and foreign development agencies and banks, which have historically made a significant contribution to development projects in Brazil.

In addition to investments and incentive programs by public, governmental and international entities, the debt securities market should be another important source of financing for basic sanitation projects. Infrastructure debentures, which are governed by Law 12.431/2011, are likely to be an effective instrument for raising funds. Despite the tax advantages, good rates of return, and relatively moderate risk they offer, infrastructure debentures still have not become popular among the investing public, particularly because of their long maturity dates and reduced liquidity in the secondary market.[1]

Bill 2646/2020 is also worth mentioning. Now before Congress, the proposed legislation would introduce new alternatives for financing infrastructure projects, such as a type of infrastructure debenture that offers tax incentives and benefits to the issuer, in addition to making changes to the current rules governing debentures issued under Law 12.431/2011 and infrastructure investment funds, by expanding the scope and application of the incentives. The benefits under the Bill would be even greater for debentures issued to fund infrastructure projects involving sustainable development ("green bonds") – and the Bill expressly includes water and waste management and treatment of sewage and solid waste among qualifying sustainable projects.[2] If the Bill does become law, it has the potential to expand even further the range of financing available to players in the basic sanitation sector.

As to security for financing, the expectation is that the types of security usual for project financing will be used, including: (i) the sponsor's corporate guarantee or a performance bond during the period of construction and/or financial completion, (ii) "fiduciary alienation" (defeasible transfer of ownership) of shares in SPEs, equipment and/or land and buildings, and (iii) "fiduciary assignment" (defeasible assignment) of rights under concession contracts and receivables under contracts with users of the basic sanitation services. Specific regulations on the matter have still to be issued by the National Waters and Basic Sanitation Agency (ANA – Agência Nacional de Águas e Saneamento Básico).

Another way to fund projects covered by the New Basic Sanitation Legal Framework is to turn to the equity markets. The opening-up of a sector that was historically controlled by state-owned companies, along the prospect of legal certainty promised by the Framework Law, will allow various new national and international players to enter the sector. Basic sanitation enterprises may also give a boost to the stock market, through privatization of existing sanitation companies, and by launching shares issued by SPEs created by new participants.

Aside from its impact on national infrastructure and the lives of Brazilians, the New Basic Sanitation Legal Framework has the potential to shake up the country's financial and capital markets – investment in the sector is expected to be in the range of BRL 500 to 700 billion.

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Notes:

1. Although the liquidity issue was temporarily addressed by Constitutional Amendment 106 of May 10, 2020, which allows Brazil's Central Bank to trade in assets rated BB- or higher on the secondary capital market, the trading permission is valid only while the state of public emergency lasts.

2. Once the legislative process is completed, it will be possible to confirm the applicability and extent of tax benefits to sanitation projects.

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