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**STATE INCENTIVES FOR INVESTMENT PROJECTS USING**  
**PROJECT FINANCING**

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**Abstract**

Within the tendency of reducing budget expenditures for infrastructure and the urgent need to build new and modernize existing industry facilities, the project financing mechanism is becoming one of the most important instruments of financing for investment projects in Russia. This determines the relevance of the study conducted by the authors. The paper is devoted to the analysis of the use of the state project financing. The first attempts to establish project financing in the Russian Federation are described, as well as the problems of implementing various programs in modern conditions are studied. The paper considers the stages of selection of investment projects in Russia with the identification of criteria for such selection. The interest rates of refinancing in terms of their dynamics were analyzed. The authors analyzed the government incentives for business in the implementation of investment projects using project financing, which is based on the use of such well-known scientific methods as system analysis, comparative analysis, modeling, observation. Based on the results of the analysis, conclusions were drawn on the need to use project financing with state support during crisis periods of the country's development. The paper studies the mechanism of project financing of investment projects in priority sectors of the Russian economy, providing for the advance of funds to borrowers on the basis of syndicated loan agreements. Moreover, the performed analysis revealed a special role of the state corporation Vnesheconombank (now VEB.RF) in project financing, which is an authorized bank for the provision of preferential loans.

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*Keywords:* Project financing, investment, infrastructure, project selection, criteria



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## 1. Introduction

Project financing is one of the most effective mechanisms for accumulating huge amounts of various financial resources for the implementation of investment projects. During the formation and development of the digital economy, the use of the project financing mechanism in the implementation of innovative investment projects becomes particularly important (Pereverzeva, 2018).

It is noteworthy that in the first stages of implementation an investment project may not be profitable, but rather unprofitable. In other words, profit will not be generated immediately, but, for example, each year over 20 years. Hence the complexity of making rational decisions by comparing marginal costs and benefits.

The works of such Russian researchers as I.A. Nikonova, A.L. Smirnova, V.V. Pereverzeva and others are devoted to the issues of project financing. As Nikonova (2015) notes in her article on the analysis of the state and trends in the development of project financing in Russia, an important factor in stimulating the use of project financing was the Decree of the Government of the Russian Federation No. 1044 “On the approval of the program for supporting investment projects implemented in the Russian Federation based on project financing”. However, the state support scheme for the development of lending based on project financing proposed in the Decree No. 1044 to some extent distorted the concept of project financing generally accepted abroad and used by large Russian banks as a multi-tool form of financing a company specially created for the implementation of an investment project, in which future cash flows of the project are the main source of settlements with creditors and shareholders of the project company (Nikonova, 2015).

## 2. Problem Statement

Project financing is used in different countries in cases where funding is required for a large investment project. Thus, the practice of other countries shows that all required funds are not invested in advance within project financing. Project financing implies that a financial institution finances the project against the anticipated cash flow compared to the advance balance. The institution will invest in the project if the cash flow is beneficial to the financial institution. For example, a project initiator requests a bank or a financial institution to provide 10% of the required funding that exceeds the anticipated future cash flow. The bank or the financial institution has every right to decide whether to invest in the project or not. If there is a choice to invest, usually there are several investors that invest as sponsors. Granted loans usually represent non-recourse (secured) loans issued under project assets. Loans are fully repaid from the project cash flow. If the parties do not pay the loan, then the property of the project is confiscated. The Special Purpose Company (SPC) is created for the entire project to ensure the efficiency and accuracy of the process (Jae-Il et al., 2018).

The financing mechanism for large projects has great potential in Russia. After energy, oil and gas industry, where a large share of investment projects is implemented using project financing, the Russian government is currently paying special attention to the development of infrastructure. Within the tendency of reducing budget expenditures for infrastructure and the urgent need to build new and

modernize existing industry facilities, the project financing mechanism is becoming one of the most important instruments of financing for investment projects (Luskatova & Roberts, 2019).

The support program for investments implemented in Russia on the basis of project financing increased the volume of lending to organizations on preferential terms. The credit system is being transformed. Lending to innovative investment projects is gradually changing. Requirements and guarantees for the repayment of loans are increasing every year. One of the examples of the transformation of the system to minimize risks in lending to investment projects includes project financing carried out at the state level, the beginning of which is attributed to the adoption of the Decree No. 1044 in 2014.

Thus, it should be noted that “the goal of all project efforts is optimal solutions, i.e. the choice of optimal opportunities for action, since this does not happen automatically or only in some cases is achieved without effort, the preparation of design solutions is necessary. The systematic preparation of solutions is just efficient project development” (Bashirzade et al., 2020, p. 129).

### **3. Research Questions**

Russia has been making attempts to develop project financing since the mid-1990s. At the same time Russia began to participate as one of the parties in the project to create the Sea Launch floating cosmodrome in the Pacific Ocean, in 1994-1996 – in Sakhalin-2, and in 1997 the country agreed on the construction of the Blue Stream gas pipeline to Turkey (it was built already in 2001-2003). These three projects are described as the Russia’s first landmark experience in project financing, but all of them were international and not oriented towards the development of infrastructure within the country (InfraOne, 2018). Such attempts to develop project financing are observed in 2010, when the Government of the Russian Federation decided to stimulate the development of project financing, and in 2014 with the approval of a program to support investment projects implemented in the Russian Federation through project financing.

The relevance of this study is to analyze the decisions taken towards the development of project financing to attract capital, as well as to analyze whether this instrument has earned its full potential.

### **4. Purpose of the Study**

The purpose of the study is to analyze the state support measures using the mechanism of project financing of infrastructure projects from the moment of issuing a separate regulatory act of the Government of the Russian Federation with the participation of the Bank of Russia (2021) and VEB.RF, as well as involving not only domestic banks (organizations), but also international (foreign) companies of the banking sector in the selection of investment projects.

### **5. Research Methods**

The analysis of state incentives to business for investment projects using project financing is based on the use of such methods as system analysis, comparative analysis, modeling, observation. The analysis

made it possible to conclude on the need to use project financing with state support, especially during crisis periods of the country's development. The authors clearly illustrate the procedure for selecting investment projects implemented under the Decree No. 1044.

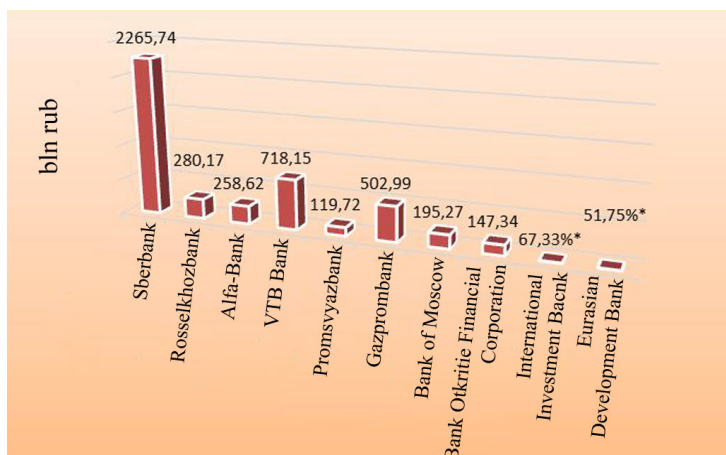
## 6. Findings

Due to the adoption of the Decree No. 1044, on November 12, 2014 the Bank of Russia decided to refinance loans provided for the implementation of investment projects selected in accordance with the Decree No. 1044. According to this decision, the loans are refinanced within the framework of the refinancing mechanism created on April 25, 2014, which provided banks with the opportunity to use the Bank of Russia's loan security rights to claim loans for financing investment projects selected in accordance with the Decree of the Government of Russia No. 1016 dated December 14, 2010.

Initially, loans under this mechanism were provided to banks at a rate of 6.5% for up to 3 years inclusive, and from March 26, 2018 the interest rates on loans secured by the pledge of claims for loans for financing investment projects selected before 01.01.2016 were reduced to 6.25% per year.

So, for the selection of investment projects implemented in accordance with the Support Program, the Ministry of Economic Development of the Russian Federation created an interdepartmental commission that selects investment projects of Russian and international credit and financial organizations, and keeps the list of the same organizations. This list includes 10 banks, which are given in Figure 1. Within the framework of the Investment Project Support Program, a special role is assigned to Vnesheconombank, which is the authorized bank for granting preferential loans.

Today, Vnesheconombank has been renamed as the VEB.RF, which functions on the basis of a special federal law "On the State Corporation for the Development of VEB.RF". VEB.RF acts as an agent of the Government of the Russian Federation in accordance with the federal laws on the federal budget for the relevant financial year and the planning period, as well as the agreement No. 01-01-06/04-472 of December 25, 2009 between the Ministry of Finance of the Russian Federation and VEB.RF on performing the functions of an agent of the Government of the Russian Federation.



**Figure 1.** Russian credit organizations and international financial organizations. *Compiled by the author.*  
 Source – Ministry of Economic Development of the Russian Federation

According to the Ministry of Economic Development of the Russian Federation, 42 investment projects were approved for a total of 235,535 million rubles as of May 20, 2015. The credit terms for these projects range from 5 to 16 years depending on the project scope.

The Program specifies the following priority sectors:

- agriculture;
- manufacturing;
- chemical industry;
- machine-building complex (aircraft engineering, shipbuilding, automobile engineering, etc.);
- housing construction;
- transport complex, including air transport (airports, air carriers, transport infrastructure);
- communication and telecommunications;
- generation and distribution of electricity (gas, water and other resources).

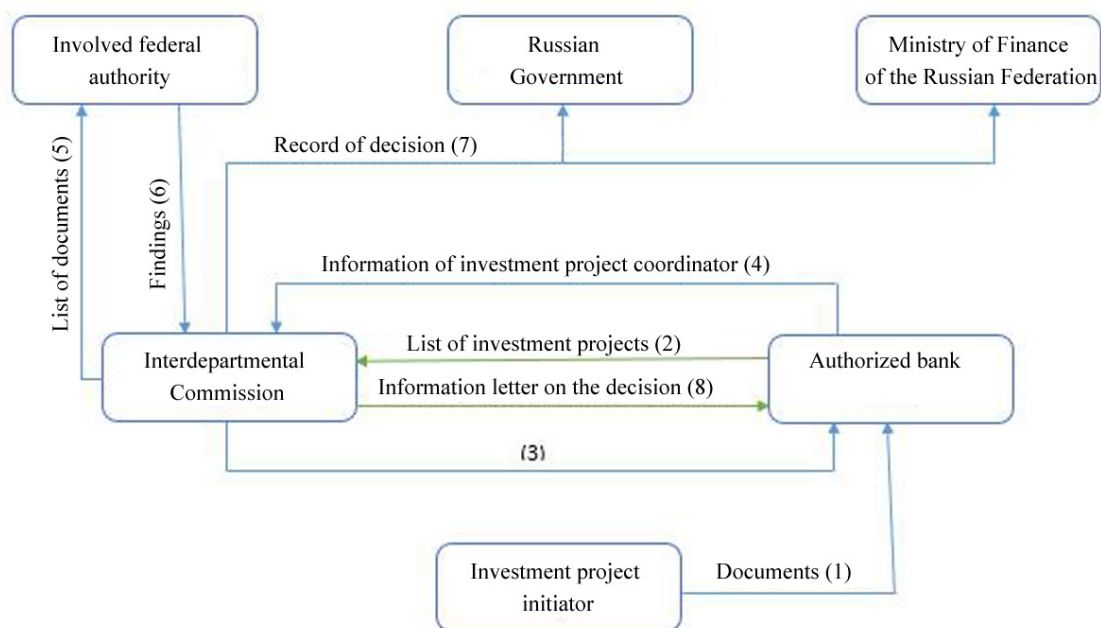
At the same time, according to the provisions of the Program, VEB.RF as an authorized bank checks investment projects initiated by organizations according to the criteria established by the Program and submits them to the Ministry of Economic Development of the Russian Federation, which performs the functions of an interdepartmental commission.

Below are the main criteria for selecting investment projects for participation in the Program. First, this is the implementation of an investment project based on project financing and compliance with the Russian classifier of types of economic activities, the location of the production area of the investment project in Russia. Besides, the total cost of the investment project should be in the range from 1 billion rubles to 20 billion rubles, as well as financing from borrowed funds should not be more than 80%.

At the same time, the authorized banks, in accordance with their internal documents, may set additional requirements for investment projects.

It should be noted that the same person may be the initiator of the investment project and the borrower.

An investment project, which was rejected to participate in the Program, may be resubmitted by any authorized bank for further consideration by an interdepartmental commission. At the same time, the same investment project cannot be submitted to the interdepartmental commission more than twice. If the investment project is selected for participation in the Program, but was subsequently excluded from it by the decision of the interdepartmental commission, then this investment project cannot be submitted again to the interdepartmental commission. A more detailed selecting procedure for investment projects is presented in Figure 2.



**Figure 2.** Selection procedure for investment projects implemented in the territory of the Russian Federation on the basis of project financing. *Compiled by the author.*

In addition to the above programs, VEB.RF implements a program specially developed for business – Project Finance Factory approved by the Decree of the Government of the Russian Federation No. 158 dated February 15, 2018.

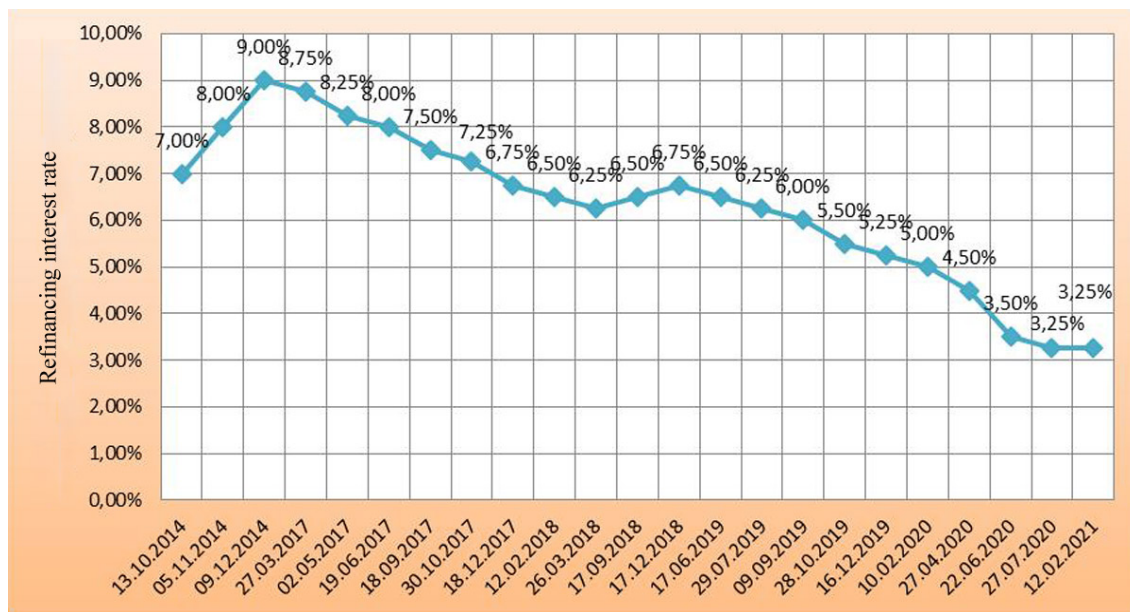
It should be noted that the factory is a project financing mechanism for investment projects in priority sectors of the Russian economy providing for funds to borrowers on the basis of syndicated loan agreements (loans) implemented using state support measures and contributing to an increase in lending to organizations implementing investment projects. Here, the benchmark approach plays a key role in selecting projects for financing (Tavbulatova & Khakhanaev, 2020). The Project Finance Factory uses three main criteria for project selection:

- a) Project on the territory of the Russian Federation starting from 3 billion rubles.
- b) Project payback – up to 20 years.
- c) Funds of the project initiator – at least 20% of the total amount.
- d) Project budget.
- e) Project is implemented on the basis of project funding.

The Ministry of Economic Development of the Russian Federation also acts the sponsor of the Project Finance Factory and the main distributor of the subsidy, while the Ministry of Finance of the Russian Federation represents state guarantees for bonds of a specialized project financing company and state subsidies. The Central Bank maintains a special procedure for regulating commercial banks in terms of lending to Factory projects.

## 7. Conclusion

The Bank of Russia has been providing support to large investment projects since July 2020 at a refinancing rate of 3.25%. If we compare this rate with the refinancing rate, which was when the Program was adopted in October 2014, which amounted to 7.00%, then the refinancing rate for February 2021 decreased by slightly more than 2 times (Fig. 3).



**Figure 3.** Interest rates of the Bank of Russia on specialized refinancing mechanisms. *Compiled by the author. Source – Bank of Russia*

The interest rates set by the Bank of Russia, which are presented in Figure 3, were applied to projects selected in accordance with the rules established by the Decrees No. 1044 and No. 1016.

Despite the importance and necessity of implementing investment projects, at present they are not selected for participation in the Support Program implemented on the basis of project financing. The selection of investment projects was terminated due to the fact that the federal law on the federal budget for the next financial year does not provide for the provision of state guarantees for loans attracted by legal entities selected in the manner established by the Program on the basis of project financing. It should also be noted that the acceptance of applications from authorized banks to participate in the Program for investment projects was suspended.

However, despite the complexity of the economic situation in the country, VEB.RF continues to invest cash flows in infrastructure projects together with other financial institutions.

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