

# World-class investors drawn to St. Petersburg airport project

Citi serves as transaction advisor for Pulkovo Airport's public-private partnership project

## Case Study

### The Challenge

St. Petersburg is Russia's second largest city after Moscow with almost five million inhabitants and is recognised as an architectural masterpiece and a globally important cultural center. As a result, tourism plays a major part in the city's economy (it is Russia's number one tourist destination), although it is also the location for the headquarters of many international companies. Given its dynamic and globally-connected economy, transport links are exceptionally important to the prosperity and growth of St. Petersburg.

The transport infrastructure of St. Petersburg, like many Russian cities, has suffered from under-investment in recent years, and has failed to keep pace with growing demand. In 2008, the city's airport, Pulkovo, served seven million passengers. In 2012, it is expected to have traffic of 11 million passengers. Unfortunately, the capacity of the airport is just eight million, meaning it is already significantly overloaded.

As a result, the airport frequently suffers from long queues, especially during the summer tourist season. Problems with the existing infrastructure also impact the level of customer service the airport can deliver. Given double-digit passenger growth every year and already over-stretched facilities, it is impossible to improve service quality. Tourist and business passenger satisfaction with the airport is therefore low, which has a negative impact on St. Petersburg's reputation.

The airport industry requires significant forward planning in order to remain effective. Generally, airport expansion programs are put in place four to five years in advance - usually when existing facilities reach 80% of capacity. By this measure, Pulkovo was already too small when it last received significant investment in 2000. Also the push to upgrade aviation security worldwide requires additional space that Pulkovo simply does not have: the airport is even unable to separate inbound and outbound passengers - a basic contemporary security requirement.

### The Solution

#### **Restoring St. Petersburg's Reputation**

The City of St. Petersburg Government was eager to address the problems facing Pulkovo and begin to restore the reputation of the city. However, given budgetary pressures and many more pressing claims on the government's resources, it needed to find a way to finance the project without using public money. Indeed, the government hoped that any airport development project would generate revenues for the city in the long term.

### The Solution (continued)

The Government recognized that it would need to attract international investment capital to fund the project if it was going to be successful. Given the challenges facing Pulkovo, it was also important to attract companies with the experience of operating existing large international airports. In order to encourage such international companies to become involved in Pulkovo's redevelopment, the government decided to appoint a leading global bank, Citi, as the transaction advisor to structure the tender. Citi decided that to attract the right quality of bidders it was essential for the tender to be conducted according to St. Petersburg PPP law and financing (more than EUR 700 mio syndicated loan) was arranged under international laws in order to attract foreign investors- a first of its kind of transaction Russia.

Working with the Government, Citi put together an ambitious financial model for Pulkovo. The project would be the largest Russian airport Public-Private Partnership (PPP) concession with €1.2 billion of investment in the first phase of the project and a 30-year lifespan. The winning bidders would have an obligation to invest (according to detailed specification in the bidding documentation) to 2014 in order to build a new terminal, refurbish an existing terminal, extend the apron (where aircrafts are parked, unloaded or loaded, refueled and boarded) and build a new energy center for heating and cooling the airport. After 2014, the consortium would be required to maintain the airport to IATA standard C, which stipulates requirements for waiting times, security and other parameters.

### Financing Pulkovo's Redevelopment

The tender process started in 2008 and bids were presented in 2009 following pre-marketing of the project by Citi to more than 100 potential investors. Seven pre-qualified consortia were selected and were required to present draft contracts for construction and finance to ensure they were viable. On October 30, 2009, the City of St. Petersburg, Pulkovo Airport Company and a consortium called Northern Capital Gateway (comprised of Frankfurt Airport operator Fraport, Greek industrial and technology group Copelouzos and VTB Capital, an investment arm of the Russian state bank VTB) announced the signing of a PPP agreement for the reconstruction, development and operation of the Pulkovo Airport under a 30-year concession agreement.

While the financial crisis that began in 2008 served as the backdrop for the tender and selection of Northern Capital Gateway, the finance for the project was primarily provided by development banks, which meant that while covenants on the project were tough, finance remained available despite the dislocation of many financial markets. Of the first phase of €1.2 billion, 40% came from the shareholders and existing cashflow with the remainder from banks. On April 28, 2010 Northern Capital Gateway signed the financing contract and the project began soon afterwards.

The challenge for Northern Capital Gateway in running an overloaded airport while working to a tight deadline to build a new terminal and refurbish an existing terminal has been significant. However, the company is performing well and the construction is on target for completion in 2014.

### The Result

#### An Airport to be Proud of

The reputational, economic and competitive benefits that St. Petersburg will gain from the development of Pulkovo are immeasurable. The huge improvements in customer service that will result from the project will boost the city's tourism and business prospects and help to attract additional traffic. Moreover, the project will also have direct benefits for the City of St. Petersburg Government and its citizens.

Specifically, in addition to the €1.2 billion investment made by Northern Capital Gateway in Pulkovo, the City will receive concession fees that are expected to total €650 million – average 9 % of the revenue generated by the airport operator – over the 30-year lifespan of the project. The City will also get ownership of the airport, with its significantly improved facilities, at the end of the concession period. The project will directly boost employment in the construction sector and in the airline sector and the many service sectors that service it.

St. Petersburg's pioneering PPP project has been closely watched by cities across the region as the first project finance deal of its type. Members of the Northern Capital Gateway consortium have spoken frequently at events worldwide to explain how the deal works. The partners in the consortium are also known to be considering other similar infrastructure projects in the region.

Citi played a crucial part in the success of the project by gaining the involvement of the world-class investors in the Northern Capital Gateway consortium. Citi's involvement and broader support of the project has continued long after the project tender process completed. After a competitive tender, Northern Capital Gateway selected Citi to manage its offshore accounts that are used for operations, interest accruals and to repay loans. As part of this relationship, Citi is also responsible for Northern Capital Gateway's agency and trust requirements. Citi is also very visibly supporting Pulkovo with extensive advertising and marketing activity within the airport.