Russian government support for industrial investment projects and the real effects on the investor's financial model



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Today in Russia, there are a large number of state measures and instruments aimed at increasing the investment attractiveness and development of the country's economy. This topic is obviously quite extensive, and it is impossible for one article to cover the full range of support measures available in Russia, which also vary by industry. Therefore, this article will focus on industrial investment projects and provide an overview of the most popular state stimulus measures and their crucial impact on the financial model of investment projects.

The main issues of concern to investors at the initial stage are: the selection of a production site; support from the state in the form of tax benefits, etc.; the search for optimal funding.

In order to answer these questions, we tried to structure and simplify the information as much as possible, presenting it in the form of "Four Squares©".

What are the most popular sites for hosting industrial projects in Russia?

The priority is undoubtedly land plots, which investors will be able to acquire more quickly and affordably. At the same time, the degree of development of engineering and transport infrastructure and the full provision of required resources for the planned production complex during commissioning are of particular importance. Well-known sites such as Special Economic Zones, Industrial Parks, Territories of Advanced Socio-Economic Development (TASED/ТОСЭР) and other land designated for industrial use are relevant here. The first three types of sites are aimed at increasing investment attractiveness and the development of industry in Rus-

Government support – in general

Special Economic Zone

Tax benefits	✓
Benefits for insurance premiums	
Customs preferences	✓
Other state support programs	✓
Infrastructure and Capacity	✓

Industrial Park

Tax benefits	✓
Benefits for insurance premiums	
Customs preferences	✓
Other state support programs	✓
Infrastructure and Capacity	✓

TASED

Tax benefits	✓
Benefits for insurance premiums	✓
Customs preferences	✓
Other state support programs	✓
Infrastructure and Capacity	✓

Neutre Land Plot

Tax benefits	✓
Benefits for insurance premiums	
Customs preferences	✓
Other state support programs	✓
Infrastructure and Capacity	✓

✓ - provided ✓ - on condition

Government support – taxes

Special Economic Zone

Profit tax	fed	2%
Profit tax	reg	0…13,5%
Property tax	fed	0% (~ for 10-12 years)
Land tax	fed	0% (~ 5-10 years)
Transport tax	reg	0% (~ 5-10 years)
VAT (import)	fed	0%

Industrial Park

Profit tax	fed	3% (2017-2024)
Profit tax	reg	0…17%
Property tax	reg	0%…2,2% (~ for 4 years)
Land tax	reg	0%…1,5% (~for 4 years)
Transport tax	reg	2…500 rub/hp
VAT (import)	fed	0…20%

TASED

Profit tax	fed	0% (5 years)
Profit tax	reg	0..5..10..17% (5 + 5 + more than 10 years)
Property tax	reg	0% (~ for _ years)
Land tax	reg	0% (~ for _ years)
Transport tax	reg	2…500 rub/ле
VAT (import)	fed	0…20%

Neutre Land Plot

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● - provided ● - on condition

sia. For this reason, each of them has not only a high degree of development and readiness in transport and engineering infrastructure, as well as favourable technical interconnection conditions, but also a certain set of preferential conditions. Let's consider the main ones.

As shown in the diagram, all sites offer investors roughly the same set of preferential placement conditions. However, it is worth noting that in the SEZ and TASED/ТОСЭР, these measures are provided and guaranteed mainly at the federal level, whereas in industrial parks and other land plots they are provided at the regional or municipal levels and depend on the specific region and applicable local regulatory legal acts. In our diagram, red signifies collateral at the federal level, while grey represents the regional level (both may be present or absent in various regions).

As such, it is impossible to immediately conclude which of these sites is more attractive and suitable for an individual project. Evaluation and selection must account for the presence and proximity of the raw material base for the producer, or the proximity of the manufactured products to the main buyers.

Going deeper into the study and the comparison of tax benefits and customs preferences, it is likely that there are misconceptions that the platform with the largest set of benefits and the lowest rates is the most attractive. This may remain only a psychological factor that influences the decision-making process while having absolutely no effect on the main indicators of the project's financial model, such as NPV (Net Present Value), IRR (Internal Rate of Return) and PBP (Payback period). We will now provide a detailed example and a conclusion about it.

What additional tools does Russia offer to stimulate the investment activities of industrial projects?

There are a large number of state programmes, funds, and development institutions willing to provide additional support measures aimed at providing a comfortable environment for implementing investment projects, creating new industrial enterprises, localizing production, creating new jobs, supporting exports, etc.

Investors can choose the most suitable programme for the project depending on the specific industry. For an investor who attaches particular importance to the stability of the legal regime for carrying out activities, it may be appealing to conclude an Agreement on the Protection and Promotion of Investments (СЗПК), which contains guarantees for a stabilization clause and also includes compensation for the costs of creating (reconstructing) any necessary support or infrastructure for the project. This agreement may also include other support measures, but federal law does not provide for any tax benefits compared to the owners of SPIC 2.0.

When considering the possibility of concluding a special investment contract (SPIC 2.0), it should be highlighted that from now on, it is aimed at implementing investment projects for the introduction of modern technologies included in the list for the de-

Financial model – main project assumptions

Technical Information

	Unit	Amount
Area Information		
Land plot	Ha	2,0
Building Area	m2	10 000
Infrastructure		
Electricity	MW	1,5
Gas	m3/h	400
Water supply	m3/d	5
Duration	months	15
Labor	per	15
Shift	unit	1
Average salary	Rub/m	40 000

Investment Costs

Scenario I

Item	Rub (mil)	
Land Plot	40	5%
Construction	250	33%
Equipment	400	53%
Infrastructure	60	8%
Total	750	100%

Scenario II (TOSER and SEZ)

Item	Rub (mil)	
Land Plot	-	0%
Construction	250	38%
Equipment (all imported)	400	62%
Infrastructure	-	0%
Total	650	100%

Taxes and Profit Margins

VAT	20,0%
Profit Tax	20,0%
Property Tax	2,2%
Personal Tax	13,0%
Social Funds	30,0%
	Cost/Income 87%
Margins	
Operational Expenses	65,0%
Administrative Expenses	22,0%
EBITDA/Income	13,0%
Net profit/Income	5,0%
Interest Rate	10%

Investor's Questions

- When will the project pay back ? (PB)
- How much interest does an investment bring me? (IRR)
- What if, I use loan instead of equity?
- What is the interest rate and what for?
- How much tax preferences effect the Fin. Model?
- How the Infrastructure and Land cost effect results?

velopment of the serial production of industrial products. In turn, the state provides a set of incentive measures in the form of tax benefits, the possibility to apply accelerated depreciation, an accelerated and simplified procedure for obtaining "Made in Russia" status, the ability to obtain the status of sole supplier for government orders, and more. The state also ensures the stability of business conditions.

At the same time, investors have access to various subsidiary programmes such as the Corporate Programme for Increasing Competitiveness, which provides support for export-oriented production in Russia and/or abroad in the form of interest rate credit subsidies.

Of course, we must not forget the importance of the question that the investor has before the implementation of the investment project, by choosing the optimal way of financing.

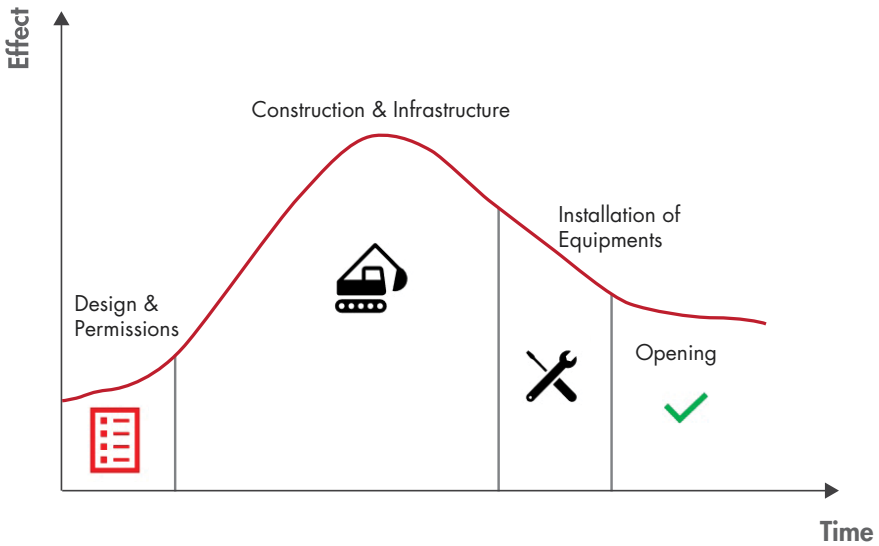
What options does Russia offer to support financing for industrial projects?

As mentioned above, there are various subsidy programmes available for different industries. In addition, there are funds and development institutions such as the Industrial Development Fund (IDF/ФРП), which offers preferential conditions for financing projects. The MSP Corporation and regional guarantee organizations offer guarantee support, while MSP Bank is responsible for offering financing at reduced interest rates.

Numerous support mechanisms are available, including preferential conditions for the purchase of land, tax and customs benefits, subsidies and preferential loans. That said, it is the figures on how a measure really affects key financial indicators that ultimately show the attractiveness of a project to investors.

To do this, we propose analyzing an example of an average medium-sized project located on 2 Ha land plot that requires a 10,000 m2 closed area, consumes gas and water for production, and is supplied 1.5 MWt of power.

We know that any kind of industrial investment has 4 main stages: the 1st stage is permission and design; the 2nd is construction and infrastructure connection to the building, and the 3rd is the installation of equipment already ordered during the construction



period and the beginning of production. Let's say that the total time span of our project will be 15 months.

As shown in the table on the previous page, we can estimate that the total cost of the investment will be roughly RUB 750 million. Of this, RUB 250 million will be construction costs, more than half will be allocated to imported equipment, and the rest will be for the land plot and infrastructure costs.

The next step: how to finance the project

Let's assume that 25% will come from investor equity and the remaining 75% will come from a bank loan. The principal amount and interest payments will be repaid through the sale of the finished product after opening with a 13% EBITDA margin.

Once we have estimated the total budget and its breakdown, time schedule, loan/equity ratio, operational and administrative expenses, taxes, salaries, etc., we can comfortably say that we have enough input data to create a financial model to see traditional parameters of financial models such as the NPV, IRR and PBP for the project.

But there's another important variable: the total cost of construction can change in some cases. For example, in state Special Economic Zones, the government offers land plots and infrastructure almost free of charge. That means that the total cost of the 2 Ha land plot will be around RUB 100 million less than the RUB 750 million total. This leaves us with a RUB 750-million scenario and a RUB 650-million one.

If we want to establish a correlation between these parameters, then one of them should be variable and the others should remain constant under the same conditions.

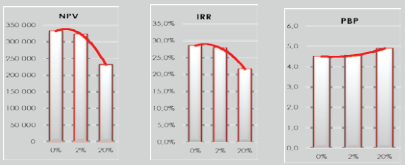
Let's start with profit tax as though we have received tax incentives under a contract with the government, such as 0% in TASED/TOCЭP, SEZ and Industrial Parks instead of the standard 20% rate. When we compare the effect of these rates, the maximum government support demonstrates the highest NPV – around RUB 333 million and a 6.9% IRR surplus, where the payback period is 0.4 years less.

Unfortunately, the next diagram does not show the same behaviour for

Financial model – scenario I: If we assume that the total cost is RUB 750 mln for all

Profit Tax

Location	%	NPV	IRR	PBP
TOSER	0%	333 151	28,6%	4,5
SEZ	2%	323 652	27,9%	4,6
IP	20%	231 717	21,7%	4,9
	20%	101 434	6,9%	0,4



Total cost: RUB 750 mln
Profit tax changes from 0% to 20%,
while other rates stay maximum

Social Tax

Location	%	NPV	IRR	PBP
TOSER	7,6%	235 323	21,9%	4,9
SEZ	30,0%	231 717	21,7%	4,9
IP	30,0%	231 717	21,7%	4,9
	22%	3 606	0,2%	0,0



Total cost: RUB 750 mln
Social fund changes from 7,6% to 30%,
while other rates stay maximum

Property Tax

Location	%	NPV	IRR	PBP
TOSER	0,0%	244 492	22,3%	4,8
SEZ	0,0%	244 492	22,3%	4,8
IP	2,2%	231 717	21,7%	4,9
	2,2%	12 775	0,6%	0,1



Total cost: RUB 750 mln
Property tax changes from 0% to 2,2%,
while other rates stay maximum

Interest Rate

Location	%	NPV	IRR	PBP
TOSER	5,0%	432 343	27,85%	4,21
SEZ	7,0%	395 821	27,91%	4,27
IP	10,0%	345 163	28,00%	4,36
	7%	87 180	0,1%	0,2



Total cost: RUB 750 mln
Interest rate changes from 0% to 12%,
while other rates stay maximum

* All in mln RUB, PB in years

The total cost of construction can change. For example, in state Special Economic Zones, the government offers land plots and infrastructure almost free of charge.



property taxes and social fund payments, as their effects on the financial model are very minor.

Given that we know that some investors may be confused about when to use their own funds instead of a loan, the effect of interest rates on the financial model also become significant parameters. Additionally, some state funds now offer investors up to half interest compared to the average rates in the market for project finance deals.

If we analyze this difference in the table on the previous page, we see (as in the profit tax case) that the NPV will be much higher than the standard interest rate's effect, while IRR and the related repayment period will not significantly change.

Furthermore, in the second RUB 650-million scenario, the effects on financial parameters are the same.

Given that financial models account for not only the investment period but also the post-operational period, productivity becomes increasingly important in investors' race against time.

How should we approach all these parameters?

Know that the most important thing an investor considers is the expectation of a quick and easy return on their investment – but it also has to be as safe as possible.

You may notice something else hidden among these three principles: "the cost of time". If we have a graph of cost and time on the X and Y axes, we can use maths to find the accuracy. In other words, this is an area where financial models are a crucial decision-making tool for investors.

Given that financial models account for not only the investment period but also the post-operational period, productivity becomes increasingly important in investors' race against time. Time goes faster than we think, and ends up being more expensive than we expect.

In conclusion, the cards in an investor's hand are raw materials, suppliers, qualified workers, location, tax incentives, subsidies, equity and loan conditions, equipment productivity, efficiency and other such parameters. Only a tailor-made and considered financial model can reveal the real rules of the game.