

Waste reform in Russia: financing issues

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One of the main objectives of “waste reform” in Russia that began in 2019 is the creation of sufficient production capacities for the processing and disposal of municipal solid (i.e. household) waste (MSW).

In addition to organisational and administrative measures, the achievement of this objective largely depends on the financial support of the reform programme.

This article covers the existing sources and forms of project financing, as well as additional newly announced support measures.

This material continues the series of our articles on the waste reform (which you can access below).

Main sources of waste-reform financing

According to various estimates, at the start of the reform programme the share of processed MSW was 3% of the total generated MSW. The rest of the waste remained unprocessed and was removed to landfills for disposal. In the course of the reform programme, it is hoped that the amount of processed MSW will increase to 60% by 2024.

Another target of waste reform is to commission MSW-processing facilities with a capacity of 37.1m tons by 2024.

[According to*](#) the public company “Russian Environmental Operator”, which was established in 2019 specifically for the purpose of coordinating and ensuring the implementation of waste-reform measures, creating the necessary infrastructure for MSW management will require an investment of more than RUB 400bn (EUR 4.4bn).

According to the [report*](#) of the Minister of Natural Resources and Ecology, in 2019 Russia constructed 55 MSW processing facilities with a capacity of 6.4m tons per year in its 33 regions. The total investment amounted to RUB 28bn (EUR 311m).

There are several components of financial support for implementing reform and achieving the above goals:

- public investment at the federal and regional levels;
- the payment of tariffs by individuals and legal entities;
- the levy of environmental fees on producers and importers of goods under the existing extended product liability (EPL) scheme;
- private investments, including various forms of public-private partnerships.

Despite the availability of several possible sources of financing, overall there is insufficient financing available at the current stage of reform, and this fact jeopardises the ability to achieve the waste-reform programme's stated objectives.

For example, a sharp increase in tariffs early in the reform process resulted in a decrease in their collectability.

[According to*](#) the Russian Environmental Operator, by spring 2020 the total amount overdue to regional operators across the country reached RUB 50bn (EUR 555.5m). In fact, the actual proceeds from tariffs only cover part of the current operating expenses of the operators. It is obvious that in such a situation investment in new production facilities is out of the question.

The EPL system is also inefficient. The total amount of funds collected for Russia's EPL system in 2018-2019 did not exceed RUB 3bn (EUR 33.3m) although the target was RUB 30bn (EUR 333.3m). This amount is also insufficient to implement the necessary projects.

The federal budget remains the main source of financing for MSW processing and disposal-infrastructure projects. However, the federal budget cannot fully finance reform. On the contrary, it has been proposed to actively seek private investors and gradually decrease the state's participation. Moreover, the investments included in the federal budget for 2019-2020 either remain unutilised or are being channelled to support regional operators during the pandemic.

As a result, seeking private investment to create MSW processing disposal facilities and possibly thereafter eco technology parks is a growing priority. Another important issue is investment in waste-incineration plants.

Existing forms of financing

Federal level

As mentioned above, it is currently envisaged that waste reform will be financed mainly through federal subsidies provided from the federal budget in the form of asset contributions by the Russian Federation to the Russian Environmental Operator.

Furthermore, the Russian Environmental Operator is financing projects in the following ways:

- participation in investor charter capital;
- issuance, acquisition and disposal of bonds;
- provision of guarantees and sureties on loans, borrowings and other obligations for investors;
- participation in concession agreements, public-private or municipal-private partnership agreements.

An eligible investor must meet the following criteria:

- the investor will have no outstanding obligations to pay taxes, duties, insurance premiums, penalties, fines, interest and other mandatory payments;
- the investor will have no outstanding obligations to repay federal subsidies, return budgetary investments or other overdue debts to the federal budget;
- the investor is not in the process of reorganisation, liquidation, bankruptcy;
- the investor does not receive funds from the federal budget for waste processing and disposal purposes under other statutory regulations.

The financing is efficient if the ratio between the attracted private investments (including investor funds and borrowed funds) and the subsidy reaches at least RUB 2.46 (EUR 0.03) to RUB 1 (EUR 0.01) respectively.

However, as noted in a [report*](#) by the Accounting Chamber of the Russian Federation, there is little demand among investors for the above forms of project financing by the Russian Environmental Operator.

Currently, there is no information about any investments by the Russian Environmental Operator in MSW management projects. Plans announced in mid-July 2020 to invest RUB 2.5bn (EUR 27.7m) in three waste sorting projects in the Moscow Region were never implemented.

At the same time, to attract investors, the Russian Environmental Operator plans to develop packaged offers for investments into the waste-management industry and to issue "green bonds".

There are other measures to support investors at the federal level (i.e. keeping the environmental impact fee rate at the 2018 level, VAT exemptions for regional operators, allowing the use of MSW disposal facilities commissioned before 1 January 2019 and having no documentation required under applicable laws). None of these measures, however, are sufficiently effective. For example, keeping the environmental impact fee rate at the same level cannot compensate investors for the high costs of infrastructure development, and VAT exemption for regional operators does not allow them to account for payments made for the goods, works and services of their suppliers and subcontractors.

Regional level

Some regions of the Russian Federation have adopted regional waste management programmes, including MSW management, which provide for support measures, such as investment programmes by regional operators for MSW management. For example, the Kemerovo Region and the Republic of Kalmykia have approved such investment programmes to support relevant regional operators.

It is obvious, however, that this type of support for investment activities cannot be regarded as universal or efficient since it is aimed at specific market participants (i.e. regional operators), and the amount of support depends largely on the financial condition and well-being of the region at that period of time.

Private investment

Against the background of the general inefficiency of state financing for projects, interest in the industry has been shown by fully or partially state-owned entities (e.g. the Russian Direct Investment Fund, Sberbank, Rosatom, VEB.RF).

An example is an agreement between the Russian Direct Investment Fund, Sberbank and a foreign investor on an investment in the construction of a waste sorting and disposal complex in the Kaliningrad Region through the acquisition of shares in a relevant company that entered into a 25-year concession agreement with the regional government.

Another example is the investment company "RT-Invest", which is already constructing five waste-incineration

plants in the Moscow Region and Kazan with a total value of over RUB 150bn (EUR 1.6bn), and agreed in May 2020 with Rosatom and a syndicate of banks in which VEB.RF participates to construct 25 more plants of this type across the country. This new project is valued at RUB 600bn (EUR 6.7bn), including RUB 200bn (EUR 2.2bn) to be provided by VEB.RF.

According to* the Ministry of Natural Resources and Ecology, as many as 72 concession agreements totalling RUB 51bn (EUR 566.7m) have been concluded. The authority forecasts that ten more agreements worth RUB 10bn (EUR 111.1m) will be signed by the end of 2020.

Clearly, due to the low efficiency of existing state-support measures, investment projects for MSW management are mainly being implemented through banks, state corporations and investment funds as co-investors.

New support measures

In September 2020, the Russian government announced the expansion of the Russian Environmental Operator's powers to finance MSW treatment and recycling projects. The Russian Ministry of Finance and the Russian Ministry of Natural Resources and Ecology together with the Russian Environmental Operator have been instructed to develop support measures for investment projects in this field.

The proposed new support measures vest the Russian Environmental Operator with the following additional powers:

- acquisition of bonds with a rate of 50% of the Bank of Russia's key rate and provision of loans to investors;
- compensation of costs incurred for infrastructure construction and reconstruction as well as for financial leasing of the main technological equipment, and partial compensation for the interest rate on infrastructure-development loans;
- granting subsidies to hard-to-reach and sparsely populated territories to create MSW treatment facilities.

In addition, draft amendments to tax laws have been published, which propose giving the following tax incentives to regional operators for MSW management:

- as of 2021, introducing a zero VAT rate on regional operator services provided to citizens (as noted above, the existing VAT exemption is inefficient);
- exempting them from corporate profits tax on the transfer of their selected recyclable materials (this should also reduce the cost and increase the competitive advantage of products made of recyclable materials);
- exempting waste collection vehicles from transport tax (currently the cost of MSW transportation accounts for up to 70% of operators' costs);
- setting a zero property tax rate for MSW treatment and recycling facilities and reduced social security contributions for five years after commissioning.

The market participants take a favourable view of the proposed new support measures, noting that MSW management tariffs should also be worked out since income and a return on investment will be mainly derived from such tariffs.

Conclusion

One of the key problems in implementing waste reform is underfunding, both from the state and due to the insufficient number of private investors.

In regard to state support, one can point out the problems of administering the allocated funds and non-coordination between spending units against the background of a lack of a consistent approach to the selection of priority projects for this support.

Private investors are, in their turn, deterred by the fact that income generation and return on investments are unguaranteed due to a restricted ability to raise the existing tariffs.

However, MSW treatment and recycling projects are still in high demand: the primary demand being for the creation of waste sorting and recycling plants and related infrastructure as well as the supply and installation of necessary equipment.

In this connection, it is of particular importance to involve a reliable public partner and a financing party in projects. Among other things, these projects would be based on appropriate concession agreements or public-private or municipal-private partnership agreements, the terms of which, on the one hand, would allow for sustainable financing of projects and, on the other hand, would guarantee a certain level of profitability.

For more information on opportunities in waste management in Russia, please contact CMS Russia experts **Thomas Heidemann**, **Dmitry Bogdanov** or your regular contact at CMS Russia.

* In Russian

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