

INSIGHTS

Federal and State Infrastructure Projects in Mexico

March 21, 2019

By: [Nicolai J. Sarad](#) and [Fernando J. Rodriguez Marin](#)

Members of Bracewell's Project Finance team recently visited financial institutions, consulting firms and law firms in Mexico City to gain a better understanding of the current trends related to infrastructure development and project finance in Mexico. Below is a summary of the information obtained by the team related to infrastructure projects promoted by the federal or state governments.

1. Federal Infrastructure Projects

Given the developments of the last six months, the participation of public and private foreign investment in some of the major infrastructure projects promoted by the federal government will determine whether these projects are implemented without significantly increasing Mexico's public debt.

The large infrastructure projects supported by the new federal administration will require aggregate investments that exceed \$30 billion. For example, the new administration estimates that the refinery to be built in Dos Bocas, Tabasco, with a capacity of 340,000 barrels per day, will require investment of approximately \$8 billion, and the cost for the Tren Maya, a multiphase rail project proposed to traverse the Southern peninsula of Mexico, will be approximately \$9 billion for all phases. While the new administration has not published its estimated cost for the Isthmus of Tehuantepec Intermodal Corridor, several of the cost estimates developed during prior administrations for different variations of this project exceeded \$10 billion. Cost estimates of other projects, such as the network of 300 rural roads in the states of Oaxaca and Guerrero, completion of the train between Mexico City and Toluca and subway-related projects have not been published, but the required investment will be significant. The Mexican federal government cannot fund 100 percent of all of these projects, support PEMEX, finance its social programs and make the other investments and expenses included in the 2019 budget that the Ministry of Finance delivered to the Mexican Congress on December 15, 2018, without significantly increasing public debt. Therefore, other investor participants will be needed.

While the new administration has publicly acknowledged that it will need private investor participation to fund significant portions of the Tren Maya and the Isthmus of Tehuantepec Intermodal Corridor, the attitude towards private investment in infrastructure projects in Mexico has shifted. As was broadly publicized in the press, the new administration cancelled the new international airport in Mexico City. In addition, certain teams within the new ruling party, MORENA, have criticized project finance structures and Public-Private Partnerships (P3s)

that facilitate private investor participation. Nevertheless, it is possible that with time the new administration may be more cautious in its approach to balancing politics against the need to pursue a successful economic-development strategy. The consensus is that private investment will be allowed to continue to play a role in infrastructure projects promoted by the federal government even if, in the current political climate, the vehicles that facilitate such private investment may need to adopt a different nomenclature and form (e.g., *empresas mixtas*, instead of P3s).

We note in this context that some of Mexico's M&A activity in 2018 and early 2019 has involved Mexican investors reducing their Mexico exposure and/or taking advantage of opportunities abroad, and foreign investors with a certain risk appetite being attracted by the potentially higher returns from relatively discounted Mexican assets. If this trend continues, domestic private investors may not be a significant source of equity or debt funding for local infrastructure projects. Depending on the trajectory of the Mexican economy and financial markets in the coming months, these (and other) foreign investors may become increasingly comfortable with Mexico's new type of political risk. Many of the Mexican assets being sold are brownfield projects, but if Mexico's economy is resilient enough to remain stable despite the political uncertainty, foreign investor risk appetite may expand to greenfield projects. If this occurs, foreign private investors will play an increasingly important role in providing debt and equity funding for infrastructure projects that are economically viable. If domestic private investors continue to look outside of Mexico, other foreign players, such as multilateral financial institutions and foreign export credit agencies, will gain importance.

At the same time, the new administration's apparent trend of cancelling significant tenders – as was the case with the fourth long-term energy auction, the Baja California transmission line project and the Second and Third Tenders of Round Three of new areas for the exploration and exploitation of hydrocarbons – is drawing significant concern. Many of these cancellations have been rationalized as a necessary step in an effort by the new administration to ensure a fair and competitive process. To be sure, qualified firms that can provide the necessary financial, technical, legal and other consulting services could play an important role in assisting the new administration in its efforts to manage tenders while ensuring transparency.

2. State Infrastructure Projects

Projects promoted by the states in Northern and Central Mexico are likely to face two primary challenges in the coming six years. *First*, they will experience reduced federal funding. In Mexico, major infrastructure projects promoted by a state require federal funding or a mix of federal and private investment because in the aggregate the project's revenues, the funds of the states and local private investment tend to be insufficient to support such projects. The new administration is clearly focusing on Mexico's southern states, including Oaxaca, Tabasco, Chiapas, Quintana Roo and Campeche, as the list of projects cited above shows. The lack of federal funding is expected to be especially severe in the North, which is an area that is perceived by the new administration as requiring less support than the South. *Second*, the lack of resources available to the state governments creates a barrier to the states' access to funding. Major infrastructure projects require feasibility studies, technical analyses, economic and financial modeling, as well as regulatory, structuring and other legal analysis. Many states do not have access to such resources locally or the funds to import them. Assisting the states to close this gap is key if state-sponsored projects are to succeed. We have not found evidence suggesting that the federal government is consistently directing resources to state

administrations across the country to address this problem.

Here again, advisory firms could play an important role, assuming they can be affordably sourced. At the state level, the short term answer may be to seek the assistance of foreign and multilateral development agencies who can provide some of these services at relatively low cost, as well as providing grants and other funding to the states.

In the short term, with political risk and uncertainty at the forefront, private investors in publicly-procured infrastructure projects will likely take a wait-and-see approach. In the meantime, we anticipate transactional activity to be driven by M&A deals of the type discussed above and limited development of private-to-private infrastructure.