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Issues Paper on facilitating additional TEN-T investment

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This Issues Paper outlines the various long-term strategic financing challenges that confront the financing of the TEN-T (Trans European Transport Network) as well as those arising from the current difficult economic conditions. This paper was prepared by a Working Group consisting of representatives from the Directorate-General for Transport and Energy (DG TREN) (and DG ECFIN) as well as the EIB with the purpose of identifying potential measures for consideration by EU and national policy makers that could deepen and diversify access to sources of finance as well as financial instruments capable of facilitating additional investment in the development of the TEN-T Infrastructure.

1. Introduction

The Trans-European Transport Network (TEN-T) policy aims to provide the infrastructure needed for the internal market to function smoothly and for the objectives of the Lisbon Agenda on growth, competitiveness and jobs to be achieved. It also aims to improve accessibility and social and territorial cohesion. It supports every EU citizen's right to move freely within the territory of the Member States. Furthermore, it integrates environmental protection requirements with a view to promoting sustainable development.

The overall investment cost of the Network (TEN-T) as presented in the Decision of the European Parliament and the Council in 1996, and last amended in 2004¹, has been estimated at around EUR 900 billion (from 1996 to 2020). The EUR 400 billion invested so far has helped to complete a large number of projects of common interest, interconnecting national networks and overcoming technological barriers across national borders. While progress is being made on implementing the Trans-European Transport (TEN-T) programme, there is still a lot to do due to the intrinsic long-term nature of the projects involved, the considerable delays in the completion of a number of projects as well as the scale of investments required: an estimated EUR 500 billion by 2020.

The Green Paper: *TEN-T: A policy review - Towards a Better Integrated Trans-European Transport network at the service of the Common Transport Policy* of 4 February 2009 (COM/2009/0044) recognises that there has been a lack of progress in certain areas: bottlenecks in project preparation and in the adoption of policies and programmes; lengthy process of obtaining planning and other consents and, at times, revisions due to poor economic profitability linked to high project costs and/or insufficient demand. It also highlights that an additional hurdle to overcome is insufficient finance, both public and private - most notably access to appropriate long-term finance.

The lack of access to finance has been due, in significant part, to public sector budget constraints, hence the increasing utilisation of alternative private sector sources and risk sharing finance instruments to complement public finance in recent years. In the current economic and financial context, however, the aggravation of public finance constraints cannot be easily compensated by an additional flow of private finance. While the public sector is likely to continue financing most TEN-T investments directly, the urgent strategic need due to the crisis to increase public spending to help the economy overall has limited the growth of resources in national budgets that are available for TEN projects.

As far as the private finance market is concerned, traditional sources of senior debt for infrastructure investments are currently also severely constrained, indeed impaired. This is constraining the utilisation of the current PPP model, with for example banks being highly selective on deals and focusing somewhat more on national markets. The capital markets are currently providing little senior debt as practically no new transactions are being underwritten by monoline insurers and there is low investor appetite for non-guaranteed project bonds.

¹ Decision No 1692/96/EC of the European Parliament and of the Council on Community guidelines for the development of the trans-European Transport Network, as last amended by Decision No 884/2004/EC of 29 April 2004

Project and PPP financing have to, therefore, compete with more attractive corporate opportunities for scarce regulatory capital. Also obtaining bank funding is currently particularly challenging due to significant liquidity, maturity and capital constraints of a number of the major banking groups; the low volume of syndications and a marked reduction of the average amount each bank is prepared to commit for each transaction. These factors together have made it significantly more challenging to get some of the larger projects financed, especially with longer maturities, and therefore delays can be expected even to projects that are ready to proceed.

As the development of the TENs is a major EU priority, budgetary resources at EU level have grown over time. Such resources are, however, necessarily constrained by the agreed Budgetary Framework and other competing demands. The EIB's commitment to the development of TENs has been maintained and expanded over the years both through the amount of financing provided as well as through the development of specialised financing instruments (debt, guarantee and equity) as well as Financial and Technical Advisory programmes developed in collaboration with the Commission, member states and other financial institutions.

Despite such significant support from all Community institutions for TENs, the size of the financing requirements for TENs investment overall and the scale of risks involved are such that well diversified and deep sources of finance both from public (EU, national and regional) and private (financial institutions and corporates) are required, if the objectives of the TENs programme are to be met. Accordingly, additional measures and approaches that enhance the use of the existing sources of TEN-T financing as well as develop new ones are required.

In September 2008 the Commission Vice-President Antonio Tajani met the EIB President Philippe Maystadt and EIB Vice-Presidents Dario Scannapieco and Marta Gajęcka to discuss possible strategies to improve the utilisation of the existing sources of finance (including EIB) for large infrastructural transport projects. A working group consisting of representatives from Vice-President Tajani's cabinet, the Directorate-General for Transport and Energy (DG TREN) and DG ECFIN as well as the EIB was established with the aim of exploring the possibility of new instruments for the financing of TEN-T projects that would in particular facilitate greater participation by private sector institutions and investors.

This Issues Paper, which resulted, identifies how the various stakeholders could possibly contribute more effectively to the planning and financing of TENs infrastructure assets. Private sector and public sector both at national and community level have distinct roles to play. This Paper summarises – to facilitate discussion – the potential roles national governments, the private sector, the Commission, and the EIB could play.

2. Main issues to be considered for facilitating additional TEN-T investment

2.1 *Enhancement of national PPP and Project Finance programmes*

Project Financing techniques and PPP programmes in various members states have in recent years proven to be useful additional instruments to expand the financing capacity available for investment in infrastructure and in TENs. They have also expanded the procurement programmes and financial instruments available to public authorities for that purpose. Small projects nevertheless continue to be financed.

The existing PPP programmes throughout the EU continue to be implemented - but to different degrees. Also some new programmes are being established, even though many deals have been delayed or are struggling to reach financial close. There are some examples of PPPs not being pursued as PPPs anymore, which are particularly concerning, as it could have longer-term implications for the sustained development of the infrastructure financing. Even medium-size, reasonably standard projects have proven difficult to close and in some cases have required additional EIB and sponsor support to do so.

It is vital that PPP programmes are enhanced rather than discounted or abandoned given the long decision periods as well as the need for continuity required for infrastructure investment. A short-sighted reaction to the current difficult market conditions could have lasting effects: bid preparation costs already incurred would be wasted, sponsors would lose confidence in deal flow, know-how would be lost as expert personnel and resources are re-directed elsewhere etc. It is particularly important for market confidence that PPP programmes are appropriately adapted to reflect the current market conditions.

2.2 National measures to provide relief in current market conditions including government guarantee/lending facilities for key infrastructure investments

There have been some significant government responses to the current crisis in infrastructure and TENs financing but these have varied in each market depending on the size of the current programme as well as the outstanding PPP and Project Finance pipeline. The UK, France, Portugal and the Netherlands, with large programmes under way, are the most affected and thus were also most responsive. Some countries are putting in place lending facilities (for example the UK announced a new treasury lending unit, Germany announced a facility to be operated by KfW and Italy has enabled CDP to enlarge its scope of action for example by allowing the postal savings to be used to increase its participation in infrastructure finance). The UK facility is seen as a temporary GBP 1.5 to 2 billion "top-up" facility, at commercial terms, designed to "patch the holes" in syndications and to be refinanced at the earliest possible opportunity. Other countries (e.g. France, Portugal) are implementing large guarantee facilities (EUR 10 bn for France, EUR 6 to 7 bn for Portugal). It is not yet fully clear how these guarantees will be employed, priced and structured. In addition, France is implementing a EUR 8 bn funding facility managed by Caisse des Dépôts ("Fonds d'Épargne"). The relationship between PPP and public infrastructure investment stimulus programmes in some countries is still to be worked through.

2.3 National measures mitigating particular obstacles deriving from current market conditions, for example re-financing risk due to shorter maturities of private funding (so-called mini-perms)

At the moment significant volumes of senior debt seem to be obtainable only with relatively short maturities thereby imposing a refinancing risk on the project. Market related lack of re-financing (i.e. not related to the project itself) is a risk the project companies/sponsors have difficulties to predict or manage. Accordingly, public procuring authorities might consider sharing this risk with the private sector.

2.4 Adjustment of national procurement approaches to reflect the difficulties of securing fully committed funding at the bid stage

Traditionally competitive bidding process required each consortium to provide committed funding for their bid. This was a reasonable requirement at the time of more than sufficient supply of senior debt. However, in current market conditions it appears unreasonable to require all bidders for the same transaction to obtain financing commitments from different sources thereby absorbing a disproportionate part of banking capacity available. Therefore, in the short term, it would be in the best interest of public sector promoters to adjust their procurement approaches to reflect the difficulties of securing fully committed funding at the bid stage. Alternatively, the authorities could consider, for example, some form of funding competition at the preferred bidder stage.

2.5 Maintaining private sector activity in this key sector by retaining the necessary expert personnel and know-how

Some large banks, which have been particularly badly hit by the crisis, have pulled out of (or significantly scaled down their) Project Finance and PPPs, while some have engaged in major strategic revisions. Others continue to show commitment to the infrastructure market, but are suffering from liquidity problems, maturity limits and/or

capital constraints. Most mid to small size players have all but withdrawn from this market. This has caused the market capacity to contract, as these banks formed the bulk of the syndication and secondary markets. There is evidence that new (small) players may be attracted by the "void" created, but this remains so far a marginal phenomenon.

2.6 Development of capital markets throughout the EU to finance Infrastructure

The rapid development of the EURO capital market over the last 10 years for different maturities and risk categories has not yet contributed to the financing of the TENs-infrastructure market as could have been expected. Though this situation was understandable in recent years when banking markets had substantial liquidity and could provide long maturities at low margins, this is no longer the case and such conditions are unlikely to return again in the foreseeable future. The long-term strategic contribution that could be made by the EURO, Sterling and other European Capital markets towards financing TENs infrastructure needs therefore to be looked at again as a matter of priority.

There is a widespread agreement that the fundamentals are strongly in favour of financing Infrastructure and TENs through the capital markets (infrastructure projects are expected to provide long term, low volatility income, which should match the long-term fixed liabilities of many institutional investors). Historically, there was considerable investor appetite for infrastructure bonds in selected markets (e.g. the UK sterling market) although less so in some other parts of the EU. Currently, there are number of market and structural issues in the way of the development and expansion of the capital markets for financing infrastructure. These include (i) investor reluctance to invest in unwrapped (non-guaranteed) bonds, (ii) perceptions of the lack of liquidity of a potential infrastructure bond market and (iii) investors' lack of know-how to evaluate Project Finance/PPP risks. When each of these issues is addressed, a significant step up in volume of infrastructure bond issues should be possible as is currently the case in the US Dollar capital markets.

Actions are required by both the public and private sector to develop the bond markets; governments as well as EU institutions have a role, particularly in respect of promoting liquidity. Private sector (investors, underwriters, issuers) will need to demonstrate willingness to play their respective roles. For example, the institutions may need to develop their capacity to assess risks in Project Finance and PPP transactions – a function previously delegated to monoline insurers, which no longer fulfil this function.

The Commission, the EIB and national procurement authorities could also contribute by the greater use of co-financing with the capital markets in Europe including in appropriate cases the use of long term fixed rate funding. In the future, if capital market financing of Infrastructure develops sufficiently, it could also be applied to investments in other areas adjacent to the EU² that meet the policy and financing requirements for such investments.

An idea that has been considered is that the Commission could issue bonds at EU level to increase the budget available to projects (so called Eurobonds). This idea has been periodically discussed since the European Commission's White Paper on Growth, Competitiveness and Employment of 1993 (COM (93) 700). However, the idea has not so far found the necessary political support.

2.7 EIB support for TEN-T investments with standard and specialised loans/instruments as well as equity

EIB has followed a long-term strategy in collaboration with the Commission, national authorities, financial institutions as well as public and private investors, which has resulted in EIB financing for TENs Transport and Energy growing from EUR 7.9 billion in 2004 to EUR 12.8 billion in 2008, totaling EUR 46.5 billion in this 5-year period. These results reflect the merits of individual Projects appraised on a case-by-case basis within the overall TENs policy framework.

² Neighborhood Countries in the Eastern and Southern Neighborhood.

Standard EIB senior loans are made either directly to promoters/projects or on a bank-intermediated/guaranteed basis. Specialised SFF³ loans and LGTT⁴ are also used increasingly to support TEN-T investments. In the current market conditions, the importance of these existing instruments for the overall TEN-T programme has been further demonstrated by a significant increase in EIB's lending volume to TENs and PPPs as well as the expansion of its SFF lending for investment in infrastructure and TENs as illustrated by the three LGTT operations already signed in 2008/9, the first year of implementation of the LGTT programme.

As part of its overall strategy for financing TENs, EIB is also considering the utilisation of instruments providing improved leverage on the use of EIB as well as the resources of risk sharing partners. Such instruments are considered important as a response not only in short term to the crisis but also for the longer-term development of the market.

The benefits of this approach are evident from the example of the A5 Motorway, a PPP-TENs project in Germany, where a limited investment had a significant effect on the overall financing structure. This Project which reached financial close in the middle of the financial crisis utilised 3 specialised EIB instruments: (i) SFF loan; (ii) LGTT and (iii) equity investment through the Meridiam Infrastructure Fund. An LGTT facility of EUR 25 million supported senior debt of several hundred million euros; the provision of an LGTT guarantee requires careful financial analysis and structuring but a relatively small capital contribution by each EIB and DG TREN, thereby providing valuable leverage of EIB and Commission resources. Similarly by investing through an equity fund, EIB's proportional investment in the project amounted to a few million euros but made a significant contribution to an over €500 million project being fully funded without any need in this case for public sector budgetary financing.

2.8 Facilitation of the issuance of TEN-T Project Bonds

There is general agreement amongst market participants that the greater availability of subordinated debt tranches could enhance the credit of projects or portfolios. The size of this tranche would depend on the risk profile of the project/portfolio as the purpose is to uplift the credit profile of the higher ranking senior debt financing to A/AA/AAA, which establishes a range within which certain institutional investors would be interested to invest in the sector. The subordinated tranche could, inter alia, be provided on contingent basis by EIB, which would make it similar in structure to LGTT, an instrument that is based on EIB/EC risk sharing.

Such credit enhancement structure could, inter alia, be targeted towards TEN-T transactions where the income/revenues depend on the availability of the asset as such transaction do not (at least until now) have an LGTT-like instrument available and generally are considered to have low risk post construction.

In addition, EIB is exploring the possibility to provide debt service/deficiency guarantees for (a) commercial banks providing a subordinated debt tranche or (b) bonds issued in appropriate cases by a TEN-T project company, as part of a co-financing structure involving various other lenders or institutions. In such arrangement, the relevant part of the debt service obligations of the project company would be guaranteed by EIB, which means that investors in these bonds would assume EIB risk. Such a structure would differ from a traditional monoline "wrap" as the EIB-guaranteed capital market issue would only provide a portion of the project's senior debt and thus it would need to be accompanied by for example other risk financiers such as banks or capital markets and/or corporates or public authorities and/or an intermediated EIB senior loan to commercial banks.

³ Structured Finance Facility

⁴ Loan Guarantee Instrument for trans-European transport network projects. This new instrument since 2008 will partially cover the revenue risk in the early operational period of a project and thereby significantly improves the financial viability of TENs investments.

2.9 Exploration of options for using the TEN-T Budget Funds to TEN-T Project Bonds on a Risk Sharing basis

Further consideration is being given to expanding the use of Risk Sharing instruments using Community or national budgetary resources. The potential benefit of using Community Budgetary funds for Risk Sharing has been clearly demonstrated on LGTT and RSFF both of which are joint EIB/EC Risk Sharing instruments. Similar approaches could usefully be applied to both guarantees for TEN-T Project Bonds as well as for subordinated tranches to facilitate the issuance of such bonds.

2.10 Establishing Equity Funds to finance TEN-T Infrastructure such as the 2020 European Fund for Energy, Climate Change and Infrastructure – the Marguerite Fund

EIB, in partnership with a variety of public and private sector institutions, has in recent years invested in the establishment of a series of Equity Funds for Infrastructure including TENs/PPPs across the EU. These and other funds by other investors have become important sources of risk sharing finance as well as organisational capacity and expertise in support of the financing of Infrastructure projects.

In view of EIB's experience, the ECOFIN Council of September 2008 requested the EIB and the Commission to set up a Working Group including representatives from selected public long term institutional investors (CDC, CDP, KfW, ICO and PKO) with the task of proposing further coordinated action using equity and debt instruments with a focus on energy and infrastructure. Agreement has now been reached to establish before the end of 2009 the 2020 European Fund for Energy, Climate Change and TENs Infrastructure (the Marguerite Fund). The Fund will operate on market principles and invest in the areas of energy and climate change as well as TEN-transport infrastructure and is expected to have equity of €1.5 billion and an associated Debt Co-financing Initiative of €5 billion from both public and private institutional investors.

Equally importantly, this Fund is also expected to be a model in the future for other similar public and private funds in the EU: both at regional and national level for different infrastructure sectors in view of the approach taken to combining market principles while still supporting public policy objectives.

2.11 Provision of "bridge financing" to alleviate capacity constraints in sources of infrastructure funding

In the current banking market, there is a clear shortage of debt financing due to a combination of liquidity, maturity and risk capacity constraints. Absence of appropriate maturities in senior debt for medium size (EUR 200m – EUR 500m) and large projects (EUR 500m plus) has been reinforced by the reduction in the number of experienced financial institutions active in the sector.

A significant improvement could be achieved, as the EIB has already demonstrated in selected cases, if more institutions provided more senior debt and/or mezzanine debt for medium and even for large transactions. The main goal would be to provide the additional capacity necessary to accelerate financial close by ensuring that full funding is available at financial close to enable all parties to jointly commit. In addition to EIB, similar approach has been adopted to a limited extent by certain national authorities, which have been prepared to provide exceptional support beyond the norms that would otherwise apply for a temporary period while the current difficult market conditions continue.

2.12 Improvement of the coordination and use of Community Budgetary resources

Another important aspect raised by implementation of major projects is the potential scope for coordination between the different sources of public funds. The Community share in the development of the TEN-T is relatively high – the EU budget provides approximately 13 per cent of the overall funding of TEN-T through grants. EIB financing on average provides a further 16 per cent in the form of loans. For the period 2007-2013 in particular, the TEN-T budget is expected to provide 2.1% of the TEN-T overall investment needs, 8.9% will come from the Cohesion Fund and 2.1% from the European Regional Development Fund.

A strengthened system of coordination could be envisaged, in collaboration with EC/EIB/National Task Forces, which, on the one hand, could assist national authorities to make the best use of the available Community resources and on the other hand, coordinate the implementation of the TEN-T network to improve the implementation of individual projects. The European Coordinators for Priority TENs Projects for instance, with the support of Commission services and TEN-TEA, could already now take a leading role in facilitating the implementation of Priority Projects funded with the Cohesion Fund.

2.13 Support the development by the Commission and the EIB of knowledge sharing/expertise advice

Investing in advisory services, including advice on financial structuring, can provide substantial benefits by increasing quality at each stage of the project cycle. At its best, it delivers bankable projects that otherwise would not happen.

At the European level the Commission, EIB and other parties have collaborated very effectively to establish new institutional and organisational capacity for example through EPEC⁵ and an enforced contribution of JASPERS⁶ to deliver advisory services through the EU to Member States and public authorities. JASPERS is already demonstrating its potential to contribute to TENs; a substantial part of JASPERS' portfolio is in this sector.

2.14 Enhancement of the project preparation

It is considered essential that special attention is also given to improve project preparation, and in particular project readiness for the private sector involvement, as a prerequisite for attracting and absorbing public as well as private funds. A project and programme preparation facility drawing on the resources of TEN-T Executive Agency (TEN-TEA), the TEN-T budget, DG REGIO and the Structural Fund budgets in combination with the expertise in the European Investment Bank, including JASPERS for the New Member States and EPEC, could be a means to assist project promoters. The EIB is prepared to work closely with the European TEN-T coordinators to facilitate their preparatory work to enable TENs Priority Projects to be brought to launch, financial close and operation more rapidly.

For further information on EIB financing of TENs:

<http://www.eib.org/projects/topics/tens/index.htm>

For further information on LGTT:

<http://www.eib.org/about/documents/lgtt-fact-sheet.htm?lang=-en>

For further information on EPEC:

<http://www.eib.org/epec/index.htm>

⁵ European PPP Expertise Centre

⁶ JASPERS: 'Joint Assistance in Supporting Projects in European Regions', is a partnership between the Commission (Regional Policy DG), the European Investment Bank (EIB), the European Bank for Reconstruction and Development and the KfW (Kreditanstalt für Wiederaufbau). It seeks to pool expertise and resources to assist New Member States in the complex task of preparing quality projects so that they can be approved more quickly for EU support by the services of the Commission.