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EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL
COMMITTEE AND THE COMMITTEE OF THE REGIONS**

A pilot for the Europe 2020 Project Bond Initiative

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

**amending Decision No 1639/2006/EC establishing a Competitiveness and Innovation
Framework Programme (2007-2013) and Regulation (EC) No 680/2007 laying down
general rules for the granting of Community financial aid in the field of the trans-
European transport and energy networks**

{COM(2011) 659 final}
{SEC(2011) 1237 final}

INTRODUCTION

This document provides the executive summary of the Impact Assessment on the pilot phase of the Europe 2020 Project Bond Initiative. The intention is to put in place a support mechanism that would allow infrastructure projects to access capital market funding to complement more traditional bank lending. In view of the financing problems faced by projects at present, the need to test the design and ensure market acceptance of a new Initiative it is proposed to launch a pilot phase for the transport, energy and ICT sectors already in 2012-13. The pilot phase will be funded by redeploying a total of EUR 230 million from the TEN-T, TEN-E and CIP budget lines.

The pilot will serve to improve its effectiveness under the Connecting Europe Facility (CEF), which will place EU infrastructure financing on a more coherent basis in the 2014-2020 period. This impact assessment covers primarily the pilot phase.

In order to fulfill the ambitious goals of the Europe 2020 strategy significant investment is required. Despite the financial support of the Community budget through grants from the TEN-budget line, the Structural Funds and Cohesion Fund, the Competitiveness and Innovation programme as well as the European Investment Bank loans, many TENs and other infrastructure projects remain incomplete for various reasons. The Commission has identified the lack of investment as a significant obstacle to the implementation of the goals¹.

This Initiative is a part of the **Europe 2020 strategy**, which was endorsed by the European Council on 17 June 2010 and aims to make Europe a smart, sustainable and inclusive economy, which delivers high levels of employment, productivity and social cohesion in a sustainable manner. To boost growth and jobs, the EU has identified seven flagship initiatives, two of which are the "**Digital Agenda**" and the "**Resource Efficient Europe**". They relate to Trans-European Networks (TENs) in the areas of transport, energy and telecommunications.

In the period 2014-2020, the instrument would not necessarily need to be limited to the areas of CEF in future; projects in other infrastructure sectors, such as social sectors, renewable energy or certain space projects, could be eligible provided they meet the economic and financial prerequisites. Thus the instrument should be open to use in other policy contexts including structural and cohesion funds and external policies. The formulation of the CEF proposal should not preclude this.

PROBLEM DEFINITION

Europe faces enormous infrastructure investment needs in transport, energy and ICT networks, estimated to be of EUR 1.5 trillion to EUR 2 trillion, to meet the policy goals of the Europe 2020 strategy. Of course, there are also substantial investment needs in other areas of infrastructure, but these will not be considered further at this stage. In other words, the

¹ See for instance the Transport White Paper - SEC(2011) 359; the Communication on Energy Infrastructure Priorities to 2020 and beyond : A blueprint for an integrated European energy network - COM(2010) 677; Digital Agenda for Europe - COM(2010) 245; European Broadband: investing in digitally driven growth - COM(2010) 472.

aggregate figures could easily translate into annual financing volumes of EUR 200 billion or more. The lack of investment as a significant obstacle to the implementation of the goals presented above is the cause for the TEN projects being delayed or abandoned. Therefore, the existing problem is mainly defined by the nature and extent of infrastructure funding gap.

At present, public sector infrastructure investment in the EU averages approximately 1% of GDP or EUR 120 billion per annum, out of which about 80% is investment in transport and most of the remainder in social infrastructure such as schools and hospitals.

Increasingly, governments have encouraged the private sector to finance infrastructure investment, either on a purely private sector basis through privatisation, through concessions or, more recently, using the public-private partnership (PPP) model as a basis. Such privately funded projects are typically financed with equity from sponsors or other investors and bank loans.

However, the step change in investment needed to meet the Europe 2020 objectives is well beyond "business as usual" and requires a reconsideration of funding and the EU intervention.

Without the initiative (baseline scenario) the EU would continue with the current system of grant financing for individual projects without any use of so-called financial instruments in the energy and ICT sectors. In the transport sector, the two existing financial instruments, the Loan Guarantee Facility for TEN-T (LGTT), which supports bank loans to certain types of transport projects, and the Marguerite Fund, which takes equity investments in transport, energy and climate-related projects, will continue until their expiry.

The lack of infrastructure financing would subsequently affect all countries in the EU due to being transit countries or geographical periphery. The affected groups include citizens in all Member States, who benefit from the infrastructure and ultimately fund it, either as consumers or tax payers, tendering authorities which may not have multiple competitive financing offers and project promoters, who may not be able to get financing for their projects at present, affecting employment directly. This would also affect their sub-contractors, potentially including SMEs.

ANALYSIS OF SUBSIDIARITY

The right for the EU to act in the field of infrastructure financing is set out in Articles 172 and 173 which provide that in order to achieve the relevant objectives the Union (...) may support projects of common interest supported by Member States.

The Europe 2020 Project Bond Initiative complies with the subsidiarity principle as the choice of the EU Regulation for financing trans-European networks projects with project bonds is best suited to provide an efficient and inexpensive means to attract high levels of private sector financing. It will be the first EU financial instrument benefiting infrastructure projects across several sectors with similar financing needs and will as such produce higher benefits in terms of market impact, coherence, administrative efficiency and resource utilisation. By focusing on optimising the use of EU funds, the initiative will aim to improve the effectiveness of both EU and Member States action within this division of competencies.

As capital markets transcend national borders, so efficiency dictates that a financing scheme should do the same. This also avoids distorting financial markets. Countries outside of the EU

have their own policies to support infrastructure financing. Thus, a European initiative would level the international playing field for European projects seeking funding.

In summary, the EU has the potential to achieve the twin objectives of increasing infrastructure financing and creating an infrastructure bond market better in the EU and more completely than the Member States.

OBJECTIVES OF THE EU INITIATIVE

The general two-fold objective of the Initiative to stimulate investment in infrastructure and to establish debt capital markets as a new source of financing. The specific targets of the pilot phase Initiative include enhancing up to 3-6 TEN-T projects, 1 TEN-E and up to 1-3 broadband projects to allow them to issue bonds. The number of projects will depend on the volume of financing required for each project, ie the higher the volume, the more EU budget allocations are needed for one single transaction. The EU budget contribution is expected to attract 15-20 times in additional investment. As the pilot phase is necessarily limited in scope, budget and time this can only be a first step towards creating an infrastructure bond market in the EU by acting as a catalyst for private-sector bond solutions.

These objectives dovetail with existing EU policies and strategies, such as Europe 2020 as well as the ambitious energy and climate policy goals – the "20-20-20" objectives. The Initiative, together with other financial instruments, is an important building block for the **Connecting Europe Facility (CEF)** proposed for the transport, energy and ICT sectors in the **Multi-annual Financial Framework (MFF) 2014-2020**.

POLICY OPTIONS

On the basis of the measure in use to address the existing financing gap and achieve the identified objectives in the area of infrastructure, three main options have been explored:

Option 1: Grant funding, no new financial instrument (baseline scenario). This would entail the exclusive reliance on the use of grants from the public purse, including the EU with bank loans as the main source of private sector financing. In the area of transport, the two existing financial instruments would continue during the pilot phase.

Option 2: Regulatory incentives for infrastructure financing The EU as a whole does not have a true project bond market Financing in Europe has traditionally been dominated by banks and a truly integrated and liquid bond market only started developing after the introduction of the single currency. As a result of the banks' better knowledge of their customer and ability to analyse infrastructure financing proposals, they are able to accept riskier financing structures than bond investors. Thus one of way of addressing the infrastructure financing problem would be to require better security packages from sponsors or making investment more attractive to investors.

Option 3: The use of a financial instrument The financial instrument would take a form of an EIB guarantee or an EIB loan. It has the advantage of not being imposed, but driven by market demand. If well-designed, it is highly flexible and can respond to market needs in a timely manner.

The Initiative would cover pre-identified transport, energy and ICT priority infrastructure and would complement the existing sources of project financing through bank loans. The initiative divides the project debt into a senior tranche and a subordinated tranche, which is, in turn, senior to equity. The subordinated tranche may either be in the form of a subordinated loan given to the company at the outset, i.e. it is funded, or it may be in the form of a contingent credit line, which the company can draw on in case of need, i.e. it is unfunded. A mix of a funded and unfunded tranche could also be envisaged, depending on the characteristics of the project.

The presence of a subordinated tranche improves the risk profile of the senior debt, which increases the attractiveness of the senior debt to investors allowing the senior tranche to be issued as a bond. The desired credit quality can be generally described as one reaching a rating of BBB+ or above, which is likely to require a subordinated tranche of up to 20% of the senior debt of the project. The aim is to expand the investor base for private debt funding of projects to bond investors. The mechanism of the Initiative would rely on the risk-sharing between EIB and the EU.

Other alternatives considered but discarded at an early stage and not assessed in detail include direct senior lending by EU or EIB, a full debt service guarantee, a loss reserve fund and creating a European Infrastructure Bank or Guarantee Agency, which either do not promote capital market financing or distort the incentives of the different players.

ASSESSMENT OF IMPACTS

Option 1: Grant funding would mean accepting a continuing shortfall in infrastructure investment and private financing sources, to the detriment of European long-term sustainable growth. The economic and social impact of built projects would be otherwise unaffected. The infrastructure that would be implemented would likely be built at a higher than necessary cost to society. There is a risk that key EU infrastructure would be sacrificed for national priorities.

Option 2: Regulatory incentives may allow more bond financing. The economic and social impact of built projects would be otherwise unaffected. However, the final cost to the tax payer is likely to be higher as the cost of additional capital is passed on. Further, the costs of compliance in the selected sectors may also be high and lead to market distortions, but this is difficult to evaluate. In any case, this option is unlikely to be implemented quickly.

Option 3: The financial instrument would take a form of a contingent credit line or a subordinated loan. Again, the economic and social impact of built projects would be otherwise unaffected, but the cost to tax payers is expected to be lower.

The table below presents an synoptic description of the different impacts of the options considered in what concerns other economic, social and environmental impacts.

Option	Option 1: Grant funding	Option 2: Regulatory incentive	Option 3: Financial instrument + possibly regulation of the capital markets
Criteria			
Achieved objectives			
TENs	Partly	Partly	Yes
Capital markets	No	Maybe	Yes
Impacts of the options			
Economics impacts	<ul style="list-style-type: none"> - Only small efficiency gains possible - Continuing lack of financing - Relative decrease of the long-term EU growth potential and competitiveness - Higher than necessary infrastructure cost to society 	<ul style="list-style-type: none"> - No cost on budget - Distortion of the decision making leading to the mis-allocation of funds² - More costly for sponsors, tendering authorities and tax payers, thus less infrastructure being built - Less potential of extension due to barriers of different regulation - Disproportionately large compliance costs for SMEs 	<ul style="list-style-type: none"> - Most final funding attracted at lower cost - Stimulated implementation of large infrastructure projects with national and cross-border benefits - More access to the infrastructure provided at a reasonable price - More diverse financing possibilities created - Positive effect on growth and competitiveness of the EU - Market-driven
Social impacts	<ul style="list-style-type: none"> - Grant funding to projects that could be financed in the market - Potential lack of funding for weaker projects - Key EU infrastructure subordinated to national priorities - Disproportionality of cross-border projects reducing cohesion in EU 	<ul style="list-style-type: none"> - Sponsors looking for the highest return projects due to higher costs - Non-implementation of weaker projects - Increasing disproportionality cross-borders and lower cohesion in EU 	<ul style="list-style-type: none"> - Pension and insurance funds securing a higher rate of return for pension policy holders, i.e. citizens - Greater market integrity leading to better services, higher investor confidence and greater participation in financial markets - More jobs created by stimulating new infrastructure and economic growth
Environmental impacts	<ul style="list-style-type: none"> - No particular environmental impact 	<ul style="list-style-type: none"> - Higher costs leading to less infrastructure built with reduced potential (positive and negative) effects 	<ul style="list-style-type: none"> - Acceleration or enabling of financing for projects with environmental impacts that would not otherwise take place - Implementation of the Europe 2020 strategy with positive environmental impact

²

Due to increased costs of financing, sponsors are likely to be looking exceptionally for the highest return projects, which could lead to non-implementation of weaker but still viable projects in particular sectors, while investors might invest in infrastructure projects due to regulatory advantages rather than the quality of the underlined projects, which would lead to the mis-allocation of funds.

The table above shows that:

- **From an economic point of view**, Option 3 seems to be preferable overall. In fact, while achieving both objectives identified at lower overall costs, if appropriately priced it creates no market distortion and lower administrative burden.
- **From a social point of view**, both Option 2 and 3 could make it easier for economic entities to raise capital, provide the necessary infrastructure, stimulate growth and create more jobs. However, Option 3 is more desirable as it would benefit institutional investors such as pension and insurance funds, who invest in financial instruments in order to secure a higher rate of return for pension policy holders, i.e. citizens.
- **From an environmental point of view**, the general objectives of the EU initiative only relate to the financing of projects. Projects themselves are the entities that might cause environmental impacts.

The following summary table set out the advantages and disadvantages of the different options, measured against the criteria of their effectiveness in achieving the related objectives, and their efficiency in terms of achieving these options for a given level of resources or at least cost. Each scenario is rated between "---" (very negative), 0 (neutral) and "+++" (very positive).

Option	Criteria	Impact on stakeholders	Effectiveness	Efficiency
Objective 1: Stimulating investment in infrastructure, especially TEN-related				
Option 1: Grants		0	0	0
Option 2: Regulatory incentives		(--) some administrative burden for both companies and investors, but (0) unchanged for Member States in case no additional monitoring required	(+) partially enables implementation of some TENs (--) could create conflicts between regulation in each sector and requirement for more capital	(0) does not increase cost on budget (---) increases cost to almost all types of stakeholders (--) would affect all projects and financiers, not only those using bonds
Option 3: Financial instrument		(-) Lower administrative burden for companies and Member States, but (---) higher for investors (--) requires investor education	(++) facilitates the implementation of TENs (++) encourages single market (+++) stimulates competition between bank and bond markets (---) depends on other conditions such as market acceptance, procurement practices, regulatory framework and perceived uncertainties by investors	(+) budget contributions will be strictly capped (+++) lower infrastructure investment cost expected over the project lifetime
Objective 2: Establishing debt capital markets as a new source of financing				
Option 1: Grants		(---) no incentive available for investors and projects	(---)	(---)
Option 2: Regulatory incentives		(0) does not create new investment tool (+) some private initiatives as a niche activity might evolve	(+) may establish debt capital markets as financing source (+) may attract some funding	(---) higher financing costs (---) unclear whether it will attract additional funding, in which case the additional cost would have been unnecessary
Option 3: Financial instrument		(++) widens choice of financing instruments (--) promotion and education required	(+++) stimulates new sources of financing and (++) possibly creates new asset class (+++) attracts most of	(++) lower financing cost expected (-) uncertainties remain as regards additional costs such as rating or listing

	for a novel EU instrument	funding (--) factors such as controlling or monitoring creditor requires multiple approaches	
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Option 2 is the least costly from a Commission perspective, but it imposes costs on all project sponsors, small and large, without a clear benefit. Since there is no incentive for banks and investors to adjust behaviour, the desired development of capital markets may not take place. It is expected to have rather negative impact on stakeholders as well as perform poorly in terms of effectiveness and efficiency compared to other options. It is therefore the least preferred option.

Option 1 does not per se raise costs on any stakeholders, but nor does it generate additional funding from loan or capital markets. It would also have no influence on effectiveness and efficiency of achieving identified objectives. This is therefore the second-most/least desirable option.

The preferred option is the use of a financial instrument – **Option 3**, since it gives market participants economic incentives to adapt their behaviour without imposing blanket regulatory costs. It is considered to be the most effective solution with the most positive impact on stakeholders and the most tangible improvement of the financing of infrastructure.

MONITORING AND EVALUATION

The Commission may work through one or several financial institutions with a public mission, which would normally receive and assess the applications for support, the financial structure of the project, its economic viability etc according to their internal rules and procedures. The pilot phase will be implemented in particular with EIB.

EIB Financing Operations will be managed by the EIB in accordance with the EIB's own rules and procedures, including appropriate approval, audit, control and monitoring measures which are the subject of regular reporting to the Commission.

The Commission already collects data on the EU bond market and may also request information from the banks that place the project bonds. These sources and specific performance indicators will help the Commission to review the pilot phase before the end of 2013 in order to draw conclusions on the future design. The mid-term review of the CEF facility will assess whether the scheme introduced (still) adds value and should be maintained.