

# **EU Guarantee Instrument for TEN-Transport Projects**

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# Overview



- 1. EIB – TEN Investment Facility**
- 2. The “TEN Guarantee”**
  - Key features
  - Risk sharing
- 3. Summary and Conclusions**



# 1. EIB - TEN Investment Facility

# The EIB implements EU policies

EIB - European Union's financing institution:

- Created by the Treaty of Rome in 1958, to provide long-term finance for projects promoting European integration.
- Subscribed capital EUR 163.7bn.
- EIB shareholders: 25 Member States of the European Union.
- Lending in 2004: EUR 43.2bn (EUR 39.7 bn within the EU).
- Total outstanding loans at 31.12.2004: EUR 265.8 bn

*Development of Trans European and access networks is one of five key strategic priorities set by the Board of Governors of the EIB*

# Trans European Transport Network (TEN-T)

## Investment challenges for the European Union until 2010

- 75 200 kilometers of roads
- 79 400 kilometers of railways
- 430 airports
- 270 international seaports
- 210 inland ports
- traffic management systems, user information and navigation services



## EIB operations in support of Trans-European Networks and corridors in neighbouring countries 1993-2004

- Priority Trans-European Networks (TENS)
- Sections of these TENS for which financing has been committed
- Other infrastructure and networks financed with a European dimension
- Road and rail corridors in Central and Eastern Europe
- Sections of these corridors financed

- Road/rail
- ↔ Electricity
- Gas
- ✈ Airport
- Multi-regional project
- ◆ Intermodal freight terminal
- ▼ Port
- ✈ Air traffic management
- Development of oil and natural gas deposits
- Multilane free-flow tolling system



**EIB total loan approvals to TEN-T projects since 1993:**

**EUR 66 bn in EU15 Member States;**

**EUR 12 bn in Central and Eastern Europe**

# Challenges to project delivery

- Planning and permitting process: Complex projects and many parties.
- Design optimisation under technical, environmental, financial, legal and regulatory constraints: Long time to decisions and final design.
- Structuring of the procurement and financing including correct costing: Complexity encourages keeping costs on public budget.
- Funding: Complexity of most TEN projects reduces scope for risk sharing and PPP-type financing.
- Construction on time and on budget: Average construction costs in rail 40% higher than forecast<sup>1</sup>.

# Challenges to project delivery (cont.)



- Traffic/ revenue uncertainty:
  - Construction delays impact both costs and revenues
  - Average number of rail passengers 39% lower than forecast<sup>2</sup>.
  - Ramp-up may be slower than anticipated.
  - Larger risks more difficult to hedge (e.g. inflation linked).

*... however, uncertainty on traffic/ revenues diminishes dramatically over the project cycle*

# The TENs Investment Facility ....

.... in the context of the European Growth Initiative

- Strengthen and, where possible, accelerate the investment in TENs.
- Increase the EIB resources available for the development of TENs transport to 2010.
- Improve the range of financial instruments available from the Bank.
- Take additional risk where it adds value, but apply appropriate risk pricing.

... in collaboration with the Commission, Member State Authorities and the Private Sector.

# EIB wider role in the Growth Initiative



- Financing of transport infrastructure is a core expertise of EIB. Dedicated organisation has been established and is proven
- EIB is a strategic advisor to the Commission, Member States and Public Authorities on TENs and other institutional issues. It collaborates effectively with national PPP taskforces
- Proven risk management record with increasing use of structured finance, securitisation, banking and capital markets
- Commission and EIB have an established common interest in realizing the Community objectives. Combined use of budgetary resources and EIB loans is envisaged under the Growth Initiative.



## **2. The “TEN Guarantee”: Key Features**

# A new Instrument within the 2007-2013 Financial Perspective



- A proposal from the Commission to the European Council and the European Parliament
- Jointly developed by DG TREN and DG ECFIN
- To be financed out of the TEN Budget available over the 2007-2013 Financial Perspective

*EIB is the proposed Agent to manage the TEN-Guarantee on behalf of the Commission*

# The problem we intend to solve



- Currently limited private participation in TEN-Transport, especially in large scale cross-border projects, due to the well known obstacles already discussed ...
- ... but there is also a clear reluctance to bear high initial uncertainty for otherwise viable projects (e.g. initial lack of continuity or interoperability)

*Market participants expressed strong interest in a specific instrument mitigating “early operation risks”*

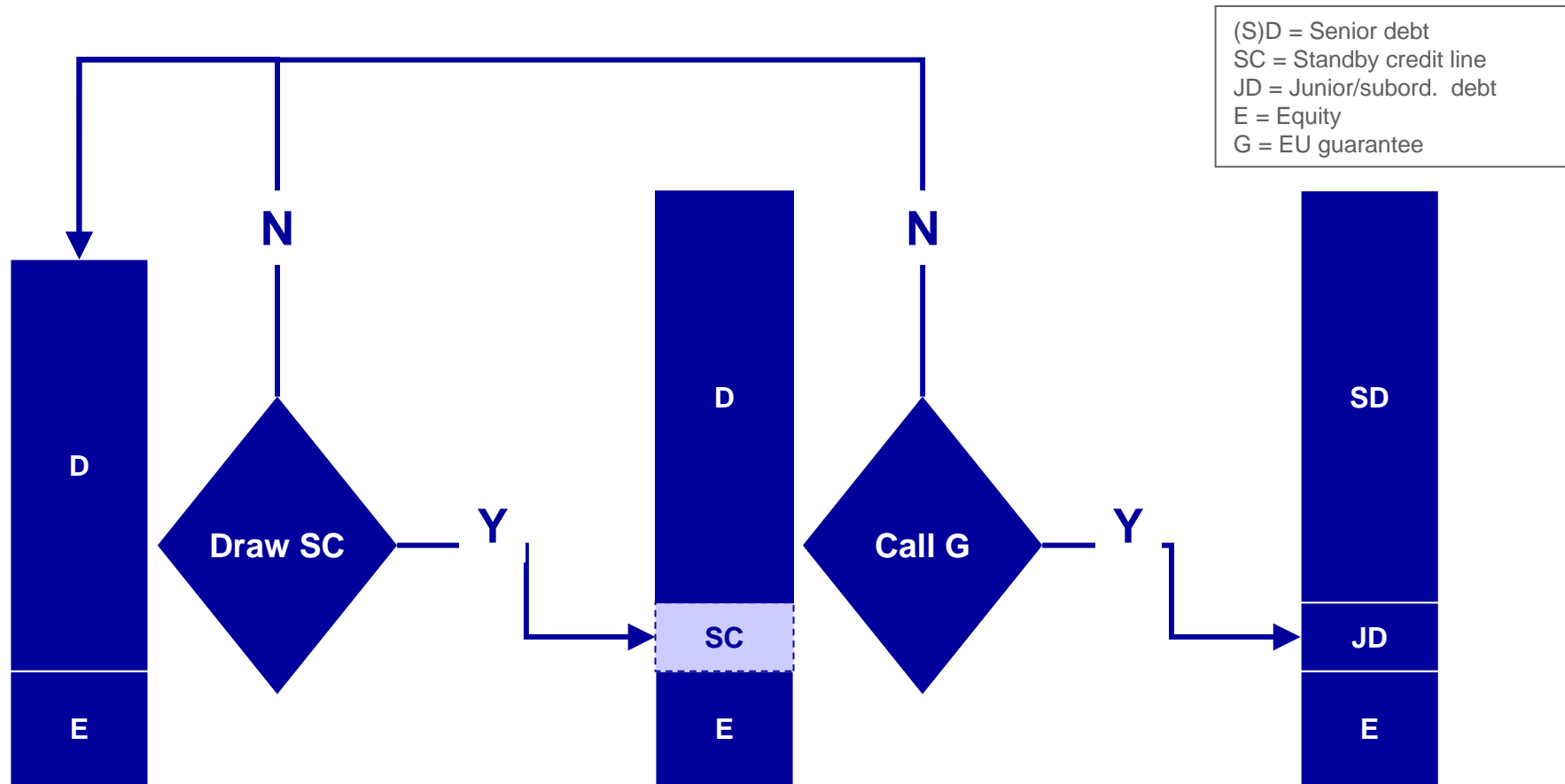
# Key technical features



- Aims at covering early traffic, revenue, operation risks ...
- ... for projects that are fully funded ...
- ... and expected to be financially viable in the long-term.

*Technical form: TEN Guarantee issued to cover standby credit facilities available for 3-5 years post construction*

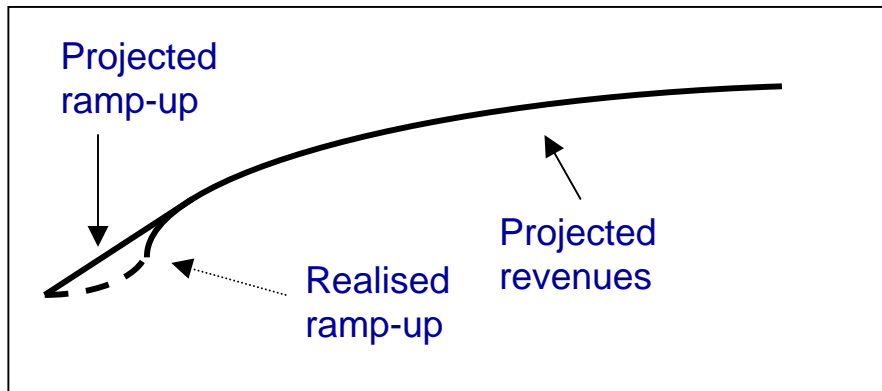
# Projects are fully funded for the long-term, independently of the TEN Guarantee



- SC becomes part of capital structure only once it is drawn, due to initial revenue shortfalls.

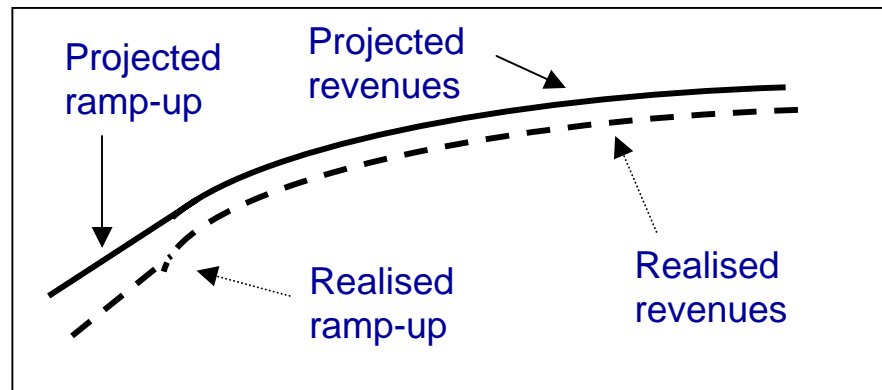
# Early operation vs long term risks

**Fig. 1: Traffic shortfall during ramp-up**



- Temporary revenue shortfall during ramp-up;
- Post ramp-up traffic catching up to projected level;
- Guarantee will add value in this cases

**Fig. 2: Traffic shortfall throughout project life**



- Temporary revenue shortfall during ramp-up and
- Post ramp-up traffic stays significantly below projected level;
- Guarantee not designed to ensure long-term viability

- Subordination implies that the Guarantee underpins senior debt in a similar way as equity
- Standby nature of the commitment implies that liquidity will be provided only as needed

*EUR 1 billion of liquidity provided by the EU could underpin the credit quality of EUR 20 billion of senior debt under effective project appraisal and credit risk management*

# Goal is efficient provisioning



- A portfolio of 25 – 35 Guarantees will be built over the course of the Financial Perspective 2007-2013
- Guarantees will be assessed for ability to meet investment grade creditworthiness over time
- Provisioning will be built so that it will be sufficient to cover potential claims at a high level of confidence

*This will imply decreasing provisioning rates as the portfolio is gradually built*



## **2. The “TEN Guarantee”: Risk Sharing**

# The public sector



- Commitment to selecting economically viable projects and tendering financially viable concessions
- Long term financial viability may still require substantial, partial grant funding from national sources ...
- ... and/or appropriate revenue schemes (e.g. mixed toll and availability payments to concessionaire)

*Required to provide equivalent support, in the form of a matching guarantee, or other suitable instruments as appropriate to the differing national contexts*

- Fund the project with sufficient equity to make them capable of reaching investment grade over time
- Benefit from the presence of TEN Guarantee (e.g. lower cost of senior debt), but ...
- ... will be charged a risk based premium on the TEN Guarantee and ...
- ... will be subordinated to the EU in case the TEN Guarantee is called and subsequently needs to be repaid

# Senior lenders and bondholders



- Benefit from improved creditworthiness
- Should be able to offer better terms
- Retain in full the construction and the long-term revenue risk of the project

- A strong signal of partnership with the Member States and the private sector beyond the pure construction phase
- A more targeted and efficient use of Community budget, also through enhanced coordination among different sources of EU financing, whether from Commission or EIB
- A systematic recourse to EIB's appraisal capacity and endorsement of the viability on key TENs projects

*The Guarantee is potentially a « path-finder » for innovation in Community instruments*

- February 2004 decision requires that PPP retains both:
  - Construction risk and
  - Either demand or availability risk
- The TEN Guarantee does not mitigate construction risk by design ...
- ... and it will always leave availability risk with the PPP

*Recourse to the Guarantee « per se » will not have an impact on whether project debt is consolidated on the government accounts*

A blue-tinted photograph of a large, modern building with a courtyard and flagpoles. The building has multiple stories and a prominent central tower. In the foreground, there is a paved area with a low wall and a set of stairs leading down to a lower level. Several flagpoles with flags are visible on the left side of the building. The overall scene is brightly lit, suggesting a clear day.

# 3. Summary and Conclusions

- Projects eligible under the TEN-T Financial Regulation will be eligible under the Guarantee, provided they benefit from a substantial level of financial support offered by the Member States and/or other national public authorities as well as the private sector.
- The combined support of EU, national level grants and private capital should be such that project debt is capable of reaching investment grade credit quality over time.
- Guarantee will support standby credit facilities aimed at covering post construction risks (e.g. traffic or revenue shortfalls) with availability limited to the early operational phase (3-5 years).
- A EUR 1bn Guarantee Facility is expected to underpin the credit quality of up to EUR 20bn of senior debt, over the period of the 2007-2013 EU Financial Perspective.

# Conclusions



- Accelerating the TEN programme calls for increased private sector participation, but this will only come in the presence of further and tangible commitment by EU, Member States and EIB.
- EIB is committed to work with the Commission for the establishment and the success of the TEN Guarantee
- It will require increased prioritization of projects that are economically viable for the public sector and financially viable for the private sector
- It will need that a sufficient critical mass is made possible by the envisaged budget allocation of EUR 1 billion



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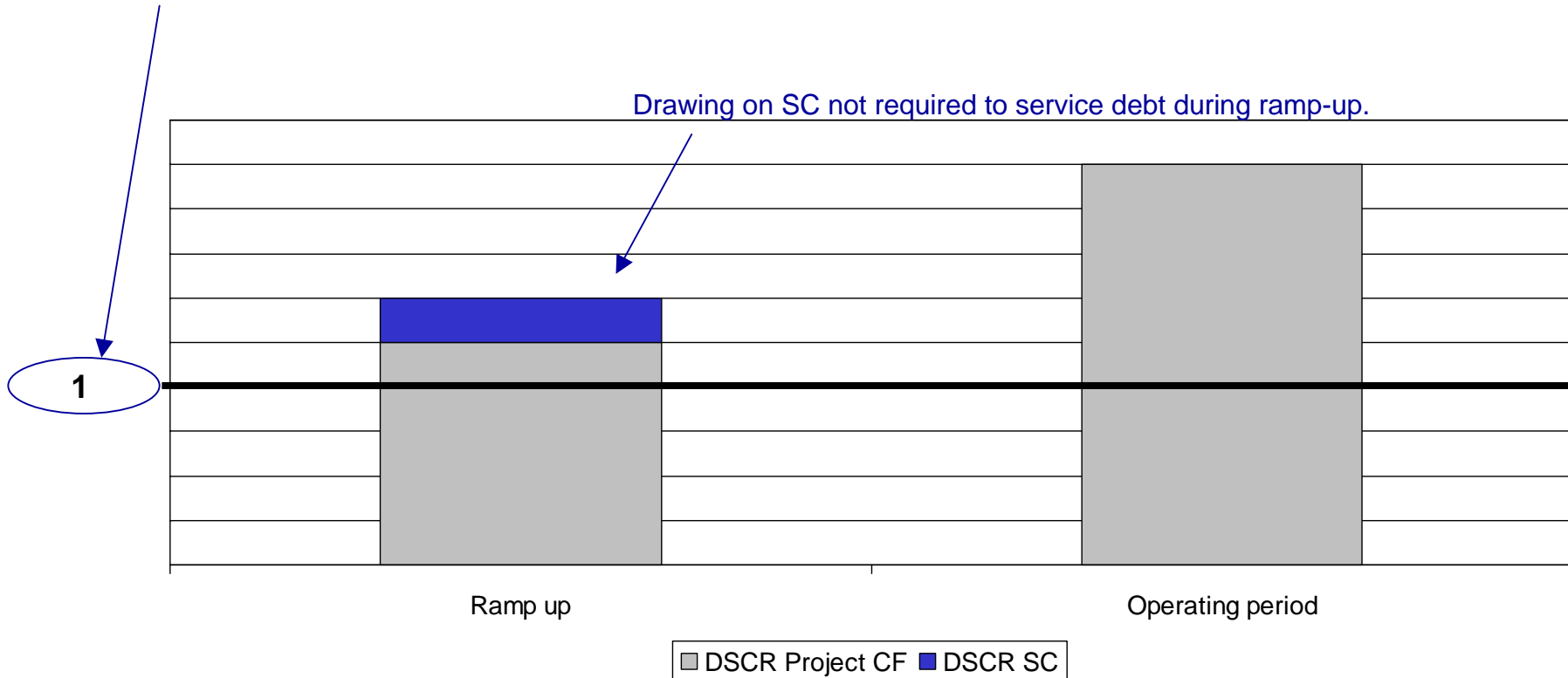
<http://www.eib.org>

# Technical Appendix

Impact of the EU TEN Guarantee on Cover Ratios

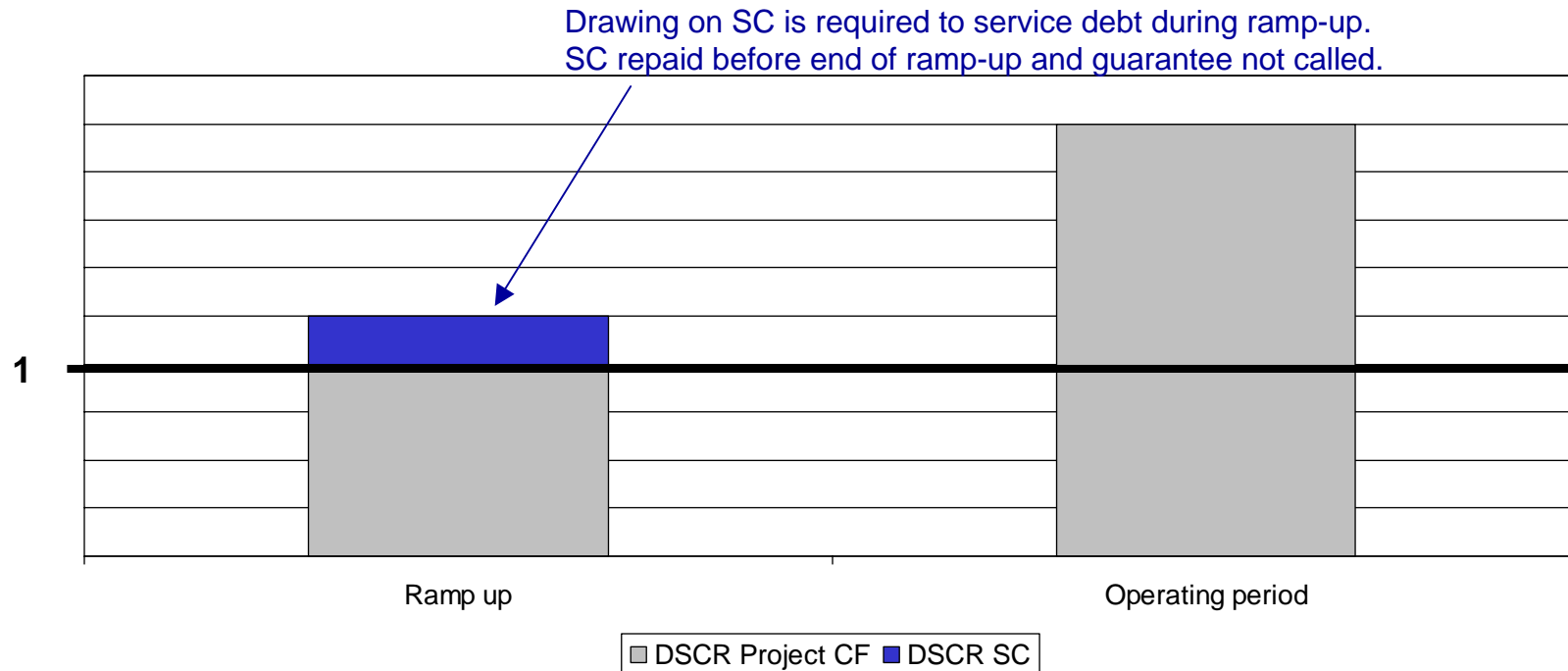
# Scenario: Base case

Debt service cover ratio (DSCR) indicates ability to service debt.



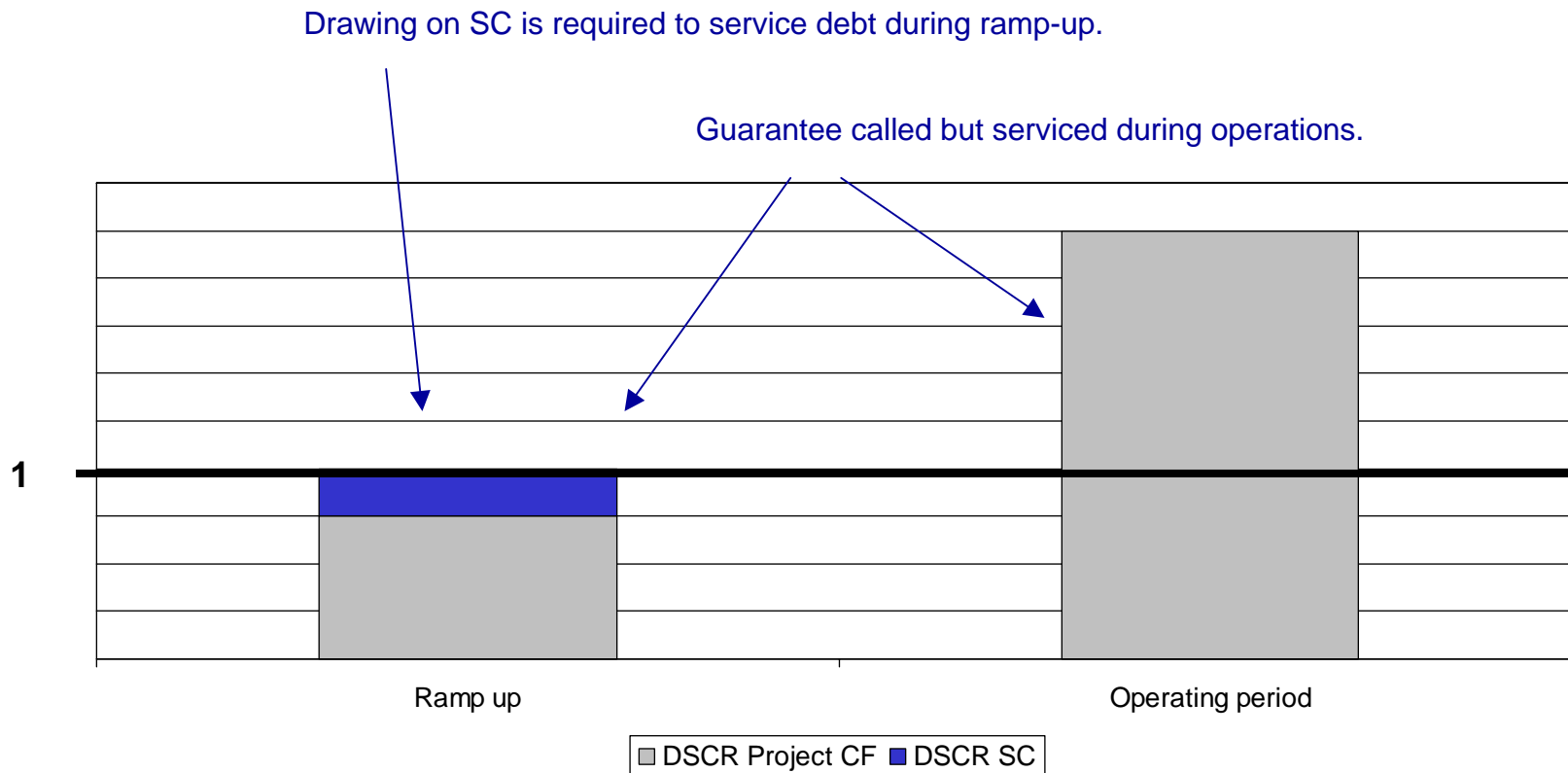
- Standby credit line not expected to be drawn in base case.

# Scenario: SC used but G not called



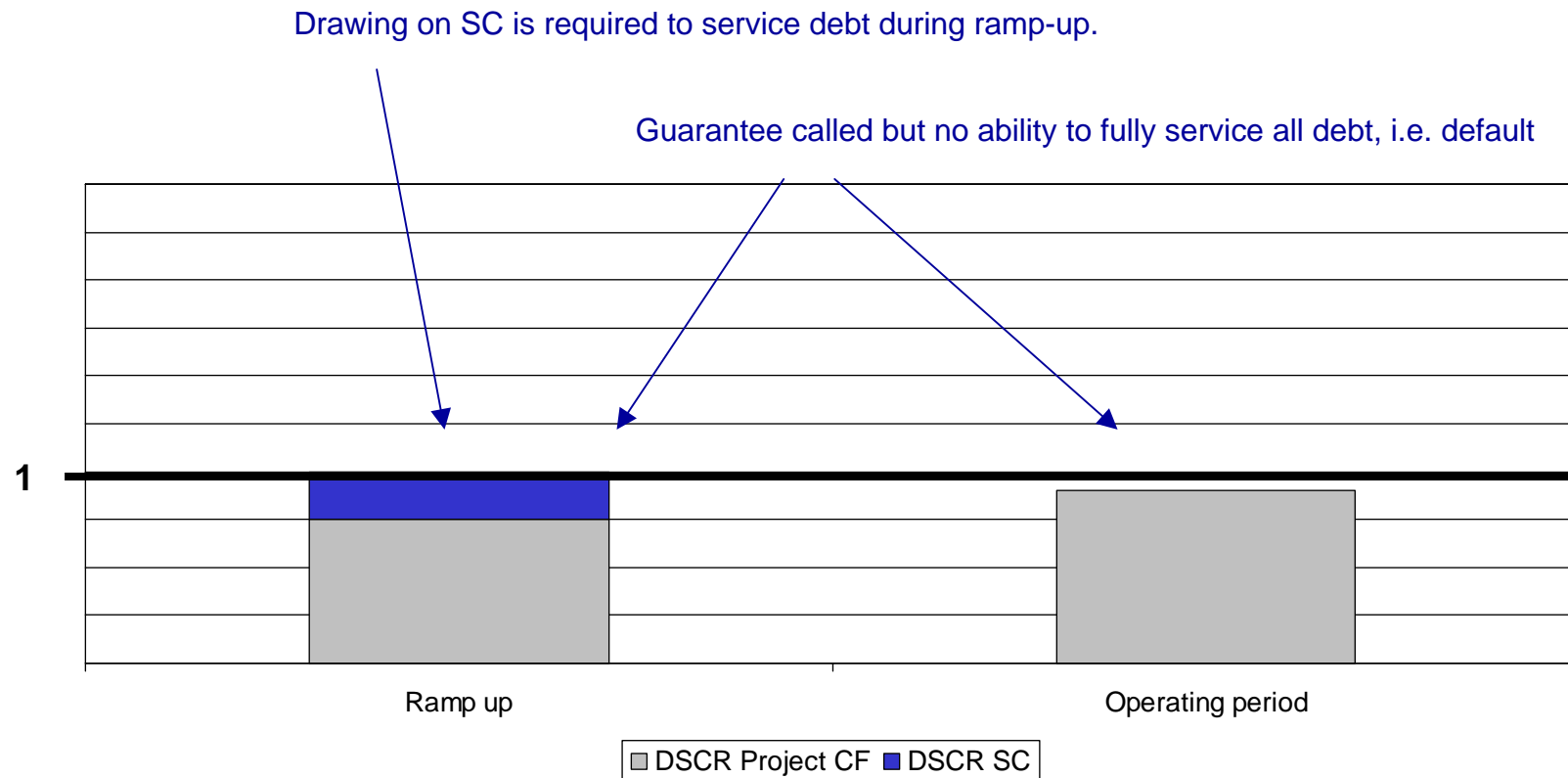
- Standby credit used but repaid during ramp-up.

# Scenario: Call on guarantee



➤ Guarantee called and debt serviced.

# Scenario: Default



➤ Guarantee called and default.