

European infrastructure finance: a stock-take

July 2017



Author: Katie Kelly, ICMA
RegulatoryPolicy@icmagroup.org

Disclaimer

This paper is intended for general information only, and is not intended to be and should not be relied upon as being legal, financial, investment, tax, regulatory, business or other professional advice. While the information contained herein is taken from sources believed to be reliable, neither AFME nor ICMA represents or warrants that it is accurate, suitable or complete and none of AFME, ICMA or their respective employees or consultants shall have any liability arising from, or relating to, the use of this paper or its contents.

Your receipt of this paper is subject to paragraphs 3, 4, 5, 9, 10, 11 and 13 of the Terms of Use which are applicable to AFME's website (available at <http://www.afme.eu/Legal/Terms-of-Use.aspx>) and, for the purposes of such Terms of Use, this document shall be considered a "Material" (regardless of whether you have received or accessed it via AFME's website or otherwise).

AFME and ICMA would like to thank the individual experts and their firms from the AFME ICMA Infrastructure Working Group who participated in this paper. Without their invaluable input and insight, this paper would not have been possible.

© International Capital Market Association (ICMA), Zurich, 2017. All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means without permission from ICMA.

Contents

Why infrastructure	4
Pipeline	4
Future requirements	4
Financing the shortfall	5
Risk	6
Country-specific risk	7
Stability	8
Harnessing expertise	9
Disclosure	9
Secondary Markets	10
Solvency II	10
Basel III	10
European Fund for Strategic Investment	11
Procurement	13
Conclusion	13

This report is a stock-take of infrastructure financing, investment and related initiatives, and an assessment of how to further advance and encourage private sector finance for infrastructure projects. As such, it relates to, and builds upon, the Guide to Infrastructure Financing produced by AFME and ICMA in June 2015¹.

Why infrastructure

Connecting the world. Encouraging economic development to meet long-term macroeconomic needs. Boosting growth. Enhancing GDP. Increasing tax revenues. Creating jobs. Strengthening productive capacity. Enabling trade. Powering small businesses. Stimulating competition. Generating long-term stable returns. Connecting workers to their jobs. Improving lifestyles at home, and in developing countries. Improving health. Enabling social mobility. Funding research and innovation. Guaranteeing and improving education. Offering consumers value and choice. Ending extreme poverty. Increasing shared prosperity. Creating opportunities for struggling communities. Managing natural disasters. Mitigating the impacts of climate change. Improving global security....the list goes on.

Pipeline

Creating the optimal conditions for infrastructure financing would serve to support the flow of financing. But the fundamental bottleneck overwhelmingly cited for lack of infrastructure investment over a number of years has been the supply of investible projects. In stable, creditworthy economies, there is no shortage of finance which investors are prepared to commit, and small projects are being financed, but a significant shortage of big, financeable deals and transparent, upcoming long-term investment plans – plus competition for whatever deals there are – present a challenge. Innovation and co-operation between, for instance, commissioning authorities, national infrastructure banks and the private sector (whether banks, insurers or other investors) could help to stimulate the pipeline. Furthermore, a renewed focus on the willingness of users to pay to use the infrastructure once it has been put in place could lead to the transformation of unquantifiable usage/demand risk into projects with measurable usage.

Certain initiatives, such as the Global Infrastructure Hub Project Pipeline², the European Investment Project Portal³ and the UK's National Infrastructure Delivery Plan⁴ have been seeking to capture known and existing pipelines of deals in the hope of matching up projects to potential investors, but a more fundamental exploration of issues affecting the pipeline, and proposed solutions, is required.

Future requirements

Since 2012, there has been a year on year increase in infrastructure financing and investment in Europe⁵ (as indicated in Fig. 1 below), yet according to a study conducted in June 2016 by McKinsey⁶, US\$3.3 trillion needs to be invested each year globally to 2030 to support currently expected rates of growth (with the majority being required in emerging economies) – a substantial increase over current investment levels of \$2.5 trillion per year.

Fig. 1 Global and European infrastructure debt investments (loan and bond) - in Euro billions

	2008	2009	2010	2011	2012	2013	2014	2015	2016
Europe	74,010	28,113	50,071	52,956	34,533	44,080	66,164	70,840	94,636
Global	188,376	101,644	170,687	182,112	168,854	183,756	256,603	292,847	265,369

Source: Thomson Reuters Project Finance International (PFI) League Tables

1 [Guide to Infrastructure Financing](#)

2 <https://pipeline.gihub.org/Account/Login>

3 <https://ec.europa.eu/eipr/desktop/en/index.html>

4 [National Infrastructure Delivery Plan 2016-2021](#)

5 Europe can include up to 36 countries including the EEA and EFTA members as well as the Russian Federation, Croatia, Macedonia, Montenegro, Serbia and Ukraine.

6 [Bridging Global Infrastructure Gaps](#).

Financing the shortfall

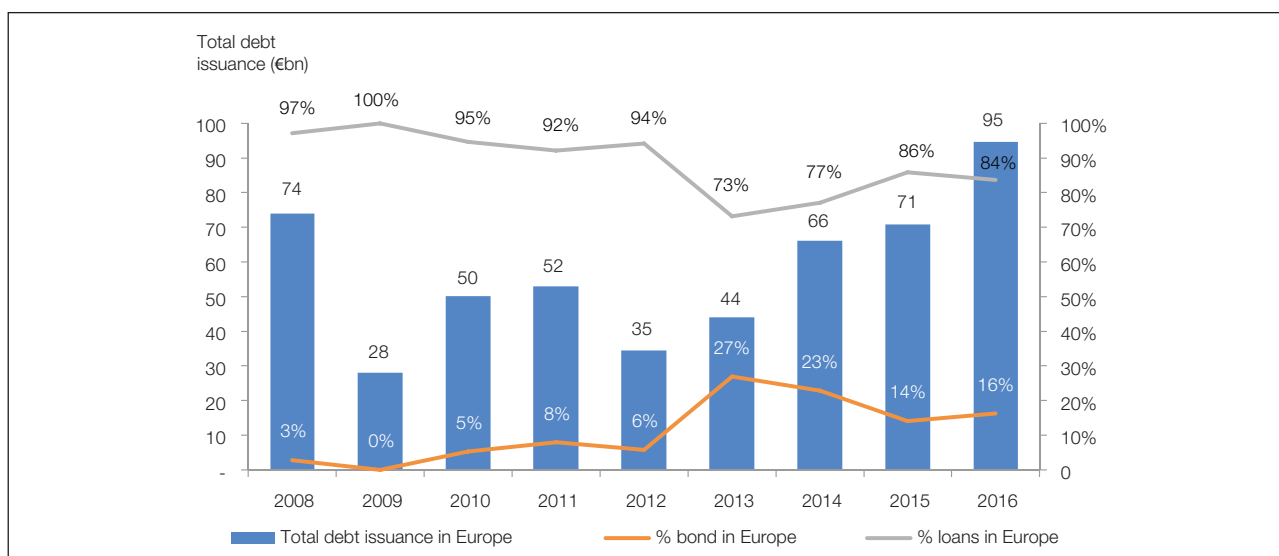
Different phases of an infrastructure project have different risk and return characteristics, calling for a mix of financial instruments, as well as financing solutions and investors. Therefore, no one type of financing is necessarily optimal, but circumstances have affected this mix over the past 10 years, requiring some innovative thinking when it comes to financing infrastructure.

Banks

Traditionally, an ability to match funding to the long-term profiles of infrastructure projects, together with staff who are experts in project finance credit evaluation with the skills to make appropriate decisions when a borrower's circumstances change, meant that banks were the first port of call for the financing (including the hedging of interest rate and inflation risk) of many infrastructure projects. As for those seeking to raise finance, bank relationships could be leveraged to ensure the maximum flexibility offered by loans - in terms of pre-determined drawdown schedules, pre-payment options, confidentiality and a simple process for amendments and waivers to the financing terms.

But in a post-crisis world, banks are facing stricter capital and liquidity requirements, and will have to hold significantly higher buffers of equity and debt that is capable of being bailed-in should the bank approach default. Increasing restrictions in the tenor of the loans they have been able to offer in order to meet their (mostly) short-term liabilities, rising funding costs and concerns over political and regulatory risk, all affect the economics of financing infrastructure for banks, which have had a knock-on effect on their willingness to finance infrastructure projects (see Fig. 2 below, which indicates a decrease in the percentage of infrastructure loans from a high of 100% in 2009, with a notable drop in 2013 due to the impact of post-crisis regulation implementation).

Fig. 2 European infrastructure bond and loan issuance 2008-2016



Source: Thomson Reuters Project Finance International (PFI) League Tables

Governments

Meanwhile, government budgets are being slashed in all areas, with infrastructure spending being particularly vulnerable. Cutting infrastructure budgets does not tend to attract strong taxpayer opposition, and scarce resources are focused on higher political priorities than long-term investment. Added to that is the relatively long lead-time for payback on an infrastructure project which does not sit well with short-term electoral cycles. But recognising the importance of investment in infrastructure, government support may be available where needed, and appropriate, to help projects access finance. This may be by way of increasing public spending, but also by supporting the private financing of infrastructure projects through, for example government guarantee schemes⁷, or by encouraging an institutional framework allowing governments to bridge the gap between short-term imperatives and long-term investment horizons.

⁷ See for instance the [UK's National Infrastructure Delivery Plan – Funding and Finance Supplement](#)

Institutional investors

Banks remain important financiers (as to which, see Fig. 2 above, which shows an increase in bank financing levels from 2013, probably owing to the emergence of post-crisis stability), but meanwhile, an alternative source of liquidity has been emerging. According to the McKinsey report, institutional investors (such as pension funds, insurance companies and sovereign wealth funds) and banks have \$120 trillion in assets that could partially support infrastructure projects (of which banks account for \$40 trillion). According to a Preqin study, the number of institutional investors in the infrastructure asset class has increased by over 116% between 2013 and 2017⁸.

Institutional investors typically seek infrastructure assets offering long-term stable returns that match their liabilities, and generate sufficient revenue to provide them with maximised returns over the life of the project. These have tended to be in those countries with stable economies and robust legal architecture which respect the rights of secured creditors. Their exposure to infrastructure may be via infrastructure funds, bonds, regulated assets, and increasingly by financing projects directly.

As “risk-free” rates have continued to reduce across mature economies, insurance companies and pension funds have increasingly allocated capital to illiquid asset classes such as infrastructure, seeking to access stable long-term assets which pay a premium to government or liquid corporate bonds. In particular, project finance transactions often provide good diversification within an investor’s portfolio given the relative lack of correlation to the broader economy. Notwithstanding this, according to Preqin, 63% of institutional investors are below their target allocation to infrastructure, the reasons for which may include investor concerns regarding the pricing of infrastructure assets eating into the eventual returns, and the availability of assets for deals. However, this figure, coupled with a generally positive outlook on the asset class and a projection of 88% of investors intending to commit more capital or the same levels of commitments over 2017, indicate the availability of capital and the continued potential growth prospects in this asset class, according to the same Preqin study. A number of large institutional investors are developing dedicated infrastructure teams, so it is important that the market innovates to accommodate the requisite risk, return and maturity appetite.

This is not to say that institutional investors are usurping banks as financiers of infrastructure; rather, they complement each other to provide a mix of financing sources, increasing the options available to sponsors. But how best to facilitate this innovation and harness this source of finance to best match the infrastructure financing deficit? Therein lies the challenge.

Risk

Understanding, structuring and allocating risk is key to the successful financing of an infrastructure project. Infrastructure is a complex area with risk profiles changing significantly as the project moves both within and between planning, construction and operational phases. An understanding of which parties can adopt risk, and at which phase, is crucial to optimising the financing. In order to encourage private infrastructure investment and increase competition, governments should show willingness to provide some form of support, especially during an infrastructure project’s development stages, where the risk profile is higher, especially in greenfield development. That said, if the public sector retains too much risk (by way of a credit enhancement mechanism, first loss guarantee or other) it would erode the returns for yield-hungry private sector investors, while transferring too much risk to the private sector may affect the incentive to invest, thereby deterring investment in the first place or significantly increasing the cost of the finance. Where key risks cannot be quantified, simply providing a first-loss guarantee does not transform a project into a financeable investment opportunity. The Global Infrastructure Hub has set up a helpful searchable guide on how to best allocate risk in PPP projects across sectors⁹.

⁸ Preqin Investor Outlook: Alternative Assets H1 2017

⁹ <http://ppp-risk.gihub.org/>

Country-specific risk

Institutional investors require certainty regarding the stability and robustness of the policy framework underpinning infrastructure projects in a particular jurisdiction: it follows that greater certainty leads to lower risk and, therefore, lower cost of capital. Not surprisingly, investors, rating agencies and regulatory authorities ascribe lower risk to jurisdictions with a track record of a favourable and stable regulatory environment over the long term, and limited political risk.

Country-specific risk can have a broad effect on the projected success of infrastructure investment on an individual country basis. This can be illustrated by reference to sovereign credit ratings, which reflect multiple factors, including, in broad terms, economic strength, institutional strength, fiscal strength and susceptibility to event risk¹⁰. The credit quality of an infrastructure project is typically constrained by the credit quality of the project off-taker, which can often be a sovereign or government-related entity. More generally, the credit quality of an infrastructure corporate is typically constrained to a maximum of 1-2 notches above the credit rating of the host government due to multiple channels of shared exposure and contagion. So, while there is significant capacity to finance infrastructure projects for countries with robust credit quality, this is not necessarily the case for those with weaker credit quality. In simple terms, borderline investment grade and non-investment grade countries face greater challenges in attracting private sector debt for infrastructure (see Fig 3 below).

Fig. 3 European sovereign ratings as at 28 June 2017



Source: Moody's

¹⁰ Moody's Sovereign Bond Ratings criteria

One means of mitigating country-specific and other types of risk is use of the European Investment Bank's Project Bond Initiative (PBI), the pilot phase of which concluded successfully with 10 projects reaching financial close across 7 European countries. Under the PBI, the EIB provides credit enhancement to senior secured project bonds issued by a project company undertaking an eligible infrastructure project. The credit enhancement would then ensure better credit quality to institutional investors. A requirement of the initiative was the production of an independent evaluation of the relevance of the PBI, as well as its effectiveness in increasing investment in priority projects and in making efficient use of funds. The evaluation was carried out by Ernst & Young, who also recommended, *inter alia*, that current market needs should be addressed in a more appropriate way, and that credit enhancement should be more targeted, such as being diverted where it is needed most (in their opinion, Southern and Eastern Europe) and directed at projects involving substantial risk.¹¹

Stability

The arbitrary exercise of regulatory or political power, for instance in the form of unexpected policy or regulatory changes or the unilateral renegotiation of existing contracts by new governments, does nothing to incentivise investors who require fundamental comfort as to long-term regulatory and policy stability in order to protect underlying revenues. A coherent and trusted legal framework for infrastructure projects is also necessary to ensure that the rule of law takes precedence, as opposed to subsequent government decisions. Investors need to be confident that the legal system of a particular jurisdiction in which the project is being carried out has a robust enough investor protection mechanism which covers foreign and institutional investors as well as local ones. Stable and predictable tax systems which allow investors to appropriately price infrastructure investments and returns are also an important feature in any jurisdiction's organisation. In this case, governmental behaviour in relation to existing infrastructure assets is a key element of the risk analysis in relation to future projects.

Regulatory inputs, policies and legal and tax frameworks in one jurisdiction can have a knock-on effect, creating contagion on investor confidence in other jurisdictions. Complete standardisation of infrastructure projects may be difficult for reasons such as the bespoke nature of projects, the wide range of sectoral nuances and corresponding logistical and contractual requirements. But in order to assuage investors' concerns over the different risks associated with a project, and to allow the investors to build up expertise over time based on a fixed set of assumptions, certainty, cross-jurisdictional stability, predictability, transparency and consistency of regulatory, legal and tax frameworks and political systems are vital.

In addition, transparency and consistency of public authorities in setting and maintaining subsidies, tariffs, fees and regulatory controls after the close of an infrastructure financing transaction would help to mitigate investors' concerns over the regulatory risk associated with the projected revenues of a project. By way of example, in their "Viewpoint – Infrastructure Investment: Bridging the gap between public and investor needs"¹², Blackrock have highlighted incidents and effects of ex post changes, such as a change to renewable energy subsidies in the United Kingdom, which not only reduced the revenues of operating renewables projects, but also undermined investor confidence in emerging technologies, and cuts to tariffs in the Norwegian gas sector, which not only left investors with a potential 40% reduction in return expectations, but also harmed the jurisdiction's perception as a stable regulatory environment for infrastructure investment.

The McKinsey report recommends a *"non-binding international investment rule model (principles of international investment) to reduce complexity...[which] would include establishing and enforcing a body of laws and regulations that provides for fair and equitable treatment, national treatment, and most-favored-nation treatment of foreign investment; setting clear limits on expropriating investment and providing for payment of prompt, adequate, and effective compensation when it occurs; and providing for resolution of disputes between business and government through binding dispute-resolution mechanisms."*

¹¹ [Ad hoc Audit of the Pilot Phase of the Europe 2020 Project Bond Initiative](#)

¹² [Viewpoint – Infrastructure Investment: Bridging the Gap Between Public and Investor Needs](#)

Harnessing expertise

Infrastructure is a highly complex, specialised area requiring expert knowledge and experience to ensure prudent long-term investment at all stages – from financial close of the financing to completion of the project and beyond. This requires long-term thinking, long-term structuring and long-term monitoring of the projects' performance. It also requires significant resource on the investors' side, leading to a judgement call between the cost of employing a team of experts and ensuring steady revenues on a sustainable and predictable pipeline of transactions as compared to other assets. For those seeking to raise finance, a limited capacity to select, appraise and procure new infrastructure can be a further constraining factor, particularly in emerging markets and developing countries where expertise and markets have not yet developed. In addition, it is important to have buy-in from the general public as to the benefits of private infrastructure investment, particularly in those jurisdictions where deemed "privatisation" of public services and assets is politically controversial: this could be achieved by way of highlighting infrastructure needs, education and public backing of infrastructure investment through the life of the investment in order to create and encourage optimism.

For reasons already explained, complete standardisation of infrastructure projects may not be easily achievable, although it may be desirable, given that infrastructure experts estimate that the use of specialists and advisers can account for 1 to 5 percent of project costs, which may not be capable of being recouped. Standardisation of market practices however may be easier, and would ensure a certain degree of homogeneity in fragmented markets. Initiatives such as bundling help to encourage standard practices, and have already started to gain traction (see further *"European Fund for Strategic Investment...Bundling"*).

Other initiatives and support mechanisms are in progress with a view to standardising market practice, whether on a national, pan-European or even global basis. One such support system is the French initiative FIN INFRA¹³, which provides centralised expertise in areas such as complex contractual issues, how to finance a project, the suitability of certain types of infrastructure structures and how to go about using them.

In addition, the Global Infrastructure Hub aims to establish best practice, and the European Investment Advisory Hub¹⁴ (EIAH) is an invaluable resource which addresses some of the complex inherent issues in infrastructure finance. With a renewed focus on projects that contribute to the sectorial and geographical diversification of the European Fund for Strategic Investment, the EIAH works closely with National Promotional Banks who have knowledge of the local context, business and investor communities as well as national policies and strategies, and with other international partners such as the European Bank for Reconstruction and Development and the World Bank. Together, they provide advisory and technical assistance to ensure that projects are as advanced as possible, and facilitate the exchange of good practices between local, regional, national and EU authorities.

Disclosure

An important factor that would make it easier for investment decisions to be reached on infrastructure investment is more and better quality disclosure on infrastructure projects and on ongoing infrastructure debt performance. Mindful of the difficulties of standardisation, a consistent and comparable level of required information disclosure (for instance, as a starting point, on cashflows, probability of cash flow and defaults and other risks), as well as better availability of data would help the market to understand the nuances of projects by reference to a series of metrics, to benchmark existing infrastructure projects by reference to a series of agreed financial indicators in an index, to price risk and to assess the suitability of a project in different contexts. This would have the effect of commoditising the market to a degree and instilling more confidence, making it easier to assess new investment opportunities and thereby encouraging the pipeline. An increase in data availability would also assist prudential regulators with their calibration of infrastructure investment within certain risk-based frameworks, such as Solvency II and Basel III.

In this regard, the EDHEC Infrastructure Institute-Singapore has undertaken efforts to, among other things, collect private infrastructure investment data to create a global database of infrastructure project cash flows spanning several decades. EDHEC also build models for private infrastructure equity and debt investments that can compute risk and performance measures¹⁵.

¹³ <http://www.economie.gouv.fr/ppp/bienvenue-sur-site-fin-infra>

¹⁴ <http://www.eib.org/eiah/>

¹⁵ <http://edhec.infrastructure.institute/>

Secondary Markets

A means of controlling availability of data and keeping the project information fresh is key to unlocking secondary market liquidity in infrastructure finance, where often the only information available is whatever exists as at the closing date of a financial transaction, so is likely to be already stale. Although insurance investors usually invest in private debt as part of a “buy to hold” strategy, both they and pension funds expect liquidity from public bond issues. Opening-up the secondary markets for infrastructure products – as well as increasing the pool of financing sources between banks and institutional investors - could help to unlock the pipeline, with more projects resulting in more liquidity and more private investors able to access the market. Governments could also help to stimulate a secondary market by issuing equity and debt on government-owned infrastructure projects and infrastructure operators.

Solvency II

Current Solvency II capital requirements not only mean higher capital charges for infrastructure (as compared to other asset classes) but also reduce the assets' relative value, given higher returns achievable in other asset classes for similar credit ratings. In the last couple of years, members of the AFME ICMA Infrastructure Finance Working Group (and others) provided evidence to EIOPA to assist with the latter's analysis of the identification and calibration of infrastructure investment risk categories, as a result of which the European Commission established an infrastructure project asset class for which insurers benefit from reduced capital charges. Interpretation of these definitions is a matter for individual country regulators and it is important that regulators work together in the spirit of Capital Markets Union to prevent different interpretations favouring or hindering investors from different countries.

Notwithstanding this development, until recently, a distinction remained between the Solvency II regulatory treatment of qualifying infrastructure projects as opposed to infrastructure corporates. However, the European Commission has recently announced their proposal to reduce capital requirements by up to 25% for “qualifying infrastructure corporate investments” subject to the fulfilment of a number of criteria and a number of other conditions.

This is a welcome move, in particular as, according to Moody's, capital expenditure by infrastructure corporates in Europe was more than 4 times that delivered by infrastructure project finance transactions between 2012-2014¹⁶; this would indicate that a reduction in capital charges for insurers' investments in infrastructure corporates is likely to have a substantial impact in financing infrastructure and attracting more private capital into infrastructure investments.

Well-structured infrastructure projects have been proven to be less risky than non-financial corporate credits, and should logically therefore require less capital to be set aside against them. Moody's analysis of the credit performance of 1,033 (Moody's-rated) corporate infrastructure debt securities has found, among other things, that in the aggregate, corporate infrastructure debt experiences substantially lower default rates relative to non-financial corporate issuers. The ten-year cumulative default rate for non-financial corporate issuers is five times higher than that for corporate infrastructure¹⁷.

Basel III

The Basel Committee on Banking Supervision (BCBS), which is the primary global standard setter for the prudential regulation of banks, released a consultative document “Standards - Revisions to the Standardised Approach for credit risk”¹⁸ in December 2015, in which it proposes that for project finance, where issue-specific external ratings are either not available or not allowed for regulatory purposes in a jurisdiction, a 150% risk weight would apply to banks in the pre-operational phase, and a 100% risk weight in the operational phase. The BCBS is of the view that these proposals increase granularity while striking the right balance between simplicity and risk sensitivity. At the time of writing, negotiations are still continuing as to whether these proposals should be modified before being adopted, although the BCBS has largely completed the technical work required to implement them, which, if adopted, could significantly increase the regulatory capital that banks would need to provide against project finance loan exposures.¹⁹ When it comes to the start date for the new rules and the adoption of any transitional and phase-in arrangements, it is important to note that these are solely at the discretion of the national supervisor.

¹⁶ For Moody's-rated infrastructure corporates and all infrastructure project finance transactions, whether rated or not. [Moody's: Bridging the 1 trillion global infrastructure gap](#)

¹⁷ [Addendum: Infrastructure Default and Recovery Rates, 1983-2015](#)

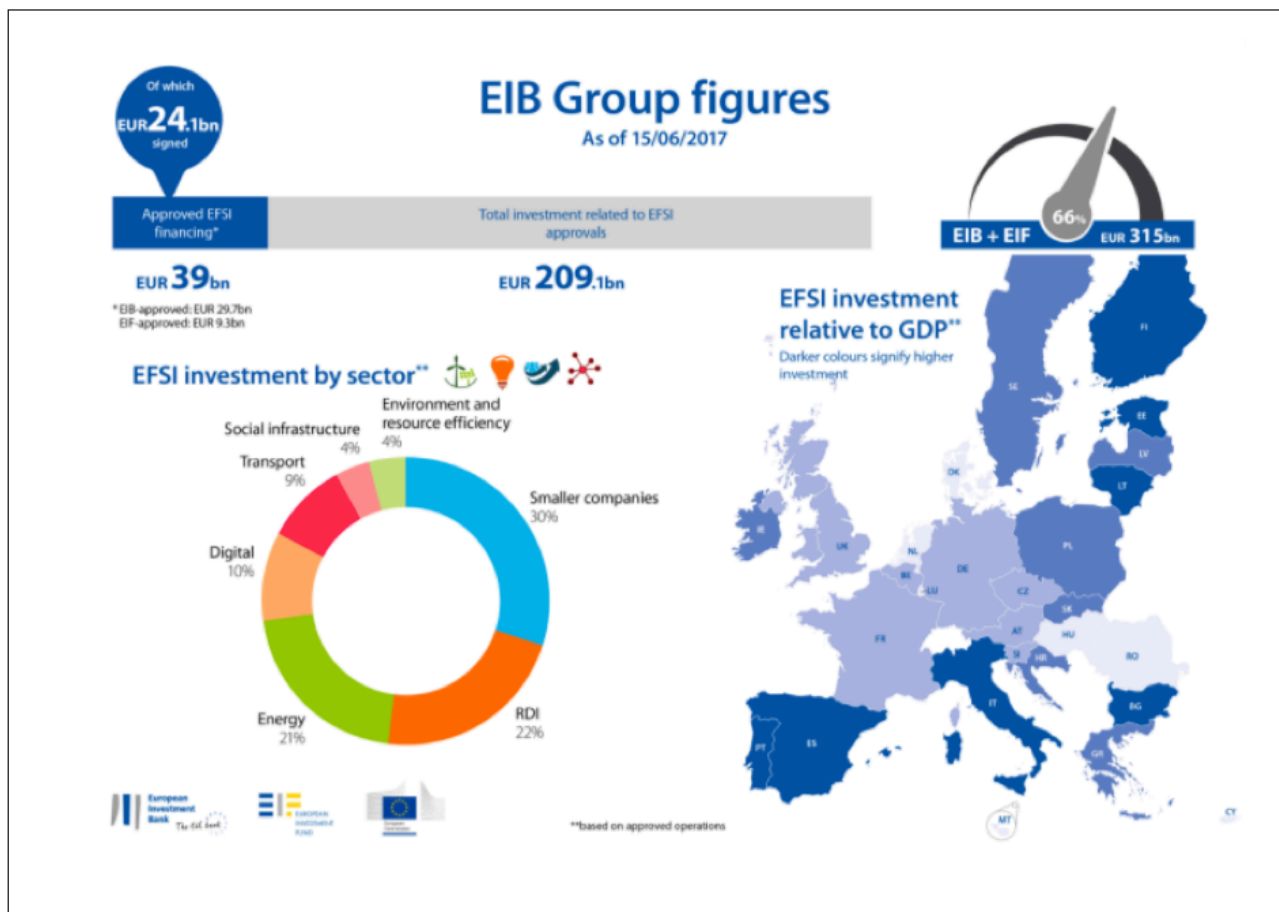
¹⁸ [BCBS Standards – Revisions to the Standardised Approach for credit risk](#)

¹⁹ <http://www.bis.org/speeches/sp170525.htm>

European Fund for Strategic Investment

The European Fund for Strategic Investment (EFSI) had approved €39 billion of financing as of 15 June 2017, with the potential to trigger €209 billion of investment (see Fig. 4 below).

Fig. 4 EIB EFSI Group figures as of 15 June 2017



Source: <http://www.eib.org/efsi/>

Extension of the EFSI

An extension by the European Commission of the EFSI announced in September 2016²⁰, doubling the investment target and extending its effective date to 2020, indicates a continued acknowledgement of the needs of private capital for investment in infrastructure, but an appropriate environment in which to encourage institutional investment in Europe's infrastructure is still required.

On the announcement of the extension, the Commission also proposed a number of technical improvements for the EFSI. This included calling upon Member States to contribute to the EFSI as a matter of priority. In this regard, there may be an increased role for both national governments and national infrastructure banks in developing a more conducive environment for private investment by enhancing market awareness to ensure that procurement processes reflect investor needs, and that projects which are "investor-ready" are being developed (see further "Procurement"). The development in each Member State of a governing body such as a national infrastructure board could also be beneficial to co-ordinate divergent actions of government departments, to co-operate with national or regional development banks, to ensure accountability over implementation and national infrastructure policies, to coordinate with EFSI priorities and to challenge policy changes which may endanger long-term investment decisions.

²⁰ State of the Union 2016: The EFSI FAQs

Expanding geographical and sectoral coverage

One of the objectives of the extension of the EFSI is to enhance its geographical coverage to reinforce the take-up in less developed regions²¹, in particular, to Member States in central and eastern Europe where a lack of experience and expertise means that the capacity to structure and plan projects may be less developed, the markets less sophisticated and the regulatory and legal frameworks less robust. In this respect, the Commission will encourage greater involvement from National Promotional Banks offering support (including financial support) and local intelligence for potential infrastructure projects (see further "*Harnessing expertise...*"), including with a view to setting up investment platforms. It will also aim to make it easier to combine EFSI with other sources of EU funding, although this may complicate the process of assessing the suitability of projects for investment by making it more difficult to unravel the hierarchy and structure of existing capital, investment allocations and subordination. Involvement of EFSI can help not only by improving the credit profile of a project (through use of project bond credit enhancement for example) but also because of the "halo" effect for investors of knowing that the host government will be particularly careful in its treatment of creditors due to the involvement of EIB. If, however, this means greater coordination between public authorities, it could provide an additional push to address bottlenecks in critical cross-border projects.

Sectoral adjustments have also been proposed, such as enhancing technical assistance to projects in agriculture and those that contribute to climate action in line with the COP21 objectives²², in the latter case with the EIB building on its experience as a major provider of climate financing and using internationally agreed methodologies to identify climate-related components and costs.

Additionality

However, the focus on greater geographical distribution of funding in less-developed regions should not take place at the expense of the principles of additionality or quality of the projects. The concept of additionality (i.e. that projects should be considered for EFSI support if they would not have happened at the same time or to the same extent without EFSI financing) has been reinforced by the Commission who are committed to raising the level of additionality, presumably on the basis of market commentary that the majority of the projects which have been financed so far are in more developed Member States with strong legal and administrative infrastructure and where there is more infrastructure expertise²³. But with much of the public debate focusing on how an infrastructure project will be financed rather than on the critical question of funding, i.e. whether there will be users ready to pay to use the infrastructure, the challenge is to help transform projects with unquantifiable usage/demand risk into projects with measurable usage. Where key risks cannot be quantified, simply providing a first loss guarantee does not turn a project into a financeable opportunity.

Transparency

Another proposed technical improvement announced by the Commission was to enhance the transparency of the investment decisions made, and the EFSI governance procedures. The published decisions of the EFSI Investment Committee should explain the reasons for granting EFSI support, the additionality factor and the value that EFSI can add to a particular operation, and scoreboards for the approved operations should now be published pursuant to these proposals. This information would be valuable to investors, with its publication bringing about greater confidence in investing in specific projects.

Bundling

It has been recognised that bundling of EFSI projects by way of investment platforms as a means to aggregate investment projects could reduce transaction and information costs and provide for more efficient risk allocation between various investors, and should encourage investment in a portfolio of projects, particularly in smaller projects with low individual investment values and returns. It could also help with the standardisation of certain practices for a certain ilk of investment. The portfolio may have a particular sectoral or geographic focus, with National Promotional Banks playing an important role as sponsors/investors or implementing entities. Detailed rules of engagement²⁴ determine the operation of investment platforms under the EFSI, which address issues such as market failures

²¹ See <http://www.eib.org/efsi/map/index> for an interactive map showing a selection of EFSI-supported projects

²² <http://www.cop21paris.org/about/cop21>

²³ According to *Standard and Poor's*, the EFSI portfolio one year after launch, excluding multicountry operations, was highly concentrated (92%) in Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and United Kingdom.

²⁴ [EFSI Rules applicable to operations with investment platforms](#)

and include a recommendation for a market study identifying the market potential and needs, as well as the related promoters' and investors' requirements. While the concept of bundling is not new, it is expected that in the EFSI context, it will catalyse more investment in infrastructure projects by improving credit strength and overall attractiveness of projects²⁵.

Procurement

From the point of view of deliverability of funding, as well as to be able to ascertain relative value for money, a procurement authority often perceives the importance to secure committed financing at an early stage. Many procurement processes accept bank financing as more deliverable than bond financing, however this ignores (a) the caveats on approval subject to prevailing market conditions within almost all banking support letters, (b) the conditions precedent to funding and (c) the fact that the price of a bank financing is also volatile through its reliance on the swaps which are only fixed at financial close. Rarely is any account taken of the benefits of "natural" long-term fixed rate debt from institutional investors versus the additional risks imposed through swap counterparties. In order to create a level playing field as between bond and bank financing for infrastructure, a review of national procurement legislation is recommended, in particular how the concepts of "deliverability of funding" and "value for money" are to be quantified. Furthermore, partnerships between, for instance, commissioning authorities, national infrastructure banks and the private sector (whether banks, insurers or other investors) to ensure that procurement processes reflect investors' needs could also help to bring about a more reliable stream of viable projects.

Conclusion

There can be little doubt that infrastructure finance requirements must increase in order to invest in the future and keep up with expected rates of growth. While there is no shortage of finance which investors can commit, the challenge lies in creating the optimal conditions to respond to these requirements, some of which have been highlighted in this report.

Signs are that this is starting to happen. The effects of, and amendments required to, certain regulations are featuring on the agenda of the regulatory authorities. Existing initiatives, such as the EFSI, are starting to yield dividends, albeit that they require some adjustments. Institutional investors are continuing to ramp up their capabilities and investments in infrastructure, but this requires increased expertise, information disclosure and better availability of data to facilitate investment decisions and to drive improvements and innovations in infrastructure financing. Governments, National Promotional Banks and other international players such as the European Bank for Reconstruction and Development and the World Bank all also have a part to play.

Much remains to be done, and AFME and ICMA remain committed to exploring the forces required to boost infrastructure finance, to encourage and facilitate the debate among its members and to help drive forward the changes required.

²⁵ [Bundling – A Growing Trend As Stakeholders Look To Unlock The Potential Of The Infrastructure Asset Class](#)

**ICMA Zurich**

T: +41 44 363 4222
Dreikönigstrasse 8
CH-8002 Zurich

ICMA London

T: +44 20 7213 0310
23 College Hill
London EC4R 2RP
United Kingdom

ICMA Paris

T: +33 1 70 17 64 72
62 rue la Boétie
75008 Paris
France

ICMA Hong Kong

T: +852 2531 6592
Unit 3603, Tower 2,
Lippo Centre
89 Queensway Admiralty
Hong Kong

www.icmagroup.org

**London Office**

T: +44 (0)20 3828 2700
39th Floor
25 Canada Square
London, E14 5LQ
United Kingdom

Press enquiries

Rebecca Hansford
European Media Relations Manager
rebecca.hansford@afme.eu
T: +44 (0)20 3828 2693

Brussels Office

T: +32 (0)2 788 3971
Rue de la Loi, 82
1040 Brussels
Belgium

Membership

Elena Travaglini
elena.travaglini@afme.eu
T: +44 (0)20 3828 2733

Frankfurt Office

Skyper Villa
Taurusanlage 1
60329 Frankfurt am Main
Germany
T: +49 (0)69 5050 60590

Follow AFME on Twitter

[@News_from_AFME](https://twitter.com/News_from_AFME)