



COMMISSION OF THE EUROPEAN COMMUNITIES

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**COMMUNICATION FROM THE COMMISSION  
TO THE COUNCIL AND THE EUROPEAN PARLIAMENT**

**European Initiative for Growth  
Concept for the design of an EU loan guarantee instrument for TEN-Transport projects**

**{SEC(2005) 323}**

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Concept for the design of an EU loan guarantee instrument for TEN-Transport projects**

**Table of contents**

1.	Executive summary.....	3
2.	The revised proposal for a guarantee instrument.....	4
2.1.	The EU guarantee instrument.....	4
2.2.	Key objectives.....	5
2.3.	Main benefits.....	5
2.4.	Eligible projects.....	6
2.5.	Risk sharing.....	6
2.6.	Legal base.....	7
2.7.	Cost of the guarantee to the Community.....	7
2.8.	Provisioning and pricing.....	8
2.9.	Impact on the Community budget and liquidity fund.....	8
2.10.	Management.....	9
3.	Final remarks.....	10

## 1. EXECUTIVE SUMMARY

Following the request of the European Council of December 2003, the Commission services, in collaboration with the European Investment Bank (EIB), carried out a market testing exercise to examine the feasibility of a loan guarantee instrument for transport projects. The market testing exercise is presented in the Commission Communication COM(2005) 75 final.

Consultations with a number of experts throughout the European Union have led to some technical modifications of original Commission ideas set out in the Communication of 11 November 2003<sup>1</sup> on the Growth Initiative.

The goal of the guarantee instrument is to increase the leverage capacity of limited public resources to stimulate private sector investment in priority TEN-transport (TEN-T) projects by providing credit assistance.

The instrument will provide useful support for specific types of PPPs and for a specific period of the project cycle. It will thus widen the range of TENs financing instruments. The guarantee instrument will only achieve full impact if the proposed total TEN budget of € 20 billion is adopted. This will signal to investors that the completion of networks is realistic. The guarantee instrument will therefore complement European grant financing but not replace it.

Under the new design of the instrument the EU would issue loan guarantees to mitigate revenue risk in the projects' early years. Specifically, the guarantee would fully cover a liquidity cushion, called "a stand-by credit line", which would only be drawn upon in cases where project cash-flows are insufficient to service senior debt. These stand-by credit lines would cover around 10% of the total senior debt (in certain more risky cases up to 20%) and would not usually exceed 5 year maturities. To be eligible for the EU loan guarantee, projects must receive a comparable level of financial support from the Member States or other national public authorities, in a form that recognises the diversity of the tools available and which is appropriate to different national realities.

In line with the original proposal, the guarantee would be priced in order to cover the risk and management costs relating to the instrument.

If the guarantee were called, the Commission would obtain a financial claim which would rank subordinated to the senior debt but senior to equity. This mezzanine debt would have to be paid back by the borrower to the Commission as and when project revenues permit.

The funding of the instrument will be carried out under the new Financial Perspective, under the budget heading for Trans-European Transport networks for the period 2007-2013. This action is already included in the financial framework of the proposed TEN-T regulation<sup>2</sup>. The Commission risk assessment, based on a model using published data from rating agencies, suggests that a budget allocation of EUR 1 billion could support around EUR 20 billion of

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<sup>1</sup> COM(2003) 690 of 11 November 2003

<sup>2</sup> COM (2004) 475 final - Financial Statement, page 41"

senior debt, assuming a portfolio of transactions with a near investment grade creditworthiness. In any case, the provisioning mechanism and liquidity fund would reduce the risk of a direct call on the Community budget to a negligible level.

The Commission envisages selecting an international financial institution for the management of the instrument and considers to the EIB Group to be an appropriate management candidate.

The conclusions of this paper provide the basis for launching an EU loan guarantee instrument for TEN-T projects within the framework of the Commission's proposal for a Regulation of the European Parliament and of the Council determining the general rules for the granting of Community financial aid in the field of trans-European transport networks and energy amending Council Regulation (EC) n° 2236/95<sup>3</sup> (the "new TEN-T Financial Regulation"). While this scheme would not come into effect until 2007, the Commission together with the EIB would envisage drafting implementation rules during 2005 and would then start selecting and assessing projects to be included in the portfolio from 2007 onwards.

This Communication is intended to create a basis for further discussions in particular with Member States authorities on its implementation, its management and the possibilities for the Member States to provide comparable support.

This report is divided into 3 sections. Following the executive summary, section 2 presents the proposed design of the EU guarantee instrument, its funding and provisioning needs, as well as its management requirements. Section 3 concludes the report. This Communication is accompanied by the Commission staff working paper SEC(2005)323.

## **2. THE REVISED PROPOSAL FOR A GUARANTEE INSTRUMENT**

The following sections provide a description of the revised design of the loan guarantee instrument. The Commission staff working paper SEC(2005)323 includes a general overview of stand-by credit lines and more detailed information on the indicative main features of the instrument in order to facilitate the understanding of this topic.

### **2.1. The EU guarantee instrument**

Under the new design, the Community would guarantee up to a predetermined cap rate, and possibly up to a nominal ceiling, a stand-by credit line in a PPP type of project. The guarantee would cover unexpected debt service shortfalls due to certain specific risks which would include in particular traffic risks. The guarantee might also be extended to availability/performance risks provided that these risks can be reasonably assessed. Concerning availability payment based projects, the EU guarantee could only cover well isolated risks which are not linked to the management of the project and which would not give rise to moral hazard for the concessionaire/operator. Depending on the creditworthiness of the project, the stand-by credit line would be around 10% of the senior debt outstanding at the time of completion and in certain cases the percentage could go up to 20%.

The Community would not necessarily be exposed over a long period of time. The guarantee would cover only the early years of operations of a project, the so called ramp-up period, which would not exceed 5 years.

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<sup>3</sup> COM(2004) 475 final of 14 July 2004.

This guarantee would be available for projects demonstrating a near investment grade creditworthiness. The requested creditworthiness, linked to the financial viability of the projects, would limit the likely calls on the guarantee instrument. If called, the Community would acquire a claim corresponding to the funds provided. The seniority of the claim on the borrower would, in principle, rank subordinated to the senior debt, in order to maximise the credit enhancement provided by the EU, but in any case senior to all equity layers.

The Community would share the concerns of market investors about timely reimbursements and financial liquidity, but the Community would be a more ‘patient lender’ than the private sector. The claim should be reimbursed to the Community as soon as there are revenues left after having paid the operational costs of the projects and the debt service of the senior lenders. If justified, the reimbursement schedule could be structured so that the available revenues are divided between the Community and the equity shareholders (partial cash-sweep). The patient lender approach enables the private investors to meet their investment goals, possibly allowing the project sponsors to complete a favourable financing package in an acceptable period of time and, in the event of problems, to make a satisfactory restructuring.

It is essential that the guarantee instrument should provide a workable response to the needs of market operators i.e. it should be a standardised product that can be taken into consideration during the early steps of project/concession/financing negotiations. In cases where the project is based on revenues that do not have a substantial ramp-up period and/or is linked to stable revenue sources, the EU guarantee may not be needed.

At the same time, the guarantee should be as flexible as possible so that it can be adapted to the needs of the projects, for example if the concessionaire changes or if a debt restructuring takes place. Consequently, the design of the guarantee instrument should make it possible to take into account the differences between countries and between projects in terms of length of construction period, length of ramp-up periods and sectors (road, railway, maritime, aviation, inland waterways, intermodal platforms).

## **2.2. Key objectives**

The goal of the EU guarantee instrument is to leverage limited public resources and stimulate private capital investment in transport infrastructure projects by providing credit assistance to projects of European significance. The key objectives of the instrument are to:

- Facilitate and accelerate the completion of projects of European significance;
- Encourage private participation in those projects and new approaches to financing them;
- Fill market gaps for guarantees;
- Avoid excessive exposure to the Community budget by relying on market mechanics whilst achieving high levels of leverage for budget resources.

## **2.3. Main benefits**

Stand-by credit line providers often try to protect themselves from improper utilisation of the credit line, for instance, to defer a clearly unavoidable insolvency. For this reason, they include clauses targeted at preventing drawdown, for example in cases of material adverse

change or violation of performance covenants. Rating agencies look unfavourably on these provisions as they might inhibit utilisation precisely when it is most needed. The attractiveness of an EU guarantee instrument is reflected in its potential to de-facto insulate the stand-by credit line providers from a major project risk.

Not being subject to project risk and benefiting from a zero-risk weighting for regulatory purposes because of the EU guarantee for the full amount of principal, interest and other debt service charges, the providers of standby credit could limit such charges to a minimum. Also, lending capacity would, in principle, be available to increase the amount of senior debt, which would benefit from the improved liquidity situation of the project. Assuming that the charge for the EU guarantee is risk-based, but not market based, and depending on the scale and frequency of the drawn amounts, significant reductions could be achieved in the cost of finance.

The common perception that the EU guarantee would have strong symbolic effect which could facilitate the conclusion of financial packages should not be overlooked. Finally, from the point of view of the Commission, it is important to stress that a significant proportion of the projects for which the EU guarantee would be called would probably be able to service the EU claim in a reasonable time frame. This means that the global leverage effect of this instrument could, in fact, be substantial and potentially lead to a more efficient utilisation of EU funds.

#### **2.4. Eligible projects**

All projects that are eligible under the TEN-T Financial Regulation, and in particular priority projects, would also be eligible for support by the guarantee instrument. However, precedence would be given to cross-border projects.

Typically the senior debt of the projects is expected to have a near investment grade creditworthiness before the support of the EU loan guarantee. At the time of application, the sponsors have to demonstrate near investment grade creditworthiness of senior debt on the basis of the project's overall economic and financial viability. From the point of view of the Commission, such a requirement is put in place to ensure that the project's overall risk profile is manageable, that the provisioning needs for the EU guarantee are not excessive, and that the overall financing of guarantee scheme is feasible within the Commission's budget. From the point of view of commercial lenders, such requirements should enable an optimal leverage while guaranteeing a timely service of debt.

#### **2.5. Risk sharing**

In line with the original idea of the instrument, to be eligible for the EU loan guarantee, projects must receive a comparable level of financial support from the Member States or other national public authorities, in a form that recognises the diversity of tools available and is appropriate to different national realities. While the market deems it to be very important that Member States/national authorities provide comparable financial support to the project in the form of grants, guarantees or similar, there is no need for a strict requirement for Member States to be co-guarantors in the instrument. Moreover, this might not be possible as some Member States are not willing to set up a specific mechanism to provide guarantees either themselves or through other public entities for a limited number of projects. The requirement on Member States and regional authorities would be the provision of sufficient financial

support in whatever form in order to contribute at least equally with the Community to achievement of the required creditworthiness.

Risk-sharing with the private sector is a powerful tool to leverage Community funding. The projects should involve an appropriate level of private participation in the form of debt and equity, depending of course on the type of project. The EU guarantee instrument would cover the stand-by credit lines that are available for a limited time period, i.e. during the ramp-up phase thus enhancing the credit quality of the senior debt during this period. In contrast the senior lenders would have to cover the risk during the whole maturity of the senior debt. The equity shareholders would still have the incentive to invest and manage the project properly as their return expectations would be ensured by a structured reimbursement schedule if the guarantee were to be called.

## **2.6. Legal base**

Article 155, paragraph 1, third indent, of the EC Treaty, foresees the possibility for the Community to provide loan guarantees for TEN transport projects. Council Regulation (EC) No 2236/95 of 18<sup>th</sup> of September 1995, as amended<sup>4</sup>, lays down general rules for the granting of Community financial aid in the field of Trans-European networks.

At present, Article 4(c) of this Regulation only includes provisions for “contributions towards fees for guarantees for loans from the European Investment Fund or other financial institutions”. It is therefore necessary to amend Regulation 2236/95 to provide a legal base for the type of innovative guarantee instrument discussed in the present document.

Consequently, the Commission has adopted a proposal for a Regulation of the European Parliament and of the Council determining the general rules for the granting of Community financial aid in the field of the trans-European transport networks and energy and amending Council Regulation (EC) No 2236/95 for the period 2007-2013<sup>5</sup> so as to include the possibility for the Commission to issue loan guarantees to cover financing shortfalls during the first years of TEN-T project operations.

This general legal provision should be complemented by implementation rules, taking account of the advice of the TEN-T Financial Assistance Committee. The utilisation of this instrument will rely on the fulfilment of general eligibility conditions and project selection criteria as laid down in the amended Regulation and in the implementation rules to be adopted by the Commission.

## **2.7. Cost of the guarantee to the Community**

The Commission has to set aside capital reserves to cover the long-term risk related to the guarantee instrument. Analogous to a private banks’ loan reserve, the main cost represents an estimate of expected and unexpected losses associated with the provision of the guarantees issued. In addition, Commission would have to pay the management fee to the managing agent (see point 2.9 hereunder) and any auditing or legal costs relating to a possible Community claim. An appropriate provisioning system and the creation of a liquidity fund

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<sup>4</sup> Regulation (EC) No 807/2004/EC of the European Parliament and of the Council of 21 April 2004, amending Regulation (EC) No 2236/95 laying down general rules for the granting of Community financial aid in the field of trans-European networks; OJ L 143 of 30.4.2004., page 46

<sup>5</sup> COM(2004)475 final of 14 July 2004.

should reduce the risk of direct and unexpected calls on the Community contingent liability to a negligible level. When an un-drawn stand-by credit line expires, the guarantee would expire as well.

## **2.8. Provisioning and pricing**

The objective of provisioning is not to minimise the overall risk exposure but to optimise exposure, i.e. to take prudent risks in order to increase the leverage capacity of Community funds as much as possible. Forecasting the long-term cost of the guarantee instrument requires estimates of the loss probabilities of the projects (expected and unexpected losses) and possible correlations between the projects. A provisioning framework should ensure that sufficient budgetary resources are set aside to cover the underlying risk.

The Commission will make use of a provisioning model which has been developed internally following discussions with rating agencies and using available statistical data<sup>6</sup> and information<sup>7</sup>. The provisioning model is presented in the Commission staff working document SEC(2005)323. This model is based on the assumption that the guarantee instrument would be available to cover shortfalls due to traffic risk, though it would need to be adapted if the instrument were to be extended to availability/performance risk. It also incorporates a buffer for potential downgrading of the creditworthiness of the portfolio. For risk management purposes, limits to exposure for individual projects should be determined.

Ideally each beneficiary should pay an up-front premium, which could be charged when the guarantee is signed or when the guarantee becomes effective, i.e. after the substantial completion of the project, and would be payable either as a one-shot payment or as annual premiums to be paid during the remaining life of the guarantee.

If the EU guarantee were called, the beneficiary will be required to reimburse the amount of outstanding capital and interest to the Community. As the Community claim is comparable to mezzanine financing, the amount due following the call should be priced according to the risk taken and reflecting management costs.

The appropriate pricing system will require further fine-tuning. In any case, the pricing will be set in such a way that the guarantee instrument would cover its expected costs.

## **2.9. Impact on the Community budget and liquidity fund**

The funding of the instrument should be foreseen under the new Financial Perspectives i.e. for the period 2007-2013, under the budget heading for Trans-European Transport Networks. The Community budget would have to cover the amounts needed for the operations and management.

The Community would need to enter into irrevocable guarantee commitments very early as part of the completion of financing packages for projects, normally before full construction begins. Budget resources would therefore have to be committed and paid during the following years in line with the Financial Regulation. The amount committed would constitute a first 'provision' against calls on the guarantees themselves. Such a provision would not be

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<sup>6</sup> Standard & Poor's, Infrastructure Finance, Traffic Forecasting Risk: Study update 2003, November 06, 2003.

<sup>7</sup> Fitch, A risk assessment model for federal credit, 15 March 1999.



intended to cover 100% of the face value of the outstanding loan guarantees (mainly principal plus interest) and there would therefore remain a residual contingent liability on the Community budget. The prudent rules governing the provisioning of the instrument (see point 2.7 above) will keep the risk of such a residual liability at a negligible level. The residual contingent liability of the Community will be properly taken into account in the Community budget through a 'pour mémoire' budget line as is currently the case of the Community Guarantee for the EIB external lending mandate.

In order to have an effective and practical payment mechanism, the Commission should create a liquidity fund for the guarantee instrument. The liquidity fund would cover the management costs of the instrument and guarantee calls. The resources of the liquidity fund should be built up based on the project pipeline and the above mentioned provisioning system. It is estimated that the total investment costs for the priority projects<sup>8</sup> in the enlarged EU amount up to EUR 140 billion for the period 2007-2013. It is expected<sup>9</sup> that the private sector would provide approximately up to 20% of these costs as equity and debt financing so that the private sector financing could amount up to EUR 28 billion. Assuming a portfolio of transactions, which have a near investment grade creditworthiness, a budget allocation of EUR 1 billion could support guarantees on about EUR 20 billion of debt. An indicative annual breakdown of the budgetary needs is presented in Annex 3 of the Commission staff working paper SEC(2005)323.

Any reimbursements and interests earned would be added to the resources of the instrument. The liquidity fund could have a self-sustaining and/or revolving character thus reducing the long-term need for commitments and payments from the Community budget, which would otherwise be needed to cover new operations. At a certain stage, an examination of funding needs should be carried out and the resources not needed to cover guarantee calls and management costs could be returned to the Community budget.

## **2.10. Management**

In order to comply with the principle of good governance, the most appropriate course would be for the Community to entrust all its guarantee management activity under this instrument to a single managing agent, under appropriate arrangements. The managing agent should have an in-depth knowledge of project financing, together with appropriate credit risk management systems in place in order to assess the project risks and to manage the provisioning system and the liquidity fund in the long-term. It should also have in-house legal expertise and the appropriate front office staff to interface with financial institutions, monoline insurers, venture capital funds, national authorities and/or shareholders. The managing agent will have to demonstrate its ability to enter into a long-term contractual relationship with the Commission for the management of the instrument (minimum 15 years). The lifetime of the guarantee instrument makes it difficult to envisage an outsourcing of management to a purely commercial body.

On the other hand, the management of this type of financial instrument differs significantly from the current grant management practice, which seems to effectively exclude recourse to an agency, unless it was staffed with specialist project financial expertise. The most

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<sup>8</sup> Priority projects within the meaning of Annex III of the amendment n° 884/2004/EC to the Council Decision n° 1692/96/EC on the guidelines for the development of the trans-European transport network.

<sup>9</sup> The Van Miert report considered that the private sector could contribute up to 20% of the total cost of the transport project but under certain conditions.

practicable option would be to select an international financial institution as the managing agent, an obvious candidate being the EIB Group.

The managing agent would have the mandate to undertake all guarantee activities in line with the best banking practice on behalf of and at the risk of the Commission. However, the Commission would be responsible for monitoring the instrument and reporting to the budgetary authority. The Staff working paper provides further details on the tasks of the managing agent.

The Commission would take the final decision on the guarantee by approving the eligibility of the projects through an appropriate mechanism to be agreed with the Member States. The Commission will also periodically report to the budgetary authorities based on the accounting and reporting provided by the managing agent.

### **3. FINAL REMARKS**

The guarantee instrument will increase private financial participation for specific kinds of PPPs. It will complement European grant financing but not replace it.

The explicit objective of the instrument is to induce private investment in transport infrastructure mainly through facilitating the conclusion of financial packages. Project sponsors and banks will seek to use the EU loan guarantee to maximise the creditworthiness of senior debt obligations and to achieve a less expensive overall financial package. By guaranteeing the stand-by credit lines, the EU would assume a greater credit risk because its potential future claim on project revenues is subordinate to that of the senior lenders. The EU guarantee would not eliminate the risk for the senior lenders, but it would offer greater debt service coverage for the senior tranche and thus boost its creditworthiness. The EU guarantee would be priced so as to reflect the risk taken by the EU and the management costs relative to the management of the instrument.

The EU loan guarantee instrument would enhance the financial viability of the overall project without exposing the Community to excessive credit risk. A positive feature of the guarantee instrument is that it would comprise a number of projects of different geographic location and size into one portfolio and thus be able to obtain a level of diversification at the European level which would not be possible at a national level. The Commission considers that the current provisioning model is sufficiently robust to take a decision in principle on the creation of the guarantee instrument. The precondition for the modelling and functioning of the provisioning system of the guarantee instrument is the availability of relevant statistical data. A proper monitoring/assessment system of project risks is needed in order to collect statistical data during the coming years. This would improve the fine-tuning of provisioning in order to obtain the best possible leverage for the Community budgetary funds.

The current TEN Financial Regulation does not provide a legal base for this kind of innovative guarantee instrument. Therefore, the proposal for the new TEN Financial Regulation 2007-2013 has been drafted so as to allow the implementation of the guarantee instrument in 2007. The funding of the instrument is foreseen under the proposed TEN budget 2007-2013 of EUR 20 billion. The Commission would prepare implementing rules at an early stage. This would ensure that projects could be included in the guarantee portfolio immediately following the adoption of the new TEN Financial Regulation, thus securing a degree of portfolio diversification right from the start.

## FINANCIAL STATEMENT

### LEGISLATIVE FINANCIAL STATEMENT

#### 1. NAME OF THE PROPOSAL :

EU loan guarantee instrument for TEN-transport projects

#### 2. ABM / ABB FRAMEWORK

Policy Area(s) concerned and associated Activity/Activities (Activities ABB)

Trans-European networks, 1. Objective : Develop the network and priority projects 2. Objective : Improve the efficiency of the financial aid to the network, 3. Objective : Connect the trans-European networks with neighbouring countries

Inland, air and maritime transport: 3. Objective : to promote a more environmentally friendly transport system

#### 3. BUDGET LINES

##### 3.1. Budget lines (operational lines and related technical and administrative assistance lines (ex- B.A lines)) including headings :

06.0301 (Financial support for projects of common interest in the trans-European transport network)

##### 3.2. Duration of the action and of the financial impact:

The operational period of the instrument concerning new commitments covers at least the period 2007-2013.

##### 3.3. Budgetary characteristics :

Budget line	Type of expenditure		New	EFTA contribution	Contributions from applicant countries	Heading in financial perspective
060301	Non-comp	Diff <sup>10</sup>	NO	NO	NO	No [1 a]

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<sup>10</sup> Differentiated appropriations

## 4. SUMMARY OF RESOURCES

### 4.1. Financial Resources (indicative amounts)

**Important remark:** all financial resources in terms of operational expenditure indicated in this financial statement are already included in the financial framework of €20,350 billions of the Commission proposal for a Regulation of the European Parliament and of the Council determining the general rules for the granting of Community financial aid in the field of the trans-European transport networks and energy and amending Council Regulation (EC) n° 2236/95<sup>11</sup>.

#### 4.1.1. *Summary of indicative commitment appropriations (CA) and indicative payment appropriations (PA)*

A precise quantification of the annual budget allocations for the EU Loan Guarantee Instrument is difficult at this stage due to limited availability of projections of eligible projects that are expected to involve private sector participation. A working assumption, consistent with the overall Van Miert objectives, is to consider a flow of private sector debt financing of the order of EUR 3 billion per year in the period 2007-2013, with all the TEN priority projects receiving private support.

Based on the provisioning model, developed by the Commission and EIB services, the table below presents a scenario requiring a total budget allocation of around EUR 1 billion, with a specified annual breakdown. It should be noted that, while the exact amount needed and the timing will vary, front-loading of approximately one third of the total budget in the first year would be needed for the following reasons. Firstly, as the portfolio effect builds up only gradually, the level of provisioning needed for the first project is almost twice as large as the amount needed for the last one. Secondly, as interest accumulates on the early budget allocations, the overall need for budget allocation in the later years is further diminished.

The detailed calculation of the provisioning rates (used in the table below) is presented in Annex 3 ‘technical paper’ of the Commission Staff working paper.

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<sup>11</sup> COM/2004/0475 final (COD 2004/0154) – Financial statement for TEN-T projects, page 41

Amounts in EUR million

Year	Private sector lending		Number of projects Cumul.	Provisioning Calculation				Interest *)	Budgetary needs	
	Annual	Cumul		Rate	Cumul.	Cumul.	Cumul.		Annual	Request
2007	3,000	3,000	5	10.3%	309	0	309	0	309	<b>310</b>
2008	3,000	6,000	10	7.1%	426	43	469	15	144	<b>150</b>
2009	3,000	9,000	15	6.2%	558	56	614	23	122	<b>120</b>
2010	3,000	12,000	20	5.7%	684	68	752	31	108	<b>120</b>
2011	3,000	15,000	25	5.5%	825	83	908	38	117	<b>120</b>
2012	3,000	18,000	30	5.5%	990	99	1,089	45	136	<b>120</b>
2013	3,000	21,000	35	5.3%	1,113	111	1,224	54	81	<b>80</b>
	<b>21,000</b>								1,017	<b>1,020</b>

\*) Provisioned amounts are capitalised at a 5% annual rate

These indicative calculations do not take into account the fees paid by the beneficiaries for the guarantee, nor the management costs of the guarantee instrument to be agreed with the agent. Nevertheless, it is foreseen that the fees paid by the beneficiaries will be set at an appropriate level, in order to cover the management costs of the instrument.

Concerning payment appropriations, the working assumption is that the amount of indicative annual commitments is paid to a trust account during three years in order to cover potential future guarantee calls. For example, the commitment of € 310 million in 2007 is paid as follows: € 100m in 2007, € 100m in 2008 and € 110m in 2009.

EUR million (to 3 decimal places)

Expenditure type	Section no.		2007	2008	2009	2010	2011	2012 and later	Total
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**Operational expenditure<sup>12</sup>**

Commitment Appropriations (CA)	8.1	a	310	150	120	120	120	200	1.020
Payment Appropriations (PA)		b	100	150	200	130	120	320	1.020

**Administrative expenditure within reference amount<sup>13</sup>**

Technical & administrative assistance (NDA)	8.2.4	c	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
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**TOTAL REFERENCE AMOUNT**

<b>Commitment Appropriations</b>		<b>a+c</b>	310	150	120	120	120	200	1.020
<b>Payment Appropriations</b>		<b>b+c</b>	100	150	200	130	120	320	1.020

**Administrative expenditure not included in reference amount<sup>14</sup>**

Human resources and associated expenditure (NDA)	8.2.5	d	0,324	0,324	0,324	0,324	0,324	0,648	2,268
Administrative costs, other than human resources and associated costs, not included in reference amount (NDA)	8.2.6	e	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

**Total indicative financial cost of intervention**

			2007	2008	2009	2010	2011	2012 and later	Total
<b>TOTAL CA including cost of Human Resources</b>		a+c +d +e	310,324	150,324	120,324	120,324	120,324	200,648	1.022,268
<b>TOTAL PA including cost of Human Resources</b>		b+c +d +e	100,324	150,324	200,324	130,324	120,324	200,648	1.022,268

<sup>12</sup> Expenditure that does not fall under Chapter xx 01 of the Title xx concerned.

<sup>13</sup> Expenditure within article xx 01 04 of Title xx.

<sup>14</sup> Expenditure within chapter xx 01 other than articles xx 01 04 or xx 01 05.

**4.2. Human Resources FTE (including officials, temporary and external staff) – see detail under point 8.2.1.**

<b>Annual requirements</b>	Year n	n + 1	n + 2	n + 3	n + 4	n + 5 and later
Total number of human resources	3	3	3	3	3	3

At this stage one could estimate that an average of 3 persons of existing Commission staff would be necessary under the condition that the operational management of the instrument is mandated to an operating agent.

**Co-financing details**

In accordance with the requirements formulated in the final report of the Growth Initiative of November 2003, the market deems it to be very important that Member States/national authorities provide comparable financial support to the project. However, the market and the consulted governments felt that it is not appropriate to enforce a strict requirement for Member States to be co-guarantors in the instrument. Instead the financial commitment may take the form of equity, grants or other types of guarantees. Moreover, a strict co-guarantee requirement might make the implementation of the instrument impossible as some Member States are not willing to set up a specific mechanism to provide guarantees either themselves or through other public entities for a limited number of projects. The requirement on Member States and regional authorities would be the provision of significant financial support in whatever form in order to contribute at least equally with the Community to the achievement of the required creditworthiness. Co-financing modalities cannot be given in this stage. They can only be given on the basis of concrete guarantee applications. However, the eligibility conditions, to be concretised subsequently, will define the rules of co-financing in more detail.

**Contingent liability**

The Commission has to set aside capital reserves to cover the long-term risk related to the loan guarantee instrument. Analogous to a private banks' loan reserve, the main cost represents an estimate of expected and unexpected losses associated with the provision of the guarantees issued.

The objective of provisioning is not to minimise the overall risk exposure but to optimise exposure, i.e. to take prudent risks in order to increase the leverage capacity of Community funds as much as possible. Forecasting the long-term cost of the guarantee instrument requires estimates of the loss probabilities of the projects (expected and unexpected losses) and possible correlations between the projects.

The Commission and EIB services have developed a methodology to set provisioning rates, taking into account the diversification obtained through the portfolio effect and consistent with an AAA rating of the guarantee instrument. This model has been developed following

discussions with rating agencies and using available statistical data<sup>15</sup> and information<sup>16</sup>. The details of the provisioning model are presented in the Commission staff working document SEC(2005)323. This model also incorporates a buffer for potential downgrading of the creditworthiness of the portfolio.

This provisioning system and the creation of a liquidity fund should reduce the risk of direct and unexpected calls on the Community contingent liability to a negligible level (AAA rating of the guarantee instrument). The residual contingent liability of the Community will be properly taken into account in the Community budget through a 'pour mémoire' budget line as is currently the case of the Community Guarantee for the EIB external lending mandate.

#### *4.2.1. Compatibility with Financial Programming*

Proposal is compatible with financial programming 2007-2013 as proposed by the Commission (COM (2004) 101 final). Moreover, the guarantee instrument is already foreseen by the Commission Proposal for the new TEN-transport regulation COM(2004)475, which provide for the financial framework.

#### Financial Impact on revenue

This instrument has no direct impact on the Community budget.

In fact, the instrument will have revenues, such as fees and interests earned on the funds on the trust account, but these amounts will be used for the purposes of the instrument.

The appropriate pricing system will require further fine-tuning. In any case, the pricing will be set in such a way that the guarantee instrument would cover its expected costs. In line with the original Commission proposal from November 2003, the loan guarantee would be priced in order to cover the risk and management costs relating to the instrument. Ideally each beneficiary should pay an up-front premium, which could be charged when the guarantee is signed or when the guarantee becomes effective, i.e. after the substantial completion of the project, and would be payable either as a one-shot payment or as annual premiums to be paid during the remaining life of the guarantee.

Furthermore, if the guarantee were called, the Commission would obtain a financial claim which would rank subordinated to the senior debt but senior to equity. This mezzanine debt would have to be paid back by the borrower to the Commission as and when project revenues permit. As the Community claim is comparable to mezzanine financing, the amount due following the call should be priced according to the risk taken and reflecting management costs.

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<sup>15</sup> Standard & Poor's, Infrastructure Finance, Traffic Forecasting Risk: Study update 2003, November 06, 2003.

<sup>16</sup> Fitch, A risk assessment model for federal credit, 15 March 1999.



## **5. CHARACTERISTICS AND OBJECTIVES**

### **5.1. Need to be met in the short or long term**

Council and Parliament have adopted on 29th April 2004 the revised TEN T guidelines which include a list of 30 priority projects. The implementation of these priority projects is estimated at a total cost of € 225 bn, € 140 bn of which in the upcoming period of financial perspectives. Such a substantial investment task cannot be financed by the public sector alone.

### **5.2. Value-added of Community involvement and coherence of the proposal with other financial instruments and possible synergy**

In a number of publications, the Commission has underlined the role the private sector should play to achieve those objectives<sup>17</sup>. The guarantee instrument is the major new instrument to attract private capital and will have a strong leverage effect. Once applicable, this will contribute to the achievement of the goal to attract 20% private co-financing to the TENs implementation. Due to the strong public attention related to the new instrument, this impact may already be visible from 2007 on but will be more substantial towards the end of the decade.

The goal of the guarantee instrument is to increase the leverage capacity of limited public resources to stimulate private sector investment in priority TEN-transport (TEN-T) projects by providing credit assistance.

The instrument will provide useful support for specific types of PPPs and for a specific period of the project cycle. It will in so far widen the range of TENs financing instruments. It has also to be underlined that its elaboration and application will not serve as a substitute for Community grant co-financing. On the contrary. It will only achieve full value if the proposed total 20 bn € TENs budget will be adopted. The guarantee instrument will in so far complement European grant financing but not replace it.

Under the new design of the instrument the EU would issue loan guarantees to mitigate revenue risk in the projects' early years. Specifically, the guarantee would fully cover a liquidity cushion, called "a stand-by credit line", which would only be drawn upon in cases where project cash-flows are insufficient to service senior debt. These stand-by credit lines would cover around 10% of the total senior debt (in certain more risky cases up to 20%) and would usually not exceed 5 year maturities.

The granting of a community guarantee may lead to synergies with other financing forms for TENs projects, including the investment policy of public investment banks and it may contribute to increase the confidence of financial markets in the feasibility of the TENs (priority) network as a whole.

An important positive feature of the guarantee instrument is that it would comprise a number of projects of different geographic location and size into one portfolio and thus be able to

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<sup>17</sup> They include: COM 2003 132 on innovative financing of the trans-European transport networks, the final report of the High level group on the transport trans-European network of June 2003, published on the 'Europa' website, the justification and explanation of the amendment of the TEN T guidelines (Decision Nr. 884/2004) and the "exposé des motifs" and the financing rules itself of the proposed TEN financial regulation of July 2004 for the upcoming period of financial perspectives 2007-2013.

obtain a level of diversification at the European level which would not be possible at a national level.

### **5.3. Objectives, expected results and related indicators of the proposal in the context of the ABM framework**

Trans-European networks :

1. Objective : Develop the network and priority projects; output : budget allocation in favour of the 30 priority projects and with special attention to the promotion of privately co-financed projects.

2. Objective : Improve the efficiency of the financial aid to the network; output : implementation of the TENs budget and application of current rules to increase the leverage-effect of the budget. Careful scrutiny of procedures and rules in order to improve the PPP financing possibilities. Preparation of the multiannual programme for the period of the new financial perspectives. Preparation of implementation rules, eligibility criteria and organisational settings for innovative financing instruments including the guarantee instrument.

Inland, air and maritime transport:

Objective : to promote a more environmentally friendly transport system: output : CLWP 2005 Communication on the mid-term state of the implementation of the White paper « European transport policy for 2010 : time to decide CLWP 2005 : Communication on a common transport infrastructure tarification framework, including ports and airports

### **5.4. Method of Implementation (indicative)**

#### **X *Centralised Management***

X Directly by the Commission, with a view to delegate certain tasks to an international financial institution, preferably the EIB Group

Indirectly by delegation to:

Executive Agencies

Bodies set up by the Communities as referred to in art. 185 of the Financial Regulation

National public-sector bodies/bodies with public-service mission

#### *Shared or decentralised management*

With Member states

With Third countries

*Joint management with international organisations (please specify)*

**Relevant comments:**

The lifetime of the guarantee instrument makes it difficult to envisage a complete outsourcing of management in general and especially an outsourcing to a purely commercial body.

In order to comply with the principle of good governance, the most appropriate course would be for the Community to supervise the application of the instrument and to entrust all its guarantee management activity under this instrument to a single agent. The agent should have an in-depth knowledge of project financing, together with appropriate credit risk management systems in place in order to assess the project risks and to manage the provisioning system and the liquidity fund in the long-term. It should also have in-house legal expertise and the appropriate front office staff to interface with financial institutions, monoline insurers, venture capital funds, national authorities and/or equity providers. The agent will have to demonstrate its ability to enter into a long-term contractual relationship with the Commission for the management of the instrument (minimum 15 years). The most practicable option would be to select an international financial institution as the managing agent, an obvious candidate being the EIB Group.

## **6. MONITORING AND EVALUATION**

### **6.1. Monitoring system**

By Commission Services

### **6.2. Evaluation**

#### *6.2.1. Ex-ante evaluation*

Following the request of the European Council, the Commission and EIB services carried out a market testing exercise between March and July 2004. For this exercise, the services developed a questionnaire, which was discussed with the market testing participants. Results of this exercise are outlined in the Commission Communication on feasibility report on EU loan guarantee instrument for TEN Transport projects. Furthermore, if the Member States provide a positive opinion on the setting up of this instrument, the Commission could consider carrying out a stakeholders' consultation in order to obtain the opinion of a larger circle of stakeholders.

#### *6.2.2. Measures taken following an intermediate/ex-post evaluation (lessons learned from similar experiences in the past)*

An ex-post evaluation can only be made at a later stage in case this guarantee instrument is implemented.

#### *6.2.3. Terms and frequency of future evaluation*

This is a very long term instrument and therefore the first evaluation on its implementation will be carried over in 2010 and thereafter a second evaluation end 2012.

## 7. Administrative Expenditure

The needs for human and administrative resources shall be covered within the allocation granted to the managing service in the framework of the annual allocation procedure.

### 7.1 Number and type of human resources

Types of post		Staff to be assigned to management of the action using <b>existing</b> resources ( <b>number of posts/FTEs</b> )					
		Year n	Year n+1	Year n+2	Year n+3	Year n+4	Year n+5
Officials or temporary staff <sup>18</sup> (XX 01 01)	A*/AD	3	3	3	3	3	3
	B*, C*/AST						
Staff financed <sup>19</sup> by art. XX 01 02							
Other staff <sup>20</sup> financed by art. XX 01 04/05							
<b>TOTAL</b>		3	3	3	3	3	3

The indicative amount of administrative expenditure relating to the human resources at the Commission services is calculated as follows: € 108.000 per person on average, an average of 3 persons of Commission existing staff under the condition that the operational management of the instrument is mandated to an operating agent:

<sup>18</sup> Cost of which is NOT covered by the reference amount

<sup>19</sup> Cost of which is NOT covered by the reference amount

<sup>20</sup> Cost of which is included within the reference amount