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PUBLIC VERSION

WORKING LANGUAGE

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Subject: **State aid N 55/2008 – Germany**
GA/ERDF subordinated loan scheme for Brandenburg

Sir,

1. PROCEDURE

(1) Beginning of 2007, Germany put into effect the block exempted regional aid scheme of the Land Brandenburg ("joint-task scheme Brandenburg", hereafter: "the scheme")[1], which provides grants for regional investment projects. By letter dated 30 January 2008, registered at the Commission on the same day (A/1868), the German authorities pursuant to Article 88 (3) of the EC Treaty notified an amendment to the block exempted scheme in order to provide in addition to grants State aid in the form of subordinated loans in the Land Brandenburg. The present decision only addresses the compatibility of the notified amendment.

(2) Following a meeting between the Commission services and the German authorities that took place on 5 March 2008, the German authorities amended their notification by letter dated 17 March 2008, registered at the Commission on the same day (A/5254).

[1] Original title: "Richtlinie des Ministeriums für Wirtschaft des Landes Brandenburg zur Förderung der gewerblichen Wirtschaft im Rahmen der Gemeinschaftsaufgabe 'Verbesserung der regionalen Wirtschaftsstruktur' – GA", XR 31/07; OJ C 102, 5.5.2007, p. 11. Scheme implemented under Commission Regulation (EC) No 1628 of 24 October 2006 on the application of Articles 87 and 88 of the Treaty to national regional investment aid.

Seiner Exzellenz Herrn Dr. Frank-Walter Steinmeier
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(3) The Commission requested further information by letters dated 5 May 2008 (D/51774), 28 July 2008 (D/52966) and 8 October 2008 (D/53893), which the German authorities submitted by letters of 29 May 2008 (A/10174), 20 August 2008 (A/17150) and 10 November 2008 (A/23705).

2. DESCRIPTION

2.1. Objective of the aid scheme

(4) The measure aims at modifying the scheme in order to be able to provide certain parts of the available co-financing budgetary means of ERDF in the form of interest free subordinated loans instead of non-reimbursable grants, which is the standard form of aid under the scheme, to beneficiaries, which carry out initial investment projects in the meaning of the Regional Aid Guidelines for 2007-2013 (hereafter: "RAG")[2] in the Land Brandenburg.

(5) Currently, the entire Land Brandenburg is assisted area under Article 87 (3) (a) of the EC Treaty in accordance with the German Regional Aid Map for 2007-2013[3][4].

(6) Due to its subordinated nature, the public loans should enable the beneficiaries to receive additional senior loans from the market to finance their initial investment projects.

2.2. The nature and form of the aid

(7) The aid will be provided in the form of interest free subordinated loans, which can be combined with grants out of the same scheme.

2.3. Legal basis

(8) The legal basis for the scheme is the following: (a) Haushaltsordnung des Landes Brandenburg und dazu erlassene Verwaltungsvorschriften; (b) GA-Gesetz; (c) GA-Rahmenplan; (d) Richtlinie des Ministeriums für Wirtschaft des Landes Brandenburg zur Förderung der gewerblichen Wirtschaft im Rahmen der Gemeinschaftsaufgabe "Verbesserung der regionalen Wirtschaftsstruktur".

2.4. Administration of the scheme

(9) The scheme will be administered by the public support bank ILB ("Investitionsbank des Landes Brandenburg").

2.5. Budget and duration of the measure

(10) The overall maximum budget for subordinated loans foreseen under the scheme in the period 2008-2013 is EUR 150 million.

[2] OJ C 320, 28 December 2006, pg. 16, Commission decision C 25/2006.

[3] State aid N 459/2007, OJ C 295, 5 December 2006, pg. 6-24.

[4] The region Brandenburg-Südwest is a so-called statistical effect region eligible under the derogation of Article 87(3)(a) of the EC Treaty until 31.12.2010.

(11) The scheme will be operated from the date of the Commission decision until 31 December 2013.

2.6. Beneficiaries

(12) Beneficiaries are firms of all size.[5] The provision of the loan is connected to an initial investment project in the Land Brandenburg in the meaning of the RAG.

(13) Germany expects that the number of beneficiaries is in the range between 501 and 1000.

(14) The German authorities confirmed that no loans will be granted to firms in difficulties in the meaning of the Community guidelines on State aid for rescuing and restructuring for firms in difficulty[6].

2.7. Sectoral scope

(15) The scheme will apply to all sectors of the economy, with the exception of the production of the primary products referred to in Annex I to the EC Treaty, fishery, coal industry, steel, the synthetic fibres sectors, transport and shipbuilding sectors.

(16) The scheme will apply to the processing and marketing of agricultural products but only to the extent laid down in the Community Guidelines for State aid in the agricultural sector[7].

2.8. Basic elements of the scheme

(17) Germany intends to use budgetary means provided by ERDF, which are available for co-financing projects aiming at regional development that are promoted under this scheme, in order to transfer part of the available ERDF means from non-reimbursable grants to subordinated loans.

(18) The loans are interest free and have a duration of 8 or 10 years, combined with an either 3 or 5 years grace period.

(19) The loan is paid out with 100% and the beneficiary does not have to provide any securities for the loan. ILB will receive in case of insolvency or liquidity problems of a beneficiary only the remaining amounts after all other creditors.

(20) The ILB decides on the basis of the individual requirements of the beneficiaries on the ratio between the subordinated loan and a grant out of the scheme. The possibility exists that the public support is provided entirely in the form of the subordinated loan. However, at maximum 75% of the initial investment project can be financed by the public authorities due to ERDF requirements and,

[5] While the initial beneficiaries are companies of all size, the re-investment of the budget after repayment of the loans is limited to SMEs due to requirements of ERDF.

[6] OJ C 244, 1 October 2004, pg. 2-17.

[7] OJ C 319, 27 December 2006, pg.1.

therefore, also the maximum amount of the loan is limited to 75% of the eligible costs.

(21) Germany additionally confirmed that the RAG requirement of a 25% own contribution of the beneficiary is respected.

(22) The subordinated loan can be combined with other public loans (for example, from KfW or the ERP-programme). Germany confirmed that the maximum allowable aid intensities in line with the German Regional Aid Map for 2007-2013 are respected taking into account all sources of public support.

(23) Germany provided a detailed analysis how subordinated loans are classified in accountancy terms showing that these measures can be classified as debt.

2.9. Mechanism to establish the aid element of the subordinated loan

(24) In order to establish the aid element of the subordinated loan, Germany proposes to use a rating of the beneficiary, which is carried out by ILB. The ILB has an own rating system in place, which can be transferred into standard rating categories used by international rating agencies via the 1-year probability of default.

(25) On the basis of the loan margins indicated in the column "low collateralisation" of the Communication from the Commission on the revision of the method for setting the reference and discount rates (hereafter: "new reference rate Communication")[8] aid elements of the ILB loans will be established.

(26) In addition, in order to reflect the higher risk of subordination compared to normal senior debt, ILB will apply a system by which it is ensured that the subordinated loan is always classified one notch lower in terms of rating categories of international rating agencies compared to the company rating of the beneficiary.[9] Picture 1 below shows this mechanism.

[8] OJ C 14, 19.1.2008, p.6.

[9] Germany confirmed that for certain special purpose vehicles for which no company rating is available a loan margin of at least 400 basis points is applied.

S & P	EU Reference rate Communication		ILB		Application for subordinated loans	
Rating category	unsecured 'normal' loans		Rating category "Bonitätsklasse"	PD % up to	Company-Rating	top up subordinated loans
AAA					AAA	
AA+					AA+	
AA					AA	
AA-	strong	100 bp	1		AA-	100 bp
A+					A+	
A					A	
A-				0.13	A-	
BBB+			2		BBB+	220 bp
BBB	good	220 bp			BBB	
BBB-				0.45	BBB-	
BB+					BB+	
BB	satisfactory	400 bp	3		BB	400 bp
BB-				2.00	BB-	
B+					B+	
B	weak	650 bp	4	7.50	B	650 bp
B-					B-	1000 bp
	bad	1000 bp	5	18.55		

Picture 1: Transfer between Standard & Poor's rating categories and ILB Bonitätsklassen, loan margins according EU reference rate Communication and applied margins to subordinated loans

(27) The German authorities will ensure that the Hausbank[10] of the beneficiary will at the moment of applying for the loan indicate the 1-year probability of default of the beneficiary according to the rating system used by the Hausbank. With this information it is then possible to assign a rating category of the Standard & Poor's system to the beneficiary. This transfer is necessary in order to allow for a "one notch lower" rating of the subordinated loan compared to the company rating since the ILB system does not differentiate sufficiently as it only comprises 5 categories ("Bonitätsklassen").

(28) Beneficiaries in ILB Bonitätsklasse 5 are excluded from the programme and will not receive loans under this programme. Furthermore excluded are start-ups for which no rating is available.

(29) The aid element of the loan is then calculated by discounting the annual aid element (which equals the base rate defined by the EU reference rate Communication plus the top up depending on the rating of the beneficiary, taking into account a lower rating due to the subordinated nature) to the moment of granting the loan.[11] For discounting purposes the new reference rate communication foresees a uniform top up of 100 basis points on the base rate.

[10] The German term 'Hausbank' stands for the main bank of the beneficiary.

[11] Since the ILB loans are interest free, the entire applicable reference rate will define the aid element of a loan.

2.10. Monitoring

(30) The German authorities agreed to submit by 30 June a yearly report to the Commission on the application of the notified amendment, indicating the number and amounts of subordinated loans granted in each rating category and the loan margins applied.

(31) In addition, the German authorities will provide after five years, counted from the start of the measure, submit to the Commission a detailed report, which allows for an evaluation of the appropriateness of the applied loans margins.

3. ASSESSMENT

(32) The Commission notes that the transfer of budgetary means from non reimbursable grants to subordinated loans to promote regional development is a positive proposal and in line with recommendations given in the ERDF context. Generally, the effectiveness of limited public resources will be increased and the loans allow the beneficiaries to generate additional private financing for their regional investment projects.

3.1. Legality of the measure

(33) By notifying the aid measure before putting into effect, the German authorities respected their obligations under Article 88 (3) of the EC Treaty.

3.2. Existence of state aid

(34) State resources are involved in the notified scheme since the subordinated loans are provided interest free, meaning that interest revenues are foregone for the State budget.

(35) The measure is selective since it will be granted only to certain firms in the Land Brandenburg. Moreover, the State has a discretionary power in awarding the loans.

(36) The measure conveys an advantage by relieving the beneficiaries of costs which they would have to bear under normal market conditions since, without the intervention by the State, the borrowers would obtain loans only at higher costs, if at all.

(37) The measure affects trade between Member States since the scheme is not limited to beneficiaries which are active in sectors where no intra-community trade exists.

(38) In view of the above, the Commission considers that the notified measure constitutes state aid within the meaning of Article 87 (1) of the EC Treaty. The German authorities do not contest that conclusion.

3.3. Compatibility of the measure

(39) Having established that the measure involves state aid within the meaning of Article 87 (1) of the EC Treaty, it is necessary to consider whether the above mentioned measure can be found compatible with the common market. The Commission has examined the measure in the light of Article 87 (3) of the EC Treaty.

(40) The present decision only addresses the compatibility of the notified amendment of the scheme regarding the intention of the German authorities to grant interest free subordinated loans in the Land Brandenburg on the basis of the joint task scheme.

(41) The Commission has examined the amendment under the Regional Aid Guidelines for 2007-2013 ("RAG")[12] and considers that the amendment is compatible or does not change provisions of the scheme, which could conflict with the general requirements of the RAG, in particular, the rules on incentive effect, the definition of an initial investment project, eligible costs, own contribution of the beneficiary, maintenance of the initial investment project and cumulation[13] are respected.

(42) Moreover, in line with the German Regional Aid Map for 2007-2013, all the regions where this scheme applies are indeed regions eligible for regional aid pursuant to Article 87(3) (a). Germany has confirmed that in case the statistical effect region (Brandenburg-Südwest) will loose its status under the derogation of Article 87(3)(a) after 2010 and will automatically become eligible under the derogation of Article 87(3)(c), they will respect the maximal aid intensity of 20% foreseen in the RAG for this type of regions till the end of the year 2013.

(43) Having analysed the general compatibility of the amendment with the RAG, the following assessment is limited to the question whether the notified mechanism to establish the aid element of the interest free subordinated loan is adequate.

Assessment of the methodology to define the aid element of the subordinated loans

(44) In line with the decision taken in case C 33/07[14], the Commission considers that the interest free subordinated loans can be classified as debt since there is a contractual obligation to repay the loan together with a "fixed" remuneration (0% interest rate) of the loan.

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[12] OJ C 320, 28 December 2006, pg. 16.

[13] As indicated in point (22) of the present decision, the subordinated loans can be combined with other public loans, e.g. from KfW. Since the German authorities notified in parallel the KfW interest rate system (ex N 313/314/315/08 now NN 65/66/67/08), Germany accepted that until final decisions are taken on the KfW interest rate system, a clause is introduced in the aid contracts regarding the provision of the subordinated loans under this measure, that a later correction of the aid amounts is still possible in case maximum regional aid intensities would not be respected.

[14] http://ec.europa.eu/comm/competition/state_aid/register/ii/doc/C-33-2007-WLAL-de-08.10.2008.pdf

(45) The Commission considers that the new reference rate Communication can not directly be applied for the assessment of the subordinate loans and is of the opinion that the Communication only applies to senior debt. The loan margins indicated in the Communication including the margins in the column "low collateralisation"[15] are not directly transferable to subordinated loans. The lender of subordinated loans, by not participating in a situation of loan default in the recovery of assets until claims of all lenders of senior debt are satisfied, offers a quasi-guarantee commitment in favour of lenders of senior debt and thus accepts a higher risk than the lender of senior debt which is not reflected in the reference rate grid.

(46) Subordinated loans constitute a specific situation. Specific situations are caught by the introductory sentence to the loan margins grid of the new reference rate Communication, which underlines that the following loan margins are to be "applied in principle depending on the rating of the undertaking concerned and the collateral offered". The qualification "in principle" allows the Commission to deviate from the grid in justified circumstances.

(47) The Commission, therefore, takes the view that the additional risk of subordination is not fully reflected in the loan margins of the column "low collateralisation" of the new reference rate Communication, which therefore must not be taken as benchmark for subordinated loans. According to available information, banks, in line with the approach suggested by international rating agencies[16], normally apply a lower rating for subordinated debt.

(48) In line with this approach, Germany will apply a system by which the rating of the beneficiary is not directly applied to define the loan margin that is to be added to the base rate but confirmed that for the subordinated loans a lower rating classification is applied – as shown in picture 1, always one notch lower on the basis of the Standard & Poor's rating system.[17]

(49) To apply this principle, ILB has to use the rating information of the Hausbank of the beneficiary since its own rating system is not differentiated enough. The Commission considers the proposed approach to use the Hausbank rating acceptable.

3.4. Conclusion

(50) The Commission is of the opinion that the notified amendment to allow for the possibility to use available budgetary means in the context of the joint task scheme Brandenburg in order to provide interest free subordinate loans instead of grants to support initial investment in the Land Brandenburg is in line with the general provisions of the RAG.

[15] Low collateralisation stands for a "loss given default" (LGD) above or equal to 60 %.

[16] See for example: www2.standardandpoors.com/spf/pdf/products/2007_Default_Study.pdf, page 11.

[17] Since all rating systems can be converted into each other via the 1-year probability of default, the approach also allows the use of other rating systems, like Moody's or, for example, the German system of the Sparkassen association DSGV.

(51) In addition, the Commission considers the proposed methodology to define the aid element of the subordinated loan as adequate and correct to reflect the income forgone and the risk taken by the State in providing these interest free subordinated loans.

4. DECISION

(52) The Commission has accordingly decided to consider the notified amendment of the scheme as compatible with the EC Treaty.

(53) The Commission, therefore, accepts that Germany grants investment aid in the form of interest free subordinated loans in the Land Brandenburg on the basis of this scheme until 31 December 2013.

(54) The Commission reminds the German authorities on their commitment to fulfil the reporting obligations.

(55) The Commission further reminds the German authorities that all plans to modify this aid scheme have to be notified to the Commission.

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Your request should be sent by registered letter or fax to:

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Yours faithfully,
For the Commission

Neelie KROES
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