CER

The Voice
of European
Railways

Stakeholder consultation on the Europe 2020 Project Bond Initiative

Response of the Community of European Railway and Infrastructure Companies (CER)

6 May 2011

Preliminary comments:

CER, as the largest representative of the rail sector in the Union, responds to the questions of the consultation from the perspective of rail projects only. The most important general issue which CER wishes to stress is that rail projects typically exhibit significantly positive *social returns* but low *private returns*. Furthermore, payback periods for rail projects tend to be long (30-60 years).

This implies that **direct state funding is the first-best solution** for rail infrastructure funding in the vast majority of cases. In addition, some of CER's member companies have pointed out that, as state-owned companies, they benefit from triple-A ratings if they want to issue *company bonds*. The recourse to *project finance*, i.e. *project bonds*, with lower ratings like single-A, is thus clearly a second-best solution.

Of course, CER understands that state budgets are more constrained today than in the past. But the point must be made that the current fiscal constraints, if applied in a manner which is unwise, will end up costing more for companies and for the economy as a whole than traditional state funding. CER strongly believes that linear cuts across all categories of government spending constitute bad policy.

In addition, the recent empirical record in terms of private-public partnerships for rail projects suggests that the sector poses greater challenges than, for example, road infrastructure projects. One notable reason is the higher technical complexity of rail infrastructure. Besides the building and maintenance of the tracks, technology-intensive "track-side" equipment is necessary for signalling and safety purposes. That suggests that all-in-one PPPs may not always be the best way forward, and that concurrent projects may be preferable in certain cases.

These observations do not rule out the recourse to PPPs in the rail sector. There are specific categories of projects within rail that present better characteristics than others, notably **high-speed rail lines** as well as certain short-distance high-traffic links, e.g. missing connections to airports (for passenger traffic) and to seaports (for freight).

However, in order to ensure higher private returns and (somewhat) shorter payback periods, **CER stresses the necessity for further reforms in transport policy**. The two most important pillars for further action – in line with the general goals expressed in the March 2011 Transport White Paper of the European Commission – are the *internalisation of the external costs of transport* (including greenhouse gas emissions) and continued state funding in order to account for the *positive externalities of transport infrastructure*.

COMMUNITY OF EUROPEAN RAILWAY AND INFRASTRUCTURE COMPANIES - COMMUNAUTÉ EUROPÉENNE DU RAIL ET DES COMPAGNIES D'INFRASTRUCTURE - GEMEINSCHAFT DER EUROPÄISCHEN BAHNEN UND INFRASTRUKTURGESELLSCHAFTEN

CER aisbl Avenue des Arts, 53 B-1000 Bruxelles Tel: +32 2 213 08 70 Fax: +32 2 512 52 31 contact@cer.be www.cer.be

CER believes that the positive externalities of rail projects are high. Besides the external economic benefits of enabling more transport activity and participating in the economic revival of newly-connected locations, **rail projects help to reduce future external costs**, notably future greenhouse gas emissions, which would otherwise occur.

There is as yet no formal (legal) framework to quantify the value of avoided external costs and to use such estimates to explicitly justify the allocation of public funds. CER's position is that cost-benefit analyses for public spending decisions in transport should reflect that aspect. In the context of public-private partnerships, CER suggests that **the value of avoided future external costs should be covered by public funds**. This would reduce the capital expenditure requirement and increase the chances of attracting private capital.

Similarly, a well-targeted use of existing funding mechanisms, in particular TEN-T and Cohesion and Structural Funds, may be considered as well – what DG Move refers to as "blending" (use of EU funds to co-finance transport PPPs).

Numerous additional questions and adjustments to the economic framework conditions may also be necessary in order to successfully attract private capital into rail infrastructure projects. For example, some CER member companies have asked whether projects with private capital should be exempted from the legislation on rail infrastructure charging. Existing rail sector legislation is designed under the assumption of state funding for a share of the fixed costs of the infrastructure, while users (train operating companies) should pay for the marginal cost ("wear-and-tear"), plus a mark-up "that the market can bear". That construction, which CER approves of, makes it difficult to envisage exactly how 'project finance' solutions with private capital should function. In particular, should user charges then be allowed to be higher, should public budgets contribute in the form of availability fees, or should there be some combination? There are, in conclusion, many unanswered questions at this stage due to the specific nature of rail infrastructure.

CER would therefore like to ask the Commission and the EIB (including EPEC staff but not exclusively) to engage in a deeper dialogue with the rail sector concerning how, and under what circumstances, private capital could be successfully deployed for rail projects. On a preliminary basis, CER suggests the formation of an ***expert group on private financing of rail infrastructure*** that would gather experts from the rail sector and officials from DG EcFin, DG Move and the EIB in order to discuss these issues in more depth.

General questions:

1) Is the chosen mechanism likely to attract private sector institutional investors to the sectors of transport, energy and ICT in particular? If you are an investor, would you be prepared to buy such project bonds?

CER member companies are cautious, even sceptical, about how the Project Bond Initiative could make a contribution for rail infrastructure projects. The main reason is that the specific economic characteristics of most rail infrastructure projects do not naturally call for private capital (see above).

CER cannot speak for potential investors. However, in the context of CER's proposal above, CER would greatly appreciate a feedback from the Commission concerning which categories of investors have expressed interest in rail projects to the Commission, within this consultation or at other times.

2) Are there other sectors with large-scale infrastructure financing needs that should be included?

CER does not wish to speak for other sectors of the economy.

Specific questions:

3) Would the credit enhancement facilitate/accelerate the conclusion of financing packages?

The question is loaded towards a positive answer: of course it is clear that private investors will be more willing to invest if their risk is reduced, and that is what credit enhancement does for them by design.

The real question is how to best combine risk reduction techniques (in this case the prioritisation of the use of the project revenues) with public co-financing. Other mechanisms to reduce project revenue risk (increase average project revenue flows, increase stability of revenue flows, increase share of public co-financing) should be explored as well.

4) What minimum rating of the bonds would be sufficient to attract investors?

CER doesn't wish to express a position on that.

5) What degree of credit enhancement would be necessary to achieve this rating?

CER doesn't want to express a position on that.

6) Which impact would the Initiative have on financing costs and on maturities?

In the typical case financing costs may well be higher than with traditional state funding. This reality should not be overlooked by Member States.

7) Is it essential that a single entity acts as controlling creditor?

It seems preferable that the EIB should play this role alone. However more detailed discussions would be necessary in order to answer this question in more depth. One would have to clarify what the alternatives could be.

Disclaimer

Community of European Railway and Infrastructure Companies (CER) AISBL

Avenue des Arts 53

B-1000 Brussels

Belgium

Tel +32 2 213 08 70
Fax +32 2 512 52 31
contact@cer.be