# The Europe 2020 Project Bond Initiative

# **Consultation Conference**

Brussels, 11 April 2011



- 1. Project Bonds: Why and How
- 2. The Project Bond Instruments and EIB's Potential Role

# Why Project Bonds?

- Since 2000, more than EUR 100 bn of infrastructure assets in Europe are estimated to have been financed in the capital markets;
- Monoline-wrapped capital market issues became <u>important providers of liquidity for infrastructure</u> and were placed with institutional investors (insurance companies, pension funds);
- However, the financial crisis has brought about the disappearance of the sufficiently highly rated "monolines". Basel 2 & 3 have put pressures on banks' balance sheets, while public budgets remain constrained. This has significantly reduced the available long term funding for infrastructure assets;
- There is thus the need to find ways to <u>bring back private sector financing</u> of infrastructure projects, without increasing direct public funding and therefore public indebtedness.

# Why Project Bonds?

- Up to the "crisis", "Monolines" provided debt service guarantees ("wraps") to senior debt/senior bonds issued by project companies;
- Project companies issued debt at "stand-alone" ratings of at least BBB-. By virtue of the monoline's AAA rating, the wrapped bonds benefitted from a AAA rating, thus eligible for institutional investors;
- "Monolines" also provided financial structuring, credit assessment and monitoring services;
- They also played the role of "controlling creditor" within inter-creditor structures;
- The "project bond" model is intended to step into the void left by the disappearance of the "monoline-wrapped" infrastructure bond market.

# Project Bonds: Delivery Mechanism

- Rather than providing guarantees directly to senior debt holders, the "Project Bond" concept is based on the idea, familiar from the securitisation market, of <u>"tranching" (i.e., dividing) an issuer's debt into several layers of</u> <u>different seniority;</u>
- "Tranching" an issuer's debt into several layers allows for the creation of different types of debt, each with its own risk/return characteristics, and appealing to different categories of investors;
- More specifically, a Project Company (an SPV) would divide ("tranche") its debt into two layers:
- 1. A Senior portion, which will be securitised and turned into a <u>Project Bond</u>, to be placed with institutional investors, and
- 2. A (smaller) <u>Subordinated debt obligation</u>, (funded or unfunded) which would be underwritten by the EIB.

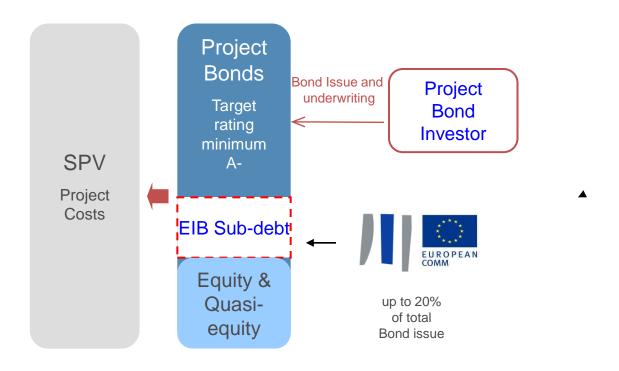
#### Project Bonds: Delivery Mechanism

- Depending on the robustness of the financial structure, the EIB's intervention targets to "credit enhance" the <u>Senior Bonds issued by the "Project Company"</u> into a A AA rating level, thus making these "Project Bonds" eligible for the portfolios of institutional investors;
- The EU will support the products under the Project Bond Initiaitive via appropriate <u>risk sharing mechanisms</u> with the EIB;

# Project Bonds: Delivery Mechanism

- Under the Project Bond proposal, the EIB would <u>not</u> undertake the traditional guarantee function of Monolines, that is it will <u>not provide a full AAA wrap</u> like the Monolines did;
- The appraisal and pricing of the individual subordinated loans underlying the Project Bond Initiative will be based on <u>EIB's traditional standards</u>;
- Therefore, in addition to its attractive pricing, EIB would be perceived "to add value" also given its <u>reputation</u> and track record in screening, assessing, mitigating and monitoring project risk.

#### Subordinated Project Bond Instruments





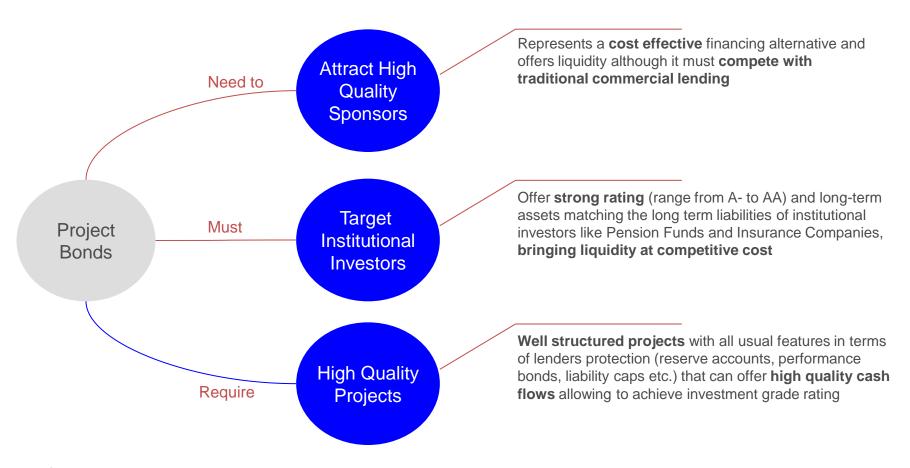
**EIB Sub-debt** participation can be combined with different types of funding sources (bonds and other senior loans)

**EIB Unfunded Sub-debt** participation can be flexibly used and structured in order to ensure target rating.

- Covers funding shortfalls during construction
- Comes on top of a fully funded structure

# Conclusion - Why « Project Bonds »?

In order to be meaningful and successful Project Bonds must gather a varied set of conditions





The overall Project Bond proposal must be a competitive alternative based on high quality asset cash flows and parties

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# Project Bonds – An Evolution of LGTT

- "Project Bond" instruments <u>provide credit enhancement for senior debt</u> similar to the "Loan Guarantee Instrument for TEN-T Projects" (LGTT) Financial Instrument;
- LGTT, like "Project Bonds", is a <u>common initiative</u> of the EU and EIB, where traffic and revenue risks relating to the initial operating ("ramp up") period of TEN transport infrastructures are jointly taken by EIB and EU;
- LGTT, like "Project Bonds", is a <u>subordinated (unfunded- guarantee)</u> <u>product</u> designed to provide cover to senior (bank) lenders supplying stand-by facilities in the early phases of such infrastructure projects.

# Project Bonds – An Evolution of LGTT

The Project Bonds Initiative, as currently conceived, has points in common with LGTT, but it would extend the LGTT experience to:

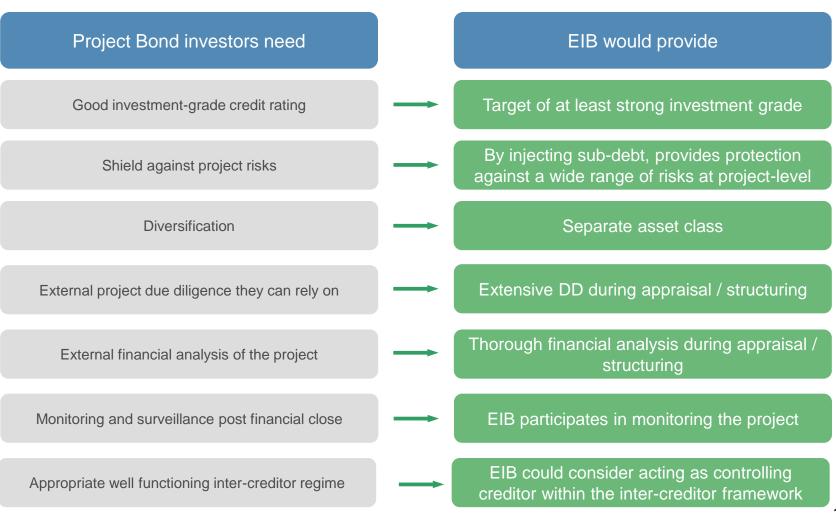
- Other categories of <u>project-related risks</u>, possibly including construction, operations, performance, traffic etc.;
- A wider <u>sector eligibility</u> range, to be defined by the EU, but potentially extending to: transport, energy, environment, and ICT;
- In principle, both unfunded and funded structures, depending on the project's characteristics and requirements. As in the LGTT, in the unfunded version, once EIB guarantee is called it would crystallise into a subordinated loan.

#### « Project Bonds » - Other Features

- It is anticipated that the credit enhancement provided by EIB could go <u>up to 20%</u> of the senior securitised project debt;
- This is expected to provide de facto <u>debt service protection</u> in the vast majority of scenarios during project's life;
- Traditional <u>equity requirements</u> to be met, i.e. subordinated debt supplied by EIB is not meant to replace shareholders' loan or equity contributions;
- EIB is open to <u>other institutions</u> joining in the offering of sub-debt credit enhancing products;
- Underlying projects must <u>satisfy EIB's ordinary assessment criteria</u>, that is projects must be technically robust and financially sound.

# Summing Up:The Potential Role of the EIB

EIB's participation could provide substantial benefits to the Project Bond investor



# **Questions & Answers**