WWF response to the European Commission Stakeholder Consultation on the Europe 2020 Project Bond Initiative

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Summary

• WWF is very concerned that the present Project Bond Initiative is not clearly linked with the European environmental policies, and could therefore jeopardise EU environmental policies and commitments by 2020 and 2050 (especially on climate change).
• The Project Bonds Initiative represents a transfer of private sector risk on to the public sector; in the post-financial crisis period, given the already overburdened public purse in Europe, the consultation background document should explicitly deal with this issue. Such a risk taking approach can only be accepted if there is a strong rationale: the support of environmental public goods (like the preservation of our climate) is such a rationale.
• We therefore call for consistency of the Project Bond Initiative with EU environmental targets is ensured for all projects. Due to the time horizon of infrastructure projects, it is essential that climate considerations are central to infrastructure planning and financing, and that biodiversity and resource efficiency are also clearly integrated.
• To clarify this further, we recommend the initiative is renamed Green Project Bond Initiative and focuses exclusively on sustainable projects by aligning eligibility criteria with EU sustainable development and environmental integration policies.
• WWF opposes any public initiative that facilitates further the financing of high-carbon long-term infrastructures.
Requiring consistency with EU policies: financing infrastructures for a low carbon renewable highly efficient economy

1. We emphasise that public support for Project Bonds needs to be fully consistent with the environmental objectives of EU policies.
   EU policies rightly place a strong emphasis on climate change, energy savings, biodiversity and resource efficiency objectives. This initiative must only support projects that respect these objectives. This is in particular the case for:
   - the Europe 2020 Strategy headline targets of 20/30-20-20: 20/30% carbon reduction below 1990 by 2020; 20% of EU energy consumption to come from renewable resources; 20% reduction in primary energy use compared with projected levels, to be achieved by improving energy efficiency;
   - The 2010 commitment by the EU Council to halt biodiversity loss by 2020;
   - The Flagship Initiative “Resource efficient Europe” of the Europe 2020 Strategy to reach a fully sustainable management of resources;
   - The 2011 Energy Efficiency Plan;
   - The 2050 Roadmaps for a Low-Carbon Economy, for energy, and for transport, that restate the EU commitment of reducing domestic CO2 emissions by 80-95% by 2050, and by 60% in the transport sector.

2. Build a strong rationale: the support for environmental public goods
   Considering that the Commission/EIB will be covering subordinated debt (paid after bonds and before equity), the Project Bonds Initiative represents a transfer of private sector risk on to the public sector. In the post-financial crisis period, given the already overburdened public purse in Europe, the consultation background document should explicitly deal with this issue and propose a strategy to control the risk. Such a risk taking approach can only be accepted if there is a strong rationale. The rationale exists: the support of environmental public goods (like the preservation of our climate) cannot be achieved by the private sector alone and requires public action and support. The support of environmental public goods, again, needs to be fully reflected in the selection of projects benefitting from the Project Bond Initiative.

3. Support renewable energy infrastructures
   In the Commission’s proposal, renewable energies are singled out and considered as “challenging” and the coverage of “new markets” (e.g. smart metering, renewable energy electricity infrastructure for transport) is seen as problematic. On the opposite, it has been understood that this demand driven initiative is rather well structured to support motorways, airports and gas pipeline projects. According to informal discussions with EIB staff, we understand that the model portfolio that currently looks to best fit the risk-layering approach is constituted of motorways. This hypothesis was unfortunately confirmed in the Project Bond conference on 11 April 2011, where several speakers gave examples of roads and airports projects supported that way, while it was said that smart grids would hardly benefit the initiative because it does not seem to fit their specific needs.

The fact that financing renewable energies might be considered as challenging shows precisely where the Project Bond Initiative could have an added value by supporting these projects, instead of business as usual. WWF demands that the Project Bond Initiative supports renewable energies and smart grids for renewable electricity. This proposal has been recently backed by Giulio Tremonti, Finance Minister
of Italy, who proposed “that the European Union launch eurobonds to develop renewable energy sources”.

4. Support energy savings
The Europe 2020 Strategy has also set an ambitious energy savings target. The most important means of achieving climate, energy, economic and security of supply goals is through energy savings (especially building retrofit). To avoid costly, unnecessary and polluting energy infrastructures and contribute to the 20% energy efficiency target by 2020, the Project Bond Initiative must support energy savings projects. Energy savings represents one of the biggest, quickest, most cost-effective and job creative low carbon solutions, especially refurbishment and insulation in the building sector. Yet Europe is not even half way to reaching its 20% energy savings target by 2020: such a massive failure is equivalent to the energy imported through 7 Nabucco gas pipelines. The Project Bond Initiative must support energy savings projects to contribute to the achievement of the 20% target by 2020.

5. Set strong environmental eligibility criteria and reproduce the selection process of major projects of Cohesion Policy
The Project Bonds facility will be limited, so we need to make it count. The most urgent infrastructure priorities in Europe relate the low-carbon sectors of energy and transport. But the EIB is set up as an organization that responds to project proposals made at a Member State level. It has deliberately limited remit and capacity to seek out or develop projects to fund that will provide the greatest economic leverage opportunity as well as policy returns. In that context they have to wait for proposals to be made to them and can only respond to proposals as they arise.

EU government and industry are in the early stage of developing proposals for low-carbon transition projects such as inter-country power grid connectors. But project proposals already exist for new motorways, gas pipelines and other investments that our high-carbon economy is more familiar with. These investments are not consistent with a coherent approach to achieving the EU’s climate change related policy objectives.

But there are no references in the proposal regarding environmental, sustainability and climate assessments and eligibility guidelines. This omission raises strong concerns on the consistency of the Project Bond Initiative with EU sustainable development and environmental integration policies. This issue was raised in the Project Bond conference on 11 April 2011, but Commission’s representatives argued that eligibility criteria was not up for discussion during the consultation and would be addressed at a later stage, without intimating what the later stage might be.

Eligibility criteria for the Project Bonds Initiative are critical issue to ensure coherence with:
1. EU environmental policy, in particular climate change policy, and
2. the maximising of financial leverage.

They should notably include reduction of CO₂ emissions, high energy and resource efficiency and biodiversity protection. A mechanism already exists that should be re-used in the context of the Project Bond Initiative: the mechanism in place in Cohesion Policy for assessing and selecting major projects (above €50 million)², with requirements of environmental, socio-economic and financial assessments, publication of all documents, public consultations, and final approval by the Commission.

¹ Financial Times, 20 April 2011, Italy freezes return to nuclear power, http://www.ft.com/cms/s/0/d7989d14-6ab4-11e0-80a1-00144f5ab49a.html
² Cohesion Policy, General Regulation, article 39
6. Maximise the amount of (green) jobs created with a limited financial support
The Europe 2020 Strategy has also set ambitious employment targets. The low carbon solutions have a huge job potential, as shown by several studies: according to the Commission, meeting the EU objective of 20% of energy from renewable sources will mean 600,000 jobs and adding in the 20% target for energy efficiency could result in well over one million new jobs in the EU. A new report commissioned by the German Federal Ministry for the Environment shows that committing to a 30% reduction in emissions by 2020 will provide 6 million additional jobs Europe-wide. In the energy sector, fossil fuel projects create less jobs per million invested than renewable energy projects because they are more capital intensive.

Given the current job crisis in Europe, the Project Bond Initiative should support low carbon projects to create the biggest possible number of green and quality jobs with a given limited financial amount.

7. Don’t focus only on TEN-T and TEN-E (that are currently under review)
The consultation background paper focuses essentially on TEN-T and TEN-E projects. But there is no clear explanation of why the large infrastructure projects are considered as backbone of the Europe 2020 strategy. The link between the EU resource efficiency flagship initiative and large infrastructure as priority investments needs to be assessed. TEN-T is currently under review and several TEN-T projects are controversial because they increase carbon emissions (notably roads) and thus are likely jeopardising 2050 roadmaps’ targets. Therefore the Project Bond Initiative should not focus solely on TEN-T and TEN-E and should check in every project its consistency with mid and long term EU climate targets.

Follow innovative ‘green’ financial initiatives

1. Require consistency of the EU financing framework with the EU low carbon agenda
The world’s largest global investors, totalling over $15 trillion (more than one quarter of global market capitalisation), sent a strong message before the UN climate negotiations in Cancun in November 2010, demanding determined policy action on climate change. “A basic lesson to be learned from past experience in renewable energy is that, almost without exception, private sector investment in climate solutions has been driven by consistent and sustained government policy. Experiences from countries such as Spain, Germany and China show how structured policies can bolster investor confidence and help drive renewable energy investments”, said Ole Beier Sørensen, Chairman of the Institutional Investor Group on Climate Change and chief of Research and Strategy at the Danish pension fund AT.

Getting the trust of investors requires consistency of the financing framework put in place by the EU with the EU low carbon and environmental agenda.

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3 European Commission, Staff working document of Regional Policy contributing to sustainable growth in Europe 2020, COM(2011) 17
4 Oxford University, Potsdam Institute for Climate Impact Research (PIK), National Technical University of Athens, Université Paris 1 Panthéon-Sorbonne, European Climate Forum, Study commissioned by the German Federal Ministry for the Environment, A new Growth Path for Europe, February 2011
5 Pollin et al., 2009. E.g. in the US, money invested in energy efficiency and renewable energy is estimated to produce between 2.5 and 4 times as many jobs per dollar invested in producing energy from oil
6 Institutional Investor Group on Climate Change. The world’s capital markets demand determined policy action on climate change, 16 November 2010. The statement was signed by 299 investors from Asia, Africa, Australia, Europe, Latin America and North America
Yet the EIB is at risk of developing a reputation for allocating capital without regard to the coherence of EU emission-reduction policies. The Bank continues to fund high-carbon (and unleveraged) projects such as coal-fired power plants in Slovenia that work directly against the EU’s ability to meet its emission reduction targets. The right and left hands of the EIB do not work together.

2. Reproduce best practices of other stakeholders
This proposal comes at a time when several Member States and significant stakeholders are looking at green bond schemes, for instance the UK Green Investment Bank, the World Bank, the EIB, the EBRD, the IFC and other more modest players such as NIKKO in Japan, US solar power firm SunPower Corporation, and others. This indicates strong demand for such green bonds and is encouraging for EU Project Bonds to be considered from a green angle. The EU should not lag behind these initiatives and should lead the way towards the financing of a green economy. To clarify it further, the Project Bond Initiative should be renamed “Green Project Bond Initiative”.

How will the objectives of the Initiative be met?

1. Use the facility to support project aggregation as well as single projects
Many individual investments in renewable energy and emission-reduction areas are too small for typical bond issuance (€200 million-1 billion). Wind farms are typically built in €10-$50 million batches; ditto with solar. Energy storage technologies are often under €100 million, district heating initiatives might be up to €200 million.

Aggregators are needed in the market to pool investments into offerings suitable for the scaled up appetite of institutional investors. These provide exit strategies for risk taking developers, helping them churn their higher risk equity at a faster rate and thus develop more projects. Aggregators might be companies or they can be bond vehicles, whether asset-backed or in the style of Covered Bonds. Diversity is required.

Because of the lack of experience with the underlying investments and the novelty of their scale, investors and rating agencies remain cautious for the moment about their creditworthiness. This cautiousness has been exacerbated by concerns of political risk for various government funding frameworks. But aggregating projects has already been done successfully.

The Project Bond Initiative should be able to be used to support the establishment of a market for aggregation vehicles as part of necessary financial infrastructure. Support would, as per the 2020 Project Bonds model, be in the form of narrow tranches of guarantee for such funds. That would allow them to quickly take their place in the market and channel institutional investment.

2. Improve due diligence of the Commission and the EIB
We need to emphasise that the Commission and the European Investment Bank needs to improve due diligence to ensure efficient issue of green project bonds. Adequate mechanisms for assessment, monitoring and evaluation should be designed for Commission’s and EIB’s involvement in any such initiative. The evaluation of environmental and social impacts is equally as important as the financial ones.

The project’s selection should be based on strict standards, with a solid monitoring system to ensure the
respect of the standards throughout the construction and management of the projects. Evidence\(^7\) has shown in big infrastructure projects operated as Public-Private Partnerships that even the performance standards that do exist are hard to implement as it is in no-one’s interest that the project fails. The public sector therefore has then little choice but to provide generous financial concessions to the private operators in order to see the project implemented – watering down the financial leveraging effect of the approach.

3. Be cautious with potential credit guarantee from host Member State

The Commission and EIB may choose to mitigate their own increased financial risk by seeking to take additional security for such projects from the host Member State, perhaps through that government’s credit guarantee on the project. This is merely another form of transferring private sector risk (i.e. the risk of the project promoters and of the private investors) on to the public sector, in this case the taxpayers of the host State who would be required to bear the financial risks and associated costs. In such a case, the potential failure of an expensive project could have disastrous consequences on the balance of payments of that government - given that most EU Member States are already deeply in debt or even requiring EU and IMF financial support to restructure their debt and avoid a default of payments. Therefore, would the Commission and EIB envisage these instruments, they would have to be extremely careful not to simply pass associated financial risks to the host State, potentially burdening it further instead of helping it.

General questions of the consultation

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?

Depending on the level of guarantee, the mechanism explained in the consultation paper is likely to act as a definite incentive to private sector institutional investors. A full level of guarantee from the EU/EIB may be sufficient to reach high enough rating to qualify for institutional investor investment.

Further details are provided below in subsequent questions.

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

The current foreseen emphasis on the sectors of transport, energy and ICT covers an important ground of financing infrastructure projects.

However, very sizable infrastructure investments may be also envisaged in other areas of transition to a low carbon economy. This is in particular the case of low carbon development of infrastructure at a city level especially transportation issues within cities, and large scale energy savings programmes within cities. Such projects are usually left to cities to find their own finance, done occasionally through municipal bonds. However, a level of guarantees brought in by the EU as suggested in the consultation paper would favour necessary transformation of cities which we cannot leave for a distant future.

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\(^7\) e.g. UK National Audit Office: Private Finance, a paper for the Lords economic affairs committee, October 2009, p. 56
Large amount of financing will also be required in adapting to the impacts of climate change. This is in particular the case in building better fresh water management infrastructure to ensure that some already dry regions of Europe do not become totally infertile territories, for instance that the agriculture of Southern Europe does not disappear. More generally, this may apply at least partly to green infrastructures and ecosystem-based climate adaptation and risk prevention, e.g. smart coastal defence.

Specific questions of the consultation

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

One of the challenges of large-scale infrastructure investments in many of the areas required for Europe is that they involve significant risks with new technology or with policy frameworks (including secondary dependence on public funding, such as the risk inter-country grid investments to support renewable power inputs face in relation to renewable energy feed-in tariffs in different countries). These risks are magnified in countries facing substantial public debt challenges, with investors being doubly concerned about the limited capacity of individual countries to guarantee policy frameworks.

While there is modest appetite for marginally investment grade fixed income investments, the asset allocation strategies of most institutional investors restrict their fixed income investments to mid to higher levels of investment grade. Improved credit ratings can be expected from bonds with modest public sector guarantee support as proposed in the Project Bonds Initiative; on the basis of advice from our investor contacts, we believe that a public sector guarantee would reassure investors to the extent that they seriously consider investing in such bond.

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

“Investors” is a vague and generic term, however we suspect this mostly refers to institutional investors in which case the minimum rating to achieve is double A whether with Moody’s, Standard and Poors or Fitch. We believe that if the guarantees brought in by the EU is well understood by the market this would most likely enable the issuer to achieve such rating. This also takes into account that issuing banks will issue bonds only on assets of sufficient quality not too overexpose the guarantee brought in by the EU. We understand that this will be thoroughly checked by the EIB.

However, the A rating “Upper medium grade, low credit risk” bond suggested in the paper may not be enough to attract large institutional investors.

Considering a wider range of investors, anything below Standard and Poors’ and Fitch’s BBB or Moody’s Baa would be considered as junk bonds and become too speculative to be considered by reputable investors.

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

We are not in a position to indicate with certainty what is necessary to achieve a high rating ensuring successful bonds issuance. However it may be wise for the initial issuances to be successful to use a full credit enhancement.
6) Which impact would the Initiative have on financing costs and on maturities?

These types of bonds have today almost disappeared due to the absence of monoline insurance and therefore, bringing back such bonds to the market will be costly in terms of informing and convincing potential investors.

However such initiative should not have significant impact on upfront financing costs and maturities as compared with similar bonds pre-crisis.

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

It may not be necessary to have one single entity, in this case the EIB, acting as a “controlling creditor” to monitor the project implementation and negotiate with project company or sponsor on behalf of bondholders in case of needs; as long as it is done by a reputable and capable organisation.

But in a scenario where insufficient financial assessment has been conducted and a subordinated debt position has been taken in a project, there must at least be the guaranteed ability for the EIB to have a leading creditor role (either sole or joint) to ensure some control over the project and the funding provided in cases of a breach of covenant or default. If the EIB is not the controlling creditor, WWF is concerned that the Commission and EIB are unable to control any process, should the projects fail to perform financially and contractually.