EUROPE 2020 – Project Bond Initiative

Advantages and disadvantages compared to current financing models

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Project Bonds Background

- Monolines provided bond market investors access to the project market
  - “AAA” wrap for projects
  - Created a large pool of liquidity for long duration paper in € and £
  - Monitored and controlled credit exposure on behalf of bondholders

- Following the collapse of the monolines, there has been no access to the market
  - Investors want to buy well rated (A-/A3) assets
  - Current structures available are typically Baa2 / BBB or even lower so cannot attract size and scale of required investment

- Disenchantment with the now failed monoline model
  - Lack of transparency and little ongoing information on the project
  - No voting rights despite monoline downgrade

EIB / EU Project Bonds Initiative

- Bond investors sitting on large amounts of cash that they want to invest on a long-term basis
  - Infrastructure seen as good assets with “essentiality” and high public importance
  - Capital markets an alternative source of funding for projects
    - Tenor
    - Basel III impact on bank lending
- EIB / EU as an enabler to re-open project bond market
  - Guarantees / sub-debt to obtain ratings uplift
  - EIB an experienced counterparty to monitor projects and make day to day decisions

Issues to Consider

- Structure of guarantees
  - We believe best solution could be to use 2 separate caps
    - Liquidity cap
    - Loss given default cap

- Procurement
  - Current legislation across Europe not supportive for bond solutions

- Controlling creditor / voting
  - We think that bond investors will not accept EIB / EU acting as sole controlling creditor
  - Following their experience with the monolines, we believe investors will require voting with regards to Trigger Events and Events of Default
  - Day to day monitoring and waiver by EIB acceptable

Current Funding Environment in Project Finance

- Current Situation:
  - Strong and hungry bank market for long term debt <u>still</u> available (Basel III)
  - Narrow market focus
  - Hesitation of Sponsors to run costly rating process in competitive environment

- Current procurement practice often not supportive:
  - Requires firm credit spreads on financing at BaFO
  - Often insufficient compensation on termination regime
  - Running bank debt process in parallel -> Relationship issues with Banks

✓ **Consider Project Bonds also within refinancing scenarios (shared risk)**

✓ **Motivate tendering authorities to reconsider procurement practice**

Bonds vs. Bank Debt

- Markets <u>currently</u> not the constraint
- Currently pure mathematical consideration:
  - Differences in Margins
  - Costs of Credit Enhancement
  - Cost of carry
  - Available maturities
  - Refinancing gains vs. Make-whole
- If at reasonable costs, credit enhancement powerful instrument to boost appetite on bonds

✓ **Sponsors will follow bond route if resulting in competitive advantage**

✓ **It is not “either-or” but finding the appropriate mix between bond and bank debt**

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