Financing EPC with ESIF grants and financial instruments

Robert Pernetta, Financial Instruments Advisor,
European Investment Bank

Laurent Bender, Financial Instruments Advisor,
European Investment Bank

#ficompass

Challenges and solution of financing EPC in public buildings

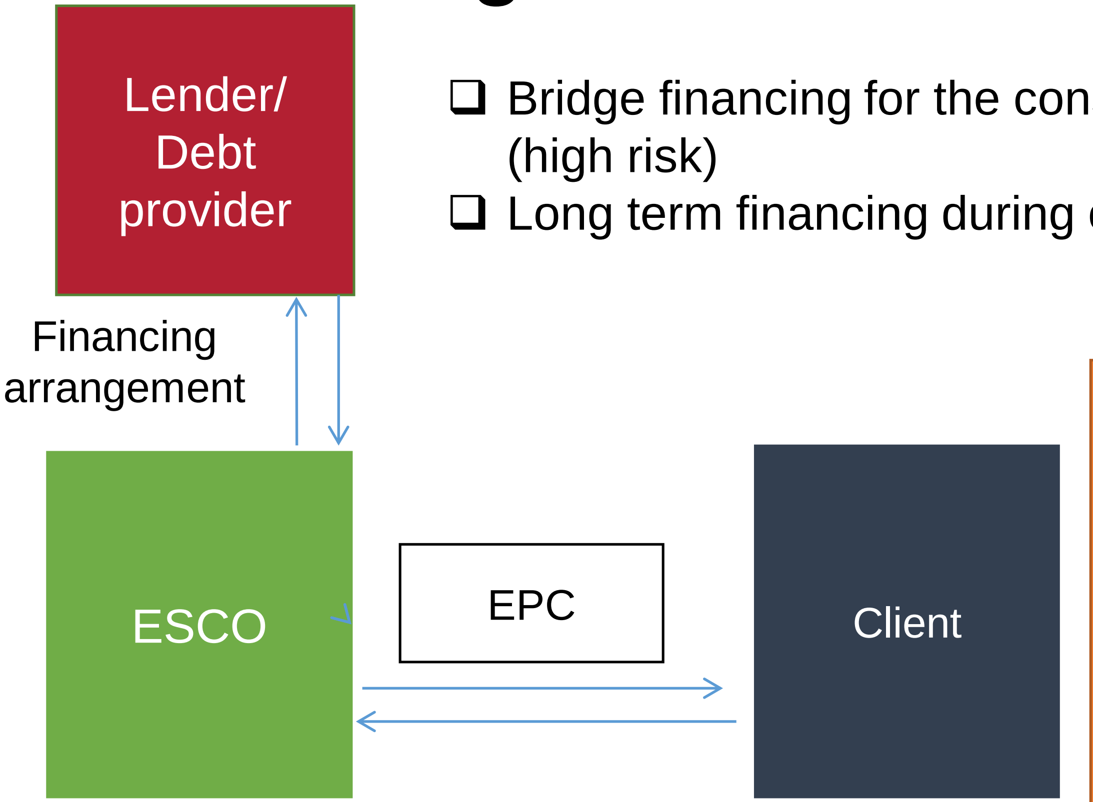
Challenges

- Project preparation cost
- Long-term payback times
- High risk during implementation, but low risk during performance period
- ESCOs have limited balance sheet
- EPCs do no have tangible collaterals
- Financial intermediaries may not be familiar with business model
- Access to finance in view of “Maastricht constrains”
- Potentially not all investment can be paid back by energy savings

Solutions

- Technical support, standardisation
- Long-term financing
- Using different forms of financing during project implementation
- “Off-loading” debt from ESCO’s balance sheet
- “Step in rights” of financial intermediary
- Capacity building of financial intermediaries, forming specialised fund
- Using “Maastricht neutral” preferential financing, e.g. ESIF FIs
- Using grants, e.g. from ESIF

ESCO financed EPC: The financial challenges



- ❑ Bridge financing for the construction and ramp-up period (high risk)
- ❑ Long term financing during contract period (low risk)

Challenge of financing “Maastricht neutral” EPCs

- More risk shifted to private sector
- Contract duration longer than 8 years
- Performance based EPC fees
- Limits to using government financing or guarantees

Possible solutions

- Standardised templates
- Best practises
- ESIF financial instruments

- ❑ Combining financing and technical solution
- ❑ ESCO has limited borrowing capacity due to equity/debt ratio

What type of financing for EPC?

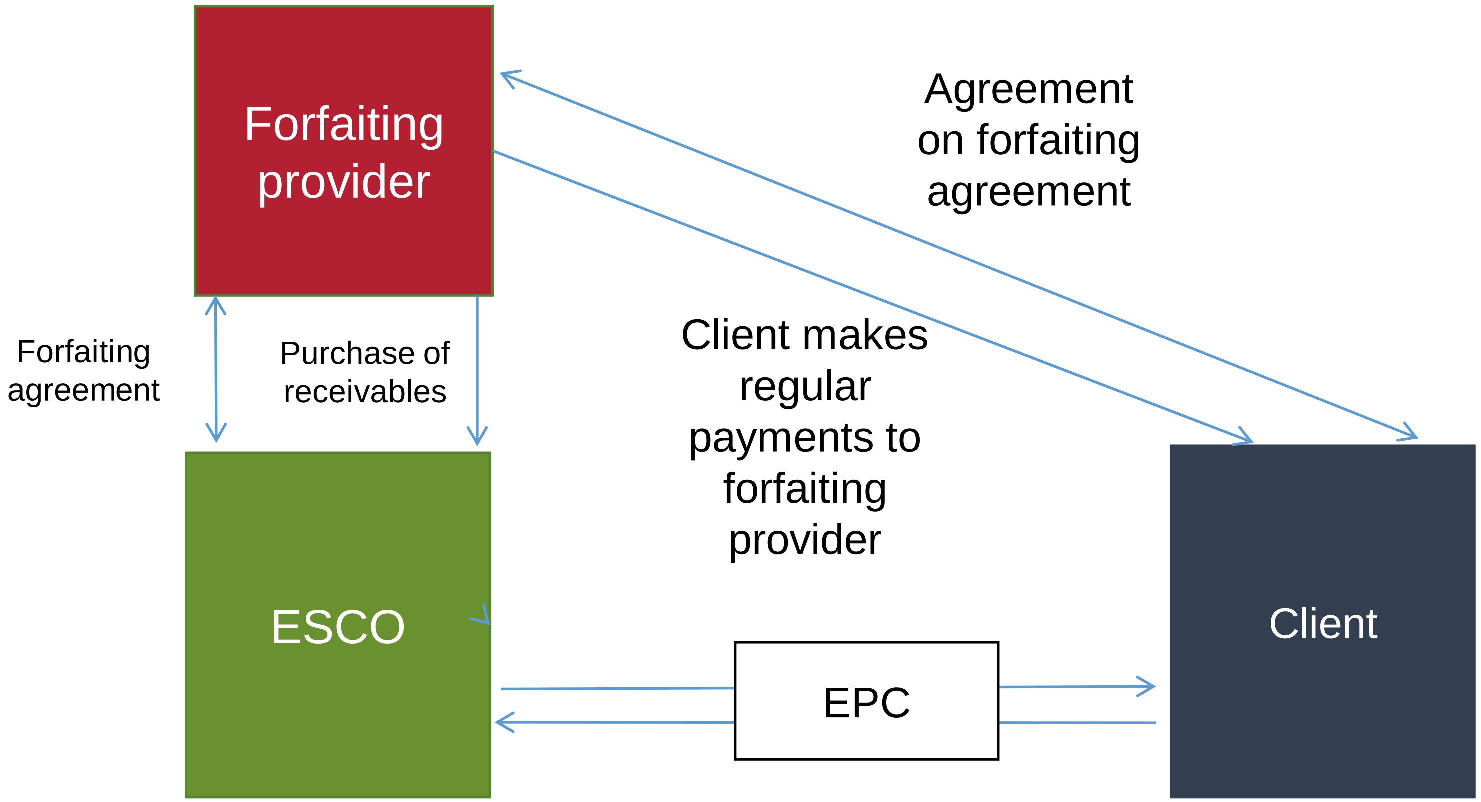
- **Loans**
  - Long-term financing, as long as contract duration
  - Stable interest rate during contract period
  - Grace periods for the implementation period
- **Guarantees**
  - Reducing risk of default for financial intermediary
    - Project risk: technical and performance risk
    - Counterparty risk: ESCO and EPC client
- **Equity**
  - Support the set-up of new ESCOs or to increase capital base of existing ESCOs
- **Forfaiting**

What is forfaiting?

- **Forfaiting** is selling (future) receivables to a financial institution at Net-Present Value (NPV) without recourse to ESCO
- In case of EPC the ESCO sells (all or parts of) the future EPC fees to a financial institution at NPV
- Advantage
  - ESCO can reduce its debt and undertake new projects
  - Financial intermediary has a long-term, low risk payment stream
- Difficulties
  - What happens if savings are not achieved?
  - Financial intermediaries may not be familiar with this form of finance

Many banks offer this under **factoring**

Forfaiting example



#ficompass

Using ESIF as financial instrument for EPC

Setting up an FI for EPC

- Ex-ante assessment is key
  - Testing the interest of ESCOs, financial intermediaries and potential clients
- Financing for ESCO or for client?
- Setting up a dedicated instrument for EPC or including it into an existing FI
  - Scale
  - Eligibility (ESCO is private company but investment is in public or residential sector)
  - Do the characteristics of financing fit to the existing instrument (maturity, grace periods, risk profile,…)
  - Diversity of portfolio - limited number of ESCOs, similar risk profile of EPC deals
  - Are intermediaries able/willing to lend to ESCOs?
  - Combination with grants

ESIF loan product for EPC

- Advantages:
  - Long-term financing
  - Grace periods
- Disadvantage:
  - Does not reflect different risk profile for implementation and performance period
  - Does not reduce performance risk on bank
  - Debt stays on balance sheet of ESCO
- Market perspective:
  - In most countries ESCOs have access to debt
  - Instrument may be interesting for (partly) client-financed EPC

ESIF guarantee product for EPC

- Advantages:
  - Extended loan tenure
  - Lowering collateral requirement
  - Covering different risks during lifetime of project
- Disadvantage:
  - Debt stays on balance sheet of ESCO
  - Less suitable for financing to EPC client
- Market perspective:
  - In most countries ESCOs have access to debt
  - Interesting for financial intermediaries to lend to ESCOs

ESIF equity product for EPC

- Advantages:
  - Supports set-up of new ESCOs and increases capital base of ESCO
  - Transfer of financial expertise from investor to ESCO
- Disadvantage:
  - ESCOs usually work with low percentage of equity
  - Potential conflict of interest: public ownership and public clients
- Market perspective:
  - Only relevant in very few cases
  - Not relevant for EPC client financing

ESIF grants in EPC

Two options

a) Client as beneficiary

- ➢Client applies for ESIF grant to MA
- ➢Operation is approved by MA/IB
- ➢Client tenders ESCO and signs EPC agreement
- ➢Client pays ESCO with capital grant for investment – *like in standard works contract*

Issues:

- ➢ESCO financing of EPC does not count as co-financing
- ➢Public co-financing from OP or from client may impact “Maastricht neutrality” of EPC

ESIF grants in EPC

b) ESCO as beneficiary (*Under CPR Article 62-63 on PPPs)*

- Client applies for ESIF– proposing that an ESCO selected after approval of operation be the beneficiary of grant
- Operation is approved by MA/IB
- Client tenders ESCO and signs EPC agreement
- MA satisfies itself that the ESCO fulfils and assumes obligations as beneficiary
- ESCO receives capital grant from MA

Features:

- ESCO financing of EPC counts as national private co-financing
- Replacement of beneficiary if ESCO does not deliver guaranteed savings
- Risk of “non-grants” is with ESCO and not client

fi compass
ERDF

financial instruments revolving capacity building
added value ERDF funding agreement ESF EU guidance
governance ex-ante assessment
technical support seminars leverage financial intermediaries microfinance
co-financing case studies
investments ESIF fi-compass final recipients
business plan Thank you thematic objectives
advisory services guarantees loans CF equity
banks life cycle combination of support
EAFRD private investors factsheets
conferences EMFF investment strategy
fund of funds
managing authorities manuals

#ficompass

European Commission

European Investment Bank
The EU bank