Presentation Q&As
September 2024

September Workshop – Scale up

25 September 2024 - Combination of FI and grants

2nd session: How to structure different grant components at final recipient level?

European Commission

European Investment Bank

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How to structure different grant components at final recipient level?

Presenters:

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Presentation: "Grant and FI combination at final recipient level"

- Energy Efficiency combined FI (loan and capital grant based on performance) in Hungary, presented from the perspective of the Managing Authority and the implementing body.
- Description of the set-up, legal structure and repayment scenarios based on performance criteria.
- Challenges of combined FI implementation.
- Performance-based grants with unfavourable treatment from a State aid perspective. The gross grant equivalent (GGE) is calculated based on the maximum grant final recipients could benefit from, but this doesn't always materialise. However, the GGE cannot be amended later if less support is provided (in case performance targets are not met). This is a disadvantage for final recipients and hinders demand for the FI.
- In Bulgaria, the register is updated ex post for the actual aid – but this only applies for de minimis. Hungary has this issue with the General Block Exemption Regulation (GBER).

Note: The answers are provided by the Presenters.

Q: Is this FI risk sharing or guarantee?

A: No, it is a loan and an upfront grant (implemented by financial intermediaries).

Q: Where does the loan funding come from?

A: The loan and the capital grants are 100% funded by the programme (public) money.

Q: You do not charge interest on the loan or the grant for the grace period?

A: Correct, no interest rate is charged

Q: What State aid regimes do you use?

A: It depends on the programme.

Q: Do the intermediaries have to calculate the State aid?

A: It is automatically calculated.

Q: Do the banks receive management fees to manage both the loan and grant?

A: Yes.

Q: The FI is fully funded by the programme and the banks receive management fees. Do the banks perform the checks or the Managing Authority?

A: Banks perform their regular checks for the loan applications. Banks are chosen by public procurement procedure.

Q: You mention that an independent authority has to confirm if the requirements have been met, is that a public entity?

A: It depends on the programme and usually it is regulated by the Managing Authority, e.g. for digitalisation, they entrust this to an independent professional body that gives this certification to enterprises.

Q: Is the cost of the certifications paid by final recipients or the Managing Authority?

A: It is paid by the final recipients, and it is an eligible cost for the FI.

Q: Is there a higher rate of default because the banks do not take the risk and perhaps they are less strict/ demanding with their assessment?

A: The banks had to follow their normal procedures (risk assessment) and they haven't observed any exceptional default rate.

Q: What were the incentives for banks to administer the grant (where grant management is often considered a burden by banks)?

A:

- Banks get a management fee for the grant part as well for the loan. There are no issues with the banks' motivation and the agreements with the banks are already in place (public procurement).
- The FI is considered a good product and helps the banks be competitive by offering a good product to their clients.
- There is a big allocation (3bn) to FIs across all the programmes and a big market.

Q: Why were there two consortiums of banks for two different programmes: SMEs and residential?

A: This ensures national coverage: The Managing Authority had specific requirements regarding the number of branches in regional areas, thus two consortiums were formed (each with two banks).

Q: Do the banks need to be certified to manage the grants?

A: No, for the performance award criteria, banks

- receive specific certification; and
- based on the certification, they check if the rules/criteria are met but don't have to assess the content.

To summarise, there are two key conditions that facilitate management of the grant component by the banks:

- the performance certificate is issued by an independent body; and
- the banks only have to say yes or no. They don't have to check against a list of detailed questions/conditions.

Q: We often hear that the banks don't want to be liable if they provide upfront grants. What must the banks check upfront for the grant?

A: The grant is pending until the performance measurement is confirmed. Banks don't check anything upfront, but give the loan and the grant to the final recipient at the same time. Essentially, the FI provides cash-flow at first, but the nature of these amounts is registered as a grant and loan or only a loan after the performance criteria are confirmed or not confirmed (after the grace period). This depends on the programme.

If the project performance measurement is available at project closure, they are both checked at the same time and the outstanding loan amount is defined at that point. If the performance measurement is after the project closure, the whole project is in a grace period while they wait for the performance measurement. If the final recipient uses the money and the project is not successful, all the funding has to be repaid with interest.

When the SME application is submitted, it includes a commitment to the performance criteria. The contract defines the minimum performance criteria (scenario two from picture below) and if higher criteria are reached, there are different levels of grant. Both possibilities are considered in the contract. The GGE is defined based on the best case scenario.

LEGAL STRUCTURE

Different scenarios of the loan and grant part, parameterised text fields in the contract, the one that will be automatically filled

SCENARIO 1

when the Final Recipient undertakes the minimum performance: *"The amount of the Grant is [..........], - HUF, the amount of the Loan is [..........]."*

SCENARIO 1

when the Final Recipient undertakes higher performance than the minimum:
"The amount of the Grant is [..........], HUF, the amount of the Loan is [..........] HUF, with the proviso that if the performance committed by the final recipient does not reach the higher value at the time of the performance measurement, but reaches the minimum performance criteria, the amount of the Grant will be changed to [..........], - HUF, and the amount of the Loan will be changed [..........], - HUF at the time of the successful performance measurement, without formal contract amendment."

REPAYMENT SCENARIOS

Repayment Schedule		
Levels of performance	**Scenario 2**	**Scenario 1**
Loan amount	**Scenario 2**	**Scenario 1**
Due date for loan instalment	**Capital**	
15.01.2025	40 000 HUF	49 000 HUF
15.02.2025	40 000 HUF	49 000 HUF
15.03.2025	40 000 HUF	49 000 HUF

Source: "Grant and FI combination at final recipient level", slide 5.

Q: When the borrower is assessed by the bank for their capacity to repay (risk assessment), does the bank take into account the whole amount or only the amount reduced by the grant?

A: The full amount, the SME should be able to repay all the funding if they don't reach the performance criteria.

Q: What happens in the unsuccessful case? If the final recipient does not reach even the minimum, they cannot take the grant or the loan?

A: It depends on the programme, if the performance criteria are also eligibility criteria, then no, they can't take the loan or the grant. If the programme allows lower performance, they are given the loan but not the grant.

Q: Does it cost more money for banks to manage the grant part as well compared to only the FI, and do they ask for more fees to manage the FI?

A: For loan FIs it is simple, there is an acquisition fee (always after loan disbursement) or a portfolio fee. For combination FIs, if the grant is triggered then the portfolio fee will be less as the calculation base is lower. Hence, the required management fees will be less which is a challenge for combined FIs. However, the combination FI was very favourable for the clients which was understood by the financial intermediaries and accepted. If the grant is not triggered, this is converted into a loan so the calculation base is the same as for a loan FI.

Q: What market gap do you cover with this instrument? There is no leverage, it is all public money, is there a specific case for that (e.g. market specificities)?

A: The market relies heavily on grants. They are trying to encourage the use of FIs and convince decision makers that in case of income generating projects, it is better to use FIs instead of grants. The objective is to build an ecosystem for FIs.

Q: Please detail how the FI is structured in one operation and the difference to structuring in two operations?

A: In Hungary, in this programming period, they only implement the combined FI in one single operation. This means a single agreement with the final recipient, where the grant and other criteria are defined. In the last programming period, the combination was in two operations with the managing authority giving the grant directly to the final recipient and the loan was through the banks. Now implementation is simpler, because the managing authority gives both parts to financial intermediaries, which pass them directly to final recipients. Thus, in a single operation, the grant is channelled through the financial intermediary instead of being given directly to the final recipient as in the case of two operations.

Q: Do you have technical assistance?

A: No, it is not included. In general, the combination is grant plus loan based on the market assessment which identified that the grant is the biggest incentive for such investments. In particular for energy efficiency, the technical questions which would require professional support for the clients, they choose to go to the market. There is an Energy Obligation system, and they try to involve the players of the market to help the clients with such technical support. Thus, they choose to not provide Technical assistance with EU money, they still see the need for TA but they try to rely on the market.

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