



*advancing with ESIF financial instruments*



# Stocktaking study on financial instruments by sector



Progress to date, market needs and implications for financial instruments

## The Polish broadband loan instrument

Case study



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## Abbreviations

Abbreviation	Full name
BGK	Bank Gospodarstwa Krajowego (State development bank of Poland)
BPS	Bank Polskiej Spółdzielczości (Polish Cooperative Bank)
EC	European Commission
ERDF	European Regional Development Fund
ESIF	European Structural and Investment Funds
EU	European Union
FoF	Fund of funds
GGE	Gross grant equivalent
ICT	Information and Communications Technology
KIKE	Krajowa Izba Komunikacji Ethernetowej (National Chamber of Ethernet Communication)
NGA	New Generation Access
OP	Operational Programme
PLN	Polish złoty, the national currency
SGB	Spółdzielcza Grupa Bankowa (Cooperative Banking Group)
TISE	Towarzystwo Inwestycji Społeczno-Ekonomicznych (Social and Economic Investment Company)
VAT	Value Added Tax



The Department for Digital Development of the Polish Ministry of Development Funds and Regional Policy, the managing authority of the Operational Programme (OP) 'Polska Cyfrowa' (Digital Poland), has developed a financial instrument for the deployment of broadband infrastructure. This is one of only two financial instruments in this sector in the 2014-2020 programming period. The EUR 145 million financial instrument is managed by the Polish promotional bank Bank Gospodarstwa Krajowego (BGK) acting as fund of funds (FoF) manager and implemented through financial intermediaries.

## 1. Description of the financial instrument

### 1.1 Rationale and objectives

Poland has the lowest fixed broadband coverage rate in the EU. Unsurprisingly, Poland decided to allocate the highest amount of European Regional Development Fund (ERDF) among all Member States to the improvement of Information and Communications Technology (ICT) infrastructure. Funding of an equivalent of EUR 1 billion is delivered through the national OP. For the 2014-2020 programming period, Poland is using financial instruments alongside grants for the first time.

In an ex-ante assessment<sup>1</sup>, finalised in 2017, the following market barriers regarding the investment in broadband were identified. The focus of the ex-ante assessment was investment in the 'last mile', meaning the connection from the glass fibre trunk line to the client. In comparison to other Member States, it is common in Poland that the internet provider is a small and medium-sized company that provides the last mile connection:

- Network operators, especially micro and small operators, have major problems with accessing European Structural Investment Funds (ESIF) grants. The calls do not necessarily coincide with the request from clients and grant calls are often tailored towards project promoters such as large operators;
- Operators face problems in accessing debt financing for their projects. Despite the profitability of broadband networks, the projects are not considered bankable for commercial lenders. The risk of investments is very high due to competition between different ICT technologies (fibre vs. mobile data), strong competition between small operators and the demand risk. Projects have relatively long repayment times exceeding even 10 years and ramp-up periods from project inception until there are sufficient subscribers sometimes last three years;
- Banks have problems in assessing broadband projects and their profitability. They are generally not willing to accept the invested infrastructure as a collateral as there is no functioning market to sell glass fibre networks.

It is difficult for the public sector to address these barriers with financial support due to the specific State aid regime for ICT. Public support is limited to 'white areas', where there is no existing New Generation Access network (NGA, more than 30Mb/s) leaving out areas where there are already operators offering NGA access, so called 'grey and black areas'.

<sup>1</sup> WYG PSDP, Ex-ante assessment for financial instruments in the framework of the Operational Programme 'Cyfrowa Polska', 2017, p. 34.



The ex-ante assessment identified a market gap of debt financing of between EUR 440 million<sup>2</sup> and EUR 600 million for the period 2017-2023. A loan instrument with an allocation of almost EUR 250 million was proposed. The original ex-ante assessment did not consider the use of a guarantee instrument. The risk coverage *per* transaction, because of State aid considerations, is limited to 80% of the outstanding loan and the remaining risk would have been more than financial intermediaries are willing to accept. A risk-sharing loan with a minimum 5% contribution by the financial intermediary was considered instead.

The Polish national promotional bank, BGK, was identified as FoF manager for the instrument and several financial intermediaries were intended to be selected through a series of competitive tenders. It was also recognised that there is a need for capacity building on the level of BGK and financial intermediaries in order to assess market risk in this sector.

## 1.2 Scope

The financial instrument is designed to be complementary to existing grant schemes under the OP. The scope of eligibility is significantly wider than for grants covering project preparation cost, active and passive infrastructure, investment into connection to the client and working capital necessary for realisation of the project. Whereas grants are limited to ‘white areas’, the loan instrument can support investments also in ‘grey and black areas’. In order to qualify for the project, household and business clients need to secure access to broadband infrastructure of at least 30Mb/s networks and educational institutions of at least to 100Mb/s.

## 1.3 Financial allocation and governance

In the funding agreement of February 2017, EUR 230 million<sup>3</sup> from ERDF funding originating from the OP was committed to the FoF for the broadband loan instrument. There is no public national co-financing in the scheme. Additionally, financial intermediaries have to contribute at least 15% private national co-financing to the financial instrument, resulting in OP resources of EUR 270 million being available for the instrument.

Two financial intermediaries have been selected in the first two selection processes: the commercial bank, Alior Bank, and the loan fund Towarzystwo Inwestycji Społeczno-Ekonomicznych (TISE – Social and Economic Investment Company). The amounts allocated to the financial intermediaries allow for a later increase of the allocation if the financial intermediary is successful in deploying the instrument without the need for a further selection process. Both financial intermediaries already have wide experience in implementing ESIF financial instruments under different OPs. As part of the selection process, the financial intermediaries had to prove that they have the technical capacity to appraise projects in the ICT sector.

2 All amounts in the ex-ante assessment were calculated in Polish Złoty (PLN). For this case study a simplified exchange rate of EUR 1 = PLN 4 was used.

3 The total amount of allocation is according to EC, ‘Summaries of the data on the progress made in financing and implementing the financial instruments for the programming period 2014-2020 in accordance with Article 46 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council – Status as at 31 December 2018’, 2019, p. 112: [https://ec.europa.eu/regional\\_policy/sources/thefunds/fin\\_inst/pdf/summary\\_data\\_fi\\_1420\\_2018.pdf](https://ec.europa.eu/regional_policy/sources/thefunds/fin_inst/pdf/summary_data_fi_1420_2018.pdf).



## 1.4 Financial products and State aid

The loan can cover up to 95% of the eligible cost of the projects with the remaining amount to be provided by the network operator. The minimum size of a loan is EUR 5 000 and the maximum is EUR 12.5 million, with an expected average size of loans of EUR 170 000. The maturity of the loan is 15 years with a grace period of up to 2.5 years, depending on the needs of the client. The ESIF part of the loan will be priced at 0.25% per annum and no fees will be charged. Risk related interest and fees will be charged on the part provided by the financial intermediary. Alior Bank for example, charges a bank commission of 2% and an interest rate of 4.4% per annum on average<sup>4</sup>. The loans are provided under the *de minimis* rules and thus they can be used in white, but also 'grey and black areas'. In the case of larger loans the interest rate of the ESIF share will be increased, so that the gross grant equivalent (GGE) can remain within the *de minimis* threshold. Alternatively, loans are offered at the EU reference rate.

## 1.5 Leverage

With EUR 230 million from ERDF funding and a total volume of the loan instrument of EUR 270 million, the expected leverage of the instrument over the ESIF contribution is 1.17. The total amount of investment that is expected to be mobilised by the instrument is at least EUR 280 million, including the own resources provided by the final recipients in their respective projects. This should allow almost 100 000 final clients to have NGA broadband access.

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4 Alior Bank, 'Broadband loan at Alior Bank': [https://cppc.gov.pl/images/uploads/ALIOR\\_CPPC\\_warsztat\\_06022018.pdf](https://cppc.gov.pl/images/uploads/ALIOR_CPPC_warsztat_06022018.pdf).



## 2. Lessons learned

### 2.1 Barriers and challenges

The implementation of the instrument was much slower than originally expected. As of March 2019, only EUR 33 million have been allocated to financial intermediaries and in total EUR 9.5 million have reached final recipients. Various challenges have been reported to be making the roll out of the instrument difficult<sup>5</sup>:

- The risk of broadband projects is very high. According to a follow-up ex-ante assessment finalised in 2018, the expected risk of projects on average is 30% and the unexpected is 15%. Because banks have to use the normal scoring methods, the majority of projects are not considered bankable and small operators cannot provide sufficient collateral;
- The loan instrument is covering only a part of the financing needs of broadband investments. Working capital, Value Added Tax (VAT), and the cost of acquisition of networks from competitors are not eligible;
- The loan instrument was not sufficiently attractive for financial intermediaries, as the focus is on providing cheap funding, but not on risk coverage.

### 2.2 Addressing the challenges

In response to the challenges, the Ministry of Infrastructure and Development undertook an update of the ex-ante assessment in 2018, as referenced above. As a result of the assessment, several changes to the loan instrument were introduced in response to the challenges mentioned above:

- The scope of eligible expenditure was significantly widened. VAT and working capital associated with the investment can now be financed with loans. It is also possible to receive financing for projects that are already in construction, but have not been physically completed.
- Additionally, it is now possible for the financial instrument to finance projects receiving grants. The eligibility is limited to the costs that are not eligible under the grant, with the exception of VAT of the grant operation.

It is expected that these measures will accelerate the absorption of funding, it will allow more operators to access the funding and more projects to be supported. Additionally, it is expected that the instrument will help developing broadband financing in Poland.

In 2018, BGK reduced the allocations to the loan instrument to EUR 145 million and allocated the remaining amounts of EUR 105 million to a new guarantee instrument addressing the same market. The guarantee instrument is expected to better address the needs of financial intermediaries and final recipients. It is expected that allocations of EUR 105 million, will allow for a guaranteed amount of EUR 217 million and total of new loans issued of EUR 271 million. The guarantee rate on a deal-by-deal basis is 80% and a single guarantee may amount to EUR 2.5 million. The low multiplier of 2.5 between the amount of OP resources and new loans reflects the high level of risk in the market. Compared to the loan instrument, the guarantee instrument is simpler to administer for the bank providing the loan, as there is no detailed check required for the eligible expenditure. Additionally, the maximum maturity has been extended to 20 years. The guarantee is provided without guarantee fees.

<sup>5</sup> BGK, Financial instruments of the Operational Programme 'Cyfrowa Polska', 2019: [https://www.uke.gov.pl/download/gfx/uke/pl/defaultaktualnosci/36/193/1/popc\\_bgk\\_warsztat\\_instrumenty\\_finansowe\\_popc\\_19\\_03\\_2019.pdf](https://www.uke.gov.pl/download/gfx/uke/pl/defaultaktualnosci/36/193/1/popc_bgk_warsztat_instrumenty_finansowe_popc_19_03_2019.pdf).



So far, BGK has selected four banks to act as financial intermediaries to lend under the guarantee instrument. These are Alior Bank, which is also implementing the loan instrument, PEKAO S.A., Spółdzielcza Grupa Bankowa (SGB – Cooperative Banking Group) and Bank Polskiej Spółdzielczości (BPS – Polish Cooperative Bank). The cooperative banking groups have a strong position in the rural areas.

### **2.3 Key enabling factors**

The financial instrument focused its support on the ‘last mile’ of broadband delivery to final customers. This was made possible through the small ticket size of loans. The average size of EUR 170 000 is small for infrastructure related investments.

From the very beginning it was important that there was sufficient ICT specific technical capacity on the level of FoF manager and financial intermediaries. The financial intermediaries need this expertise on the one hand to be able to appraise the projects, but also to be recognised as business partners by the final recipients.

Flexibility in the design of the instrument is essential in sectors where there is little experience with financial instruments. This means that the funding agreements should be sufficiently flexible to allow adaptation of the financial product to market needs. The selection of financial intermediaries also should be flexible enough to allow the reallocation of amounts that are not used to other financial intermediaries or other financial products.

The managing authority and the FoF manager had regular exchanges with the regulatory body, the financial community and Krajowa Izba Komunikacji Ethernetowej (KIKE – the National Chamber of Ethernet Communication) as representatives of the broadband industry. This created awareness about the instrument and allowed also to adapt the instrument in a collaborative way with the market players.

