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# Stocktaking study on financial instruments by sector

## Progress to date, market needs and implications for financial instruments

## The infrastructure fund of funds in Greece

Case study

European Commission

European Investment Bank
The EU bank

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# Abbreviations

| Abbreviation | Full name |
|---|---|
| EE | Energy Efficiency |
| EIB | European Investment Bank |
| ERDF | European Regional Development Fund |
| ESIF | European Structural and Investment Funds |
| EU | European Union |
| FoF | Fund of funds |
| GBER | General Block Exemption Regulation |
| GGE | Gross grant equivalent |
| HF | Holding Fund |
| OP | Operational Programme |
| PPP(s) | Public-Private Partnership(s) |
| RE | Renewable Energy |
| SME | Small and Medium-sized Enterprise |
| TO(s) | Thematic Objective(s) |

In 2019, the country set up a EUR 450 million fund of funds (FoF) managed by the European Investment Bank (EIB), using European Regional Development Fund (ERDF) resources from Thematic Objective (TO) 4[1] and TO 6[2] aimed at financing projects related to Renewable Energy (RE), Energy Efficiency (EE), and Urban Development. The latter sub-sector also benefited from the reflows of the JESSICA Holding Fund (HF) set up in Greece during the 2007-2013 programming period. As of September 2019, four financial intermediaries have been selected (out of which two have combined in a consortium)[3].

Although, at the time of writing, the FoF had only been operational for a short period of time, the commitment demonstrated by the relevant public authorities for its implementation, combined with some positive aspects of the foreseen activities, makes this a positive endeavour to further observe. More specifically, in comparison with other financial instruments supporting the RE sector in the European Union (EU), the Greek Infrastructure FoF encompasses some interesting elements, namely:

- A broader scope;
- An aim at financing also large RE infrastructure projects.

Finally, as illustrated below, this case study also helps demonstrate the potential for using financial instruments' reflows.

# 1. Description of the financial instrument

## 1.1 Rationale and objectives

According to local experts and stakeholders involved in the design and set-up of the FoF and as demonstrated in the conclusions of the ex-ante assessment of 2016, the RE sector presents high potential in Greece, mainly thanks to the climate and natural characteristics of the country. RE projects already exist in relation to solar, wind, biofuel and biomass energy sources. Some biofuel and biomass projects were even supported by the JESSICA HF during the 2007-2013 programming period. The 2014-2020 FoF has been developed as a continuation of this successful JESSICA initiative.

In the ex-ante assessment performed in 2016, market failures in the Greek RE and EE markets were identified, among them: market instability (in particular in relation to changes in regulations in the RE sector), lack and asymmetry of information between project promoters and other stakeholders (among which financers and the administration), increased trading costs in these sectors (due to the length that such projects may imply), lack of specialised banking products targeting new technology products, and an overall very limited access to finance due to the financial crisis that hit the country in 2008[4].

1 TO 4: *'Supporting the shift towards a low-carbon economy'*.
2 TO 6: *'Preserving and protecting the environment and promoting resource efficiency'.*
3 https://www.eib.org/en/press/all/2019-235-eib-and-greek-banks-confirm-eur-650-million-infrastructure-investment-fund-and-agree-to-strengthen-business-support#.
4 *Ex-ante* assessment for financial instruments in Greece, 2016, p.85.

For instance, in the context of the EE market (also studied in the ex-ante assessment), the main market failure and challenge relates to the age of the buildings to renovate (while energy saving is a key policy objective), thus urging public authorities to intervene. Taking into account the economic crisis that hit the country in the 2008-2013 period, the potential for investment in the EE sector is limited, leading to a financing gap and a justification for the set-up of a financial instrument in this sector (p.91).

Although the FoF itself cannot remedy these market failures, it aspires to motivate the relevant market stakeholders and provide financing opportunities. It also aims to finance the implementation of priority infrastructure projects that have been delayed in recent years in Greece and to support new commercial projects that will be developed in previously abandoned facilities. As such, the managing authority decided to set up this comprehensive FoF in order to:

- Motivate private financiers to operate in the sector and increase available funding;
- Capitalise on the positive experience gained from the JESSICA initiative during the 2007-2013 programing period; and
- Use JESSICA reflows.

Although the FoF is multi-thematic and multi-sectoral, according to local stakeholders, it is expected that most of the funding will be allocated to finance RE projects. The support of this sector through a financial instrument is perceived as highly important by the relevant stakeholders. Prospective investors in the sector have been facing several challenges in recent years, making financiers reluctant to undertake potential risks. As described above, frequent changes in the regulatory framework have undermined the credibility of the sector. For example, while investors entered the sector with an understanding that their revenues will be generated by a tariff-based system, changes in the regulation introduced an auction-based system a few years ago. This led to a volatility in the energy prices, with the risk that price drops could render projects as non-profitable.

Although a public intervention such as the FoF cannot secure a stable regulatory environment, it can motivate prospective financiers to undertake a higher risk. According to local stakeholders, the creation of the FoF will reinforce the credibility of the sector. In addition, it is important to take into account that the Greek financial market has still not fully recovered from the financial and economic crisis. It is important to remind that the banking sector went through a massive restructuring following a reduction in value of government bonds to which most banks were overexposed. This led to almost all foreign banks shutting down operations in the country and remaining banks merging into four so called 'systemic banks'. Despite this restructuring and the recapitalisation of the remaining banks, their financing capabilities remain very limited. Because of this reality and despite Greece's great natural potential for RE, certain bankable RE projects are unable to secure financing. The presence of the FoF in the sector, combined with the gradual recovery of the remaining banks will introduce new financing opportunities for prospective investors.

As such, the development of the FoF will hopefully help:

- Bear part of the financial risk linked to investments in the sector by reducing commercial banks' exposure to risks;
- Reinforce the degree of credibility in the sector despite a proven instability of the regulatory framework; and
- Provide liquidity (under the form of soft loans), especially thanks to the use of public funding in the instrument.

## 1.2 Scope

The main target sectors of the FoF are:

- RE projects;
- EE projects in non-residential sub-sectors; and
- Urban Development projects.

It is expected to finance projects such as:

- Wind and photovoltaic parks (RE);
- Biomass and biogas plants (RE);
- Energy efficiency (i.e. energy upgrading and energy savings) in public and commercial buildings (EE)[5];
- Waste and water management projects (Urban Development with environmental objectives);
- Projects for the rehabilitation of deprived districts (Urban Development); as well as
- Industrial parks, conference centres, education and cultural facilities and tourism facilities (Urban Development).

## 1.3 2014-2020 Operational Programme

EUR 200 million of funding originating from the 'Competitiveness, Entrepreneurship and Innovation' 2014-2020 Operational Programme (OP) has been allocated to the FoF (EUR 155.76 million of ERDF funding and EUR 44.24 million of national co-financing). More precisely:

- EUR 125 million originating from TO 4, covering RE and EE projects (more specifically: TO 4b – Promotion of Energy Efficiency and Renewable Energy in Business, and TO 4c – Supporting Energy Efficiency, Smart Energy Management and the Use of Renewable Energy in Public Infrastructures); and
- EUR 75 million originating from TO 6 for Environment and Urban Development projects.

## 1.4 Financial allocation and governance

As illustrated in the figure below, in addition to the EUR 200 million of 2014-2020 OP funding, there is:

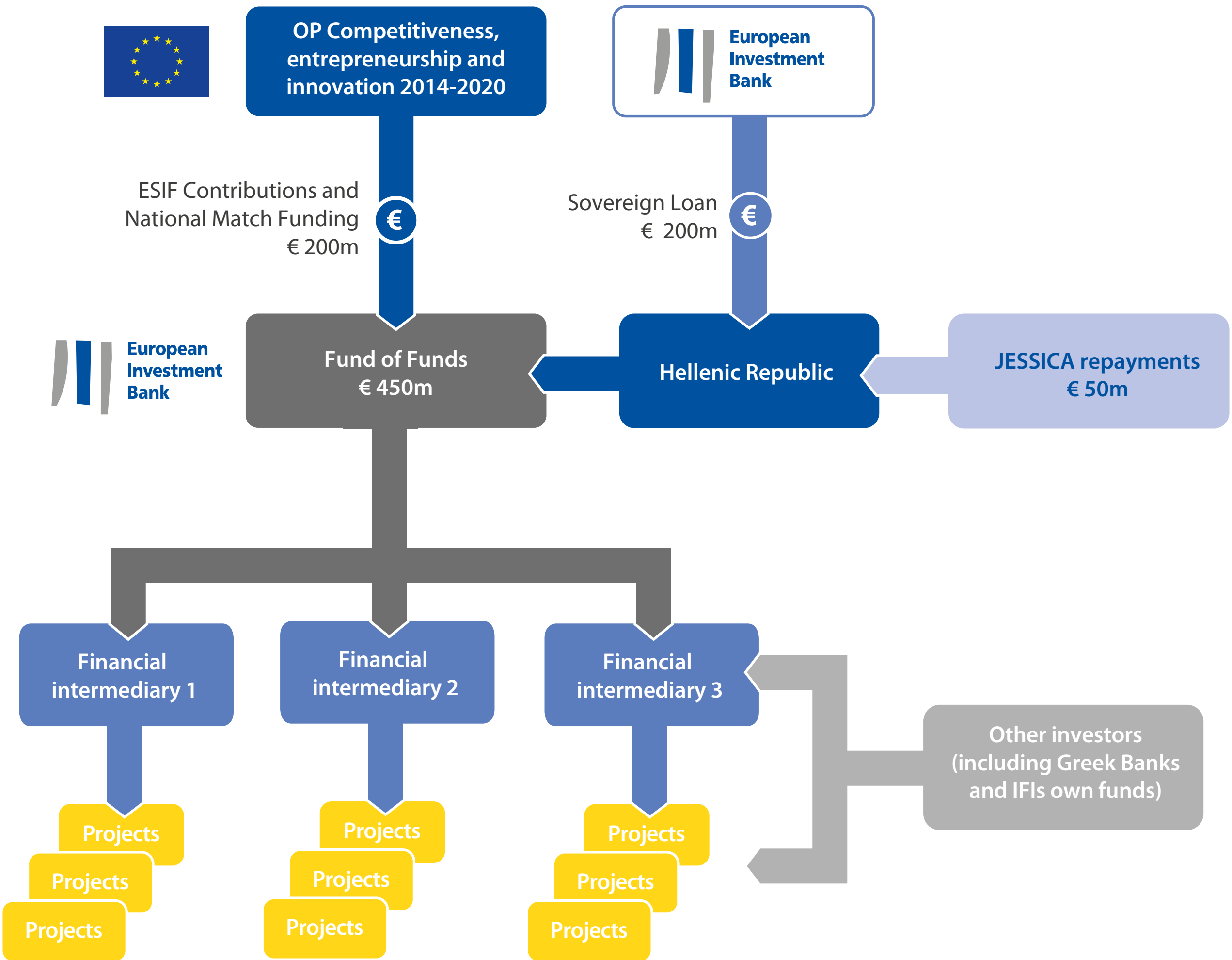
- EUR 200 million provided by the Greek State in the form of additional national contribution, thanks to an EIB sovereign loan provided to Greece, which is 100% devoted to the FoF; and
- About EUR 50 million (estimation) from JESSICA reflows (from the 2007-2013 programming period) expected to be repaid to the HF until 2022. These reflows are meant to be allocated to the best performer(s) among the financial intermediaries.

5 The Infrastructure FoF co-finances EE operations only in the non-residential sector.

Following the signature of the last Operational Agreement with the financial intermediaries, a pool of funds of up to EUR 450 million will be available to all financial intermediaries for investment. The allocation between them will be performance driven, as follows: in the beginning, 25% of the total FoF allocation (i.e. about EUR 100 million, excluding the EUR 50 million from JESSICA legacy funds which will be allocated at a later stage to the best performer(s)) will be allocated equally to all selected intermediaries, while the remaining 75% will be distributed according to the performance of each intermediary. Also, if one or several financial intermediaries do not meet certain absorption objectives, the FoF manager may reallocate the funding to other better performing intermediaries. This set-up aims to ensure the disbursement of funds and reflects the managing authority's decision to put pressure on the intermediaries and to favour competition among them.

In terms of governance, the FoF has adopted a standard structure with an independent Investment Board.

*Figure 1: Sources of funding and overall organisation of the Greek Infrastructure Fund of Funds*



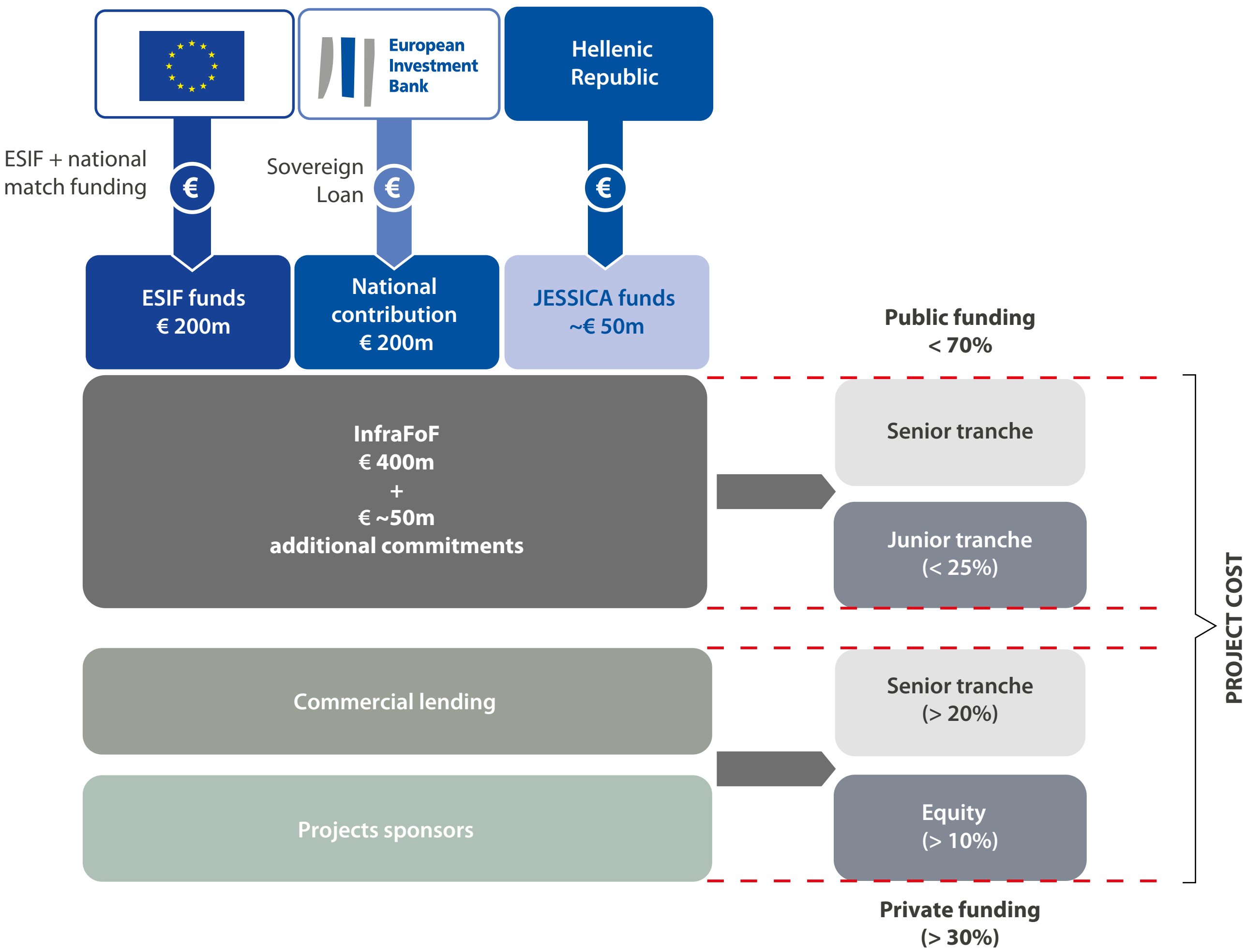

Source: EIB, 2019.

## 1.5 Financial products

The FoF will aim to provide soft loans with favourable features, including interest rates below market pricing (subject to State aid considerations) and longer tenures.

There will be a junior tranche that represents no more than 25% of the total financing provided to each project, while the remaining 75% of the total financing will take the form of a senior tranche. At project level, funding coming from the FoF will constitute no more than 70% of the total cost of each project, while the inclusion of private investors – originating from Greek banks (i.e. the selected financial intermediaries) and/or from project promoter's own resources – will represent not less than 30% of each project, with at least 10% as equity and 20% as a senior tranche loan in each project. This structuring is illustrated in the figure below.

*Figure 2: FoF structuring and project financing in the context of the Greek Infrastructure Fund of Funds*




Source: EIB, 2019.

## 1.6 Leverage

The objective of the FoF is to unlock a total investment of at least EUR 650 million. Considering the EUR 155.76 million of ERDF funding originating from the 2014-2020 OP, that indicates a leverage effect targeted of 4.17.

## 1.7 State aid

State aid was (and is still) a question for the 'RE component' of the FoF. While the use of the General Block Exemption Regulation (GBER)[6] was quite obvious for the Urban Development component, following the experience acquired with the JESSICA initiative during the 2007-2013 programming period[7], it was less easy for the 'RE component'. State aid constitutes one of the barriers to the development of financial instruments in the RE sector. In the case of Greece, the managing authority envisaged at first to notify a specific State aid regime to European Commission's Directorate-General for Competition (DG COMP), but this process did not go through[8]. As of now, the State aid regime for the 'RE component' is expected to follow Article 41 GBER. It is undergoing a fine-tuning procedure since the managing authority is currently preparing a circular relative to the gross grant equivalent (GGE) calculation for RE projects as per this Article GBER, where the calculation of eligible costs necessitates counterfactuals that may be difficult to establish. The outcome of this circular is awaited.

The need for preferential remuneration for private co-financers was also considered in the ex-ante assessment. This assessment envisages that preferential fees may need to be frontloaded, given the conditions of the Greek economy at the time the study was drafted. In that perspective, it recommended to the managing authorities to consider a few factors when attracting/remunerating private co-financers, including:

- The potential for profits (and losses) of the instrument;
- The expectations of these private co-financers (to be assessed during the selection process); and
- The necessary/appropriate amount required for the preferential remuneration; considering that this amount is to be estimated as the difference between the expected rate of return of the financial instrument, and the reasonable rate of return expected by the private co-financer[9].

6 Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.
7 The aid granted through the financial instruments for the 'Urban Development component' has to be compatible with the provisions relative to urban development aid as per Article 16 GBER.
8 The main reason for this situation being that the European Commission (DG COMP) considers that GBER offers a sufficient number of possibilities and consequently that ad hoc schemes should be limited.
9 Ex-ante assessment for financial instruments in Greece, 2016, p.159.

# 2. Lessons learned

## 2.1 Results

By the end of September 2019, the Greek Infrastructure FoF has signed Operational Agreements with all selected financial intermediaries.

## 2.2 Barriers and challenges

The fragmentation of ERDF funding in the OP, the level of detail of the eligibility criteria, as well as the coverage of various categories of regions in a single scheme may slow down the implementation of the financial instrument, especially in the RE sector. This is despite the advantages that ERDF funding brings to the set-up, such as a more intensive support to the regions lagging behind, which helps stimulate demand from projects in these regions and the capacity of ERDF funding to generate leverage thanks to a contribution in the riskiest share of the set-up. In that context, the EUR 200 million provided by the state will help to ease the implementation of the instrument and enable the development and the financing of a viable pipeline of projects throughout the country.

A key challenge for the FoF relates to its nationwide scope and the regional disbursement requirements related to ERDF (especially with regards to the different categories of regions in Greece, i.e. 'developed', 'transition' and 'less developed'). Indeed, while there might be an important demand for financing from mature projects in 'developed' regions, some of these may not be able to receive financing because of the limited available resources. In parallel, it may be difficult to source projects in 'less developed' regions, where generating demand may be challenging. This challenge is actually even greater for the 'Urban Development component' of the FoF since municipalities need to develop 'integrated sustainable urban development strategies' to benefit from the financial instrument (as per Article 16 GBER[10]). In that context, the managing authority and the EIB developed guidelines for municipalities to help them develop such strategies during the 2007-2013 programming period, and expect to leverage this former effort during the current 2014-2020 programming period with the uptake of the new FoF.

The use and combination of various sources of financing in the FoF (including from various TOs within the OP) adds monitoring and reporting complexity. The latter is however perceived as overcompensated by the added value anticipated thanks to the financing of strategic infrastructure projects in the various sectors it enables.

Finally, as mentioned above, part of the 'RE component' of the FoF is currently on hold, pending the results of the study conducted on the GGE calculation under Article 41 GBER before being fully implemented.

10 According to GBER, an '*integrated sustainable urban development strategy' means a 'strategy officially proposed and certified by a relevant local authority or public sector agency, defined for a specific urban geographic area and period, that set out integrated actions to tackle the economic, environmental, climate, demographic and social challenges affecting urban areas*' [Article 2(60)].

## 2.3 Key enabling factors

The Infrastructure FoF in Greece is presented as a positive example not only as a stand-alone public intervention but also as an element of a gradually evolving financial instruments' environment and culture in a country. Greece is an example of a country that introduced several financial instruments in various sectors. Through this process, it was then possible to increase awareness of the benefits of financial instruments, develop capacity in the public administration on specialised topics (such as Public-Private Partnerships, PPPs) and motivate private financiers to target new sectors (such as new technologies and EE).

Specifically in the infrastructure sector in Greece, the experience of JESSICA during the 2007-2013 programming period proved the importance of introducing recyclable forms of financing since the reflows from those revenue generating projects are adding up resources to the current Infrastructure FoF and influenced its very creation[11]. As such, the FoF becomes a tangible case of the sustainability element of financial instruments.

The experience acquired by various stakeholders during the 2007-2013 programming period in relation to the implementation of financial instruments is also expected to support the smooth implementation of the FoF. In that perspective, the set-up of a pipeline of viable projects is expected to be facilitated by the experience and the capacity acquired by the Greek public administration, as well as a strong communication campaign. The choices made by the different actors for the set-up of the FoF (for instance in relation to the amounts devoted to the financing scheme and to the sectors covered by it) also takes into consideration the limited remaining time for the use of ERDF funding in the context of the 2014-2020 programming period.

The FoF also provides a positive example of a streamlined approach at blending diverse sources of funds. With funds originating from ERDF, European Structural and Investment Funds (ESIF) reflows and national budget (provided through an EIB loan), the FoF can be characterised as an innovative public intervention. Moreover, in this set-up, the ERDF contribution to the FoF aims to help stimulate demand from infrastructure projects in the 'less developed' regions and contributes to the riskiest share of the financing scheme.

The FoF is also a positive sign of the public administration, and the financial market in general, becoming more confident in the use of financial instruments, and shifting from generic sectors of public intervention (like Small and Medium-sized Enterprise (SME) financing, and Urban Development), to more specialised sectors, such as RE and EE.

The FoF has also developed a 'competitive' structure enabling the transfer of funding from non-performing financial intermediaries to the more performing ones, including for the use of reflows from the JESSICA HF of the 2007-2013 programming period.

11 It is also to be noted that the JESSICA initiative during the 2007-2013 programming period was also pioneering in Greece since it enabled the combination of Structural Funds with EIB financing at project level, which notably supported a number of PPP projects.

It is also worth mentioning that Greece has one of the best public support systems in Europe for the set-up of PPPs. This well-organised, efficient and commonly perceived as successful support helps set up larger infrastructure projects in the country, including in sectors targeted by the FoF. The latter may consequently be able to benefit from it, like Urban Development projects supported by JESSICA during the 2007-2013 programming period. This support system helps generate a pipeline of viable projects in a reasonable time, which should facilitate the implementation of the FoF, despite the time needed for its set-up.

Finally, as previously mentioned, the challenges related to the use of ERDF funding into the FoF (such as the level of detail required in the eligibility criteria and the geographical distribution related to ERDF funding) is to some extent alleviated by the EUR 200 million provided by the state's national contribution into the FoF. This source of funding is allowing the FoF to be as 'market-oriented' as possible (i.e. being able to meet actual demand from the different categories of regions in Greece). This is a sign that for the setting up of the FoF, the lessons learned from the previous period were taken into account. The selection of three different financial intermediaries also aims to facilitate the geographical coverage of the FoF and the constitution of a viable projects pipeline through the country.

Overall, this Greek Infrastructure FoF provides a good example of a political and technical decision from public administration to leverage previous positive experience and strengths (such as the JESSICA HF during the 2007-2013 programming period and the PPP support system) so as to take it to a new level under the form of a multi-sectoral FoF managed by an International Financial Institution, including in support of sectors that were not supported by financial instruments in the past.

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