Guide to Financing Projects from European Technology Platforms

Financing Instruments of the European Commission and the European Investment Bank

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This working paper 'Guide to Financing Projects from European Technology Platforms' targets the Research and Technological Development (RTD) community at large, but is especially oriented towards the proposals for implementation (projects and infrastructures) of the European Technology Platforms (ETP) of the EU 7th Framework Programme for RTD. It provides a basic and practical overview of the various financing instruments offered by the European Investment Bank (debt) in cooperation with the European Commission (grants).

Certain technical terms explained in the Finance Glossary are identified in italics when first mentioned.

This draft document is the outcome of a working group about financial instruments for the implementation of European Technology Platforms. Besides representatives from the European Commission and the European Investment Bank, the following members of the working group contributed to this document: Mr. Phil Doran (Core Technology Ventures Ltd.), Mr. Claude Roulet (Schlumberger Water Services), Mr. Michel Viaud (European Photovoltaic Industry Association), Mr. Michael vom Baur (Akeryards), Mr. Lutz Walter (EURATEX).

What is the purpose of this document?

1. Introduction

Europe has set itself the ambitious goal of becoming the most competitive and dynamic knowledge-based economy in the world (Lisbon Strategy, 2000). Boosting investment in RTD will lead to substantial positive long-term impacts on European economic growth, employment and competitiveness. The European Council (Barcelona 2002) launched a call for action to increase RTD investment to 3% of GDP in the EU Member States by 2010, and the share funded by business should rise to two thirds of the total. Various European and national policy instruments have been developed to support this goal. However, it has been acknowledged by the European Commission that despite the established grant instruments, financial constraints are still an important obstacle faced by many corporations and institutions.

This 'Guide to Financing Projects from European Technology Platforms – *Debt* and Grants' targets the RTD community at large, and is especially oriented towards the proposals for implementation (projects and infrastructures) of the European Technology Platforms (ETP) of the EU 7th Framework Programme for RTD. It provides a basic and practical overview of the different financing instruments offered by the European Investment Bank (EIB) in cooperation with the European Commission to support RTD proposals.

This working document focuses on the following three key messages:

I. European Technology Platforms (ETP) projects are heterogeneous and therefore require individual financing solutions

The document demonstrates how a financing plan for an ETP project can be structured and in which cases EIB loan instruments can be used. It thereby illustrates the difference between funding from own resources, grants and debt financing (i.e. loans). Specifically, it concentrates on the nature and specific requirements of different EIB loan financing instruments and structures. Furthermore, the brochure emphasises that EIB financing complements existing EU and national grant instruments and is available for *bankable promoters* and eligible projects.

II. EIB involvement adds value

EIB financing for ETP projects adds value by offering highly competitive financing terms through risk sharing with the promoter and/or other financing partners and by providing know-how in structuring the project. Furthermore, EIB involvement is perceived as a quality label and hence can attract other financing partners (catalytic effect).

III. New instruments will mobilise additional funds for R&D in Europe

In addition to existing grant financing, the European Commission and the EIB will develop new ways of leveraging EU grant resources through EIB financing instruments. Under the 2007-2013 Research Framework Programme (FP7), a Risk-Sharing Finance Facility (RSFF) is to be set up. RSFF complements classical grants and expands the EIB's ability to finance bankable innovative projects with higher risk profiles than the Bank's main lending portfolio.

2. The European Investment Bank is a strong partner for fostering RTD and innovation in Europe

The European Investment Bank, an autonomous EU institution, was established to finance investment projects contributing to the balanced development of the European Union. It operates as a policy-driven bank supporting the political objectives of the European Union. As a major international *borrower*, the EIB holds the highest credit rating of AAA and is able to mobilise large lending volumes on the financial markets at first class rates.

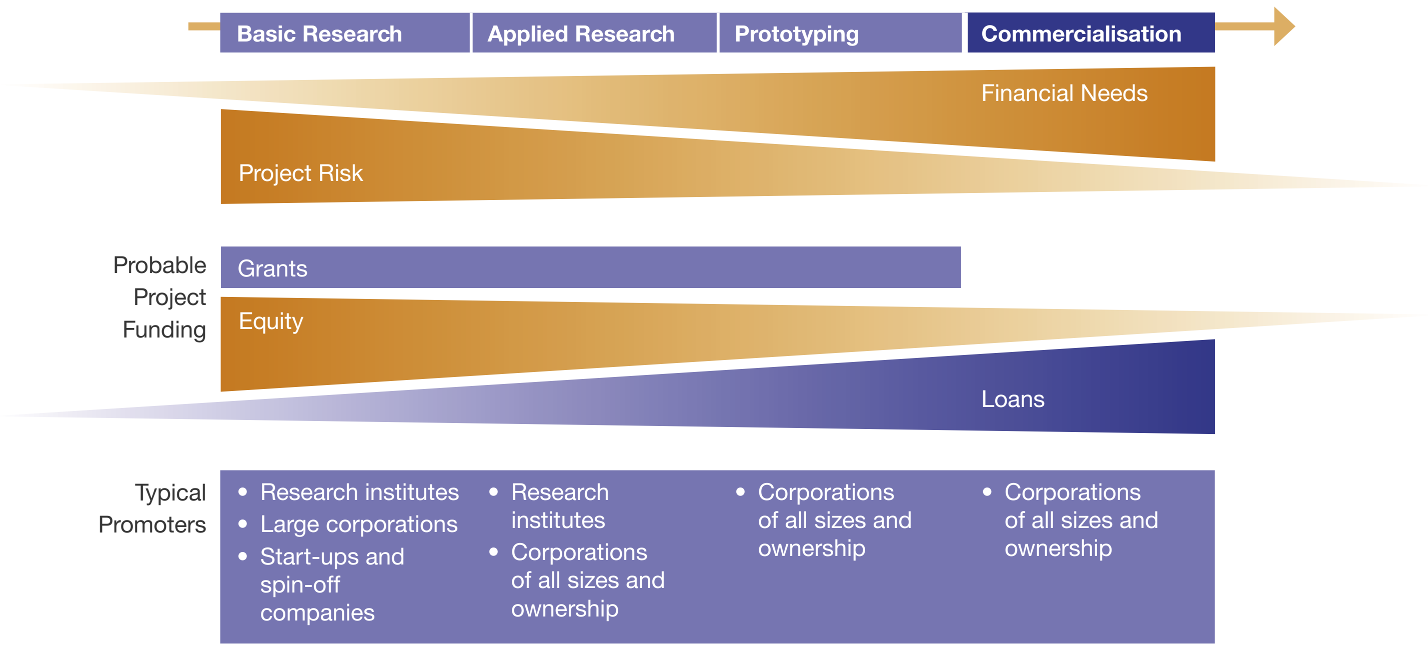
One of the strategic priorities of the EIB Group, which includes its venture capital arm the European Investment Fund, is to support innovation under its 'Innovation 2010 Initiative (i2i)'. On the one hand the EIB offers various types of debt financing and on the other the EIF invests in innovative companies via venture capital funds. The EIB has already signed EUR 34.7bn worth of loans under an overall i2i umbrella of a planned EUR 50bn for the decade. In order to strengthen its support in this field, the Bank has developed a 'toolbox' of loan instruments that can be tailored to the specific needs of projects and project promoters.

How can ETP projects be financed?

3. European Technology Platforms are heterogeneous

Projects within ETPs vary widely in terms of investment cost, implementation time frame, risk profile and financing needs. In general, for each research project and for each generic stage of such a project, an appropriate individual financing plan needs to be developed. Typical sources of financing are *own funds*, grants and/or loans. As a basic rule, the requirement of funding from own funds is higher in early project stages when the project risk is relatively high. The diagram below illustrates the different generic stages of ETP projects. For each stage the graph indicates the degree of project risk, the corresponding financial needs and the type of financing that is deemed to be suitable in most cases.

Generic Stages of Research Projects



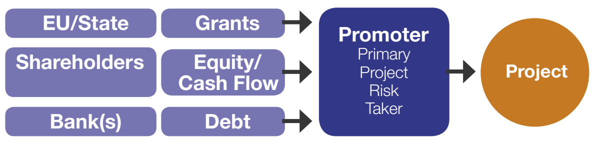
- As a project evolves, the investment cost will generally increase against a reduction in project risk. Consequently, project-based loan financing is generally more appropriate as the project matures.
- Different generic stages of an ETP project usually involve different types of project promoters ranging from research institutes to corporations.

4. Different project structures require different financing plans

The concrete development of a suitable financing plan for an ETP project or the respective project promoter(s) depends on whether the project is realised and financed on a stand-alone basis (Project Finance Model) or in the context of the activity of corporations or institutions carrying full project risk (Corporate Finance Model).

Corporate Finance Model

In the Corporate Finance Model, the financing partners (e.g. the EIB) provide funding to the promoter – which can be a company, a consortium of companies or an institution – on the basis of its financial strength. The financing partners are thereby exposed to the *credit risk* of the promoter, not of the project.

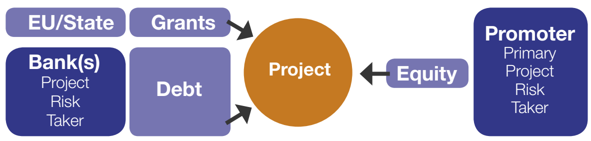


Example:

An automotive supplier company seeks financing to develop, at its own risk, a new emission filter for a leading original equipment manufacturer.

Project Finance Model

In the Project Finance Model, the project is realised and financed via a legally and financially stand-alone (i.e. ring-fenced) project company (SPV[1]) with the promoter(s) being a strategic partner (e.g. shareholder).



Example:

Two energy companies develop an innovative energy plant based on renewable energy. In order to share the risk, they create a designated project company.

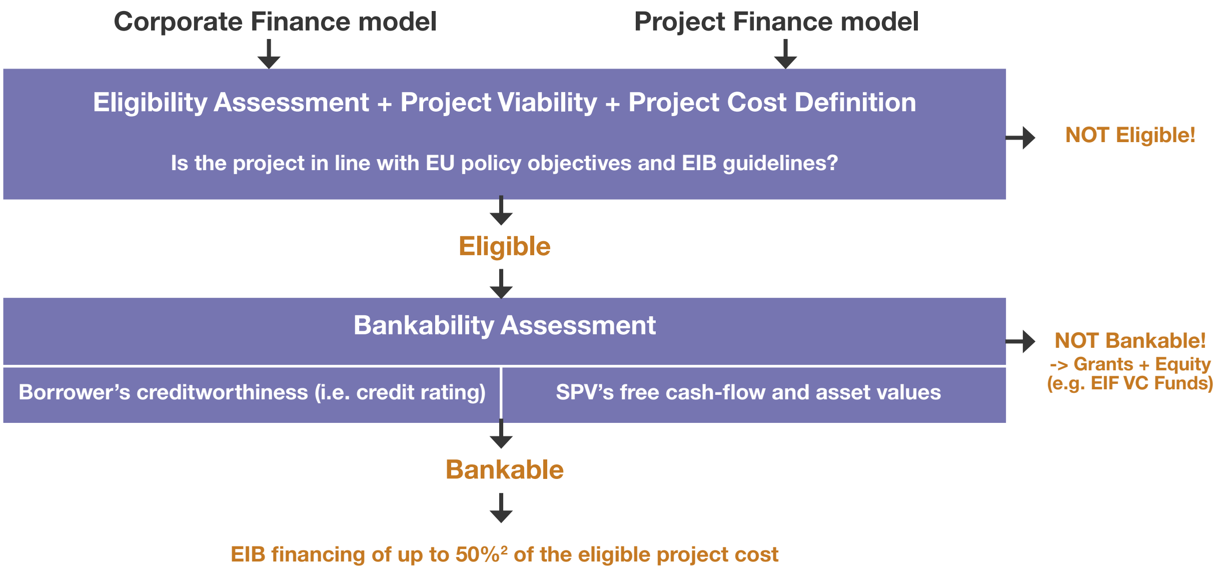
In general, debt can only be provided if the promoter (Corporate Finance Model) or the project itself (Project Finance Model) fulfil the requirements of sound banking practice (i.e. is bankable).

Typically, the gap between the investment cost and grants and bank debt has to be filled by funds from own resources.

[1] *Special Purpose Vehicle*

5. The EIB finances bankable counterparties promoting eligible projects

The financing model determines the assessment criteria for bankability, whereas the eligibility focuses purely on the project and hence is independent of the legal and financial structure. The diagram below illustrates the two main requirements for EIB loan financing: eligibility (conformity with the respective EU priorities and policies as well as project viability – technical and economic soundness of the project) and bankability. Furthermore, the illustration provides guidance on financing alternatives in the event that EIB requirements are not fulfilled.



Two steps:

1- Eligibility Assessment to check conformity with the respective EU priorities and policies as well as project viability – technical and economic soundness of the project

2- Bankability Assessment to check borrower's creditworthiness and/or SPV's cash-flow and asset value

[2] *In some cases the EIB finances up to 75% of the eligible project cost.*

The following table summarises the bankability assessment criteria for each financing model.

Bankability Assessment	
What is the borrower's ability to repay the loan and pay interest?	
Corporate Finance Model	**Project Finance Model**

• Bankability of transactions in the Corporate Finance Model primarily depends on the creditworthiness of the promoter, typically also being the borrower.
• The creditworthiness is primarily driven by the firm's ability to service the debt (repayments and interest payments).
• The assessment of a company's ability to service debt mainly focuses on its profitability, the soundness of its balance sheet and its ability to generate sustainable cash flows.
• Subject to the acceptable creditworthiness of the borrower, the Corporate Finance Model can be applied to basically all kinds of ETP projects - even relatively risky basic R&D projects as the debt service is dissociated from the project risk.
	• The assessment of bankability is based on the project itself, which is typically financially and legally isolated in an SPV (i.e. ring-fenced with no or limited recourse to the promoter).
	• Project bankability primarily depends on the acceptable performance of the following four key parameters:
	  • the SPV's ability to generate sufficient stable stand-alone cash flows/resources to service the debt,
	  • the proportion of equity in the SPV,
	  • the sustainable value of project assets and/or other security,
	  • other structural elements/risks of the financing operation, such as the tenor, financial covenants, political risks.

6. The EIB's loan amount is a function of eligible project cost

While the basic prerequisite for EIB financing is the bankability of the borrower (i.e. the promoter or the SPV), the Bank only finances eligible investments and limits its financing to 50% of the estimated total project cost.

What is an EIB project?

For the EIB, a project is an investment with a technically and economically clearly defined scope. In addition to the core investment it comprises all additional expenses that are required to achieve the project scope.

How are eligible project costs defined?

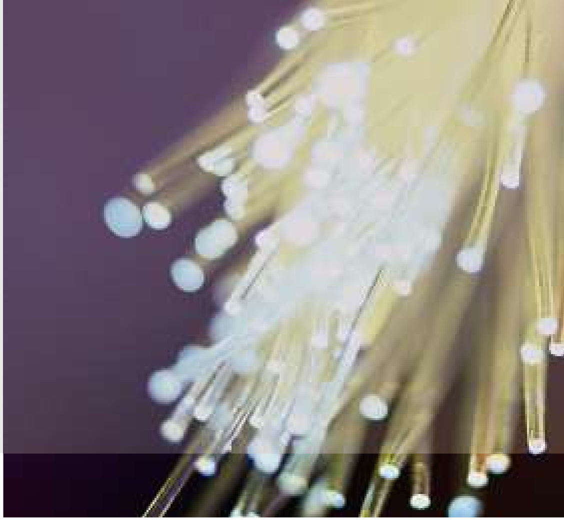
The total eligible project cost includes all investments relating to the project or series of projects. These typically include project-related capital expenditures in tangible and intangible assets, research staff costs, specific incremental working capital and related operating costs.

The diagram below provides an example of how the EIB would define project cost and the maximum EIB loan amount.

Time

Uses of Funds			Sources of Funds	
Year 1	EUR 20m	• Capital expenditures on tangible and intangible assets	Maximum EIB loan: 50%	EUR 30m
Year 2	EUR 30m	• Research staff costs • Incremental *working capital*	Other sources (loans, equity, grants)	EUR 30m
Year 3	EUR 10m	• Related operating costs, …		
Total	**EUR 60m**		**Total**	**EUR 60m**

EIB financing is always subject to the Bank's satisfactory assessment of the project's technical and economical viability and the borrower's bankability. Furthermore, the financing is subject to the EIB's terms and conditions.

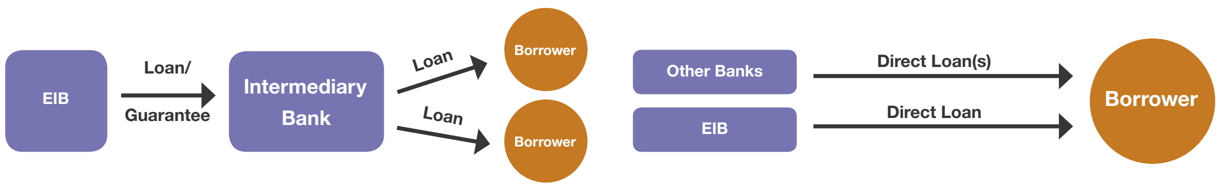


7. The EIB product line is flexible

As shown below the EIB in general provides loans to the promoter of a project directly or through an intermediary bank.
The following diagram illustrates the two main product lines of the EIB and how they can be used for ETP projects.

Global Loans:
project costs of less than EUR 15m

Direct Lending:
project costs exceeding EUR 15m



- Global loans are designed to cater for smaller projects of up to EUR 15m investment cost.
- They are EIB lines of credit made available to financial intermediaries to support smaller projects at their own risk, typically undertaken by SMEs (small and mid-sized enterprises).
- In the case of ETPs qualifying under i2i eligibility criteria, promoters of any size and ownership qualify for allocations under global loans.
- The possibility of risk-sharing arrangements between the EIB and the intermediary bank is being developed.

- The EIB's direct lending products (so-called individual loans) are designed for projects with investment costs of at least EUR 15m.
- They are individually structured according to the requirements of the borrower or the project.
- Individual loans require a case-by-case project appraisal focusing on the economic viability as well as the technical and financial soundness of the project.

Why is the EIB a suitable partner for now and for the future?

8. EIB involvement adds value

Financing ETP projects with loan facilities from the EIB adds value to projects. The EIB selects projects based on their economic and technical viability as well as their contribution to EU policy objectives.

EIB Value Added

- Low financing cost due to AAA rating and non-profit motive.
- All major currencies and flexible tenors.
- Ability to share risks with promoters, banks and other stakeholders as appropriate.
- EIB can help to structure the financing package for the project.
- EIB involvement is perceived as a quality label and has a catalytic effect for other financing partners.

9. With the Risk-Sharing Finance Facility (RSFF), the European Commission and the EIB join forces

What is RSFF?

The Risk-Sharing Finance Facility (RSFF) is an innovative new financing instrument of the EIB and the European Commission. It expands the Bank's basis for providing higher risk financing for innovative projects than its main lending portfolio. In support of this facility, the European Commission shares the credit risk of EIB transactions under RSFF. Within the scope of RSFF, the EIB can lend directly to project promoters or guarantee part of the loans made by other financial institutions. In addition to RSFF the EIB is committed to allocating own funds on a complementary basis for the financing of higher risk RDI projects.

Who is eligible for RSFF?

Most projects within the Technology Platforms are expected to be eligible for RSFF. Furthermore, the facility also caters for all partners in bankable R&D supported by FP7 (e.g. Joint Technology Initiatives, collaborative projects and research infrastructures).

The European Commission will define eligibility criteria for other large and cooperative European projects, e.g. in the context of EUREKA, or follow-up investments supported by previous framework programmes. Eligible requests will be examined by the EIB.

Benefits of RSFF

Wider Range of Funding Sources

The R&D community (e.g. represented by Technology Platforms) and innovative companies will benefit from additional financial resources and an increased risk-taking capacity of the EIB to foster innovation in the EU.

Catalytic Effect

The catalytic/demonstration effect of RSFF will raise awareness and provide comfort in other financial institutions, encouraging them to consider opportunities in the area of R&D financing.

Increased R&D Investment

The EU will benefit from increased R&D and innovation, generating higher economic growth and wealth.

EIB financing is always subject to the Bank's satisfactory assessment of the project's technical and economical viability and the borrower's bankability. Furthermore, the financing is subject to the EIB's terms and conditions.

Finance Glossary

Bankable Promoter	Promoter which fulfils the requirements of sound banking practice.
Borrower	Any 'legal entity' – a person or group – that obtains funds from a lender for an agreed period of time. Under the loan agreement, a borrower is obliged to repay the loan principal and to pay interest.
Collateral	Assets, such as securities, inventories, machinery or intangible assets that are pledged to a lender by a borrower. The assets secure the loan in case the borrower defaults (i.e. fails under the loan agreement); the lender has the legal right to sell the assets in order to recover any remaining claims under the loan.
Credit Risk	Credit risk is the probability of a borrower failing to fulfil the obligations under the loan agreement (e.g. debt service)
Debt	Money borrowed from lenders (e.g. banks) or the capital markets for a variety of corporate or personal purposes (e.g. to cover the financial needs of a project). The borrower pays interest for the use of the money and is obliged to repay the loan within an agreed period.
Debt Capacity	The total amount of *debt* a company can prudently take in relation to its projected free cash flow generation, equity base and asset values.
Free Cash Flow	Free cash flow is the amount of money that a firm can pay out to equity or debt investors after all priority costs and investments required in order to maintain an ongoing business have been covered. The firm's ability to generate sustainable free cash flow is a major component of the Bank's credit risk analysis. An important factor is the degree of reliability of such cash flow generation, i.e. the origin of and the basis for the relevant revenues and costs of the firm.
Interest	Interest is an amount charged to the borrower for the privilege of using the lender's money. Interest is usually calculated as a percentage of the principal balance of the loan. The percentage rate may be fixed for the life of the loan or vary depending on the terms of the loan. In general, interest comprises a base rate (e.g. EURIBOR, LIBOR) and a risk premium that compensates the lender for the credit risk incurred.
Own Funds	Money that shareholders own in a company. Shareholders are not entitled to a guaranteed return and participate in the losses of the company. In the event of insolvency, equity is subordinated to debt and thus carries a higher risk.
Project Financing Plan	The Project Financing Plan is an important part of the overall project appraisal process of the EIB. It is provided by the promoter and includes a summary of the project cost and resources available to cover the financial needs of the project.
Promoter	A company or institution that sponsors and/or implements a project.
Working Capital	The amount of money that a company has tied up in funding its day-to-day operations. This is calculated by subtracting current liabilities from current assets.