
European Commission DG Transport and Mobility

Ad-hoc audit of the Marguerite Fund

Executive Summary

Framework
Contract
BUDG/11/PO/03

19 May 2014

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Executive Summary

The infrastructure investment market

The term “infrastructure” covers a variety of facilities as well as a wide universe of stakeholders, i.e. the end-users of the infrastructure; the government; the contractors responsible for construction and operation, and the financiers. A widely accepted classification distinguishes between economic infrastructure, such as transportation infrastructure, energy distribution and storage facilities, energy and renewable energy production, telecommunications, environmental services, water, and waste management, and social infrastructure, such as defence and national security, education and healthcare facilities, judicial buildings, prisons, senior homes and so on.

Some of the characteristics of infrastructure assets are particularly attractive to financiers, namely the fact that they offer inflation protection, as the terms of concession agreements, long term purchase agreements or regulatory regimes often make revenue streams inflation-linked, have a long asset life, boast a low elasticity of demand, as the nature of the services provided by infrastructure are deemed necessities and can act like a defensive investment in the face of adverse economic activity and generate stable and predictable cash flows. Moreover, infrastructure investments show a low correlation to traditional asset classes like equities, bonds and commodities, therefore, investors can garner risk diversification benefits by adding infrastructure assets to their existing portfolio. Europe is a key region for infrastructure investment, and 53% of the transactions over the past 5 years have involved European assets.

The equity gap on the infrastructure market and the need to foster economic recovery in the EU at the origin of the Marguerite Fund

The links between infrastructure, economic growth and competitiveness are well-established. However, particularly in developed countries, a new set of drivers of the demand for infrastructure investment has emerged due to the need to update aging infrastructure in developed countries, an increased international trade and competition requiring an increased competitiveness of national economic actors and industries to improve their ability to export, demographic pressure calling for infrastructure to better meet the needs of Europe’s aging population and stronger environmental awareness ensure that the benefits of infrastructure investment are not neutralised by negative externalities.

Government spending has traditionally been the main source of finance for infrastructure development; however, the public sector’s ability to provide financing for infrastructure is currently being inhibited by growing fiscal pressures, inefficient or untimely allocation of financing across sectors and regions and sub-optimal effectiveness in managing infrastructure projects, factors that became particularly important in the context of the recent economic crisis. These limitations have encouraged national governments to transition away from their traditional role of infrastructure owner and provider to a new role of infrastructure purchaser and regulator. As a result, the private sector has been able to play a greater role in the financing and management of infrastructure. More specifically, infrastructure funds, particularly equity funds, are one of the main finance providers for economic and social infrastructure.

In 2012, the World Economic Forum estimated that an USD 2 trillion per annum global infrastructure financing gap exists; however, no comprehensive set of figures are known for the extent of an infrastructure financing gap in Europe. In 2009 McKinsey & Company performed an ex-ante market analysis on behalf of Caisse des depots et consignations (CDC); Cassa Depositi e Prestiti (CDP); the European Investment Bank (EIB); and Kreditanstalt für Wiederaufbau (KfW) to assess the existence of an equity gap for European infrastructure exists. Based on the analysis, McKinsey identified sufficient market potential for the deployment of a EUR 1.5 billion unlisted infrastructure fund targeting projects in Europe’s Transport, Energy and Mature Renewable Energy sectors.

Besides being a market for which an equity gap has been identified, transport and energy have long been at the core of the EU's economic and political project as driving forces behind territorial and social cohesion, reducing regional disparities, promoting growth and trade, and improving the living conditions of EU citizens. The transport and energy policy framework has also evolved in response to changes in the global economic and policy environment and now play a critical role in the pursuit of job creation and climate change mitigation.

The idea of creating Trans-European Networks (TENs) needs to be interpreted in this policy context. It first emerged towards the end of the 1980s as a pre-condition for the development of a Single Market characterised by the freedom of movement of goods, persons and services. Moreover, the construction and completion of TENs is also regarded as a key element for economic growth and the creation of employment and has therefore regained momentum since the recent economic crisis. The link between infrastructure investment and economic recovery was again emphasised in Europe 2020, which lays out a strategy for "smarter, sustainable and inclusive growth" in Europe. Investment in transport and energy infrastructure is directly linked to the 20/20/20 targets as it has the potential to significantly contribute to climate change mitigation. Furthermore, the Europe 2020 indicates a concern that Member States investment in transport is insufficient to maintain existing infrastructure or to keep up with future demand.

In response to both the described economic and policy considerations, and following an initiative launched during France's Presidency of the EU Council, six public financial institutions, Caisse des depots et consignations (CDC) Cassa Depositi e Prestiti (CDP), the European Investment Bank (EIB), Kreditanstalt für Wiederaufbau (KfW), Instituto Crédito Oficial (ICO) and PKO Bank Polski (PKO), launched the 2020 European Fund for Energy, Climate Change and Infrastructure, the Marguerite Fund, on 4 December 2009. Due to the very rationale of its constitution the Marguerite Fund is a unique infrastructure investor, being both a market- and policy-driven instrument. This reflects in its governance structure and its investment strategy.

Each of the core sponsors backs Marguerite by a contribution of EUR 100 million. In 2010, the European Commission committed EUR 80 million to the Fund and had a significant influence in the definition of the Fund's investment strategy and, more precisely, on its focus on TEN projects. Two other investors, Caixa Geral de Depositos and Bank of Valletta, committed to the Fund, EUR 20 million and EUR 10 million respectively. The Fund reached a total size of EUR 710 million by the end of its Initial Closing (3 March 2010) therefore falling short of the initial target of EUR 1.5 billion, notably due to its inability to attract other co-sponsors, particularly from the private sector.

The Fund is set up as a Luxembourg SICAV-SIF and its legal structure is a *Société Anonyme* (S.A.) including both a Management Board, in charge of the overall management and administration of the Fund and encompassing the representatives of the six core sponsors, and a Supervisory Board, which monitors the activities of the Management Board without interfering with the Fund's investment strategy. The origination and appraisal of potential investments is carried out by the Fund's Investment Adviser, Marguerite Adviser S.A., established specifically for the purpose of this Fund.

The Fund provides equity or quasi-equity financing to infrastructure projects in three Core Sectors: Trans-European Networks in Transport (TEN-T); in Energy (including TEN-E); and Mature Renewable Energies. The Fund's investments in these three Core Sectors are structured on a project finance basis for the long-term (20 years) and focus on asset creation (i.e. greenfield projects).

The performance of the Marguerite Fund in its first three years of operation

Effectiveness

When it comes to assessing the performance of the Marguerite Fund during its first years of operations several dimensions come into play. To begin with, given its strong policy-driven nature, it is important to assess its effectiveness or the extent to which the Fund has managed to meet its policy objectives.

The Fund is characterised by a rather restrictive investment strategy, which limits the range of possible investments to TEN-T and TEN-E projects and mature renewable energy investments in EU Member States. This has resulted in a much more limited project pipeline compared to other unlisted infrastructure investment funds, adding further complexity to the need to establish a reputation as a credible player on the market, to develop partnerships with co-investors and to build relationships with procuring authorities. As a result, out of the 503 investment opportunities screened by the Fund only 9 deals have been closed until December 31st 2013.

Despite this, the Fund has managed to respect its Investment Guidelines to a large extent and to achieve significant catalytic and signalling effects. More precisely, Marguerite has engaged in a ground-breaking PPP deal that can leverage EU funds in Poland, a flagship PPP deal with air traffic risk in a new Member State and two award-winning onshore deals in markets with high potential. Moreover Marguerite has been instrumental in closing a greenfield offshore wind deal alongside two pension funds, which is one of the few offshore wind deals where institutional investors have been directly involved.

Yet the Fund has shown serious limitations as regards its ability to attract private investors, which can be explained on the one hand by the Fund's less common design and set up, and on the other hand by the limited available pipeline and the challenging market conditions in which the Fund has had to operate. The peculiarity of the Fund's governance structure, notably the weight of public investors, limited its capacity to attract private sector investment. It should also be borne in mind that the Fund started its fundraising activities and its operations in a time of very difficult market conditions which negatively impacted the activities of the whole industry.

In order to better appreciate this aspect, it is interesting to compare its performance to other unlisted infrastructure funds, in terms of number and types of deals closed, financial leverage and average investment volume per transactions. This analysis reveals that Marguerite has been able to close a comparable number of deals and with higher financial leverage compared to a sample of other funds.

By contrast, the average investment volume is significantly lower than the average of its peers. Peer funds also seem to be able to participate in larger transactions. This capacity may be linked to the peers being well established on the market and having long-standing partnerships with debt providers and other equity providers, as well as to the larger investment mandate and larger size of most peer funds. Such relationships and market standing facilitate their better position of negotiation with procuring authorities and allows them to form consortia with well-reputed partners (e.g. major construction companies and utilities, as well as other private equity or infrastructure funds etc.). This, in turn, increases their chances of winning competitive bidding processes for large infrastructure projects.

The first-timer nature of the Fund and its Investment Adviser resulted in additional difficulties in getting involved in the deals. Marguerite has had to establish its own competitive consortia before entering such a competitive market. Moreover, the rather restrictive investment strategy with a strong focus on greenfield and TEN projects as well as on new markets, resulted in a limited pipeline and in longer preparation time for each deal compared to other peer funds.

Efficiency

Besides being a policy-driven instrument, Marguerite is an investment fund operating on market terms, therefore an important element of its performance is its efficiency or the balance between its benefits/outputs and its costs/inputs.

To begin with the Fund's results in terms of signed transactions are comparable to other instruments in which the EC has invested, particularly the LGTT, and the achieved multiplier effect of the EU Contribution with respect to the total project cost is higher for Marguerite when compared to both LGTT and EU grants. By investing in Marguerite, the EC has been able to achieve a high multiplier effect, which allows grant money to be saved for those projects that are not financially viable, and therefore increases the effectiveness and efficiency of the EU budget as a whole.

Moreover, the Fund's governance structure has proven to be appropriate for the Core Sponsors' pursuit of policy-driven objectives and the Investment Adviser's closure of deals. The administrative costs of the Fund are low compared to those of other unlisted infrastructure funds and the stakeholders interviewed confirm that the quality of the reporting has improved over the past three years.

A direct investment of the EC in an infrastructure equity fund alongside other public financial institutions has resulted in several significant advantages both for the Fund, particularly due to the political backing which has helped the new fund establishing its reputation on the market, and for the EC itself, such as acquiring experience in direct investment in a market-based equity fund alongside other public financial institutions and complementing the existing range of financial instruments supported by the EC in the field of infrastructure investment.

However, there would have been other possible alternatives for the actual set-up and governance structure of the Fund that seem to have been overlooked and which may have allowed the EC to better anticipate some of the risk that materialised once the Fund went live.

EU Added Value

One of the key criteria against which the appropriateness of a direct intervention from the EU budget is assessed is the EU added value, defined as the extent to which the results achieved by the Fund's activities would not have been realised without the EU Contribution and intervention. Given that the EC funding for Marguerite came from the TEN-T budget, EU added value needs to be assessed primarily against its ability to invest in TEN-T and TEN-E projects. As already noted the Fund has experienced significant difficulties in financing those projects, mostly due to the limited pipeline of projects at a suitable development stage.

For this reason it seems important to go beyond this narrow perspective, taking into account other qualitative elements of the EU added value.

The experience of the EU Contribution to the Marguerite Fund has in itself delivered added value, since it increased the EC's in-house capacity to engage with direct investment in equity funds. Marguerite has also demonstrated that six public financial institutions, along with the EC, can co-invest in an equity fund that operates on market terms and is considered as a credible investor by other players in the market.

Additionality

The final element to be analysed in order to provide a complete and representative picture of the performance of the Marguerite Fund in its first three years of operations is additionality, or the extent to which the EU financial intervention did not crowd out other forms of funding that would have been disbursed in its absence.

The activity of the Marguerite Fund appears to be additional with respect to both other private sources of capital and other existing EU financial instruments. In particular, the Fund has largely invested in greenfield projects and has generally targeted the riskier end of the infrastructure market. In most cases the Fund has not been in competition with other private sector financiers and in some instances, such as the German offshore wind project, the Fund has revived deals when the initial financial arrangements were on the brink of collapse.

In addition, the Marguerite Fund is a unique example of an equity fund supported directly by the EC and it does not seem to overlap or compete with other existing or foreseen EU financial instruments, such as the LGTT and the Europe 2020 Project Bond Initiative.

Marguerite Fund: The way forward

The first three years of operation of the Marguerite Fund have been a steep learning curve for all the actors involved. A number of lessons have been learnt from this experience, particularly concerning the impacts of a limited available pipeline and the effects of its less common governance structure. These exerted a positive influence on its credibility as a trustworthy actor on the market and a negative one on its ability to attract private co-sponsors.

On the whole, the experience of the Marguerite Fund to date has achieved very positive results as far as both its financial and policy objectives are concerned. Today the Marguerite Fund is a well-established and recognised actor on the market and has managed to close several ground-breaking deals for which it has obtained a number of awards.

At the end of the investment period, the shareholders of the Marguerite Fund, including the EC, will face several choices concerning their involvement in the successor of the Marguerite Fund. Multiple options are possible, ranging from investing in a fund with very similar characteristics to the current Marguerite Fund in terms of governance structure and investment strategy, to investing in an equity fund with similar objectives but a different governance structure, for instance with the creation of compartments allowing a stratification of shareholders, to not investing at all in a successor of the Marguerite Fund.

Based on the considerations outlined above we consider that this experience should be continued and that, from the EC's perspective, a direct investment in the Marguerite Fund represents a very important learning experience. A renewal of this commitment would mark its continuing support to the initiative and maintain its political backing, although several changes to its current structure and investment strategy are possible and could allow the Fund to overcome some of the limitations it has demonstrated.

In particular, there seems to be the need better respond to the needs of different investors having different investment strategy and policy targets. The SICAV-SIF structure offers a significant flexibility and multiple possibilities which should be explored in more detail, particularly as far as the stratification of shareholders is concerned. Other public banks and non-bank institutions, such as public institutional investors, may also be attracted to a 100% public investment vehicle.

Nonetheless, a close interaction with the private sector is crucial to the success of any successor of the Marguerite Fund. Nonetheless, it seems important to focus on the private sector as a co-investor at the project level instead of striving to attract it as a co-sponsor of the Fund. Marguerite has proved to be successful in providing comfort to private co-investors and its participation has been key in attracting private capital in markets or project types where they would not otherwise have invested. Moreover, this will also increase the catalytic effect of the EU resources committed to the Fund.

All in all, a clear definition of the objectives of the different potential shareholders and a careful analysis of the expected costs and benefits of each possible solution are essential in order to ensure that the chosen structure and the relative governance rules respond to the different needs and protect the different interests at stake.