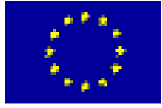

European Commission
Directorate-General for
Transport and Energy

Midterm/Final Evaluation of the Trans-European Network (TEN) Risk Capital Facility -

work order no. TREN/O5/ADM/S07.52507

Final Report

June 2006

COWI

Member of Consortium COWI

European Commission
Directorate-General for Transport and Energy

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List of Abbreviations and Acronyms

CA	Co-operation Agreement
CDC	Groupe Caisse des Dépots et Consigations
DG BUDG	Directorate General Budget
DG ECFIN	Directorate-General Economic and Financial Affairs
DG TREN	Directorate-General Transport and Energy
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EDF	European Development Fund
EIB	European Investment Bank
EIF	European Investment Fund
EPIM	European Public Infrastructure Managers
EU	European Union
GF	The Galaxy Fund
HLG	High-Level Group
KfW	Kreditanstalt für Wiederaufbau
MEURO	Million Euro
MoF	Ministries of Finance
OECD	Organisation for Economic Corporation and Development
OJ	Official Journal
PPP	Public Private Partnerships
RCF	Risk Capital Facility
SEIEF	Southern European Infrastructure Equity Finance
SME	Small -and Medium Enterprises
TEN	Trans-European Network
TEN-T	Trans-European Network - Transport

0 Executive summary

This report presents the evaluation of the Trans-European Network (TEN) Risk Capital Facility (hereafter referred to as RCF). The RCF was initiated by the European Commission as a facility to provide risk capital to TEN projects that are (partly) privately financed through the concept of Public Private Partnerships (PPP). The European Commission has made available 46 MEURO, under the management of the EIB, for this facility. 25 MEURO has been allocated for the purpose of co-investments with a private infrastructure investment fund, the Galaxy Fund (GF). Of this amount 3 MEURO has to date been disbursed to provide mezzanine debt to ALIS, a project company that holds a concession for the A28 Rouen – Alencon tolled motorway.

Our findings are based on desk research, interviews with the Commission, various market actors – both public and private - and a mission to involved representatives from the GF and the EIB. In what follows we provide an executive summary of the evaluation of RCF. The presentation follows the analytical framework - and hence headings of needs, competition, awareness, management, and results. Recommendations are presented under a separate heading.

0.1 Needs

The RCF was established in 1999. At the time of conceptualising and initiating RCF, the facility was needed because the outlook for the financial market was one where the investor market was characterised by shortage of equity. The equity available was focussed on technology investments rather than on transport investments. The evaluation therefore concludes that the RCF was devised and created at a time when the need for a financial vehicle of its kind was necessary. At the same time, the Commission had a political wish of establishing a facility that could meet the needs.

It is questionable whether the same need exists today. There are many indications that the market itself is able to supply equity finance support to TEN transport projects - and that there is therefore not presently a need for additional equity capital support.

The Consultant finds, however, that RCF may still be necessary - but for somewhat different reasons. Although PPP is gaining more and more ground in Europe, private financing of TEN-T continues to more an exception than common practice. The reluctance of national authorities to outsource operations

of infrastructure assets, and the limited expertise in the public sector to structure projects and contracts involving private sector financing are generally perceived by interviewees as major barriers to the implementation of TEN transport projects.

Looking forward, it is therefore a conclusion that a Commission facility is necessary to fill the role as a catalyst vis-à-vis national authorities in enabling private financing of infrastructure projects.

It is particularly necessary for projects that encompass a high risk profile, e.g. the projects that rely on user charges for recovery of costs. The Commission's involvement through the RCF is likely to provide comfort to possible investors and banks as confirmed by most interviewees.

The conclusion regarding the future need for a facility like RCF should at the same time be seen in light of other Commission initiatives. The Commission has initiated the development of other instruments to address barriers that hinder the development of PPPs, particularly in member states. Relevant in this respect is the guarantee instrument recently developed by the Commission which is designed to mitigate the risks for private investors. Another example is the implementation of the Commission backed JASPERS (Joint Assistance to Support Projects in European Regions) which is designed to provide technical assistance for project preparation, consequently easing the burden of high transaction costs associated with PPPs.

0.2 Competition

The evaluation has been undertaken based on the assumption that RCF needs to be competitive in order for its products to be used. Based on interviews with private risk capital providers, in particular PPP funds, the following findings have been made:

- RCF was discussed at the 1997 meeting of the High Level Group on Public-Private partnership Financing of TEN Transport Projects. At the time, Macquarie Infrastructure Group was in possession of a near monopoly on the market for private risk capital. Contractors were the only other possible providers of equity capital.

- In 2006 this situation has changed. GF was established in 2001 as a fund with exclusive focus on transport projects. Macquarie is still in the market - although with a smaller market share (approximately 30-40 %) of the global market for risk capital. But the big change was an influx in 2001 and 2004/2005 of a number of new funds. From a situation with only one fund in 1997, there is today at least 13 funds in the market. The new players do not focus on transport (except for GF) - but transport projects are still potentially part of their portfolios.

- The total volume of risk capital comes close to 16 billion. A significant portion has already been committed - estimated at approximately €6 to 7 billion, leaving 9-10 billion un-committed.

- It is reasonable to assume that of the capital not yet committed 25-40% would be available for infrastructure projects in OECD countries, including social infrastructure and utilities. Of this amount a potential supply of approximately €2 to 4 billion is likely to be available for transport projects[1], including TEN projects. The amount should be compared to RCF with a current potential fund of 46 million.

In total, the competitive situation has changed considerably. To that conclusion, should be added a further fact, namely that the size of RCF may have a negative influence on its visibility in the market - and consequently on its competitiveness and use. Interviewees have expressed the view that RCF has limited funds, and that it is therefore not particularly attractive.

0.3 Awareness

A key prerequisite for fulfilling the purpose of RCF is that the facility and its products are sufficiently visible to its potential customers (i.e. governments and PPP centres in relevant recipient countries, financial intermediaries specialised in infrastructure financing, relevant private sector consortia leaders bidding for PPP projects in infrastructure sectors).

Interviews made with these potential customers during the evaluation show that few of them are aware of the Risk Capital Facility. At best interviewees express an awareness of the existence of Galaxy Fund.

The evaluation shows that for private sector risk capital funds (such as the GF and the other similar funds emerging over the last 5-10 years) proactive marketing/servicing of sales channels and structured identification of investments should be the key management focus in the start-up phase. Proactive marketing remains important until the capital of the fund is fully invested.
The RCF involvement in GF was announced by press releases. Except from that, the market and the market actors have not been made systematically aware of the existence of the facility, neither at the start-up nor subsequently.

The evaluation has not been able to identify a communication strategy targeting key "customers". Along the same lines, it would in principle have been possible to establish a network of key players once RCF was launched, but

[1] A more accurate assessment is not possible to make as funds do not wish to make this information publicly available. The figure naturally depends on the development of the market (i.e. are there sufficient opportunities, what are the alternative investment opportunities?)

establishment of such a network has not been systematically pursued - and has consequently not materialised.

The evaluation of the reasons for the low level of marketing of RCF points to the management set-up as being one of the main reasons. The marketing role was never specified.

The cooperation agreement between EIB and the Commission does not provide any guidance to this effect. Nor has it been specified in other communications which entity should be responsible for marketing RCF and its products - whether it should be done by the EIB, the Commission (DG TREN or DG ECFIN), Galaxy Fund or possibly by others.

0.4 Management

The management structure guiding the operation of the RCF has been a matter for thorough investigation by the evaluation team, based on the assumption that appropriate management is a pre-requisite for facility success.

Interviews, desk studies and analyses show that the management set-up of the RCF is clear. RCF is managed by EIB on behalf of the Commission. Investment proposals shall be submitted to the Commission which in turn shall present the proposal to the TEN-T Committee.

While this management procedure is transparent and ensures accountability, it does leave the operational life of RCF somewhat complicated and bureaucratic. Even worse, it appears unclear to its customers and intermediaries where to turn, and who to talk to. In a financial market characterised by fierce competition, the evaluator finds that this is likely to cool of the demand for the services provided by RCF.

As for capital allocated to GF under the management of EIB, it has been stated by GF that disbursement procedures are quite efficient and effective, and that communication on pending investment opportunities is continuously in place.

The EIB is managing the facility on a contractual basis. However, its role has never been fully operationalised in the Guidelines. In addition, management instruments common to comparable funds have not all been instituted in practice. For example,

- With regard to financial conditions, the Guidelines do not explicitly require a minimum rate of return. This is contrary to regular (infrastructure) funds, where shareholders are informed about the expected rate of return on their investment. This information is normally presented in the Information Memorandum of a fund or facility. Such a memorandum does not exist for RCF.

- The financial details of the facility are not explained, i.e. required investments, estimates of costs of operations, estimates of possible returns.

- The strategy of the facility, i.e. which sectors to invest in, when to exit, in which countries, etc. is not made explicit.
- The exact organisation of the facility is not explicitly explained to potential "customers". Information is lacking regarding names of persons managing the facility, and under which incentives, who are on the "investment committee", who manages the investments and so on.
- It is not specified whether a management committee has been established. Or at least, the Consultant has not been able to identify minutes from such meetings, who is in charge of such meetings, setting the agenda, etc.
- The quarterly reports from Galaxy to EIB and from EIB to the Commission have not been completed on a regular basis (or at least they have not been available from the files).
- Both DG TREN and DG ECFIN have a role vis-à-vis the RCF. The exact roles and responsibilities of the respective DGs are, however, not clear.
- There is in practice no network between the responsible desk-officers in the respective organisations.

While above-mentioned requirements may seem overly ambitious and somewhat bureaucratic considering the size of the facility, the Consultant maintains that the requirements are still appropriate for ensuring a successful management and implementation of the facility.

0.5 Results

To date use of RCF has been limited, hence results are also limited. Of the 46 MEURO potentially budgeted for the RCF, 25 MEURO have in fact been committed in two tranches to the EIB and GF. Of the 25 MEURO, 3 MEURO have been spent.

Summing up from the above four analytical levels of needs, competition, awareness and management, it is a conclusion from the evaluation that the main reasons for the limited use are the limited investment opportunities in the market given the slow development of TEN-T PPPs, and the limited awareness in the market of the facility.

As for the limited awareness it is a conclusion that this is mostly caused by inadequate marketing efforts which is for the most part related to an unclear ownership and organisation structure of the RCF. The limited size of funds of RCF may also have a negative influence on its visibility in the market - and consequently on its use.

The analyses show another reason to be the fact that RCF is involved with GF only. While GF is the only fund exclusively focussing on the transport sector, the Consultant finds that the focus on GF restrains the facility from being

known and used by other funds. The latter may not have exclusive focus on transport, but still potentially have large funds available for the transport sector.

The evaluation finds that in general, national authorities do not facilitate private sector participation in the financing of TEN-T projects. Interviewees see this as a major barrier for developing PPP financed TEN-T projects. Therefore it is a conclusion from the evaluation that a Commission sponsored equity facility like the RCF - with a focus on removing the barriers in member states - is needed and will be welcomed by market actors.

0.6 Recommendations

Given the needs identified in the contemporary market, it is recommended to continue to make risk capital available for TEN-T projects in order to support the development of PPP's for these projects. It is even recommended to increase the available volume of risk capital in order to have a significant impact.
Given the competition it is recommended to redefine the product offering and differentiate them from the private risk capital providers. Possible options are:

- Position the RCF as a public risk capital provider. We recommend to target contracting authorities directly rather than infrastructure funds. The contracting authority could tender the project with a part of the necessary equity already committed by the RCF. This would make the RCF available to all bidders and ensure a level playing field.

- Make the terms of the RCF more attractive, e.g. offering reduced rates of return, last right of withdrawal, free of charge technical assistance in bid preparation. This of course subject to the condition that state aid regulations - and non-distortive requirements in general - are not being violated.
- Offering the product in combination with the other instruments available to the Commission. The guarantee instrument and/or JASPERS are likely to provide synergy and provide a combined vehicle for getting PPP for TEN-T off the ground.

Given the limited awareness and current management structure, it is recommended to renegotiate the terms of the agreement with the EIB as being the current manager of the facility and incorporate adequate incentives for marketing the facility. Alternatively, the Commission and the TEN Committee should consider tendering the management of the facility to a private fund manager.
Given the limited use of the capital committed to GF it is recommended to renegotiate the agreement with GF incorporating a deadline, e.g. 2 years for full utilization of the amount committed. This will enhance the incentive for GF to make use of the remaining budget.

1 Introduction

Background

Directorate-General for Energy and Transport (DG TREN), and in particular the Unit responsible for the Management of the Trans-European Network (Unit B3), together with the Directorate-General for Economic and Financial Affairs (DG ECFIN) has initiated a midterm/final evaluation of the Trans-European Network - Transport (TEN-T) Risk Capital Facility.

The evaluation assesses the appropriateness and effectiveness of the facility for providing risk capital for Trans-European Network transport projects and for involving substantial private-sector investment.

The evaluation will be used to make decisions concerning improvements to the current approach or whether to develop a more effective approach in the future.

The Draft Final report was submitted to the evaluation steering group on 16 May for the purpose of a discussion at a meeting between the Steering group and the consultant on May 23. Based on comments made at that meeting, a 2nd Draft Final Report was issued on June 8. The Final report has been finalised based on written comments made by the Commission to the June 8 report.

The report has been prepared by COWI under the existing COWI Service Framework Contract with DG TREN covering Ex Post and Mid Term Evaluations (Ref. TREN/A1/17-2003 Lot 2) and in response to the Terms of Reference included under Work Order TREN/O5/ADM/S07.52507.

Readers should note that the report presents the views of the Consultant, which do not necessarily coincide with those of the Commission.

2 Methodology

The Community contribution to the funding of TEN-T projects has so far almost solely been based on grants. In view of strong budgetary restrictions at both the European and the national levels and of the increasing number of privately co-financed and managed projects, article 4 of the TEN financial regulation (2236/95 as amended by 1655/99) foresees a range of private sector oriented forms of aid. Article 4 (e) provides for a *“risk capital participation for investment funds or comparable financial undertakings with a priority focus on providing risk capital for trans-European network projects and involving substantial private-sector investment…..*"

The evaluation shall assess

- *the potential practicalities for the implementation of this form of aid in the new financial perspective period 2007-13…..*
- *It shall be used to formally verify that the financial intervention is based on a coherent strategy, which is relevant to the needs, problems and issues that it is supposed to address.*
- *It must also ensure that this strategy is complementary to, coherent with and not in contradiction with other public interventions at European and National levels"*[2]

The focus of the evaluation is on the formative aspects, and it is a mid-term rather than a final evaluation[3].

2.1 Data and analyses

Our findings are based on analyses of data originating from desk research, interviews with various market actors – both public as private- and a interviews with relevant representatives from the Commission, GF and the EIB (see Appendix A with list of interviewees).

Also we have interviewed, representatives of PPP task forces and Member States ministries (transport, finance). We have carried out a preliminary

[2] Cited from Specification of Services.

[3] Agreement reached at kick-off and inception report meetings.

benchmark of rates offered and of the overall provision and availability of equity (primary and secondary)[4].

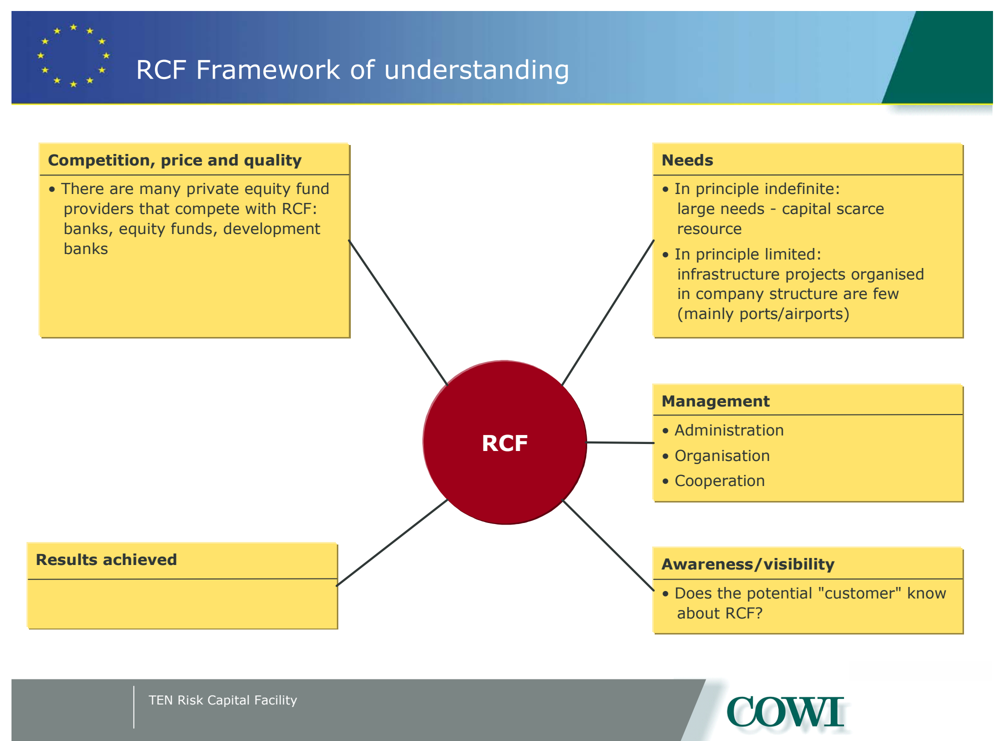
In total, we have undertaken 30 interviews, of which 7 have been personal, while 23 have been telephone based.

2.2 RCF framework of understanding

Framework

The RCF framework of understanding is shown in the following figure:

Figure 2.1 Framework of understanding



The figure shows how RCF's operation is determined by five factors:

1 the *needs* for its services and products,
2 the *price and quality* of its products compared to that of its competitors,
3 the *results* achieved,
4 the *awareness* among its potential "customers" of its existence and
5 the way the Facility is *managed*.

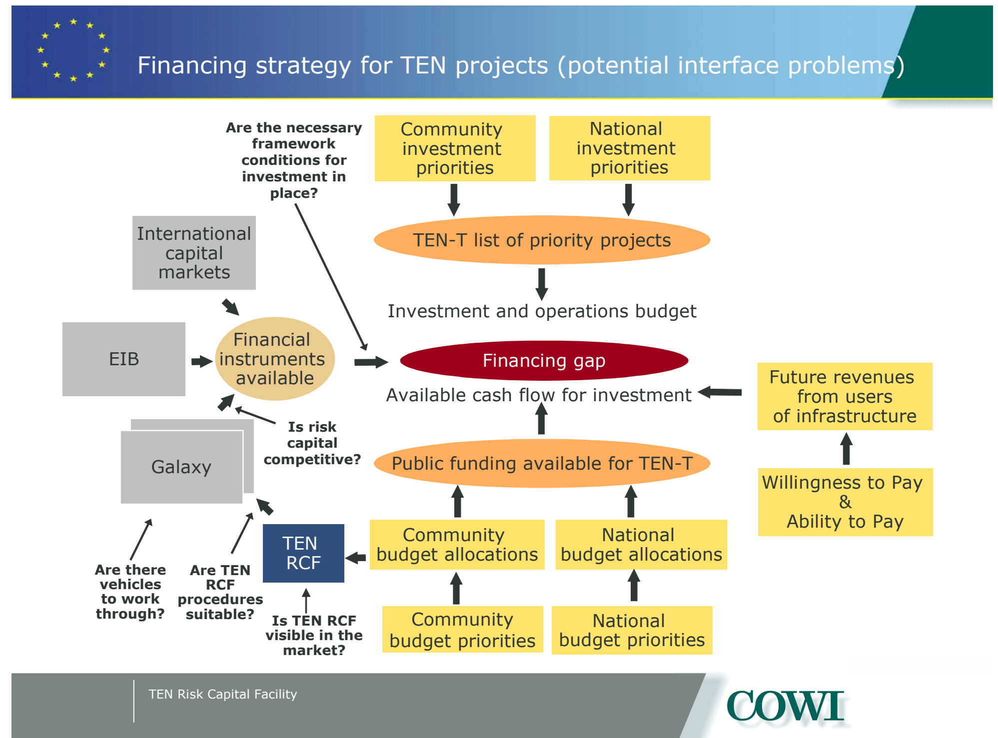
The analyses and the questions answered by the evaluation was structured along the headings of the five factors.

[4] Note that this is preliminary as funds often do not wish to disclose financial details.

Interfaces & players

A graphic presentation of the interfaces and players involved is presented below:

Figure 2.2 Financing strategy for TEN projects (potential interface problems)



The figure shows:

- the demand for, supply of and flow of financial funds for TEN-T projects,
- the key funding constraints in terms of budgetary limitations and market imperfections,
- the role of the TEN Risk Capital Facility, other EU/national programs and the private capital market in closing the financing gap (the private capital market consist of funds like KfW, international banks like EBRD, Macquarrie, private banks, etc.),
- the identified barriers and possible solutions.

Figure 2.2 is used for illustrating the barriers for the RCF activities, and the areas for recommended actions to be taken in future.

3 Background to the RCF

Since the early 1980s, the Commission has supported the development of transport infrastructure in Member States. This financial support has been increasingly organised over the years, and developed from 1995 into a proper programme to the benefit of the Trans-European Transport Network (TEN-T).

Building and completing a modern, multi-modal and reliable transport network is recognised as essential to the development of European objectives of integration and economic growth. The need for capital investment in transport infrastructure in Europe is very large, and will require time. The budgetary constraints of the Member States are limiting the level of public spending in infrastructure across Europe. Innovative forms and means of financing are explored involving mobilisation of private investments.

In 1997 the High-level Working Group on Public Private Partnerships (PPP) concluded that there was a lack of funding from PPPs in the transportation sector. Hence, the availability of private funds needed to be promoted if TEN projects were to be developed as PPPs. This meant using less public resources to help encourage investments from the private sector. The conclusions of the High-level Working Group were fully endorsed by the Commission and the Council of Ministers in October 1997.

3.1 Regulation 1655/1999

The TEN Financial Regulation No. 2236/95 of 18 September 1995 laid down the general rules for the granting of Community financial aid in the field of trans-European networks (TENs). In addition to the traditional forms of EU interventions consisting of direct grants[5] for studies and works, the 1995 Regulation also provided for interest subsidies for loans and contributions towards fees for guarantees for loans from EIF or other financial institutions. In July 1999 the European Parliament and the Council adopted Regulation No. 1655/1999 amending the 1995 Regulation, and adding the provision of risk capital to the list of instruments available to the Commission.

Risk Capital Participation for the First Time

Article 4.1. (e) of the amended Regulation was introducing a new form of intervention. The purpose of the new article of the amended Regulation was to provide for risk-capital participation in Community aid for projects with the

[5] The instrument generally preferred by Member States and project promoters.

overall aim to help facilitate the implementation of TEN projects. The Regulation was published in the Official Journal C 188 on 4 July 2001 and it entered into force hereafter.

Encouraging the Private Sector to Participate

The aim of the Regulation is to encourage a larger involvement of investments from the private sector in the future. Until now financing has mainly come from public sector investment and EU budgetary sources in the form of grants and loans from the EIF and the EIB. Public financing will, however, remain a keystone in major infrastructure investments.

Maximum Investment

Risk capital participation is allowed to a certain extent in investment funds that promote TENs. To begin with, risk capital could amount to up to 1% of the overall budget amount, which has been made available for TEN-T projects for the period 2000-2006. This limit was increased up to 2% as from 2003 following a review of the functioning of this instrument and an examination of its future possibilities.

Participation of Risk Capital

With the facility, the Commission can participate through the TEN budget in investments in TEN projects together with private investors. The TEN money will only be allocated through the facility to concrete projects.

Participation of risk capital may be made directly into the fund or comparable financial undertaking or into an appropriate co-investment vehicle managed by the same fund managers.

Prior to any investment in a project, a detailed breakdown of estimates is required concerning the sources of contributions from the Community and from national, regional and local government bodies, as well as the extent of financial contributions from the private sector.

The Commission is the overall responsible body. The Commission must regularly inform the TEN-T Committee, i.e. the Member States, of the progress of programmes and of any decisions taken by the Commission in allocating Community funds for projects.

Management

The Regulation[6] stipulates that the management of the Community contribution will be ensured by the European Investment Fund (EIF). Before the RCF commenced its activities the management was, however, transferred to the European Investment Bank (EIB) as per the Co-operation Agreement of June 2001 (see Ch 3.2)[7].

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[6] The Regulation also stipulates that Before the end of 2006, the Commission shall submit to the European Parliament and to the Council a comprehensive report of the experiences so far concerning the use of risk capital in Community aid - hence the present evaluation.

[7] With a reform of July 2000 the business activities of the EIF was concentrated on support to the development of SMEs. As the EIB since 1997 had developed its own venture capital activities, it was decided to transfer RCF to the EIB.

Financial Framework

The financial framework for the implementation of the TEN-T Regulation for the period 2000-2006 was initially set to EUR 4600 million. Thus, the maximum allocated to RCF is EUR 46 million over the same period[8].

3.2 The Co-operation Agreement

Co-operation Agreement

The Co-operation Agreement (CA) was signed by the Commission, the EIB, and the EIF in June 2001[9]. In the CA the EIB agrees to manage the RCF and to undertake all investment activities in its own name on behalf of, and at the risk of the Commission.

The Interservice Consultation on the Agreement was initiated by the DG ECFIN on 27 February 2001 and ended on 12 March 2001. For the purpose of ensuring maximum transparency on how investments are selected it was decided to publish the investment policy, which the EIB should follow in the Official Journal of the EC.

The Co-operation Agreement laid down the detailed terms and conditions for implementing Community assistance. The Agreement takes into account the provisions laid down in the Annex to the TEN Financial Regulation.

The role of the EIB was defined according to the CA as being to:

- Identify, investigate and evaluate investment proposals;
- Following approval, negotiate the terms and conditions of individual investment proposals and commit the funds required for the relevant investment;
- Ensure that the contractual documentation signed by the EIB in respect of individual investments include appropriate provisions;
- Exercise all rights relating to the investments in the interest of the Commission. This includes voting rights and rights to participate on boards and committees;
- Open and maintain bank accounts on behalf of the Commission;
- Monitor and provide information in relation to investments;
- The Commission will remunerate the EIB for the services rendered under the Co-operation Agreement;

[8] It is to be noted that the TEN regulation provided that out of the 4.6 Billion Euro, 4.17 were earmarked for Transport. Following the 2004 Enlargement the TEN budget was increased to 4.875 Billion Euro so it is assumed that RCF could in theory amount to a maximum of 97.5 Million Euro.

[9] On 4 July 2001 the notice of Implementation of TENs Risk Capital Facility was published in the Official Journal C 188.

The Trust Account

The Co-operation Agreement has established a Trust Account.

Investments shall be funded out of the Community budget. The Commission shall for this purpose make available funds to EIB through the Trust Account in accordance with Article 3 of the CA.

The EIB shall open and manage an account in euro, which shall be designated to and exclusively used for the administration of the Facility (the "Trust Account"). The Commission shall credit to the account the Committed Capital.

Remuneration

The Commission shall remunerate EIB for the services rendered under the CA.

The remuneration will be paid in terms of fees depending on the service being carried out. The EIB shall obtain a prior approval of the Designated Service before incurring expenditure in excess of EUR 10.000 for individual investments. According to Article 8 in the Co-operation Agreement, the EIB will be remunerated for:

- the appraisal and negotiation of each Investment - a success fee; The success fee shall be payable to the EIB on the date the first disbursement of the Committed Capital in relation to an Investment is made pursuant to article 5.8 and at a rate of 1,5% of the Committed Capital for such Investment to be calculated in Euro.
- the management of the Investments - an administration fee; The fee is paid on an annual basis, and at an amount of EUR 25 000 for each Investment committed. The fee is intended to cover costs of the EIB after the decision to manage a fund has been taken.
- the management of the Trust Account - a Treasury fee.

The fees will be calculated at the rates and on the basis set out in the Fee Letter. Furthermore, the Commission shall reimburse the EIB for customary and reasonable expenditure of the EIB or any of its agents, incurred in relation to legal, accountancy and tax advice and documentation, when negotiating agreements with Infrastructure Funds, independently of the results of those negotiations, or otherwise in connection with the Facility,

The fees will be paid out of the TEN budget. Any interest received on deposits on the Trust Account not yet disbursed to TEN projects can also be spent for this purpose.

Termination

Each of the parties may terminate the CA in respect of investments not yet committed if any of the parties fails to comply with the CA.

3.3 RCF Guidelines

The Guidelines for the development of risk capital into trans-European transport network projects were approved by the TEN-T Committee. In the

meeting of 25 June 2002 the TEN-T Financial Assistance Committee endorsed the draft TEN Risk Capital Facility Guidelines, which was presented by the Commission. Below, the consultant describes the content of the guidelines with respect to the nature of investments and target funds, the financial architecture, approval procedures and reporting.

3.3.1 Nature of Investments and funds targeted

The overall purpose of the TEN Risk Capital Facility is to invest in, or co-invest with, specialised investment funds or comparable financial undertakings (the Infrastructure Funds) with a priority focus on providing risk capital for trans-European network projects.

The Community stake in an investment fund shall in no case exceed 20% of the total capital of the Infrastructure Fund. The amount committed to an Infrastructure Fund will as a general rule not exceed EUR 25 million. In addition, the Infrastructure Fund must undertake to invest not less than a sum equivalent to two and a half times the Community contribution. This concerns projects which have previously been identified as projects of common interest in accordance with Article 155 (1).

The TEN Risk Capital Facility will target commercially oriented intermediary infrastructure funds operating in the EU managed by independent professional teams.

3.3.2 Architecture/financial conditions offered

With regard to financial conditions, the Guidelines do not explicitly require a minimum rate of return. This is contrary to regular (infrastructure) funds, where the shareholders are informed about the expected rate of return on their investment. This information is normally presented in the Information Memorandum of a fund or facility, in addition to the following information:

- Strategy of the fund (where to invest and where not, when to exit, which countries, and so on)
- Organisation of the fund (who in terms of persons manages the fund and under which incentives, who operates as investment committee, who manages the investments and so on).
- Financials of the fund (required investments, estimates of costs of operations, estimates of possible returns)

This type of information is not available in the guidelines or in a comprehensive way in other key RCF documents. The information included in the guidelines concerns primarily the strategy of the facility, and to a certain extent information on the organisation of the facility.

3.3.3 Approval of investments and payments

The EIB manages the scheme on behalf of the Community. The EIB shall submit investment proposals to the Commission for approval.

Within 20 Business Days the Commission may notify the EIB in writing of its decision to submit the proposed investment to the TEN-T Committee.

If the Commission wishes to carry out the investment, the Commission shall inform the EIB hereof, and an Appraisal Report shall be submitted by the Commission to the TEN-T Committee.

The Commission shall hereafter inform the EIB whether the Committee has approved the investment.

In case the Commission does not inform the EIB within this period of time or if the Commission has informed the EIB that it does not intend to submit the proposal to the TEN-T Committee, the investment proposal shall be rejected.

The Commission can reduce, suspend or cancel Budgetary Commitments if an examination reveals irregularities or non-compliance with Article 13 (2) of the TEN Financial Regulation.

The Commission can cancel Budgetary Commitments for projects that have not started within two years following their expected start.

3.3.4 Reporting and monitoring

The EIB will provide monthly statements to the Commission specifying all transactions on the Trust Account.

At the end of each year any positive balance will be paid to the Commission after deduction of any amount due to other parties.

- The Commission will report regularly to the TEN-T Committee on the implementation of risk capital participation of the TEN Financial Regulation. This includes data on the use of the risk capital investment by the Infrastructure Fund.

- The EIB shall report on the investments to the Commission and shall co-operate with the Commission in the preparation of annual reports on the implementation of the facility to the European Parliament and to the Council and of the evaluations of the facility.

For the 31 December and the 30 June of each calendar year EIB shall provide a report on the investments to the Designated Service and to EIF.

External auditors of EIB shall on a yearly basis audit the Trust Account.

4 Evaluation findings

The presentation of the findings follows our framework of understanding (see section 2.2). Hence, we report on

- Needs
- Competition, price and quality
- Awareness/visibility
- Management and
- Results

4.1 Needs for RCF services

RCF was conceptualised and created during a period with substantial changes taking place in the financial market simultaneously. As such, some of the assumptions and rationales on which the RCF was built changed rapidly.

While the need assessment made at the time of the High-level Working Group on PPP in 1997 (see Ch. 3) may have been correct at the time, these needs, and the market's ability to meet the needs were somewhat different when RCF was launched in 2001. Some of the relevant changes that have taken place concern:

- The relevant country focus of the RCF may shift with EU enlargement. New member states are no longer eligible for funding under the Phare programme, hence they may be more in need of RCF in future.

- A number of countries were previously eligible for funding from the structural funds and/or the EDF. They no longer are. Hence, they are more likely to be in need of private capital, PPP investments and the RCF in future (Ireland, Greece, Portugal, Spain).

- Yet other countries (UK, Germany, France, Italy, the Netherlands, Denmark, etc) - on the other hand - are less likely to day to be in need of RCF than when it was conceived because a capital market with many new infrastructure funds has developed (see section 4.2.1).

The findings concerning needs are presented below as seen from the point of view of the Commission and the market, respectively.

4.1.1 At Commission level

As described in Ch. 3, the initial work and discussions on RCF was undertaken by the 'High Level Group (HLG) on Public-Private Partnership Financing of TEN Transport Projects'.

At the time when RCF was discussed one of the central papers leading up to the creation of RCF indicated that *"there is a perceived need for complementary loan instruments designed to alleviate early operational stage cash-flow risk with amortisation schedule matching the risk profiles of the projects"* (HLG, 1997, p.2).

The ambition was to add leverage to the (potential) market for TEN-T investments. DG ECFIN had had a positive experience with a financial instrument concerning small and medium sized enterprises (SMEs). Clearly the intention was to bring in private sector funding to support infrastructure and transport development. DG ECFIN considered this strategy financially viable.

One interviewee expresses how the idea was to *"ignite and create ignition"*, meaning providing leverage to the financial market. As such there was an important aspiration to create an instrument which could make a difference.

In order to diagnose the need for a financial instrument, the Commission asked for "an outside opinion" by requiring an analysis prior to decision making from a consultancy company (ING Barings).

The report came up with the term of risk capital: *'The study uses the term "risk capital" to refer to equity and quasi equity (including all forms of subordinated/mezzanine debt instruments). Risk capital is defined very broadly as the finance needed in a project to support senior debt.'*

The report by ING Barings estimated the financing needs (1994-2010) to be 136 billion Ecu for Transport and 30 billion Ecu for Energy.

By and large the market seemed to lack financial revitalising. Interestingly enough, the ING Barings report suggested the level of risk capital to be either 10% or 20%. This is again significantly higher than what is the current practice. ING Barings concluded that 'risk capital is least available where it is most needed - at the development and construction stages'. Hence, RCF would be able to address a significant market failure.

Interestingly, the ING Barings report indicates that 'the interview process has clearly demonstrated potential interest from institutions in a fund'. Such funds are primarily pension funds and life insurers.

Furthermore it was reasoned that *"In a public-private partnership framework, public support will fill the gap left once the possibilities of private finance have been used up to an optimal point"* (HLG, 1997, p.4).

"The availability of public sector equity during the early years of a project significantly helps projects to get off the ground" (HLG, 1997, p. 13).

One interviewee is of the opinion that *"needs were not diagnosed"*. While needs assessment and analyses prior to launching new initiatives can almost always be improved, our findings do indicate, however, that considerable preparations for setting-up the RCF were undertaken. The analyses proved to the Commission that there was in fact a need for a risk capital facility to further attract private capital for the purpose of developing TEN-T.

To meet the needs of the future, the budgetary appropriations for the TEN-T for the period 2007-2013 will be decided upon by mid-2007. Similarly, a new financial Regulation for the TEN is under discussion. Alongside the more traditional form of direct grant support, 3 intervention types are being considered:

- At the current state of the proposal the continuation of the risk capital facility will no longer have a ceiling of 1% of the TEN budget
- A new loan guarantee fund for TEN-T projects, the management of which would be delegated to EIB
- A pure availability payment instrument for PPP projects

4.1.2 At user (market) level

Except for the UK, the market for PPPs was immature at the time the RCF was conceptualised. The ING Baring report concluded that *'the shortage of risk capital will no doubt pose an even more serious threat to development of PPPs in other EU countries where the financial markets lack the depth of the UK market'*.

It was concluded that the UK market stood out as being considerably larger than all other EU markets combined! Therefore the need for a risk capital instrument was considered large in the Commission (DG ECFIN and DG TREN).

At the same time, the number of infrastructure funds in the European market was very limited. As can be seen from Table 4.2, only two funds (Macquarrie and Innisfree I) were established at the time.

On this background it was assessed that *"A scheme providing completion guarantees involving somewhat higher risk than accepted by commercial banks would facilitate the raising of finance for transport infrastructure projects and increase the number of companies able to bid for TEN projects"* (HLG, 1997, p. 15).

As per discussion with several fund managers including Macquarie Infrastructure Group, Barclays Private Equity, Galaxy Fund Managers and Dutch Infrastructure Fund, the evaluation has made the following findings:

- The concept of RCF was and is welcomed by the market. It is generally perceived that the RCF could act as a catalyst for TEN investments, in particular for projects where demand risk was transferred to the equity providers.

- Co-investing with the RCF is considered to provide comfort to other equity providers and lenders.

Since the High-level Group meeting in 1997, a number of new funds have emerged. As shown in Table 4.2 the number has gone up from 2 to at least 12. While none of the funds focus exclusively on infrastructure or TEN-Ts this does nevertheless indicate at an overall level, that for infrastructure as such, there is today more private capital available than was the case in the mid-1990s.

In addition to RCF, the Commission has already initiated the development of other instruments to address barriers to the development of PPP in particular in the member states. For instance, the Commission has recently developed a guarantee instrument to mitigate the risks for private investors. Furthermore, the recent Commission backed launching of JASPERS (Joint Assistance to Support Projects in European Regions) to provide technical assistance for project preparation will ease the burden of the high transaction costs associated with PPPs.

Text box - Joint Assistance to Support Projects in European Regions

JASPERS is a major joint policy initiative of the EIB, European Commission (Regional Policy Directorate-General - DG Regio) and the European Bank for Reconstruction and Development (EBRD).

JASPERS will assist beneficiary countries (principally the new Member States and acceding countries of the EU) to absorb EU Structural and Cohesion Funds over the next budgetary planning period 2007-2013. All assistance will be offered free and without obligation.

The initiative will facilitate the preparation of high-quality projects ensuring optimal economic return in terms of growth and jobs. It will be complementary to the project preparation work carried out by national and local authorities; and, provide upstream technical expertise as required from the early stages of programming and preparation through to the final application and appraisal of the project.

Trans-European networks (TENs) is a key area for JASPERS. Other key areas are

- the transport sector outside of TENs, including rail, river and sea transport
- Inter-modal transport systems and their interoperability
- Management of road and air traffic
- Clean urban and public transport
- The environment, including energy efficiency and renewable energy PPPs

In total, market operators - including national authorities - are in need of support/assurance in order to proceed with investments in large transport projects. Support from guarantee instruments, JASPERS and a facility like the RCF is needed in the market.

4.2 The competition, price and quality

The ability of RCF to operate - and its success - depends on its competitiveness in comparison with other sources of risk capital. Findings concerning this aspect are presented below.

4.2.1 Benchmarking

The last 10 years have seen an emergence of private risk capital facilities, most notably in the past 5 years, alongside with the development of PPP in Europe. These facilities commonly referred to as infrastructure funds are mostly set up by banks for the purpose of investing in PPP projects, in most occasions in the area of transport. Most of these funds have been initiated in the UK, albeit that the most prominent infrastructure investment fund is from Australia, known as the Macquarie Infrastructure Group. In Table 4.1 we present a list of the most eminent infrastructure funds active in Europe.

Table 4.1 Some of the more important infrastructure funds in Europe

Name	Date of origin	Size (in mln €)	Prime Investors	Primary or Secondary	Investments	Committed (in mln €)
Macquarie Infrastructure Group	1996	3,370[10]	Listed	Primary	Toll Roads	3,370
Macquarie Airports		1,061[11]	Listed	Primary	Airports	1,061
Barclays UK Infrastructure Fund	_	290	Barclays	Primary		290
Barclays European Infrastructure Fund	_	258	Barclays	Primary	PPP projects in the UK	N/A
Infrastructure Investors (I^2)	2005	654	Barclays, SG and 3i	Secondary	PPP projects in Europe	N/A
Innisfree Fund I	1996	124	Institutional Investors	Primary	PPP projects in Europe (focus on UK)	124
Innisfree Fund II	1999	218	Institutional Investors	Primary	PPP projects in Europe (focus on UK)	218
Innisfree Fund IIII	2004	524	Institutional Investors	Primary	PPP projects in Europe (focus on UK)	N/A
Innisfree Secundary Fund I	2004	254	Institutional Investors	Secondary	PPP projects in Europe	N/A
South Europe Infrastructure Equity Fund	2006	150	Dexia, EIB	Primary	PPP projects in South Europe	-
Galaxy Fund	2001	250	CDC, KfW	Primary	Transport Infrastructure	-
Dutch Infrastructure Fund	2005	150	Institutional Investors	Primary € 70 mln Secondary € 80 mln	PPP projects in Europe	0
Secondary Market Infrastructure Fund	2001	727	Institutional Investors	Secondary	PPP projects in Europe	414
Total		**7,880**				**-**

While the table indicates the overall amount of risk capital available, it does not, however, indicate how much is available for transport projects or trans-european network projects. Figures on this are not publicly available - funds do not wish to disclose it. Amounts available today are in any case greater than was the case in the mid-1990s, as also substantiated by the following assessment:

As per discussion with Macquarie Infrastructure Group representatives it was stated that their portfolio of funds included the Macquarie European Infrastructure Fund with a capital of approximately €1,5 billion. This fund was almost fully committed. The commitments included approximately 40% for transport infrastructure, although no details could be provided to which extent this related to TEN projects.

[10] Market Capitalisation as per 31 March 2004

[11] Market Capitalisation as per 31 March 2004

It was also stated that Macquarie is in the process of launching a Macquarie European Infrastructure Fund II with a targeted size of €3 to 4 billion. Again no details could be made available on the targeted share for transport infrastructure in general or TEN specifically, but as stated *"if it is an attractive infrastructure asset we are willing to invest in it"*.

As per discussion with Galaxy it was noted that there are more funds expected to come to the market. Most notably are the Goldman Sachs Infrastructure Fund with a targeted size of €3 billion and the ABN AMRO Infrastructure Capital Equity Fund with a targeted size of €1 billion. Most likely these funds are available for both the primary and secondary investments[12]. Again, no details are available on the targeted shares for transport in general or for TEN specifically, though it can be assumed that a fair amount of risk capital is- and will be available on the market for TEN.

To date some €7,9 billion of institutional risk capital has been made available for PPP projects of which €1,7 billion (21%) solely for secondary investments, being investments in operational projects (a secondary investment implies buying equity of an already existing project company). Additional funds are in the process of being launched with an additional total volume of €7 to 8 billion (Goldman Sachs, Macquarie, ABN AMRO).

Also the level of required rates of return cannot be assessed based on publicly available information though as per informal discussion with some of the fund managers, the required rates of return are most likely to be in the range of 12 to 16% pending on the level of risk, and the financial leverage which will be assessed on a case by case basis.

It is to be noted that these funds normally co-aside with equity investments from contractors or operators with a few exceptions (Macquarie does have some 100% ownership structures).

In general, the evaluation finds that there is a large supply of risk capital present on the market today, though funds rarely provide 100% of the required equity and that to a certain extent the capital is already committed.

It is also to be noted that no funds specifically target TEN projects. Most funds are focussed on infrastructure in general including social infrastructure (schools, prisons, hospitals), utilities (water, energy) and transport infrastructure (roads, rail). However, given the accumulated volume of total capital there is a need for a large volume of bankable investment opportunities. Anything that can contribute to increasing the supply of bankable investment opportunities - whether by reducing transaction costs, addressing specific risks that the market has difficulties handling or otherwise leveraging private capital through complementary products - is welcomed by the market.

[12] Funds do not wish to disclose detailed information on this issue.

4.2.2 Comparing RCF with "competitors"

The RCF is aimed at providing funds to infrastructure funds who will invest these funds in projects. As such the RCF is competing with institutional investors for the purpose of obtaining a long-term hedge against inflation, or with private equity providers who are seeking alternative investments for the purpose of risk diversification of their portfolio of investments.

A distinctive difference between RCF and institutional investors is that institutional investors tend to be risk averse. Reviewing the infrastructure funds that are active in the market, the most sought after investments are those where public authorities engage in long-term contracts where the contractor is reimbursed through availability payments. The risk to the equity providers is limited to the construction risk (which is mostly largely transferred to a contractor) and the performance risk (which is mostly largely transferred to a maintenance company). As the availability payments are inflation indexed, these investments are a near perfect hedge for inflation which meets the needs of institutional investors.

Consequently, the fact that RCF targets infrastructure funds limits the investments opportunities of RCF as these infrastructure funds target mostly the availability based contracts which normally occur in governments accommodation projects such as schools, hospitals and prisons.

To date the main infrastructure fund willing to invest in demand risk is the Macquarie Infrastructure Group. They have a global team of about 300 people that seek investments, bid for projects, and manage investments. Galaxy has merely 6 people and is still a key alternative for demand risk transport sector projects, next to regular infrastructure operators and concession companies (e.g. Vinci, Laing, Ballfour Beaty, etc.).

As for the financial conditions the RCF is facing a dilemma. On the one hand the RCF is perceived as a possible catalyst for TEN investments. On the other hand the RCF cannot distort market competition by offering reduced rates.

The financial conditions of the RCF must be market based. Implying that the required rate of return should be based on generally accepted practices for defining these rates. Normally the required rates on return on equity are in the range of 12 to 16% depending on the type of project and the phase of the project.

In total, the evaluation has found that: RCFs "competitive edge" lies in the fact that (i) the involvement of RCF is recognised as providing "encouragement" to other market operators[13]; (ii) RCF is not able to "compete" with private funds regarding financial terms offered; and (iii) the RCF is at a "competitive" dis-advantage in terms of the size of the facility. The evaluation has found that this is generally acknowledged as being much too small. Given the size of the TEN

[13] This finding, however, need to be balanced with the level of awareness about the existence of the RCF (see Ch 4.3).

investments a much larger facility would be needed (interviews with several fund managers including Macquarie Infrastructure Group, Barclays Private Equity, Galaxy Fund Managers and Dutch Infrastructure Fund).

And size does matter - not the least in relation to being visible in the market. Recently, the South European Infrastructure Equity Finance Fund (SEIEF) was launched among others by the EIB. This illustrates how the EIB is able to establish a risk capital instrument, privately managed with sufficient funding to have an impact.

Textbox – South European Infrastructure Equity Finance Fund

Sponsors Dexia and EIB have completed the launch of their SEIEF Fund, a private equity fund targeting medium size investments predominantly in France, Italy, Spain and Portugal.

The SEIEF Fund will be managed by European Public Infrastructure Managers (EPIM), an independent management company, and will seek to exploit investment opportunities in PPPs across Europe[14].

The first closing raised €80m from Dexia and EIB (the largest investors), as well as two other European financial institutions, Banco Sabadell, acting as the Fund's sponsor for Spain, and Banca Popolare di Verona e Novara in Italy. Dexia will continue to provide assistance for the marketing of the Fund to new investors with the objective of increasing the size of the Fund up to €150m within twelve months.

Its typical investment amount will be €5-15 million per transaction. Target investee companies will have total assets in the €80m to €350m range.

The investment instruments offered by SEIEF will include mezzanine, subordinated debt and straight equity investments, with the Fund acting as either majority or minority shareholder.

4.3 Awareness and visibility

RCF and Galaxy Fund are generally not very well known nor visible. The awareness of Galaxy Fund is larger than the awareness of RCF. Thus, a common picture from the interviews is that where people may have heard of Galaxy Fund, very few are aware of the RCF.

Central players (ministries and PPP task forces) and potential customers to RCF report that they had not been aware of RCF prior to our mentioning of the facility.

[14] SEIEF focus on infrastructure in general - although not particularly on transport projects.

A common response is similarly that interviewees believe that RCF and Galaxy Fund is in fact the same thing. Yet other interviewees have indicated that according to their knowledge, RCF was not implemented as of yet.

Interviews with fund managers of Macquarie Infrastructure Group, Barclays Private Equity, Galaxy Fund Managers and Dutch Infrastructure Fund also indicate that RCF has raised none or limited awareness of its existence. Other than Galaxy, fund managers were not aware of the existence of RCF.

Officials in the Commission also see the RCF as having rather limited visibility (interviews, 15 March 2006). According to some officials, RCF lost momentum once it was handed over to EIB in April/May 2002 (interview, 30.03.2006.)

Hence, the problem is very well acknowledged by the Commission. The Commission would have to engage in "better propaganda and network in smaller circuits" than was actually the case with regard to RCF (interview, 6 April 2006). The findings also point to the risk of not promoting the RCF more than has been the case so far: "We may think that the world is waiting for us - forget it!" - "If you just sit and wait nothing happens!" (interviews 6 April, 2006 and 30, March 2006).The financial world does not possess the information concerning such new initiatives. In particular not when they are minor as RCF is, it was expressed (interview, 6 April 2006).

4.4 Management

The findings concerning management are presented as seen from the Commission, the EIB and the Galaxy Fund, respectively.

4.4.1 Assessment at Commission level

The management exercised by the Commission should be split into two parts: (1) the preparatory work leading up to the creation of RCF and, (2) the execution once RCF was put in place.

Findings suggest that the preparatory work done by the Commission in setting up RCF was an important piece of work which opened up the potential of designing a sound financial instrument.

- Creation of RCF was given sufficient priority as indicated by the High Level Working Group.
- The financial outlook in the late 1990s was characterised by a near monopoly in provision of equity, which made the rationale for RCF strong.
- It is key to bear in mind the different conditions prior to the financial bubble in 2001. Thus, financial outlooks were unpredictable under the implementation of RCF.
- Although RCF should be evaluated on its own terms, it is important to emphasise that EU was significantly smaller in mid 1990s and the enlargement made the framework conditions of RCF (cohesion fund, ERDF, EIB instruments) changing in nature.

- The drafting of documents, general preparatory work, contract negotiation with EIB/EIF and so forth was intensive and much energy was put into the process.

The launch of RCF and its implementation has been less systematic and structured. It has been characterised change of administration and change of ownership.

At the time when RCF was supposed to take off there was a change in responsibility in the Commission. "Ownership" to the idea belonged to the people involved in doing the preparatory work - and as been hard to sustain.

There was no 'RCF-event' in which the relevant players in the market (i.a. financial intermediaries) were drawn to the attention of RCF. There was no republication in the Official Journal (OJ) of RCF. It was considered a one-off event with no follow-up.

The existence of a sufficient budget line in order to sustain and support RCF projects is a contested issue among the interviewees. For instance, one interviewee suggests (15 March 2006) that one problem was that there was no budget line for appropriating money. While another interviewee (6 April 2006) suggests that *"there was no political sentiment and aspiration for RCF to flourish!"*

Another contested issue relates to the division of responsibility between different Commission services. One interviewee (6 April, 2006) has expressed the view that it is problematic that RCF is run by DG TREN as it is not the core competence of that unit: the unit has more expertise on transport than financial technicality.

Overall, it is the evaluation finding that ownership and systematic management on the part of the Commission can be improved in future. The Commission management of RCF is one element in explaining the results of the facility to date - although not the most important one.

4.4.2 Assessment at EIB level

EIB holds long and important experience with regards to administering and handling community instruments. Hence, it was only natural for the Commission to cooperate with the EIB on RCF. The cooperation was in fact supported by the ING Barings report which states: "The EIF (read: EIB) has, however, developed expertise to allocate and manage equity investments in venture capital funds for SMEs and is therefore familiar with the process of making indirect equity investments".

At an overall level it has been stated by GF that RCF disbursement procedures are quite efficient and effective and that communication on pending investment opportunities is continuously in place.

EIB manages the RCF according to the RCF Guidelines. Compared to similar funds, there are several areas where the guidelines - and hence the EIB management - can be strengthened:

- With regard to financial conditions, the guidelines do not explicitly require a minimum rate of return. This is contrary to regular (infrastructure) funds, where shareholders are informed about the expected rate of return on their investment. This information is normally presented in the Information Memorandum of a fund or facility.
- The strategy of the facility, i.e. which sectors to invest in, when to exit, in which countries, etc. is not made explicit.
- The exact organisation of the facility is not explicitly explained to the stakeholders. That is names of persons managing the facility, and under which incentives, who operates as investment committee, who manages the investments and so on.
- Financial details of the facility is not explained in any detail, i.e. required investments, estimates of costs of operations, estimates of possible returns.

It has been noted by interviewees that no such information is available for the RCF. The information included in the guidelines concerns primarily the strategy of the facility and the certain extent the organisation of the facility albeit not explicitly in terms of persons, nor is information provided on the management of the investment and the exit strategy. Consequently, there is no complete reference which can be used to monitor and evaluate the performance of the RCF.

Finally, on EIB's management of the RCF, we have found that the EIB has not made any special marketing efforts to make the RCF known among relevant stakeholders. Evaluation findings suggest that RCF is a minor element in the total basket of products with which the EIB deals. Marketing of RCF and RCF products consequently attract minor managerial attention. A point which is supported by several interviewees (16 March, 6 April, 7 April).

In summary on EIB's management of the facility, we have found that a more pro-active role is necessary in the future for the volume of the RCF to grow in terms of funds and projects, and the number of financial intermediaries with which the RCF cooperates.

4.5 Results of RCF

Several stakeholders have repeatedly stated that there is a psychological effect of the existence of RCF in the sense that it makes private investors more confident when the public sector/the Commission is prepared to create financial leverage by taking some of the risks. This effect is definitely a result of RCF although the effects could have been greater if the awareness about the facility's existence had been greater.

Another effect naturally concerns the EUR 3 million actually invested in the A28 project through the Galaxy Fund.

4.5.1 Results specifically related to Galaxy

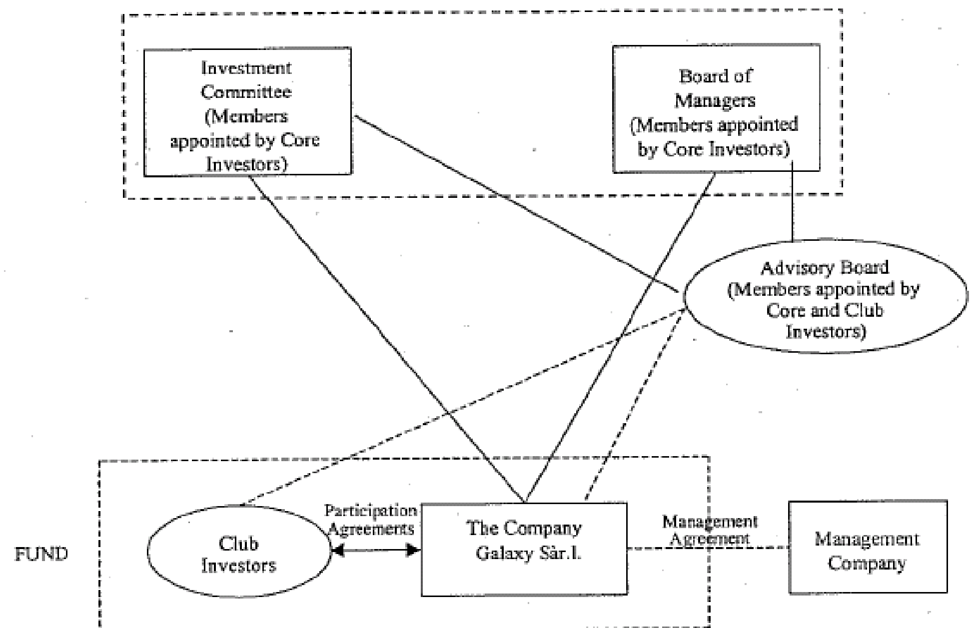
The Galaxy Fund (GF) is a dedicated transportation infrastructure equity fund looking to achieve recurring medium-term and long-term capital appreciation for its shareholders. The fund intends to make direct private equity and quasi-equity investments in a mix of "Greenfield" and "Brownfield" projects.

The Fund invests in four fundamental sectors: roads (motorways, bridges and tunnels), rail (high-speed, light & urban rail, traditional), airports, and seaports. Geographically it has activities in Europe (EU and accession countries) as well as in OECD countries.

The "Core Investors" in GF are: CDC[15], Kreditanstalt für Wiederaufbau (KfW), as well as other European Partners. They participate in all investments and are represented as voting members in the Investment Committee of the Fund.

The investments of the "Club Investors" in the Galaxy Fund are strictly limited to a certain sectoral or geographic focus. They would not be in the Investment Committee, but only in the Advisory Committee of the Fund (see Figure 4.1 below).

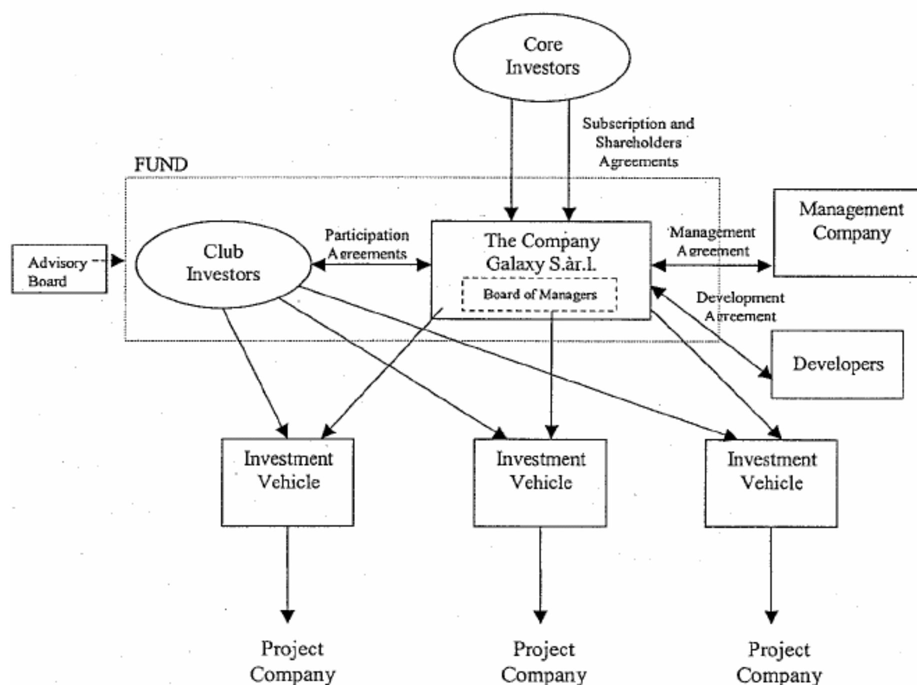
Figure 4.1 Overview of Fund Management



[15] Caisse des Dépôts et Consigations. The CDC is active in investment banking, insurance, engineering and early stage SME finance.

GF is managed by six professionals with a broad background in project financing, mergers and acquisitions, and in infrastructure and the transportation industry. The Management Company (see figure 4.2 below) is responsible for the evaluation, structure and recommendation to the Investment Committee of opportunities to make investments in transportation infrastructure projects.

Figure 4.2 The Structure of the Galaxy Fund



In June 2004, the Galaxy Fund had resources amounting to EUR 250 million, which is also the funds target size. Of the Core Investors, the CDC has invested EUR 100 million, and the KfW has invested EUR 50 million. There were no contractor investors. The Fund plans to invest this amount by 2008. It aims at a 15% return on its equity holdings.

As per the consultant's discussion with Galaxy it was noted that Galaxy is in the process of raising additional funds. It is stated by the quarterly operating and financial report of the first quarter of 2006 that due diligence is ongoing and discussion have been held with Cassa Depositi with the view to join Galaxy for a participation of up to €100 million. Recently, also BGK from Poland joined as core investor.

The termination of the Fund will be 12 years from the Final Closing subject to extension in one-year increments for up to two additional years upon the approval of the Board. However, the term of the Fund shall not exceed 14 years, at which time the Company shall be put into liquidation.

In August 2001, the Galaxy Fund was the first to submit a pipeline of potential projects, including the A28 project in France. The EIB presented the Fund to

the Commission, which was afterwards evaluated in DG ECFIN and DG TREN.

The Galaxy Fund was presented to the TEN-T Committee meeting on 22 January 2002 by the EIB, DG ECFIN and representatives from GF. Following the positive vote of the TEN-T Committee the EIB started negotiations in April 2002 of the budgetary procedure with the Fund. (EIB receives the application from the Fund and thereafter submits a notice containing information about the proposed TEN project to DG ECFIN).

In June 2002 the EIB started final negotiations with the Fund after the Committee had approved the budgetary procedure. The Commission launched an Interservice Consultation in June on the budgetary proposal.

On 30 December 2002 and 29 December 2003 the Commission approved two Decisions granting respectively EUR 7 million and EUR 18 million to co-finance TEN investment and inherent costs for projects managed by the Galaxy Fund in the form of risk capital participation, making the Commission the first Club Investor in GF.

The EIB Participation Agreement between the EIB and the Galaxy Fund was signed on 9 July 2003. According to the agreement, GF will invest in transportation infrastructure projects in the EU countries.

In addition to the project already financed, GF only made 3 formal submissions with specific reference to the fact that a co-investment would be done under the RCF facility. They concern the:

1 Brussels-Zaventem airport raillink
2 Bratislava Airport
3 Diabolo raillink

As stated there were and still are project "opportunities" which Galaxy discusses with the EIB/DG TREN. In the current Pipeline, the following projects are "earmarked" for possible RCF participation:

1 A 28 Equity
2 Enfidah airport in Tunisia (with a special "exemption" from GF's geographic scope)[16]
3 Thessaloniki Tunnel in Greece
4 Cyprus airport
5 La Roda airport (Spain)

The Koper/Trieste rail project (in relation with the two ports) as well as the Perpignan-Figueras rail project, were also discussed with the DG TREN teams[17].

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[16] While this project is mentioned in the GF Pipeline it clearly falls outside the scope of RCF, and will not be eligible for the use of TEN budget funds.

At the moment the Galaxy Fund has several projects in the pipeline[18]. The table below shows the project status divided into sections depending on, when they will be decided upon. There are four pipeline projects to be decided upon within the next 6 months, an additional five projects with a 12 months horizon and six projects with a 18 months horizon.

Active Pipeline to be decided upon within 6 months

Airports	1 project	Cyprus
Rail	2 projects	EU, Belgium
Roads	1 project	France

Active Pipeline to be decided within 12 months

Airports	2 projects	Germany, Spain
Roads	3 projects	France, Global

Other Identified Projects to be decided within 18 months

Airports	1 project	Tunisia
Rail	1 project	UK
Roads	4 projects	Greece, Netherlands, Germany

4.5.2 Effectiveness, Efficiency, Utility, Sustainability and Impact

It may be too early to assess the sustainability and impact of RCF effects. It has been operational for a relatively short period of time, and has so far only been involved in a single TEN-T project. Sustainability and impact can thus better be assessed at an ex-post evaluation stage once the RCF has been given more time to produce results[19].

In terms of utility, the RCF responded to needs identifiable at the time of its conceptualisation and initialisation.

When it comes to effectiveness and efficiency, i.e. the extent to which objectives have been achieved and in a cost-effective way, the assessment is less positive. Objectives have not been met to date. This has to do with two main reasons: (i) given the current financing needs in relation to transport

[17] A new pan-European scheme is under consideration as is the Modalhor concept which is still confidential at this stage. This last project has not yet been discussed with the DG TEN teams but is clearly assessed by the Consultant to be a opportunity for the RCF concept.
[18] Source: Quarterly Operating and Financial Report First Quarter 2006, GF (confidential).
[19] See Ch. 5 and the Executive Summary for our recommendations on how sustainability and impact may be facilitated.

projects, there is less need now for a public risk capital facility with the products that RCF presently offer, and (ii) there has been insufficient promotion of the facility, hence key stakeholders do not know about its existence and products.

With a more concerted effort to promote RCF vis-à-vis contractors and funds that have activities in the transport sector, a higher efficiency and disbursement of more than 3 out 46 MEURO could have been achieved[20].

[20] See Ch. 5 and the Executive Summary for our conclusions and recommendations on how RCF may be revised and streamlined to better meet today's market needs.

5 Conclusions and recommendations

This evaluation has assessed RCF from five analytical perspectives of (1) needs, (2) competition/price/quality, (3) awareness/visibility, (4) management and, (5) results. Conclusions and recommendations are summarised in the following. For a full account of the analyses behind conclusions and recommendations, the reader is referred to the Executive Summary.

5.1 Conclusions

The conclusions are presented under each of the five analytical headings.

Needs

The evaluation concludes that the RCF was devised and created at a time when the need for a financial vehicle of its kind was well identified. It was created as a response to an identified lack of private risk capital for transport projects.

At the same time, the design of RCF was coloured by a political wish to establish a role for the Commission in filling the identified gap.

It is questionable whether the same need still exists today. There are many indications that the market itself is able to supply equity finance support to TEN transport projects - and that there is therefore not presently a need for additional equity capital support.

At the same time the Consultant finds and concludes, however, that RCF may still be necessary - but for somewhat other reasons. Barriers today are the reluctance of national authorities to outsource operations of infrastructure assets, and the limited expertise in the public sector to structure projects and contracts involving private sector financing.

It is therefore an evaluation conclusion that Commission support to a facility like the RCF which can act as a catalyst vis-à-vis national authorities in enabling private financing of infrastructure projects is necessary, and will be welcomed by market actors, including national authorities themselves.

Competition

In 2006 the "environment" in which RCF operates has changed significantly compared to the situation in 1997 when RCF was discussed at the High Level Group meeting on Public-Private partnership Financing of TEN Transport Projects. And that has changed the facility´s competitive situation.

GF is still the only fund with exclusive focus on transport projects. Macquarie is still in the market - although with a smaller market share. But the big change is that there was an influx in 2001 and 2004/2005 of a number of new players. Today, the market in total has diversified and grown substantially. The new players do not focus on transport - but transport projects are still potentially part of their portfolios.

The total volume of risk capital comes close to 16 billion. How much is actually available for transport projects, including TEN projects cannot be assessed as funds do not wish to make this information publicly available. Nevertheless, it seems reasonable to assume that of the total supply of capital, a potential of approximately €2 to 4 billion is likely to be available for transport projects, including TEN projects. This should be compared to RCF with a current potential fund of 46 million.

Hence, RCF is a small player. And the size of RCF may have a negative influence on its visibility in the market - and consequently on its competitiveness and use.

Awareness

A key prerequisite for fulfilling the purpose of RCF is that the facility and its products are sufficiently visible to its potential customers or beneficiaries (i.e. governments and PPP centres in relevant recipient countries, financial intermediaries specialised in infrastructure financing, relevant private sector consortia leaders bidding for PPP projects in infrastructure sectors).

It is a conclusion from the evaluation that there is quite limited awareness about the product among key players. The limited awareness about RCF is in turn caused by inadequate marketing efforts. Inadequate marketing efforts are related to unclear ownership and organisation structure for RCF.

The evaluation shows that for any fund like RCF, pro-active marketing is important and necessary. As for RCF, the market and the market actors have not been made systematically aware of its existence and products.

A marketing strategy has not been developed and the role of marketing the facility has not been specified - or explicitly delegated either to the EIB, the Commission or GF.

Management

The evaluation has been undertaken on the basis that an appropriate management structure is a pre-requisite for facility success. Interviews, desk studies and analyses show that the management set-up of the RCF is clear. RCF is managed by EIB on behalf of the Commission. Investment proposals shall be submitted to the Commission which in turn shall present the proposal to the TEN-T Committee.

While the management procedure is transparent and ensures accountability, it does leave the operational life of RCF somewhat complicated and bureaucratic. Even worse it appears unclear to its customers and intermediaries where to turn, and who to talk to. In a financial market characterised by fierce competition the

evaluator finds that this is likely to cool of the demand for the services provided by the RCF.

As for the capital allocated to GF under the management of EIB, it has been stated by GF that disbursement procedures are quite efficient and effective, and communication on pending investment opportunities continuously takes place.

The EIB is managing the facility on a contractual basis. However, its role has never been fully operationalised in the Guidelines. In addition, management instruments common to comparable funds have not all been instituted in practice. For example,

- With regard to financial conditions, the Guidelines do not explicitly require a minimum rate of return. This is contrary to regular (infrastructure) funds, where shareholders are informed about the expected rate of return on their investment. This information is normally presented in the Information Memorandum of a fund or facility.
- Financial details of the facility are not explained, i.e. required investments, estimates of costs of operations, estimates of possible returns. Also, the strategy of the facility, i.e. which sectors to invest in, when to exit, in which countries, etc. is not made explicit.
- The exact organisation of the facility is not explicitly explained to potential "customers". Information is lacking regarding names of persons managing the facility, and under which incentives, who are on the "investment committee", who manages the investments and so on.
- It is not specified whether a management committee has been established. Or at least, the Consultant has not been able to identify minutes from such meetings, who is in charge of such meetings, setting the agenda, etc.
- The quarterly reports from Galaxy to EIB and from EIB to the Commission have not been completed on a regular basis (or at least they have not been available from the files).
- Both DG TREN and DG ECFIN have a role vis-à-vis the RCF. The exact roles and responsibilities of the respective DGs are, however, not clear. And there is in practice no network between the responsible desk-officers in the respective organisations.

While above-mentioned requirements may seem overly ambitious and somewhat bureaucratic considering the size of the facility, the Consultant maintains that the requirements are still appropriate for ensuring a successful management and implementation of the facility.

Results

The last analytical dimension is results. To date use of RCF has been limited, hence results are also limited. Of the 46 MEURO potentially budgeted for the RCF, 25 MEURO have in fact been committed in two tranches to the EIB and GF. Of the 25 MEURO, 3 MEURO have been spent. Reasons for the results are a complex mix of changes in needs and competition, and marketing and management efforts, explained above the respective four analytical headings.

5.2 Recommendations

Given the current needs identified by the evaluation it is recommended to continue to make risk capital available for TEN-T projects in order to support the development of PPP's for these projects. It is also recommended to increase the available volume of risk capital in order to have a significant impact.

Given the competition, it is recommended to redefine the product offering and differentiate them from the private risk capital providers. Possible options are:

- Position the RCF as a public risk capital provider. We recommend to target contracting authorities directly rather than infrastructure funds. The contracting authority could tender the project with already a part of the necessary equity committed by the RCF. This would make the RCF available to all bidders and ensure a level playing field.

- Make the terms of the RCF more attractive e.g. offering reduced rates of return, last right of withdrawal, free of charge technical assistance in bid preparation, subject to the condition that state aid regulations - and non-distortive requirements - are not being violated.

- Offering the product in combination with the other instruments available to the Commission. The guarantee instrument and/or JASPERS are likely to provide synergy and provide a combined vehicle for getting PPP for TEN-T off the ground.

Given the limited awareness and current management structure it is recommended to renegotiate the terms of the agreement with the EIB as being the current manager of the facility and incorporate adequate incentives for marketing the facility. Alternatively, the Commission and the TEN Committee should consider tendering the management of the facility to a private fund manager.
Given the limited use of the capital committed to GF it is recommended to renegotiate the agreement with GF incorporating a deadline e.g. 2 years for full utilization of the amount committed. This will enhance the incentive for GF to make use of the remaining budget.

Irrespective of the decision concerning the overall management of RCF, detailed management procedures need to be re-designed, streamlined, and made operational in practice. Including clear specifications of roles and responsibilities concerning (i) marketing, (ii) development of an Information Memorandum on financial conditions, required minimum rate of return, etc, (iii) the development of a strategy, i.e. which sectors to invest in, when to exit, in which countries, etc., (iv) development of transparent information concerning names of persons managing the facility, and under which incentives, who operates as investment committee, who manages the investments, etc., (v) develop publicly available information on required investments, estimates of costs of operations, estimates of possible returns, and (vi) produce the required quarterly and other reports.