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EUROPEAN INTERNATIONAL CONTRACTORS

Proposal by European International Contractors (EIC) for a modified EU-Africa Infrastructure Trust Fund (*"ITF Blending 2.0"*)

An innovative blending proposal to catalyse additional private sector finance resources through a mixed credit scheme for public infrastructure in Africa

I. About EIC

European International Contractors (EIC) is an industry federation that represents the **international interests of the European construction industry** vis-à-vis EU policy makers and international financial institutions. Its full members are construction federations from 15 European countries and, in 2013, the internationally active member companies associated with EIC's members recorded an international construction turnover of around €163 billion, of which around €15 billion were generated in Africa.

II. Commercial Background of the EIC Proposal

- Whilst **infrastructure is critical** for achieving the Post-2015 Sustainable Development Goals, Africa faces an **annual financing gap in the infrastructure sector of around US$ 30 billion**. African Government's own funds, development finance from multilateral and bilateral donors are insufficient to finance the growing infrastructure needs of Africa.
- Whereas **Chinese lending to Africa's infrastructure sector** amounted in 2013 to a total of **US$ 13.4 billion** – of which almost US$ 10 billion were committed to transport projects – the **EU's related development aid** is stagnating at **less than US$ 8 billion** with around half being committed to energy projects. Whereas European funds are untied and thus accessible to Chinese firms, **Chinese funds are tied to Chinese contractors** and inaccessible for Europeans. This causes an **"unfair" competition**, in particular in the transport sector, in Africa (cf. *Graph 1*).

III. The EU Blending Agenda and the Average Leverage Ratio

- In order to increase the impact of the EU development aid, the European Commission and EU Member States have set up **regional blending facilities** and have **allocated more than €2 billion** to them since the year 2007. The eligible Development Finance Institutions (DFIs) identify projects and apply for EU grants that can be disbursed in various forms, such as Technical Assistance, Direct Grant, Interest Rate Subsidy, Risk Capital or Guarantee.
- The cumulative total of grant operations approved by the **EU-Africa Infrastructure Trust Fund (ITF)** stood by the end of 2014 at **€557 million** (€428 million under the regional envelope and €129 million under the new "SE4ALL" envelope). The cost of ITF supported projects in their investment phase is currently estimated at €6.2 billion, which is **13.5 times the volume of ITF grant support** (cf. *Graph 2*). However, **only a very small fraction of catalysed finance in Africa was attracted as additional finance from non-developmental sources** whilst the bulk of the leveraged from funds which were earmarked for developmental purposes anyway.
- On this note, the **European Court of Auditors** has observed in its Special Report No. 16/2014 dated 22 October 2014 concerning the effectiveness of the regional EU Blending Facilities that *"in half of the cases,… there was* ***no convincing analysis*** *to show that a* ***grant was necessary for the*** [public] ***financial institutions to contract the loans****"*.
- Still, the European Commission attaches great importance to providing evidence that it generates a high leverage factor with its grant money. Whilst the **leverage factor evidently varies** with the sector, the country and the form of cooperation, its **high level is depending on the cooperation with DFIs whose funds are provided by EU Member States**. i.e. the public sector.
- In the **"Agenda for Change of EU Development Policy"**, dated 13 October 2011, the EU has recognised the need to *"develop* ***new ways of engaging with the private sector*** *with a view to...* ***catalyse public-private partnerships and private investment****"*. Unless, however, donors are prepared to provide a comparably **high level of subsidies**, there are certain constraints for **public-private partnerships in the infrastructure sector in Africa** (cf. *Graph 3*). In other words: The average leverage ratio of the Blending Facility for Africa would certainly diminish if catalysation of additional private finance resources was to become a main objective.

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IV. Innovative blending concept to catalyse commercial finance, covered by export credit insurance, for public infrastructure projects in Africa ("ITF Blending 2.0")

- Evidently, **not many infrastructure projects in Africa can be structured as PPP or concession**, and this is particularly true for the **transport sector**. Therefore, EIC has elaborated a specific proposal for typical public transport sector projects, which are "non-commercially viable". EIC's proposal builds upon the existing EU-Africa ITF instrument ("ITF Blending 1.0") and proposes to **catalyse for public infrastructure projects in Africa additional sources of finance** beyond the development finance community ("ITF Blending 2.0").
- EIC's innovative "ITF Blending 2.0" concept consists of (1) **EU grants** to subsidise interest rates for (2) **concessional development loans** arranged by ITF Lead Financiers which are (3) **syndicated amongst commercial banks** to the extent that commercial bank finance can be guaranteed by **comprehensive insurance cover from participating ECAs**, for which ECAs will charge a premium to adequately cover the assumed risks (cf. *Graph 4*).
- "ITF Blending 2.0" would **catalyse additional private sector finance for typical so-called "commercially non-viable" public sector infrastructure projects** that do *not* generate sufficient direct project income, but are **critical for social and economic development of the country** (e.g. transport, roads, bridges, railways, drinking water & sanitation, ports, regional airports, health and education). "Commercially viable" infrastructure projects, by contrast, would be structured as Public-Private Partnerships or concessions.
- The **borrower** of the "ITF Blending 2.0" concessional development loan would be an **African government**.
- "ITF Blending 2.0" projects would have to meet all **environmental, ethical, financial and social standards of the European Union and the OECD**. These EU and OECD sustainability standards would also be **incorporated in the tender documents** in the form of strict eligibility criteria concerning sustainable business practices in order to ensure that the highest standards and practices are applied on the project.

V. The Benefits of "ITF Blending 2.0" for the various stakeholders

- For *African governments*: By tapping the potential of the ECAs, "ITF Blending 2.0" would substantially **increase the availability of finance** for strategically **important public sector infrastructure projects** in Africa.
- For *the European Union*: By tapping the potential of ECAs, EU Institutions and Member States could collectively **increase EU development finance for Africa** and **substantially improve the EU aid efficiency, effectiveness and visibility in Africa**, even in times of declining EU development aid budgets.
- For *European Development Finance Institutions (DFIs)*: A closer collaboration with ECAs would allow European Development Finance Institutions to **draw on additional financial resources beyond development budgets**. Such collaboration is already standard practice with regard to the Chinese-administered infrastructure investments in Africa, which normally do not qualify as Official Development Aid according to the criteria of traditional donors, and would thus **level the playing field** on the financing side.
- For *European Export Credit Agencies (ECAs)*: European ECAs would be able to **increase their business portfolio in the infrastructure sector in Africa** because coverage in connection with "ITF Blending 2.0" would not be constrained by the rules of the "OECD Consensus", for instance in relations to "local costs".
- For *the European construction industry*: "ITF Blending 2.0" would support the European construction industry internationally by **structuring competitive concessional finance packages for public sector infrastructure projects in Africa**. It would create a **level playing field for European international contractors** with non-OECD competitors.
- For *the European economy as a whole*: The key driver to get out of the current economic crisis within the EU is **exports to developing countries**. A $ 1 increase in investments in developing countries is likely to be associated with a $ 0.35 increase of exports from high-income countries including the EU.
- For *sustainable development as a whole*: "ITF Blending 2.0" will contribute to sustainable development because the tender procedure guarantees that the **highest sustainability criteria will apply.** In addition, "ITF Blending 2.0" creates a **strong incentive** for non-OECD countries to join the OECD and/or to **adopt OECD-DAC and export credit standards**.

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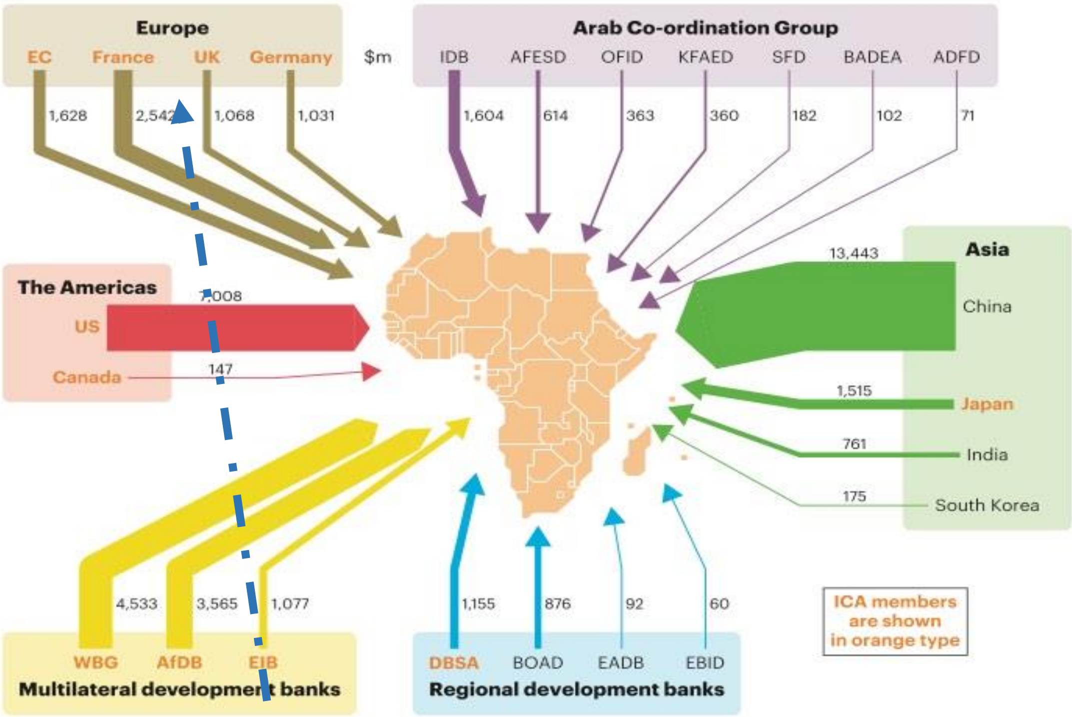
Background information and illustration of EIC's "ITF Blending 2.0" proposal for a better collaboration between the EU Commission (DG DEVCO), ITF Lead Financiers, commercial banks and EU Export Credit Agencies

Graph 1: External Financiers of Africa's infrastructure in 2013



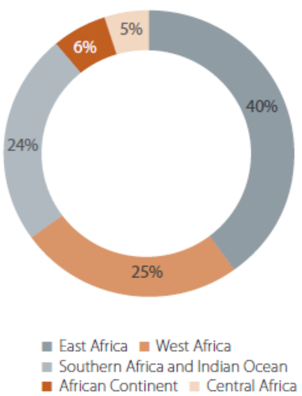
Graph 2: The EU-Africa Infrastructure Trust Fund at a glance (as at December 2014)

EU-AITF facts, figures and results since launch

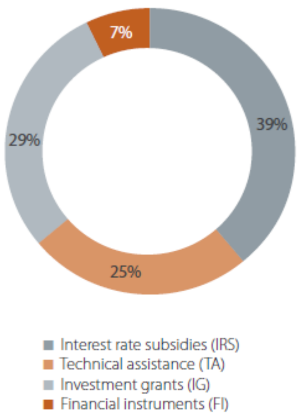
As at December 2014, the cumulative total of grant operations approved by the EU-AITF stood at EUR 557.1m – EUR 428.1m under the regional envelope (since 2007) and EUR 129m under the SE4ALL envelope (since July 2013).

The cost of EU-AITF supported projects in their investment phase is currently estimated at EUR 6.2bn, which is 13.5 times the volume of EU-AITF grant support.

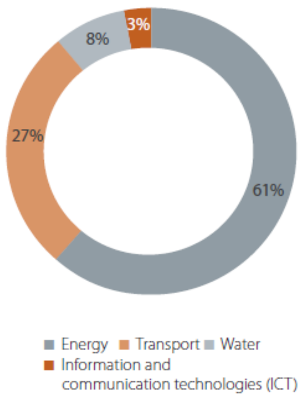
Breakdown by region:



Breakdown by type of grant:



Breakdown by sector:



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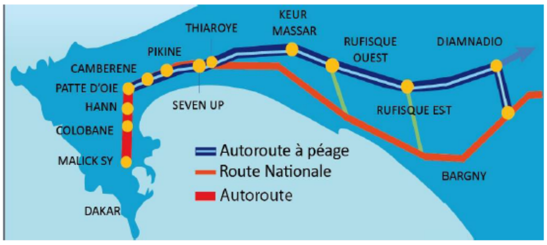
Graph 3: Structure of an Infrastructure PPP in Africa (Level of subsidies = 58%)

Transport Infrastructure PPPs in Africa

The *"Dakar-Diamniadio Tollroad"* project in Senegal shows that **Transport PPPs** in Africa are generally possible but become **"commercially viable"** only after the injection of **high subsidies** up-front (58%).



USES & SOURCES of funds	million FCFA	million EUR	%
Capex	127 279	194,0	87%
SPV & other costs	13 468	20,5	9%
Financing costs	4 154	6,3	3%
Reserve account	1 898	2,9	1%
Total Uses	146 799	223,8	100%
Subsidy	85 588	130,5	58%
Senior & Subordinated debt	40 370	61,5	28%
Equity	20 841	31,8	14%
Total Sources	146 799	223,8	100%

50% EUR and 50% CFA lending:

International Finance Corporation (IFC)
=> EUR 21 million in senior and subordinated LT debt

African Development Bank (AfDB)
=> EUR 10.5 million in senior LT debt

West African Development Bank (BOAD)
=> FCFA 15 billion in senior LT debt (~22.9 EUR m)

CBAO, a leading Senegalese commercial bank
=> FCFA 5 billion in senior LT debt (~7.6 EUR m)

Graph 4: Structure of EIC's "ITF Blending 2.0" proposal

Structure for "ITF Blending 2.0"

A/B Loan structure with involvement of DFI syndicating part of the loan to commercial bank, to the extent that it can be covered by ECAs

1. EU ODA subsidies to ITF
2. ITF Interest rate subsidy (IRS) to EU DFI
3. EU ECA insurance for DFI and participating banks
4. B-loan syndication to participating banks + distribution of ITF IRS (active catalysation role of DFI)
5. A/B concessional loan to African sovereign
6. Direct payments out of A/B concessional loan to construction companies
7. Construction contract for infrastructure project