European Investment Bank

An outline guide to Project Bonds Credit Enhancement and the Project Bond Initiative

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<u>Note</u>

This document is to provide a general outline of how it is currently contemplated that the Project Bond Initiative and Project Bonds Credit Enhancement (PBCE) will work. This document is for information purposes only; the terms and conditions of any PBCE may vary substantially from those set out herein. Furthermore, these general terms do not constitute a commitment or undertaking by either the EIB or the European Commission in respect of any PBCE transaction. Any such commitment would require, amongst other things, prior approval from the governing bodies of the EIB. Interested parties are invited to contact EIB for further information at ProjectBonds@eib.org

Acronyms used in this publication

BAFO: Best And Final Offer

BLCR: Bond Life Cover Ratio

CEF: Connecting Europe Facility

DSCR: Debt Service Cover Ratio

EIB: European Investment Bank

EC: European Commission

EU: European Union

ICT: Information and Communication Technology

LTA: Lenders Technical Advisor

OJEU: Official Journal of The European Union

PBCE: Project Bonds Credit Enhancement

TEN-T: Trans-European Transport Network

TEN-E: Trans-European Energy Network

Contents

Section 1: Introduction

> *"An EU initiative to support project bonds, together with the EIB, would help address the needs for investment in large EU infrastructure projects"*
>
> J.M. Barroso, President of the European Commission, "State of the Union" speech 2010

The European Union's "2020 Objectives" foresee the need for investments totalling EUR 2 trillion in the transport, energy and information and communication technology sectors.

This instrument is to be delivered in a challenging financial environment. The debt markets are still being used for project finance transactions. However pressure on banks' balance sheets from higher regulatory capital requirements has constrained bank long-tenor lending. In addition, bond issues have become difficult to achieve since 2007/8 as the monoline insurers (who previously guaranteed bonds issued by project companies) have become significantly less active. In the absence of the monolines, European project finance transactions have not been structured with bond issuances, due in part to bond investors being hesitant so far to invest in the low BBB range, partly in light of their own regulatory requirements (e.g. Solvency II). This is the credit rating that would typically be obtained by a traditionally structured project finance transaction without the benefit of further credit enhancement.

Since 2010, the European Investment Bank (EIB) and the European Commission (EC) have been engaged in an extensive consultation exercise to develop new financing products to respond to this funding gap.

The "Project Bond Initiative" (PBI) is the EIB and Commission's response to this challenge. The EIB and EC are confident that the credit enhancement offered through the PBI will facilitate investment by institutional investors such as pension funds and insurance companies. For these investors, project bonds whose credit ratings have been enhanced through the PBI may represent a natural match for their long-term obligations.

What are the key characteristics of an infrastructure asset?

Infrastructure investments tend to have the following characteristics:

- Essential services for the majority of the population and businesses, either relating to physical flows in the real economy (i.e. transport, energy, broadband) or to social goods (education, healthcare);
- Government either as a direct client (via fixed term concession) or highly proximate to the transaction (through economic regulation);
- Long term in nature (thus requiring long term finance);
- Stable cash flows, particularly where payments are based on availability rather than demand (which is often beyond the control of a given project); charges may be linked fully or partially to inflation;
- Natural monopolies, either due to network characteristics/capital intensity or government policy; and
- Generally low technological risk.

These characteristics mean that infrastructure businesses can generally support high leverage on a long term basis with returns that are less volatile than other investments. Some investors do not consider infrastructure a separate asset class; others consider it an alternative to (say) covered bonds or sovereign debt.

How will the PBI work?

Under the Project Bond Initiative, the EIB will be able to provide eligible infrastructure projects with PBCE in the form of a subordinated instrument – either a loan or contingent facility – to support senior project bonds issued by a project company (Senior Bonds). The core benefit of PBCE as described in this document is the enhancement it brings to the credit ratings of the Senior Bonds. The ultimate objective is to widen access to sources of finance and to minimise overall funding costs.

PBCE brings additional depth to the infrastructure mezzanine finance market and, particularly in its unfunded form, an innovative approach to credit enhancing infrastructure transactions in a straightforward manner.

These principles will be tested in the Pilot Phase of the PBI which will run until 2016.

Eligible projects

The Pilot Phase of the Project Bond Initiative is targeted at projects in the areas of trans-European networks of transport (TEN-T), energy (TEN-E), and broadband / information and communication technology (ICT).

The purpose of the Pilot Phase is to test the PBCE concept during the remaining period of the current multi-annual financial framework (2007-2013), before the next multi-annual financial framework (2014-2020) and the proposed implementation of the Connecting Europe Facility (CEF).

This testing phase will be supported by the redeployment of EUR 230 million of unused EU budgetary resources from existing programmes. The sectorial split will be as follows: EUR 200 million and EUR 10 million will be dedicated to trans-European networks in the fields of transport and energy respectively; EUR 20 million will be dedicated to financing high-speed broadband projects.

The EIB calculates that this EUR 230 million of EU funds, acting as a first loss piece, could enable EIB to provide around EUR 750 million of PBCE. This could leverage financing to infrastructure projects, on a portfolio of PBCE transactions, worth more than EUR 4 billion across the three sectors.

- One of the objectives of PBCE is to increase the flow of projects that are suitable for capital markets financing and so broaden the infrastructure investor base. The EIB's longer-term objective of the PBI are to: mobilise capital market Investment in Infrastructure projects
- radically reduce the cost whilst increasing the tenor and liquidity of infrastructure finance
- greatly increase infrastructure financing capacity throughout the European Union as a whole
- address the paucity of junior funding available in the market
- improve the capital markets by establishing tradable infrastructure project bonds that will enable investors to invest in Infrastructure as an asset class

Process

During the Pilot Phase EIB will work with the public sector body responsible for procuring projects (Procuring Authorities) and bidders/sponsors to finance eligible projects that incorporate PBCE in the overall funding structure.

To be eligible for consideration projects need to be capable of reaching financial close before the end of 2016. The EIB Board of Directors will need to have approved the project before the end of 2014.

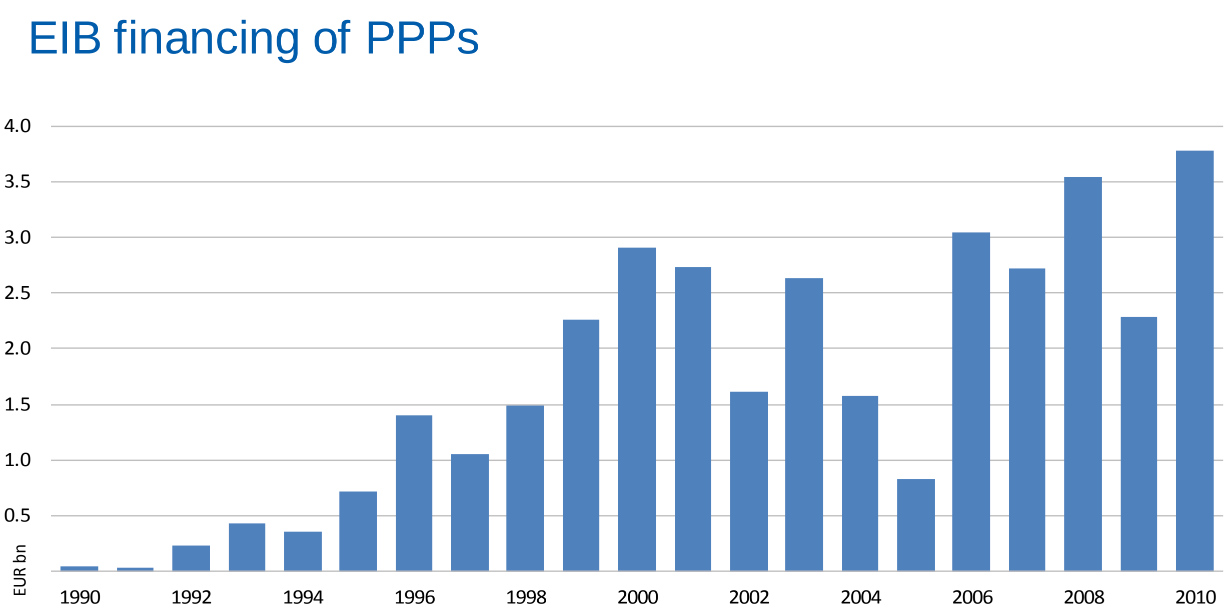
EIB will engage with multiple bidders from the outset rather than engaging only with the preferred bidder. This means that bids incorporating PBCE facilities will have been analysed and evaluated by the EIB's technical and financial teams before submission to Procuring Authorities. The early involvement of the EIB will enable bidders to submit offers based on robust assumptions and including the EIB's terms and conditions for PBCE. In addition, it should give Procuring Authorities and Senior Bond investors greater confidence in the final rating achievable by the Senior Bonds. Because the EIB will have analysed all bids which incorporate project bonds as a financing solution, Procuring Authorities will be in a position to make objective comparisons between them.

EIB should be involved at an early stage of transactions because:

- Credit quality is a key aspect of bids and should therefore be considered at the evaluation stage (while there is still competitive tension) for both procurement and commercial reasons;
- In recent years Procuring Authorities have not had the requirement to evaluate project bond structures. This also means that bidders have generally not invested the resources to develop project bonds solutions. Both parties will benefit from EIB's resources and understanding of the process; and
- Many institutional investors have not established in-house infrastructure teams, either due to irregular transaction flow or (previously) because project evaluation has been effectively outsourced to the monoline insurers. PBCE will not eliminate the need for investor diligence but it should help to increase the flow of Senior Bonds and give investors greater confidence in the existence of a sustainable pipeline of transactions, and also (where possible) to simplify and standardise project structures.

The EIB and PPPs

The EIB has long-standing experience in the analysis and successful closing of infrastructure Public Private Partnerships (PPPs). Since 1990 the EIB has progressively broadened the geographic and sectorial spread of its PPP lending and is now one of the major funders of projects in Europe with a portfolio of 130 projects and investment of around EUR 30 billion.



The EIB also has a track record in developing new products which have demonstrably met infrastructure market requirements The Loan Guarantee Instrument for Trans-European Transport Network Projects (LGTT) and the Risk Sharing Financial Facility are examples[1].

Procuring Authorities, bidders and investors can have confidence that the EIB will be able to combine its in-house financial, technical and economic expertise across all sectors to analyse proposed financing

[1] http://www.eib.org/about/documents/lgtt-fact-sheet.htm?lang=-en and http://www.eib.org/products/rsff/financing-products/index.htm

structures in a robust and timely way. All parties can also be confident that the projects approved by EIB comply with EU procurement, environmental, social and economic standards and objectives.

In addition, the EIB carries a AAA rating. It is important that investors have confidence in the credit quality of an entity providing PBCE to support the project.

Purpose of this document and contacts

This document provides Procuring Authorities, bidders and investors with a general overview of the PBCE credit enhancement products. Section 2 sets out in detail how the PBCE products are structured; Section 3 sets out the roles of stakeholders.

Procuring Authorities, bidders and/or investors who wish to approach the EIB for consideration of a project which may benefit of PBCE are invited to contact **projectbonds@eib.org**.

Section 2: Description of the Project Bond Credit Enhancement Facility

The first part of this Section describes in general terms how it is contemplated the PBCE will work.

This is followed by descriptions of core eligibility criteria with which all projects will need to comply and of the summary terms and conditions expected to be attached to EIB's participation.

How will EIB's Project Bond Credit Enhancement (PBCE) work?

The 2020 Project Bond Initiative aims to provide partial credit enhancement to projects in order to attract capital market investors.

The mechanism of improving the credit standing of projects relies on the capacity to separate the debt of the project company into senior and subordinated tranches. EIB will provide a subordinated tranche, or facility, to enhance the credit quality of the Senior Bonds, and therefore increase their credit rating.

PBCE will provide this credit-enhancing subordinated tranche in one of two ways:

- a loan given to the project company from the outset (**funded** PBCE); or

- by way of a contingent credit line which can be drawn if the cash flows generated by the project are not sufficient to ensure Senior Bond debt service or to cover construction costs overruns (**unfunded** PBCE).

The primary purpose of PBCE is to credit enhance Senior Bonds. PBCE will be available during the lifetime of the project, including the construction phase.

In the past, the credit rating of senior project bonds has sometimes been enhanced through a guarantee issued by a monoline insurance company (a "monoline wrap"). However, the mechanism of PBCE differs from a monoline wrap in several ways:

i) PBCE is not a guarantee that covers the entire amount of the Senior Bond; rather it is limited in amount from the outset. The maximum size of PBCE available for a single transaction will be the lower of EUR 200 million or 20% of the nominal of credit enhanced Senior Bonds. In some cases, it will be less than these limits;

ii) as a subordinated instrument PBCE is designed to increase the credit rating of the Senior Bonds, not to extend the EIB's AAA credit rating to the project;

IT is important to note that:

a) PBCE will only target a limited sector coverage;

b) PBCE projects will need to meet EIB's normal eligibility criteria. A description of EIB's process for determining eligibility is annexed.

What are the core requirements for an eligible project?

The Project Bond Initiative is targeted at projects in the areas of trans-European networks of transport (TEN-T) and energy (TEN-E), as well as broadband and information and communication technology (ICT).

The following general conditions will also apply:

Requires bond market infrastructure
PBCE is available to bond-financed transactions and not to bank-financed transactions.

Bond financed transactions typically require financial infrastructure such as rating agency coverage, suitable legal precedents/frameworks, bond trustees and funded pension plans (either public or private) which are permitted to invest in securities other than more limited debt classes such as sovereign debt.

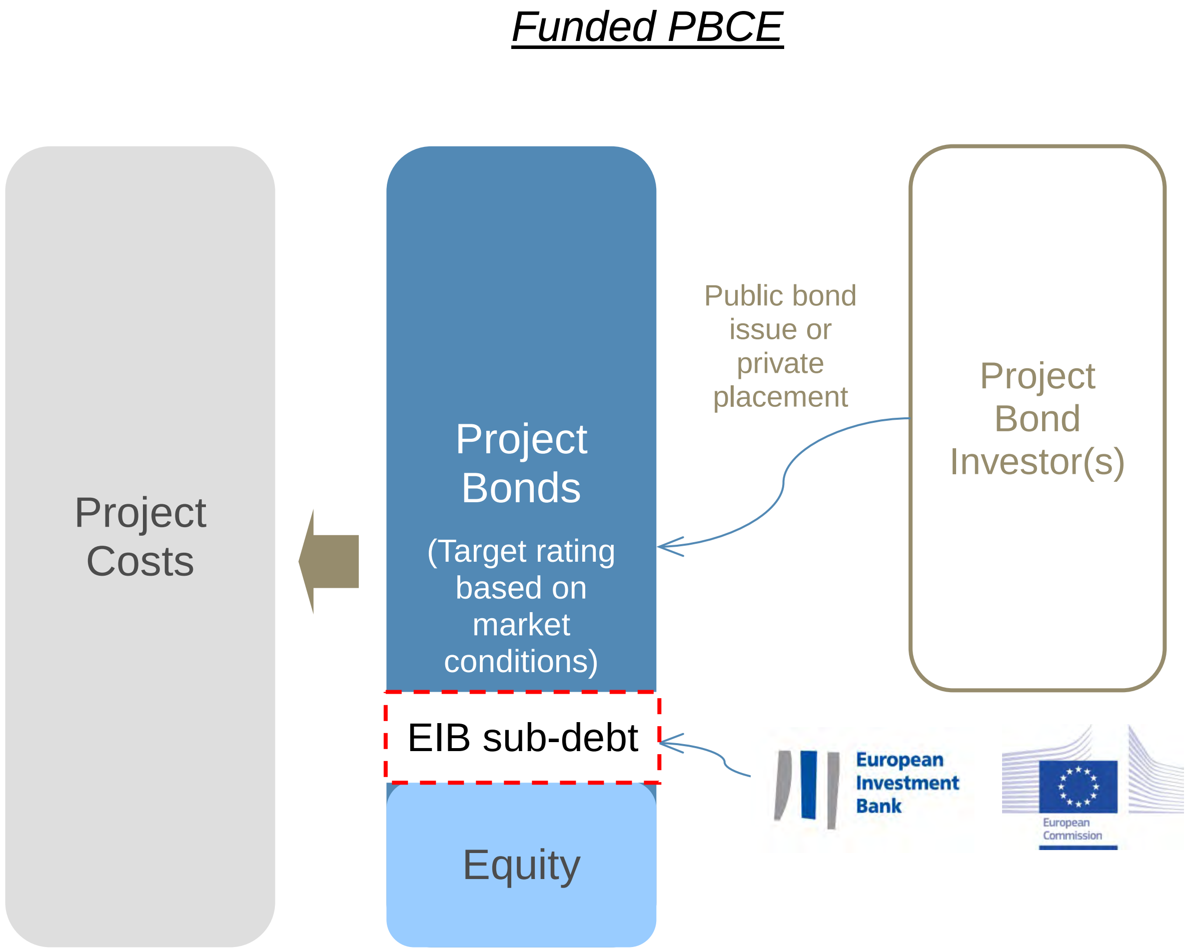
Requires Ring Fenced Assets
A core requirement of the PBI is that the support of the initiative is directed towards developing specific eligible infrastructure assets rather than merely supporting corporate balance sheets. Consequently, the initiative requires that eligible assets are ring fenced. The costs and revenues of these assets are segregated from other assets and liabilities of the Promoter. Whilst a range of security structures can be considered, the repayment of the Projects Bonds and PBCE facility will typically be determined by the performance of the ring fenced assets.

Robust project prior to PBCE
EIB will require the project (i.e. before PBCE is taken into account) have a robust (“bankable”) financial structure. The required credit rating of the Senior Bonds after PBCE is taken into account will be a function of investor demand and regulatory frameworks in each country. It is expected that Procuring Authorities will consider the overall costs and benefits of structuring a project to various rating levels.
No minimum project size, but investors may need critical mass

There is no minimum capital value threshold for PBCE projects. Whilst public bonds have traditionally been used for larger infrastructure transactions, private placements have been used for smaller transactions. The use of PBCE can be considered for the credit enhancement of either public bonds or private placements.

Detailed description of the funded and unfunded PBCE facilities:

There are two variants of PBCE, funded and unfunded, each of which is described in general terms below:



Funded PBCE - example[2]:

Sources of funds:	***Without EIB funded PBCE (EUR m)***	***With EIB funded PBCE (EUR m)***
Senior Bond	*100*	*83.3*
Funded PBCE facility (subordinated)	*0*	*16.7*
Equity	*20*	*20*
Total sources of funds	***120***	***120***

In the example above the EIB provides funded PBCE in the form of a subordinated tranche at the maximum permitted level of 20% of total credit enhanced Senior Bond.

Positive impacts for Senior Bondholders include:

[2] Source: *Moody's Special Comment on the Europe 2020 Project Bond Initiative 28 June 2011, available on-line at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_133841.*

- *substantial mitigation of loss given default during both construction and operation as the amount of the Senior Bond drawn down / outstanding will be lower and EIB will be subordinated to the Senior Bondholders in terms of repayment priority;*

- *enhancement of Senior Bond debt service cover ratios.*

Funded PBCE is similar to typical infrastructure mezzanine finance. This is used with other financing to fund construction and other project costs, and then repaid during the operations phase.

In terms of repayment priority, such finance ranks below the Senior Bond but ahead of the remaining risk capital of the project (generally subordinated debt and/or ordinary share capital but also potentially contingent equity). Under PBCE, it is expected that EIB will have no right to convert unpaid mezzanine into equity (please see the Repayment section below for details of underlying repayment timings).

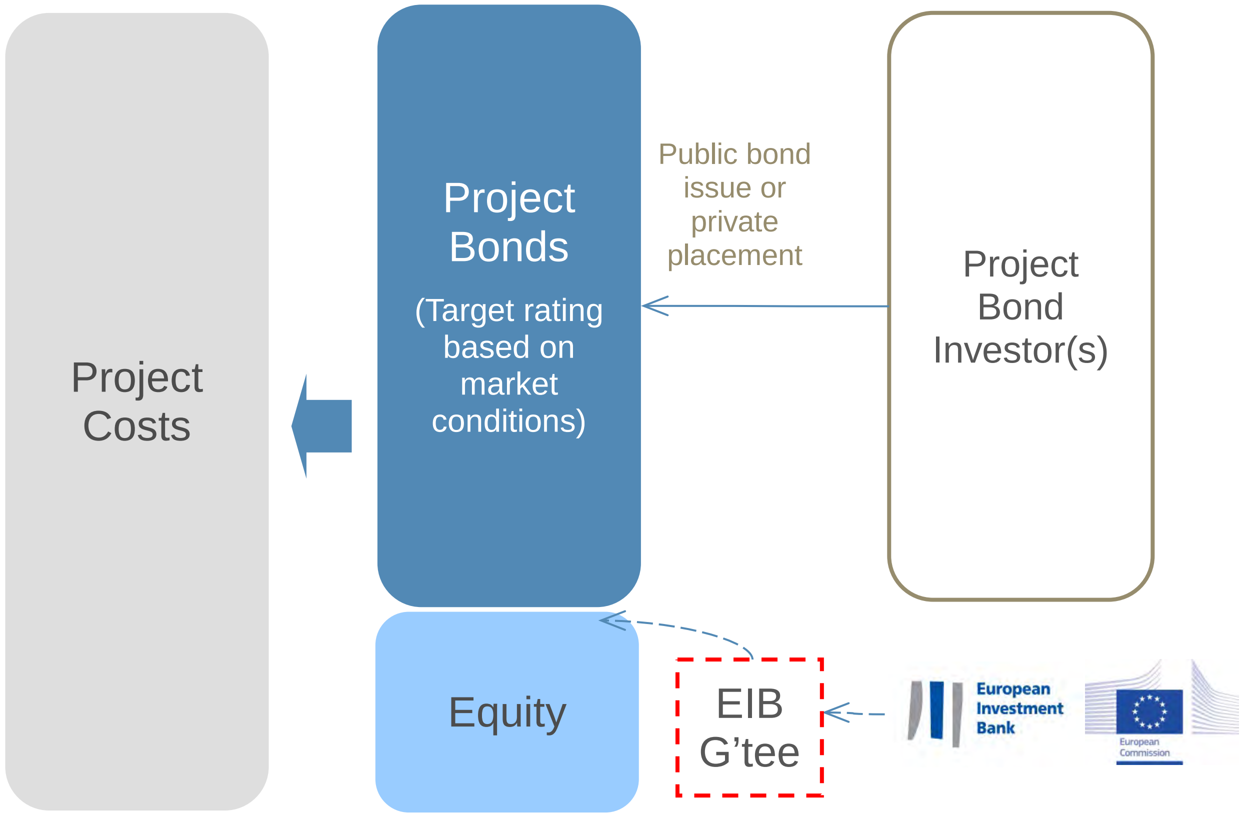
From the perspective of senior investors, funded PBCE will therefore act as a “first loss piece”[3] during both construction and operation and hence improve the credit quality of Senior Bond.

Funded PBCE will therefore generally reduce the probability of default during the operations phase. However, as the mezzanine proceeds are a source of funds used to cover eligible project costs in the base case, funded mezzanine finance will generally not improve probability of default during the construction phase to the same degree as providing an additional junior finance facility[4]- the unfunded PBCE.

[3] I If the project’s cash flow falls short in the operations phase, the mezzanine lenders would not be paid at all before the senior lenders experience any non-payment. Therefore, if the reduction in net cash flow is less than the sum of the mezzanine debt sevice and the anticipated risk capital distributions, the shortfall will not result in non-payment of the senior bond.

[4] There is however a degree of enhancement that does arise from the ability to lock-up debt service on the mezzanine finance.

Unfunded PBCE



Unfunded PBCE - example[5]:

Sources of funds:	***Without EIB unfunded PBCE (EUR m)***	***With EIB unfunded PBCE (EUR m)***
Senior Bond	*100*	*100*
Equity	*20*	*20*
Sub-total	***120***	***120***
Unfunded PBCE facility (Letter of Credit)	*0*	*20*
Total available funding	***120***	***140***

In this example the EIB provides unfunded PBCE in the form of a Letter of Credit at the maximum permitted level of 20% of total credit enhanced Senior Bond which may be drawn on occurrence of a Permitted Event (cash shortfall during construction, debt service shortfall post-completion and to pay any shortfall in amounts due on acceleration of the Senior Bond – see below for detailed explanation).

Positive impacts for Senior Bondholders include:

[5] Source: *Moody's Special Comment on the Europe 2020 Project Bond Initiative 28 June 2011, available on-line at* http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_133841

- *reduction in the probability of Senior Bond default as unfunded facility will mitigate risk in the event of cash flow shortfall; as the facility is revolving, amounts drawn and subsequently repaid will be available for redrawing;*
- *substantial mitigation of loss given default during both construction and operation as the EIB will be subordinated to the Senior Bondholders in terms of repayment priority (should amounts be outstanding under the Letter of Credit).*

In this version of PBCE, rather than funding a mezzanine debt tranche, the EIB will provide a long-term, irrevocable and revolving letter of credit ("Letter of Credit") to the project, the benefit of which will be assigned to the trustee for the Senior Bonds[6].

This Letter of Credit will act as a contingent credit line which can be drawn if cash flows generated by the project are not sufficient to achieve construction completion and/or ensure Senior Bond debt service.

In the event that the project runs into difficulties and the credit line is drawn, the EIB will inject funds under the Letter of Credit. This will create a mezzanine instrument broadly similar to funded PBCE as described above. However, the mezzanine loan only arises when the project risk occurs, not before.

Unlike traditional letters of credit, the Letter of Credit will be long-term in nature and be available until scheduled final repayment of the Senior Bonds (or at an earlier date if preferable for the sponsors and the Senior Bond investors). After financial close of the project the EIB will not be able to withdraw the Letter of Credit or amend its terms, including pricing[7]. As a revolving facility, any amounts drawn and subsequently repaid on the Letter of Credit will be available for re-drawing[8].

Similarly to the funded PBCE facility, unfunded PBCE will act as a first loss piece (please see the Repayment section below for details of underlying repayment timings). Loss given default scenarios will typically improve, as will probability of default scenarios during the operations phase. However, as the Letter of Credit represents an extra source of funds over and above those used in the base case to fund project costs, it will also generally improve probability of default scenarios during the construction phase.

Following disbursement under the Letter of Credit, EIB will become a direct, subordinated lender to the project. In a situation where the Letter of Credit is partly drawn and accrues capitalised interest, the amount of capitalised interest is excluded from the calculation of the remaining amount of the Letter of Credit available for drawdown. Such excluded interest nonetheless remains payable.

The remainder of this Section 2 outlines the key features of both the unfunded and funded PBCE facilities. However, in an actual financing these will be developed case-by-case to meet the specific requirements of the funding structure.

[6] This means that the EIB will act as a direct standby lender to the project company, rather than act as guarantor to a third party lender who would then provide the liquidity.
[7] As a practical matter, the letter of credit fee is fully payable upfront at financial close.
[8] In any case not exceeding the 20% limit on the Senior Bond as described below.

	FUNDED	UNFUNDED
Purpose and Permitted Uses	Costs representing eligible uses of funded PBCE include design, construction and commissioning, development costs & fees, interest, fees and other financing expenses (including those that relate to PBCE), funding mandatory reserve accounts and other costs and expenses as agreed by EIB. In any case PBCE proceeds cannot be used to pay make-whole payments such as spens/modified spens, costs or indemnities associated therewith	The PBCE in the form of a Letter of Credit can be drawn for the following purposes: 1. *Pre-completion cash shortfall*: to fund a cash shortfall in the event of construction cost overruns (or other shortfalls in the funding requirement) not absorbed by the construction contractor and/or funded with other project-level credit supports ("Pre-completion Shortfall"); 2. *Post-completion Senior Bond debt service shortfall*: (i) to cover periodic shortfalls in meeting scheduled Senior Bond debt service[9] by way of periodically drawing down on the Letter of Credit to make up the shortfall. (Post completion Debt Service); or (ii) to cover shortfalls in Senior Bond debt service that are considered likely to recur in future. In this scenario, the Letter of Credit will be drawn in full and the proceeds used to pay down the Senior Bond. The senior debt service coverage ratios (DSCRs) will improve by virtue of reduced Senior Bond debt service going forward (PBCE Injection); and 3. *Accelerated payments:* to pay any shortfall between the amounts due on acceleration of the Senior Debt and any termination payments from the Procuring Authority. This applies regardless of the reason for the termination (Acceleration). In any case PBCE proceeds cannot be used to pay make-whole payments such as spens/modified spens, costs or indemnities associated therewith.
PBCE Injection	Paid in upfront or over time as	As the case may be

[9] Principal, interest and fees

	FUNDED	UNFUNDED
	agreed with Sponsors and Bondholders	1. Pre-completion Shortfall : PBCE injection upon receipt of the LTA certification that other construction support has been called and that use of the undrawn amount of the PBCE will enable construction to be completed prior to the longstop date 2. Post-completion Senior Bond debt service shortfall: (i) PBCE Injection may occur at interest payment date (ii) As an alternative to debt service payment described in (i), full PBCE injection may occur under two scenarios: a) following a bondholder vote on whether to exercise the injection upon the breach of certain DSCR triggers, or b) automatically upon the breach of DSCR triggers. Such injection would trigger a prepayment of Senor Bonds in an amount equivalent to the injection. The views of bond managers / private placement investors will be taken into account in negotiating this mechanism. The application of the prepayment across the amortisation profile would be pro-rata to remaining maturity. Injection (either voluntary or mandatory) can occur only once. To the extent that the Letter of Credit is undrawn[10], subsequent drawdowns on the Letter of Credit will be permissible only to meet post-completion Debt Service or Acceleration. 3. Acceleration : PBCE Injection following the receipt of termination payments from the Procuring Authority
Acceleration	It is contemplated that any decision to accelerate the Senior Bond following an event of default under the finance documents will be subject to a vote by holders of Qualifying Debt[11] . The vote could be triggered by any of the following: • Certification by the LTA that with the use of the PBCE or any other	

[10] For example: due to partial injection or subsequent repayment of previously injected amounts.
[11] Defined as the principal amount of Senior Bonds plus outstanding principal (excluding capitalised interest) drawn under the PBCE Letter of Credit.

<table>
<tr><th></th><th>FUNDED</th><th>UNFUNDED</th></tr>
<tr><td></td><td colspan="2">support construction, the project cannot be completed prior to the longstop date under the construction contract; or

• The senior debt service cover ratios are below the default threshold as defined in the finance documents having taken into account all available amounts of the PBCE; and

• Any other event of default under the finance documents has occurred and is continuing.</td></tr>
<tr><td rowspan="2">Maximum Amount</td><td colspan="2">The maximum amount of PBCE available will normally be equal to the lesser of EUR 200 million and 20% of the nominal amount of a given project's Senior Bonds.

It may be that the desired credit quality uplift (e.g. improvement in cash breakeven or other key project sensitivities) can be attained with an amount of PBCE that is lower than the maximum facility size. The EIB recognises that the exact amount required will be subject to iteration between the EIB and the sponsor project team, but in any case will be fixed when the indicative ratings are obtained. However, it is expected that sponsors, Procuring Authorities and their respective advisers will estimate the maximum amount likely to be required and to approach the EIB as early as possible in the project cycle.

The amount of PBCE cannot be increased subsequent to financial close of the project.

The means by which the PBCE is sized varies between unfunded and funded variants, as detailed below:</td></tr>
<tr><td>FUNDED

The maximum amount may be constrained by base case requirements for total debt[12] (i.e. gearing, Debt Service Cover Ratio and/or Bond Life Cover Ratio) which will be established on a project-specific basis.
As the facility is funded, its sizing will be calculated with reference to a set percentage of the senior bond issue. There is no on-going limit on the size of the funded PBCE as a percentage of the then outstanding Senior Bond. See also comments below regarding funded PBCE amortisation profile.</td><td>UNFUNDED

There are no other indirect limits such as gearing tests or base case coverage ratio requirements although the underlying structure is expected to be sufficiently robust.

As the Letter of Credit is equal to a set percentage of the project's Senior Bond principal outstanding at any given time, it will reduce as the Senior Bond amortises. If the Senior Bond debt balance includes indexation i.e. in the case of index linked debt, the amount available under the Letter of Credit will follow the indexed nominal value of the debt (subject to the maximum size limits described above).

In a situation where the Letter of Credit is partly drawn and accrues capitalised interest, the amount of capitalised interest is excluded from the calculation of the remaining amount of the Letter of Credit available for drawdown. Such excluded interest nonetheless remains payable.</td></tr>
</table>

	FUNDED	UNFUNDED
Availability	Funded PBCE will be available during the construction phase of the project. In contrast to the unfunded variant of PBCE, the funded PBCE facility is not revolving, meaning than principal amounts previously repaid are not available to be redrawn. The PBCE facility requires a tail during which project cash flow is available to repay any balance of funded PBCE following the end of the availability period. (EIB will accept the senior debt tail required by Senior Bonds.)	For unfunded PBCE the availability period is set by definition i.e. the Letter of Credit will refer to a maximum percentage of the Senior Bond available to be drawn at any given time. The Letter of Credit will remain available for drawing for the period during which amounts of principal and/or interest are due under the Senior Bonds. The overall senior debt tail[13] requirement of the project will be set following discussion with the investors and/or bond arranger[14]. Senior debt lenders typically require a tail to cover the eventuality that project cash flows and other credit supports have been insufficient to service the senior debt. This calculation will in turn affect the availability period of the Letter of Credit. The PBCE facility requires a tail during which project cash flow is available to repay any balance still drawn on the Letter of Credit following the end of the availability period. (EIB will accept the senior debt tail required by Senior Bonds.)

[13] Being the period between the final repayment date of a given loan facility and the end of the project.
[14] Senior debt will not have a shorter tail than the PBCE facility. As such, the EIB's tail requirement may drive the overall tail requirement to the extent it is greater than that required by the senior debt investors.

	FUNDED	UNFUNDED
Interest, Fees, EIB Cost of Funds and Hedging	An arrangement fee will apply, plus commitment fees equal to 50% of margin. Commitment fees may not always be applicable, as EIB envisages the proceeds being drawn upfront and deposited in an escrow account. EIB will require escrow account providers to have a minimum credit requirement. However, EIB may also consider allowing funded mezzanine debt to be drawn into the project company towards the end of the construction period, at a time when a majority of the senior bond proceeds have been utilized[15]. Any cost of funds adjustment related to the use of mezzanine debt will be set by EIB at financial close. Interest during construction on funded PBCE will need to be payable in cash, not capitalised/rolled up into the loan balance. In the event that funded PBCE is prepaid, breakage costs will apply.	It is expected that, the Letter of Credit fee will typically be paid upfront at financial close with no on-going fee element. An arrangement fee will apply but there will be no commitment fees. Should the Letter of Credit be drawn, the EIB's cost of funds adjustment[16] and a credit margin will be added to the reference rate. The EIB's cost of funds adjustment will only be known at the time of the drawdown and margins will be set at financial close in line with market conditions. As the facility will be repaid on a cash-sweep basis, no hedging will be implemented at the time of the drawdown. Drawn PBCE will therefore be a floating rate facility with a reference rate based on the periodicity of Senior Bond debt service (e.g. quarterly, semi-annual).
Repayment	It is expected that funded PBCE will have a scheduled amortisation profile based on sculpted repayments pro rata to the Senior Bond. Repayment of the PBCE will generally commence at the same time as Senior Bond debt repayments - Repayment term to be the same as those of the Senior Bonds. - PBCE debt service will be repaid from cash flows following scheduled Senior Bond principal and interest payments and transfers to senior secured reserve accounts <u>including</u> the DSRA - Payments received by the EIB will be applied firstly to current interest, second to capitalised interest and thirdly to principal repayment.	It is contemplated that there will be no specific repayment dates for repayment of drawn Letter of Credit amounts. Following drawdown of the Letter of Credit, EIB will benefit from a full cash sweep of cash flow **after** scheduled Senior Bond principal and interest payments and transfers to senior secured reserve accounts, including the DSRA. As such, any payments in respect of the risk capital of the project (generally subordinated debt and/or ordinary share capital but also potentially contingent equity) will not be permitted until outstanding Letter of Credit amounts (principal and capitalised interest) have been repaid. Payments received by the EIB will be applied firstly to current interest, secondly to capitalised interest and thirdly to principal repayments.
Distribution lock-up	Prior to final repayment of the funded	Full cash sweep as set out above will

[15] In this case EIB would <u>not</u> provide a Letter of Credit in favour of the Senior bond-holders in respect of supporting deferred mezzanine subscriptions.
[16] Similar to EIB Senior Debt, expressed as a premium over LIBOR or EURIBOR and based on the EIB's cost of funding itself, not a given project. In contrast from EIB Senior debt, the timing (or eventuality) of drawdown is unknown and thus the premium cannot be fixed at financial close.

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<tr><th></th><th>FUNDED</th><th>UNFUNDED</th></tr>
<tr><td>requirements</td><td>PBCE, lockups will be required based on total debt[17] BLCR, backward looking total debt DSCR and forward-looking total debt DSCR. Such lockups will affect payments to risk capital below the mezzanine level and thus are distinct from the lockups that will prevent payment of PBCE debt service. Lockup levels will be set on a project-specific basis.</td><td>apply during any period in which an amount is drawn on the Letter of Credit.

Whenever there is a balance drawn on the Letter of Credit, EIB will require distribution lock-ups (to be agreed with the Senior Bondholders on a project-specific basis) based on the Senior BLCR as well as a Senior DSCR.
These lockup levels will be set on a project-specific basis.</td></tr>
<tr><td>Counterparty credit requirements</td><td colspan="2">Standard EIB minimum credit requirements will apply for counterparties such as other senior lenders, account banks, escrow account providers, insurers and hedge counterparties. At present, this requirement is generally A-.</td></tr>
<tr><td rowspan="2">Security:</td><td colspan="2">It is expected that the PBCE will benefit from the same security package as the Senior Bondholders, but in a subordinated position.
The security package will thus typically be comprised of second ranking fixed and floating security over all borrower assets (including project accounts, project documentation and insurances), plus second ranking fixed security over shares in the borrower and proceeds arising from the disposal of such shares.</td></tr>
<tr><td></td><td>In the Unfunded option case, unlike a traditional letter of credit that would attach at the senior debt level if drawn (thereby increasing senior debt), the drawn Letter of Credit would remain subordinated.</td></tr>
<tr><td>Events of default</td><td>On occurrence of a PBCE event of default the EIB will be entitled to full payment of outstanding PBCE amounts, but will be subject to receiving payments in accordance with the cash waterfall[18].

In practice this would constitute a full cash sweep after senior debt service, similar to the repayment pattern for unfunded PBCE following drawdown on the Letter of Credit.</td><td>Until the Senior Bonds are repaid in full, the EIB will not have the right to call an event of default under the Letter of Credit Agreement unless an event of default has been called under the Common Terms Agreement by the Senior Bondholders.
Calling an event of default under the Letter of Credit agreement does not block the availability of the Letter of Credit (for example in acceleration scenarios). The EIB will not be able to take separate enforcement action and will be subject to receiving payments in accordance with the cash waterfall.</td></tr>
<tr><td>Voting rights and controlling creditor</td><td colspan="2">In general the EIB will not be entitled to vote on matters subject to a vote of the Senior Bondholders, with the exception of votes on Enforcement Actions. Further detail is set out below.

The EIB recognises the gap left by the monoline insurers who traditionally held the controlling creditor role. However, the EIB does not anticipate acting as controlling creditor, in part due to the conflict inherent in having a junior creditor act on behalf of senior creditors. A Bund trustee and an Agent will be named.

The EIB has therefore developed a potential decision matrix, the specifics of which may be considered on a project-specific basis. However, the EIB will</td></tr>
</table>

[17] In which funded PBCE is counted as senior debt for the purposes of the gearing test and coverage ratio tests.
[18] Meaning the priority in which the available cash flow in the project is applied to claims on that cash flow.

<table>
<tr><th></th><th>FUNDED</th><th>UNFUNDED</th></tr>
<tr><td></td><td colspan="2">require the ability to vote the full amount of the PBCE (for the funded transactions) or the drawn amount of the PBCE (for unfunded transactions) on Enforcement Actions (such as acceleration) by virtue of being included in the definition of Qualifying Debt. This means that, post default, amounts drawn under the Letter of Credit will be included in the definition of Qualifying Senior Debt when voting on enforcement actions. For the avoidance of doubt, such voting rights will not affect the recovery of Senior Bondholders in default scenarios.

In summary, the EIB’s potential decision matrix has the following four thresholds:

• Routine matters over which the Agent has discretion. For the avoidance of doubt, this does not mean that when the Letter of Credit is drawn in the EIB becomes pari passu with the Senior Bonds;

• Ordinary voting matters, in which the Agent requires approval from a simple majority of voting bondholders (subject to quorum) before approving a request;

• Extra-ordinary voting matters, in which the Agent requires approval from a super majority of voting bondholders (subject to quorum) before approving a request; and

• Entrenched rights, where the EIB (as PBCE provider), Security Trustee or Bond Trustee need to agree changes that affect their interests.</td></tr>
</table>

Section 3: Process and stakeholders:

This section provides an outline description of the roles of the Procuring Authority, the Bidder and EIB at each stage of the tendering of a project which may incorporate PBCE.

The process should be understood in the context of the following core principles:

1. The Senior Bonds will be issued by the project company itself (generally a PPP established to build, finance and operate an infrastructure project), **not** the EIB or a Member State;

2. Project companies cannot normally combine PBCE and other EIB credit facilities within the same financing structure; and

3. Procuring Authorities will be the primary drivers of the inclusion of a PBCE within a financing structure. As such, Procuring Authorities will need to contact the EIB and design the procurement process in a way that facilities both bond financing options generally as well as potential EIB participation in the project.

Given these considerations, stakeholders should consider the following outline steps:

Step 1 - Procuring Authority, with their advisers, determines whether PBCE may be applicable to the project

Issues to be considered include:

- Whilst Procuring Authorities may have experience of evaluating bank-financed structures, experience of procuring and evaluating bond-financed facilities and credit enhancement structures such as PBCE may be limited. As such, Procuring Authorities should consider their capacity to structure the project, hire and direct advisers, evaluate the bids and negotiate with Bidders. The additional costs of specialist advisory services should be budgeted;

- EIB will not normally be able to provide both senior debt and PBCE within the same financing structure. As such, the Procuring Authority and its advisers may wish to consult EIB on the financing available and that best fit with their project (i.e. no EIB participation, EIB senior debt, unfunded PBCE or funded PBCE). Procuring Authorities may wish to consult specialist advisers qualified to advise on the evaluation of possible structures;

- Procuring Authorities and their advisers will need to undertake a preliminary assessment of the relative risks and benefits of each financing option (shadow modelling). As PBCE is intended to be an enabler of bond finance, Procuring Authorities and their advisers will need to conclude that the underlying financial infrastructure in the project's jurisdiction exists to facilitate bond financing. In addition, Procuring Authorities should consider investor credit rating requirements and rating agency criteria / methodologies in analysing whether a given project is a suitable candidate for credit enhancement via PBCE.

Step 2 – Procuring Authority and its advisers develop bid instructions and evaluation criteria

Procuring Authorities will need to instruct bidders as to how to present a financing structure including EIB PBCE. EIB will be able to engage directly with bidders who wish to use PBCE and negotiate term sheets with them. These terms may reflect differential credit quality between the bidders in terms of the requirement for other credit support.

In general, Procuring Authorities will need to consider:

- How Bidders will be required to demonstrate credit robustness i.e. do they need to provide evidence of rating agency involvement via pre-rating / ratings estimates[19] and if so, how many, from which rating agencies and when in the tender process[20]? If not, what other evidence will be required to demonstrate that sufficient credit support has been priced into the Bid at this stage and when will the pre-rating(s) be required in the process?

- How much evidence of bond manager / end investor involvement will be required?

- How to evaluate which proposals / target credit rating for the Senior Bonds will represent the lowest all-in cost to the Procuring Authority. This has an impact on the required level of PBCE, the project structure and the amount of Other Credit Support;

- To the extent public bonds or other uncommitted financing structures are used, how to deal with these in the context of procurement rules, and the interaction with the duration of the preferred bidder period;

- Whether bank or bond finance will constitute the "base case" for tender evaluation purposes, and the manner in which alternative financing options will be evaluated;

- The degree to which standardised financing assumptions will be used for macro-economic or other variables; and

- Public policy in respect of termination compensation.

Procuring Authorities may wish to refer to an EPEC paper entitled "Financing PPPs with Project Bonds - Issues for public procuring authorities"
at: http://www.eib.org/epec/resources/Financing%20PPPs%20with%20project%20bonds%20-%20October%202012.pdf

Step 3 – Procuring Authority and its advisers evaluate bids

The Procuring Authority and its advisers may be required to evaluate the relative robustness of financing structures which provisionally include PBCE facilities against structures based on more conventional forms of funding.

The experience and judgment of a qualified financial adviser will therefore be crucial to the Procuring Authority at this point in determining whether a Bidder(s) whose financing structure incorporates EIB credit enhancement should be taken forward to Best and Final Offer (BaFO) stage.

Step 4 – Procuring Authority invites BaFOs

It is to be hoped that a majority of the procedural elements associated with bond financing should have been addressed prior to this stage. However, depending on the process, bidders may not have been previously required to provide pre-ratings earlier in the process due to cost and lower overall maturity of the project. If bidders have not previously been required to obtain pre-ratings, this should be a requirement at this stage and the pre-rating should take PBCE into account. .

[19] EIB will not cover the costs of any pre-rating or ratings estimates/advisory exercises.

[20] In general, it is preferable to obtain informed views on the commercial implications of ratings requirements early on in the project while there is still competitive tension. However Procuring Authorities may wish to consider the cost implications of requiring ratings at this stage and the project also needs to be sufficiently mature to be assessed by the rating agencies.

Issues to consider include:

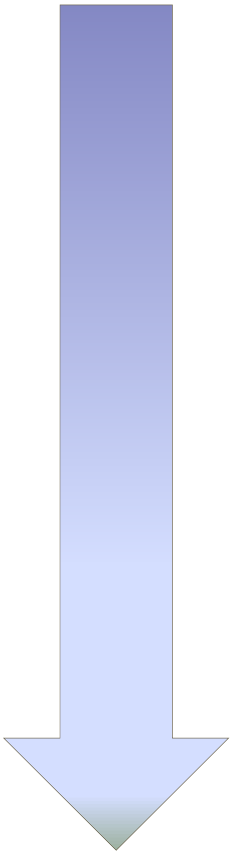
- The number of pre-ratings to require, the minimum required level of the ratings and acceptable ratings agencies (realising that approaches differ between the agencies, but that some investors require more than one rating); and
- Project timing implications resulting from any external credit rating processes.

Step 5 – Preferred bidder through to financial close

Issues to be considered include:

- Mechanisms for either benchmarking credit spreads and/or gaining visibility into the book-building process for setting the spread on the Senior Bonds;
- Mechanisms by which Bidders will accept the risk of price increases associated with failing to secure the targeted rating (other than as a result of material changes to the Project Agreement required by the Procuring Authority);
- Timescales for negotiation between EIB, Bidder and Senior Bond arranger as well as credit documentation and the ratings processes.

Key procurement steps in the case of a project bond financed PPP have been summarized in the following table[21]



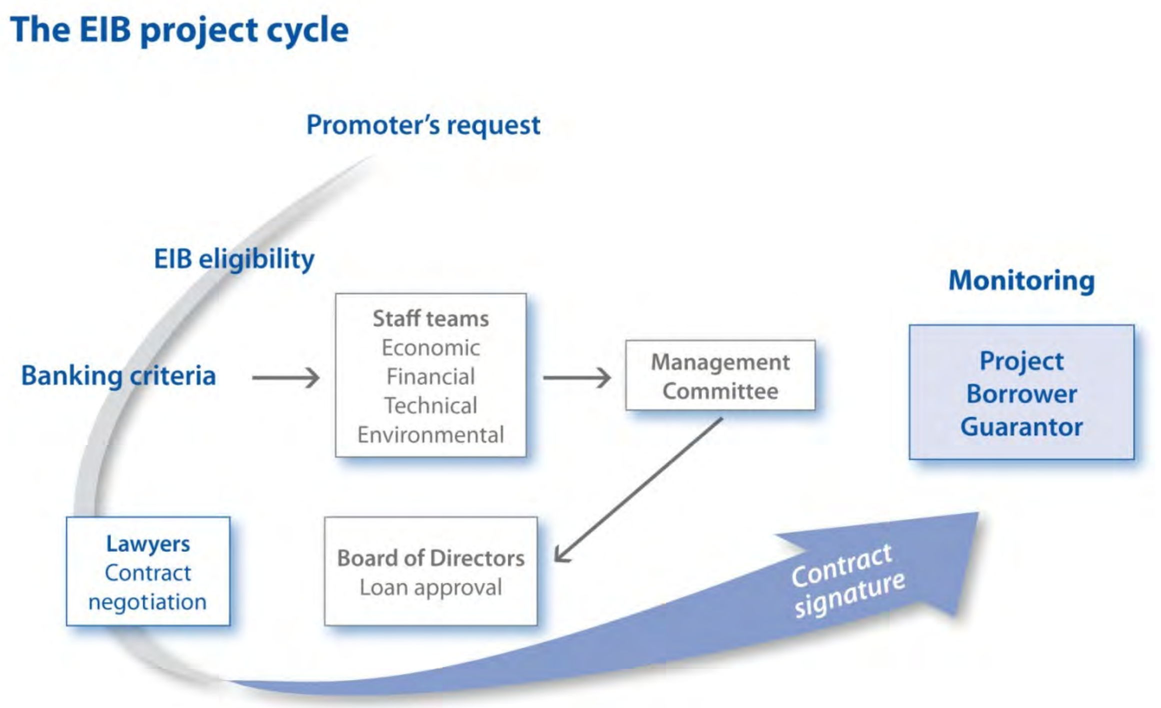
- Pre-OJEU : assess if the project fits for project bonds
- OJEU : mention the possibility of project bonds
- Bid invitations:
    - open to / request project bonds offers
    - set the terms of arrangers' letters of support
- Bid submissions : assess offers
- BAFO Invitations :
    - request pre-rating and support letters (placement strategy and pricing building blocks)
    - provide indicative bond pricing data
- BAFO submissions
- Preferred bidder phase:
    - opt for a financing solution
    - final rating
    - set price range and monitor pricing
- Financial close

[21] EPEC Financing PPPs with project bonds – issues for public procuring authorities October 2012

Annex : The EIB project Cycle

Project Appraisal is carried out by the EIB's teams of engineers, economists and financial anylists, in close cooperation with the promoter. Please note that EIB can also be involved earlier in the project if the procuring authority contacts our Services.

Criteria for a typical EIB appraisal are tailored to each specific project. Results are included in the project report to the Board of Directors for a financing decision.



Eligibility and overall quality and soundness of projects are being appraised by EIB services. The EIB finances projects in most sectors, eligible projects contribute to EU economic policy objectives like promotion of economic and social cohesion in the EU, improvement of EU transport and telecommunications infrastructure, secure energy supplies etc.

With regards to the Project Bond Initiative, EIB will explicitly concentrate, as described previously, on projects in the areas of transport (TEN-T), energy (TEN-E) and broadband / information and communication technology (ICT).

Project quality is based on

Technical scope: definition of the project's "technical description", technical soundness innovative technology, risks and mitigation measures, information on capacity for products/ services;

Implementation: promoter capability to implement the planned project, information on timing and employment during operational life

Procurement: compliance with applicable legislation and EIB guidelines

Environmental impact: compliance with applicable legislation, information on environmental impact assessment

Market and demand: analysis of the market and demand of the project's products/services over the project's life.

Investment costs: information on project costs and its detailed components, comparison with cost of similar projects

Profitability: information on financial profitability and related indicators (e.g. rate of return), information on economic profitability.

This information together with EIB's financial analysis, and in the case of PBCE, extensive structuring work, are subsequently assessed from a credit risk point of view.

Once financed, the projects progresses are regularly monitored. A financial monitoring, physical monitoring and ex post evaluations reports enable EIB Group to draw lessons from past experience.

FAQs

A set of Frequently Asked Question will be maintained on EIB's Project Bonds website. Questions can be sent to projectbonds@eib.org.

Please note that questions may be posted (anonymously) on EIB's website http://www.eib.org/products/project-bonds/index.htm

Further information:

For additional information on the 2020 Project Bond Initiative, see the EIB's website at: http://www.eib.org/infocentre/press/news/all/the-europe-2020-project-bond-initiative.htm;

For specific information for public authorities, see "Financing PPPs with Project Bonds - Issues for public procuring authorities" at: http://www.eib.org/epec/resources/Financing%20PPPs%20with%20project%20bonds%20-%20October%202012.pdf;

For information on the pilot phase, see the Europa website:

- On 10 July, ECOFIN issued country-specific recommendations on the economic and fiscal policies of the Member States and a recommendation for the Eurozone as a whole. Furthermore, it gave the go-ahead to the PBI pilot phase: http://consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/131686.pdf
- The pilot phase of the Europe 2020 Project Bond Initiative at: http://ec.europa.eu/economy_finance/financial_operations/investment/europe_2020/index_en.htm
- Q&A "A pilot for Europe 2020 Project Bond Initiative - legislative proposal adopted by the Commission - Memo/11/707 at: http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/707&format=HTML&aged=0&language=EN&guiLanguage=en

For background information, see previous related documents:

- The press release announcing the initiative (28/02/2011): http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/236&format=HTML&aged=0&language=FR&guiLanguage=en
- Introduction, Q&A and results of the consultation (Spring 2011): http://ec.europa.eu/economy_finance/consultation/europe_2020_en.htm

European Investment Bank

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